

2018 Annual Consolidated Financial Report

Energy under control



2018 Annual Consolidated Financial Report

Summary

Audit Report, Consolidated Annual Accounts

Audit Report	Page 7
Consolidated Balance Sheet	Page 14
Consolidated Income Statement	Page 15
Consolidated Statement of Comprehensive Income	Page 16
Statement of Changes in Consolidated Equity	Page 17
Consolidated Cash Flow Statement	Page 18
Notes to the Consolidated Annual Accounts	Page 19

Director's Report

1. Main milestones and key figures	Page 166
2. Market context, risks and opportunities	Page 170
3. Corporate governance	Page 176
4. Business performance and results	Page 183
5. Forecast Group performance	Page 210
6. Sustainable innovation	Page 219
7. Non-financial statement	Page 222
Annex I. Additional information	Page 284
Annex II. Alternative performance metrics	Page 286
Annex III. Glossary of non-financial indicators	Page 289
Annex IV. About this report	Page 291
Annex V. Independent verification reporta	Page 294
Annex VI. Annual corporate governance report	Page 297
Annex VII. Report on independent review of ICFR	Page 371

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Audit Report	Page 7
Consolidated Balance Sheet	Page 14
Consolidated Income Statement	Page 15
Consolidated Statement of Comprehensive Income	Page 16
Statement of Changes in Consolidated Equity	Page 17
Consolidated Cash Flow Statement	Page 18
Notes to the Consolidated Annual Accounts	Page 19

Translation of a report originally issued in Spanish. In the event of discrepancy,
the Spanish-language version prevails

**AUDIT REPORT ON CONSOLIDATED FINANCIAL STATEMENTS
ISSUED BY AN INDEPENDENT AUDITOR**

To the Shareholders of Naturgy Energy Group, S.A.:

Audit report on the consolidated financial statements

Opinion

We have audited the consolidated financial statements of Naturgy Energy Group, S.A. (the Parent) and its subsidiaries (the Group), which comprise the consolidated balance sheet at December 31, 2018, the consolidated income statement, the consolidated statement of other comprehensive income, the consolidated statement of changes in equity, the consolidated cash flow statement, and the notes thereto, for the year then ended.

In our opinion, the accompanying consolidated financial statements give a true and fair view, in all material respects, of consolidated equity and the consolidated financial position of the Group at December 31, 2018, and of its financial performance and its consolidated cash flows, for the year then ended in accordance with International Financial Reporting Standards, as adopted by the European Union (IFRS-EU), and other provisions in the regulatory framework applicable in Spain.

Basis for Opinion

We conducted our audit in accordance with prevailing audit regulations in Spain. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We are independent of the Group in accordance with the ethical requirements, including those related to independence, that are relevant to our audit of the consolidated financial statements in Spain as required by prevailing audit regulations. In this regard, we have not provided non-audit services nor have any situations or circumstances arisen that might have compromised our mandatory independence in a manner prohibited by the aforementioned requirements.

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

Key audit matters

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

Commitments for the purchase of natural gas

Description As indicated in Notes 3.4.7.3 and 35 to the accompanying consolidated financial statements, the Group has taken long-term contractual commitments for the purchase of natural gas. In accordance with usual practices in the gas industry, said contracts can be signed for a maximum period of 20 to 25 years, and establish a minimum amount of gas to be purchased (take or pay clauses whereby the buyer assumes the obligation to pay the amount of natural gas contracted regardless of whether they receive it or not) and price review mechanisms linked to international prices of natural gas and prices of natural gas in the countries of destination.

These agreements are executed and kept to meet the needs for receiving or delivering the natural gas expected by the Group in accordance with periodical purchase and sale estimates. Consequently, the Group classifies these contracts as for 'own use', and they are thus excluded from the scope of IFRS 9 'Financial instruments'. The natural gas purchase commitments under these contracts amount to 83,630 million euros at December 31, 2018 (Note 35).

The assessment of the long-term natural gas procurement contracts requires Group Management to exercise critical judgment regarding the short-, mid- and long-term demand and supply estimates and compliance with the clauses included in the contracts, in order to determine their classification as own-use contracts. Consequently, we consider this area a key audit matter.

Our response

Our audit procedures for this area consisted, among others, in:

- ▶ Understanding the accounting procedures and criteria applied by the Group regarding future procurement contracts.
- ▶ Reading and analyzing a significant sample of the natural gas procurement contracts signed by the Group.
- ▶ Analyzing, by involving our financial instruments experts, whether the analyzed gas purchase and sale agreements meet the own-use definition by verifying the requirements established for such classification in the applicable framework for financial reporting.
- ▶ Evaluating the amounts acquired during the year and checking that the minimum contractual amounts are met.
- ▶ Analyzing provisions and contingencies linked to price review arbitration proceedings, through meetings to understand and validate the ongoing arbitration proceedings, reading the corresponding contracts and obtaining the litigation confirmation letter from the Group's legal services.
- ▶ Reviewing the information related to the gas purchase agreements disclosed in the consolidated financial statements for the year.

Revenue recognition: Sale of unbilled energy

Description As detailed in Note 10, at 2018 year end, the Group has recorded in the 'Trade and other receivables' heading of the consolidated balance sheet 1,748 million euros corresponding to sales of energy that has been supplied but not yet billed because the usual meter reading period does not coincide with the closing of the financial statements for the year. The measurement of these unbilled sales is based on complex estimates that require Group Management to apply certain criteria, judgments and assumptions.

The main estimates on which Group Management apply criteria, judgments and assumptions to determine these unbilled sales are the daily consumption derived from seasonally adjusted historical customer profiles and other measurable factors affecting consumption. The information regarding the Group's revenue recognition criterion is detailed in Note 3.4.22.g) to the accompanying consolidated financial statements. Due to the foregoing, we consider this area a key audit matter.

Our

response

Our audit procedures for this area consisted, among others, in:

- ▶ Understanding the criteria and procedures applied by the Group for estimating unbilled sales, also verifying the effectiveness of the relevant controls associated with the revenue recognition process for unbilled energy supplied.
- ▶ Analyzing the Group's energy balances in physical units, by checking the correlation between the consumption in the year and sales in the same period (which include estimated unbilled energy). Additionally, verifying the reasonableness of the assumptions applied (consumption and prices) in the estimate of unbilled sales made by the Group.
- ▶ Performing substantive analytical procedures on the historical evolution of billing pending issue and the reasonableness of the sales volumes and margins of the year.

Assessment of the recovery of the book value of certain Group assets

Description As detailed in Notes 6 and 7 to the accompanying consolidated financial statements, the Group shows intangible assets and property, plant and equipment amounting to 7,845 million euros and 20,707 million euros, respectively.

Additionally, as indicated in Note 8 to the accompanying consolidated financial statements, the Group has an investment in Unión Fenosa Gas, S.A. accounted for using the equity method, the net carrying amount of which at year end is 340 million euros.

These assets are allocated to the cash generating units (CGUs) as indicated in Note 3.4.5 to the accompanying consolidated financial statements.

Additionally, as detailed in Note 9 to the accompanying consolidated financial statements, the Group holds 85.4% of the share capital of Electrificadora del Caribe, S.A. ESP (Electricaribe), which carries out the electricity distribution business in Colombia, whose net carrying amount at year end is the best estimate of its fair value and amounts to 253 million euros.

The recoverability of the book value of the indicated assets has been determined based on the present value of the future cash flows generated by the CGUs or, where appropriate, the best estimate of their recoverable amount. The cash flows are calculated based on the business plans approved by Management. The key assumptions about these cash flows are included in Note 3.4.5 to the accompanying consolidated financial statements. Additionally, Management have made a sensitivity analysis of the key assumptions that, based on historical experience, may reasonably experience some variations.

As a result of the aforementioned analyses and considering the approval of the new 2018-2022 Strategic Plan by the Board of Directors, impairment losses and write-downs on assets have been recorded in the 2018 consolidated income statement for an amount of 4,905 million euros (of which 54 million euros were recorded prior to the approval of the new Strategic Plan) and 163 million euros were recorded in the 'Other accumulated comprehensive income' heading, as indicated in Notes 5 and 9 to the accompanying consolidated financial statements.

We have considered this area a key audit matter due to the significance of the amounts involved and the existence of significant estimates of the key assumptions used in the calculations made by Management for assessing the recoverability of the assets' value.

Our
response

Our audit procedures for this area consisted, among others, in:

- ▶ Understanding the processes established by Group Management in the determination of the impairment of the assets, including the assessment of the design and implementation of relevant controls.
- ▶ Analyzing the reasonableness of the allocation of the assets to the several cash generating units (CGUs).
- ▶ Reviewing the model used by Group Management, in collaboration with our valuation specialists, covering, in particular, the mathematical consistency of the model, the reasonableness of projected cash flows, discount rates and long-term growth rates, and the results of the sensitivity analyses made by Group Management. In the performance of our review we held meetings with the people in charge of the businesses and used renowned external sources and other available information to verify the data used by Group Management.
- ▶ Reviewing the estimates made by Management and the financial information projected in the strategic plan for each CGU by analyzing the historical financial and budget information, the current market conditions, and the expectations on their potential evolution.
- ▶ Reviewing the information disclosed in the notes to the consolidated financial statements in accordance with the applicable regulatory framework for financial reporting.

Other information: Consolidated management report

Other information refers exclusively to the 2018 consolidated management report, the preparation of which is the responsibility of the Parent Company's directors and is not an integral part of the consolidated financial statements.

Our audit opinion on the consolidated financial statements does not cover the consolidated management report. Our responsibility for the information contained in the consolidated management report is defined in prevailing audit regulations, which distinguish two levels of responsibility:

- a. A specific level applicable to the consolidated non-financial information statement, as well as certain information included in the Corporate Governance Report, as defined in article 35.2 b) of Law 22/2015 on auditing, which solely requires that we verify whether said information has been included in the consolidated management report or where applicable, that the consolidated management report includes the corresponding reference to the separate non-financial report as stipulated by prevailing regulations and if not, disclose this fact.
- b. A general level applicable to the remaining information included in the consolidated management report, which requires us to evaluate and report on the consistency of said information in the consolidated financial statements, based on knowledge of the Group obtained during the audit, excluding information not obtained from evidence. Moreover, we are required to evaluate and report on whether the content and presentation of this part of the consolidated management report are in conformity with applicable regulations. If, based on the work carried out, we conclude that there are material misstatements, we are required to disclose them.

Based on the work performed, as described above, we have verified that the information referred to in paragraph a) above is provided in the consolidated management report, and that the remaining information contained therein is consistent with that provided in the 2018 consolidated financial statements and their content and presentation are in conformity with applicable regulations.

Responsibility of the Parent Company's Directors and the audit committee for the consolidated financial statements

The directors of the Parent Company are responsible for the preparation of the accompanying consolidated financial statements so that they give a true and fair view of the consolidated equity, financial position and results of the Group, in accordance with IFRS-EU, and other provisions in the regulatory framework applicable to the Group in Spain, and for such internal control as they determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

The audit committee of the Parent Company is responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

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

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

As part of an audit in accordance with prevailing audit regulations in Spain, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

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

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

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

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

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

Report on other legal and regulatory requirements

Additional report to the audit committee of the Parent Company

The opinion expressed in this audit report is consistent with the additional report we issued to the audit committee of the Parent Company on January 31, 2019.

Term of engagement

The ordinary general shareholders' meeting held on April 20, 2017 appointed us as Group auditors for 3 years, commencing on December 31, 2018.

ERNST & YOUNG, S.L.
(Signature on the original in Spanish)

Alfredo Eguiagaray

January 31, 2019

Consolidated Balance Sheet (million euro)

	31.12.18	31.12.17
Assets		
Intangible assets (Note 6)	7,845	9,921
Goodwill	3,215	4,760
Other intangible assets	4,630	5,161
Property, plant and equipment (Note 7)	20,707	22,654
Investments recorded using the equity method (Note 8)	816	1,500
Non-current financial assets (Note 9)	910	1,219
Other non-current assets (Note 10)	334	96
Deferred tax assets (Note 21)	1,689	849
Non-current assets	32,301	36,239
Non-current assets held for sale (Note 11)	202	1,682
Inventories (Note 12)	850	720
Trade and other receivables (Note 10)	5,134	4,994
Trade receivables	4,415	4,347
Other receivables	534	469
Current tax assets	185	178
Other current financial assets (Note 9)	428	462
Cash and cash equivalents (Note 13)	1,716	3,225
Current assets	8,330	11,083
Total assets	40,631	47,322
Equity and liabilities		
Capital	1,001	1,001
Share premium	3,808	3,808
Treasury shares	(325)	(9)
Reserves	11,290	9,904
Profit for the period attributed to the parent company	(2,822)	1,360
Interim dividend	(730)	(330)
Other equity items	(1,274)	(1,000)
Equity attributed to the parent company	10,948	14,734
Non-controlling interests	3,647	3,571
Equity (Note 14)	14,595	18,305
Deferred income (Note 15)	863	842
Non-current provisions (Note 16)	1,125	1,129
Non-current financial liabilities (Note 17)	13,352	15,916
Borrowings	13,352	15,914
Other financial liabilities	-	2
Deferred tax liabilities (Note 21)	2,149	2,312
Other non-current liabilities (Note 19)	1,540	1,210
Non-current liabilities	19,029	21,409
Liabilities related to non-current assets held for sale (Note 11)	93	621
Current provisions (Note 16)	297	183
Current financial liabilities (Note 17)	2,079	2,543
Borrowings	2,068	2,477
Other financial liabilities	11	66
Trade and other payables (Note 20)	4,067	3,920
Trade payables	3,267	2,885
Other payables	767	888
Current tax liabilities	33	147
Other current liabilities (Note 19)	471	341
Current liabilities	7,007	7,608
Total equity and liabilities	40,631	47,322

The accompanying Notes 1 to 38 and Appendices are an integral part of the consolidated balance sheet at 31 December 2018 and 2017.

Consolidated Income Statement (million euro)

	2018	2017 ¹
Revenue (Note 22)	24,339	23,207
Procurements (Note 23)	(17,723)	(16,628)
Other operating income (Note 24)	166	237
Personnel expenses (Note 25)	(1,010)	(1,009)
Other operating expenses (Note 26)	(1,816)	(1,969)
Gain/(loss) on disposals of fixed assets (Nota 27)	21	23
Release of fixed assets grants to income and others (Notes 15)	42	42
Gross operating results	4,019	3,903
Depreciation, amortisation and impairment losses (Notes 5,6,7,12 and 28)	(6,007)	(1,621)
Impairment due to credit losses (Note 10)	(179)	(154)
Operating profit/(loss)	(2,167)	2,128
Financial income	122	111
Financial expenses	(802)	(807)
Variations in fair value of financial instruments	(5)	(2)
Net financial income (Note 29)	(685)	(698)
Profit/(loss) of entities recorded by equity method (Note 8)	(513)	14
Profit/(loss) before taxes	(3,365)	1,444
Corporate income tax (Note 21)	779	(195)
Profit/(loss) for the year from continuing operations	(2,586)	1,249
Profit for the year from discontinued operations, net of taxes (Note 11)	(10)	448
Consolidated profit/(loss) for the year	(2,596)	1,697
Attributable to:		
the parent company	(2,822)	1,360
From continuing operations	(2,853)	940
From discontinued operations	31	420
Non-controlling interests (Note 14)	226	337
Basic and diluted earnings per share in euros from continuing operations attributable to the equity holders of the parent company (Note 14)	(2.86)	0.94
Basic and diluted earnings per share in euros from discontinued operations attributable to the equity holders of the parent company (Note 14)	0.03	0.42
Basic and diluted earnings per share in euros attributable to the equity holders of the parent company (Note 14)	(2.83)	1.36

1. The 2017 consolidated income statement has been restated in accordance with IFRS 5 (Notes 3.3 and 11).

The accompanying Notes 1 to 38 and Appendices are an integral part of the consolidated income statement for the years ended 31 December 2018 and 2017.

Consolidated Statement of Comprehensive Income (million euro)

	2018	2017
Consolidated profit/(loss) for the year	(2,596)	1,697
Other comprehensive income recognised directly in equity	(422)	(1,052)
Items that will not be transferred to profit/(loss):		
Financial assets at fair value through other comprehensive income (Note 9)	(188)	(54)
Actuarial gains and losses and other adjustments (Note 16)	15	5
Tax effect of actuarial gains and losses and other adjustments (Note 21)	(3)	-
Items that will subsequently be transferred to profit/(loss):		
Cash flow hedges	3	(109)
Tax effect cash flow hedges (Note 21)	(6)	13
Currency translation differences	(240)	(831)
Equity-consolidated companies (Note 8)	(3)	(76)
Cash flow hedges	-	(4)
Tax effect cash flow hedges (Note 21)	-	-
Currency translation differences	(3)	(72)
Releases to income statement	139	15
Cash flow hedges	107	(1)
Tax effect cash flow hedges (Note 21)	(18)	1
Currency translation differences	50	13
Equity-consolidated companies (Note 8)	-	2
Cash flow hedges	-	3
Tax effect cash flow hedges (Note 21)	-	(1)
Currency translation differences	-	-
Other comprehensive income for the year	(283)	(1,037)
Total comprehensive income for the year	(2,879)	660
Attributable to:		
the parent company	(3,089)	498
From continuing operations	(3,136)	97
From discontinued operations	47	401
Non-controlling interests	210	162

The accompanying Notes 1 to 37 and Appendices are an integral part of the consolidated comprehensive income statement for the years ended 31 December 2018 and 2017.

Statement of Changes in Consolidated Equity (million euro)

Equity attributed to the parent company												
	Share capital (Note 14)	Share premium (Note 14)	Treasury shares (Note 14)	Reserves and retained earnings	Profit/(loss) for the year	Currency translation differences	Cash flow hedges	Financial assets at fair value	Other equity items (Note 14)	Subtotal	Non-controlling interest Note (Note 14)	Equity
Balance at 01.01.2017	1,001	3,808	(21)	9,219	1,347	(183)	47	7	(129)	15,225	3,780	19,005
Total comprehensive income for the year	-	-	-	9	1,360	(716)	(101)	(54)	(871)	498	162	660
Operations with shareholders or owners	-	-	12	346	(1,347)	-	-	-	-	(989)	(313)	(1,302)
Dividend distribution (Note 14)	-	-	-	346	(1,347)	-	-	-	-	(1,001)	(233)	(1,234)
Transfer of subsidiary	-	-	-	-	-	-	-	-	-	-	(73)	(73)
Trading in treasury shares (Note 14)	-	-	12	-	-	-	-	-	-	12	(8)	4
Other transactions with shareholders or owners	-	-	-	-	-	-	-	-	-	-	1	1
Other changes in equity	-	-	-	-	-	-	-	-	-	-	(58)	(58)
Other changes	-	-	-	-	-	-	-	-	-	-	(58)	(58)
Balance at 31.12.2017	1,001	3,808	(9)	9,574	1,360	(899)	(54)	(47)	(1,000)	14,734	3,571	18,305
Impact of first application of new standards (Note 3.2)	-	-	-	10	-	-	-	(14)	(14)	(4)	(13)	(17)
Balance at 01.01.2018	1,001	3,808	(9)	9,584	1,360	(899)	(54)	(61)	(1,014)	14,730	3,558	18,288
Total comprehensive income for the year	-	-	-	15	(2,822)	(162)	63	(183)	(282)	(3,089)	210	(2,879)
Operations with shareholders or owners	-	-	(316)	959	(1,360)	-	-	22	22	(695)	(61)	(756)
Dividend distribution (Note 14)	-	-	-	(40)	(1,360)	-	-	-	-	(1,400)	(505)	(1,905)
Transfer of subsidiary	-	-	-	(22)	-	-	-	22	22	-	(9)	(9)
Trading in treasury shares (Note 14)	-	-	(316)	-	-	-	-	-	-	(316)	(5)	(321)
Share-based payments (Note 14)	-	-	-	5	-	-	-	-	-	5	-	5
Other transactions with shareholders or owners	-	-	-	1,016	-	-	-	-	-	1,016	458	1,474
Other changes in equity	-	-	-	2	-	-	-	-	-	2	(60)	(58)
Other changes	-	-	-	2	-	-	-	-	-	2	(60)	(58)
Balance at 31.12.2018	1,001	3,808	(325)	10,560	(2,822)	(1,061)	9	(222)	(1,274)	10,948	3,647	14,595

The accompanying Notes 1 to 38 and Appendices are an integral part of the statement of changes in equity for the years ended 31 December 2018 and 2017.

Consolidated Cash Flow Statement (million euro)

	2018	2017
Profit/(loss) before tax	(3,365)	1,444
Adjustments to income (Note 30)	7,131	2,529
Depreciation, amortisation and impairment losses (Notes 6,7,11 and 28)	6,007	1,694
Other adjustments to net profit (Note 30)	1,124	835
Changes in working capital (Note 30)	(208)	(155)
Other cash flow generated from operations (Note 30):	(677)	(1,050)
Interest paid	(621)	(686)
Interest collected	23	26
Dividends collected	184	48
Income tax paid	(263)	(438)
Cash flow generated from operating activities ¹	2,881	2,768
Cash flows into investing activities:	(1,904)	(1,880)
Group companies, associates and business units (Note 30)	(27)	(14)
Property, plant and equipment and intangible assets	(1,808)	(1,774)
Other financial assets	(69)	(92)
Proceeds from divestitures:	1,230	220
Group companies, associates and business units (Note 30)	1,109	136
Property, plant and equipment and intangible assets	40	39
Other financial assets	81	45
Other cash flows from investing activities:	57	54
Other proceeds from investing activities (Note 15)	57	54
Cash flows from investing activities ¹	(617)	(1,606)
Receipts/(payments) on equity instruments:	1,189	5
Issue/refund (Note 30)	1,500	5
Acquisition (Note 30)	(311)	-
Receipts and payments on financial liability instruments:	(2,813)	1,635
Issue (Note 30)	8,343	9,317
Repayment and amortisation (Note 30)	(11,156)	(7,682)
Dividends paid (and remuneration on other equity instruments) (Note 14)	(1,976)	(1,284)
Other cash flows from financing activities	(159)	(124)
Cash flow generated from financing activities ¹	(3,759)	232
Other changes in cash and cash equivalents (Note 30)	(21)	(116)
Effect of fluctuations in exchange rates	7	(120)
Variation in cash and cash equivalents	(1,509)	1,158
Cash and cash equivalents at beginning of the year (Note 14)	3,225	2,067
Cash and cash equivalents at year end (Note 14)	1,716	3,225

1. Includes cash flows from continuing and discontinued operations (Note 11).

The accompanying Notes 1 to 38 and Appendices are an integral part of the consolidated cash flow statement for the years ended 31 December 2018 and 2017.

Notes to the consolidated annual accounts of Naturgy for 2018

Note 1. General information

Naturgy Energy Group, S.A. is a public limited company that was incorporated in 1843. Its registered office is located at Avenida de San Luis 77, Madrid. On 27 June 2018, the shareholders, in general meeting, agreed to change the company's business name to Naturgy Energy Group, S.A., formerly Gas Natural SDG, S.A.

Naturgy Energy Group, S.A. and subsidiaries ("Naturgy") form a group that is mainly engaged in the business of gas (supply, liquefaction, regasification, transport, storage, distribution and sale), electricity (generation, transport, distribution and sale) and any other existing source of energy. It may also act as a holding company and in this respect may incorporate or hold shares in other entities, no matter what their corporate objects or nature, by subscribing, acquiring or holding shares, participation units or any other securities deriving from the same.

Naturgy operates mainly in Spain and also outside Spain, particularly in Latin America, in the rest of Europe and Africa.

Note 4 includes financial information by operating segment.

Appendix I lists the investee companies of Naturgy at the reporting date.

The shares of Naturgy Energy Group, S.A. are listed on the four official Spanish stock exchanges, are traded on the continuous market and form part of the Ibex35.

Note 2. Regulatory framework

European Regulatory Environment

In 2009 the Treaty on European Union and the Treaty on the Functioning of the European Union included, for the first time, a title on energy, established as a shared competence between the EU and the Member States, particularly with respect to solidarity and sustainability. This is considered as the year of commencement of the European energy policy, based on European internal energy market legislation (known as the "third package" and envisaging the Gas and Electricity Directives, the creation of the Agency for the Cooperation of Energy Regulators and the Regulations on access to gas and electricity infrastructures), and the so-called "Green Package" (Renewables Directive, national emissions targets in diffuse sectors, vehicle emissions standards) also adopted in 2009.

In this period, growing concern over the environment has also had its reflection in the regulation that affects the energy sector. On an international scale, of particular relevance is the Paris Agreement concluded on 12 December 2015, ratified on 5 October 2016 by the European Union and on 2 February 2017 by Spain within the framework of the United Nations Framework Convention on Climate Change that establishes measures for the reduction of greenhouse gas (GHG) emissions through the mitigation, adaptation and resilience of global warming effects. Its application will commence in 2020, when the Kyoto Protocol expires.

On 15 December 2018, the 24th Conference of the Parties was concluded in Katowice, Poland, in which 200 governments, in the case of the EU represented at the negotiating table by the European Commission reached an agreement on the roadmap to follow to implement the Paris Agreement which will enable the measurement, in a framework of common transparency, of efforts with respect to the fight against climate change, adaptation to its impacts and funding that the countries involved have committed to. This package establishes the manner in which countries will report, as from 2024, on their climate-related actions within the framework of the respective contributions determined at national level.

Within this framework, between 2014-2018 the European Union has set various European energy and climate targets from the present until 2030, in line with its strategy of reducing emissions to 2050. Some of these have are reflected in binding national sub-targets (e.g. reduction in emissions in diffuse sectors) but others will be freely defined by Member States during 2019 (e.g. renewable energy objectives within final energy or energy efficiency in 2030).

In 2018 a large part of European energy legislation was revised and agreements were concluded that will define EU energy regulation until 2030 and, in some cases, beyond. The legalisation covers, among other matters, the reform of the emission allowances market, the distribution of national efforts to reduce emissions in diffuse sectors, the development of renewable energies and energy efficiency measures, the adoption of Integrated National Energy and Climate Plans, internal electricity market regulations and CO₂ emission standards for vehicle manufacturers. Some of these agreements have already been published and others will be published in the coming months.

- On 8 April 2018, the reform of Directive (EU) 2018/410 which amended Directive 2003/87/EC to enhance cost-effective emission reductions came into force, and will be applicable for the period 2021-2030. In the case of sectors subject to the emission rights market, an emissions reduction of 43% against 2005 emissions is assumed for 2030 and additional measures are established to reduce the excess of emission rights in the market, for the purpose of providing a CO₂ price signal.
- On 14 May 2018, the revision of the Directive on Energy Efficiency in Buildings was approved (Directive (EU) 2018/844 of the European Parliament and of the Council of 30 May 2018) for the period 2021-2030 which amended the previous directive (Directive 2010/31 /EU) and aims to decarbonise the European building stock by 2050, working towards a stock with zero emissions.
- On 30 May 2018, Directive (EU) 2018/850 of the European Parliament and of the Council amending Directive 1999/31/EC on the landfill of waste and Directive (EU) 2018/851 which amended Directive 2008/98/EC on waste. This legislation, which came into force in July 2018, sets out clear objectives for waste reduction and establishes a long-term path for waste management and recycling. Some highlights of the proposal are the setting of a European objective to recycle 65% of municipal waste by 2035, a 10% maximum limit on municipal waste in landfills by 2035 and the extension of separate waste collection to bio-waste.

The following were published on 21 December 2018:

- Directive (EU) 2018/2001 of the European Parliament and of the Council on the promotion of the use of energy from renewable sources which sets a European target for renewable energy of 32% with respect to final energy by 2030 and a target of a 14% share for renewable energy in domestic transport demand, both revisable in 2023.
- Regulation (EU) 2018/1999 of the European Parliament and of the Council on the Governance of the Energy Union and Climate Action, directly applicable to the Member States. The Regulation delimits the content of the Integrated National Energy and Climate Plans, as well as the process for adopting them at European level.

Spain must submit its National Energy and Climate Plan 2021-2030 with domestic targets for the 5 dimensions of the Energy Union (security, market, efficiency, decarbonisation and R&D+i), with the corresponding policies and measures. This Plan will be examined by the European Commission and observations can be made on it before its final adoption at the end of 2019.

- Directive (EU) 2018/2002 of the European Parliament and of the Council amending Directive 2012/27 /EU on energy efficiency. The European Commission considers energy efficiency as an energy source in itself and highlights its contribution to reducing the consumption of fossil fuels and dependence on external suppliers, in addition to reducing consumer bills, improving air quality and protecting the environment. According to the Directive, Member States must comply with a binding objective for savings equivalent to 0.8% of annual final energy consumption during the period 2021-2030. Energy distributors and retailers and transport fuel distributors and retailers are subject to this Directive.

In 2018, informal agreements were also reached on the following legislation:

- Directive on common rules for the internal electricity market, which must be transposed into Spanish legislation within 18 months of its publication in the Official Journal of the European Union.
- Regulation on the internal electricity market.
- Regulation on risk preparation in the electricity sector, which repealed Directive (EU) 2005/89.

- Revision of Regulation (EU) 713/2009, which created the Agency for the Cooperation of Energy Regulators.
- Regulation establishing emission standards for passenger cars and light commercial vehicles as part of the EU's integrated approach to reducing CO₂ emissions from light vehicles, which repealed Regulation (EU) 715/2007.

Regulation of the electricity industry in Spain

Main regulatory developments

In Spain, concern over the environment and energy prices is reflected in the announcement of a future Climate Change Law that will be accompanied by two other packages of measures: the National Energy and Climate Plan that it is expected to be ready by 31 December 2019 and the Low Emissions Strategy 2050. These regulations will contain the specific measures which the Government feels will allow the climate targets contained in the Law to be achieved. Among other matters, they will define the energy mix for the coming years.

Among the measures taken, it is worth noting the approval during 2018 of two Royal Decree-Laws on urgent measures that have introduced major changes in the industry legislation:

- Royal Decree-Law 15/2018 on urgent measures for the energy transition and the protection of consumers extends the coverage of the electricity social bond and creates a new thermal social bond as direct assistance for certain vulnerable consumers to pay their heating costs, hot water or cooking, irrespective of the fuel they use. It also temporarily suspends the generation tax and the exemption of electricity generation from the special tax on hydrocarbons, in order to urgently moderate electricity prices and adopt other consumer protection measures. Finally, in order to boost self-consumption, it eliminates the charges on self-consumed energy, allows shared self-consumption and simplifies technical and administrative procedures.
- Royal Decree-Law 20/2018 of 7 December on urgent measures to foment economic competitiveness in the industry and commerce sectors, has created the Electro-intensive Consumer Statute and the closed electrical energy distribution network, as the main support measures for electro-intensive companies

In addition, Royal Decree-Law 1/2019 has revised the allocation of regulatory powers to the National Commission for Markets and Competition (CNMC) and the Ministry for Ecological Transition (MITECO), formerly the Ministry of Energy, Tourism and the Digital Agenda (MINETAD), to comply with European regulations.

When carrying out its new functions, the CNMC must take into consideration the strategic priorities established by the Government and set out in its energy policy guidelines. The relevant Departments of the Regional Governments have competencies in both the development and enforcement of legislation.

By last, The Government has initiated a public consultation for the preparation of the text of the Draft Bill that establishes the rates of remuneration and reasonable profitability of the regulated activities of the electrical system (transport, electricity distribution and renewable energy cogeneration and waste) for the period 2020-2025.

2.1. Regulation of the natural gas industry in Spain

Main characteristics of the natural gas sector in Spain

The Spanish gas sector is regulated by Law 34/1998 of 7 October on the hydrocarbons sector, as amended by Law 12/2007, Royal Decree-law 13/2012, Law 18/2014 and Law 18/2015, Royal Decree-Law 1/2019 and by their enabling regulations, the most relevant being Royal Decree 1434/2002 of 27 December, Royal Decree 949/2001 of 3 August and Royal Decree 984/2015 of 30 October

In general, the Spanish gas sector is characterised by the following factors.

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

- The natural gas sector is almost entirely dependent on foreign supplies of natural gas, which represent almost 99.9% of the natural gas supply in Spain.
- Under EU legislation (Directives 2003/55/CE of June 26, and 98/30/CE of June 22), the supply of natural gas in Spain is totally de-regulated, and all Spanish consumers can freely choose their natural gas provider as from 1 January 2003. The deregulation procedure for the industry has been reinforced substantially by the disappearance as from 1 July 2008 of the bundled tariff of distribution companies and the subsequent right of consumers to participate in the deregulated market (although as indicated further below a tariff of last resort has been maintained for consumers of lower consumption).

Regulation of natural gas activities in Spain

The natural gas activities are divided into: 1) regulated activities: transport, storage, regasification and natural gas distribution; and 2) non-regulated activities: production, supply and commercialisation of natural gas.

2.1.1. Regulated activities

Regulated activities are characterised by:

- Need for prior government authorisation: The undertaking of regulated activities requires prior administrative authorisation, which is regulated. In order to obtain this authorisation, the applicant must basically demonstrate its legal, technical and economic capacity to exercise this activity.
- Remuneration established by legislation: The general directives that set the remuneration for these activities are governed by Law 18/24 and Royal Decree 949/2001, while the specific remuneration to be received is updated annually by ministerial order.

The economic framework of these activities therefore seeks to incentivise grid development and allow the companies that undertake them to ensure the recovery of the investments made and the operating costs incurred.

The regulatory framework for the natural gas industry in Spain has a procedure for settlement compensation amongst companies in the sector for net invoicing of gas acquisition and other costs, so that each company receives the appropriate remuneration for their regulated activities.

- Subjection to specific obligations of third party access to the network and unbundling: The carrying out of the regulated activities is subject to specific obligations to ensure the development of competition in marketing. The two main obligations in this sense consist of permitting access by third parties to the transport and distribution pipelines (including regasification and storage) and the obligation to keep the regulated and non-regulated activities separate.

Royal Decree 948/2015, October 30, regulates access by third parties to the network, which is managed by a single telematic platform, as well as the rights and obligations of each person involved in the system, changing the procurement regime capacity established in 2001 by Royal Decree 949/2001. The owners of the transport and distribution pipelines have the right to receive tolls and levies in consideration for this access, which are revised annually under ministerial order.

The legislation establishes the duty of functional separation, which means not only accounting separation, in order to avoid cross-subsidization and increase the transparency of the calculation of rates, tolls and levies, and legal separation, through separate companies, but also the requirement of independent operation of the regulated subsidiary company in relation to the other companies in the group, as well as the separation of the brand and brand image.

In relation to this last matter, on 6 September 2018 the CNMC issued a Ruling on the adoption of a binding decision regarding compliance with the legal obligation of the distribution and supply companies concerned not to create confusion for consumers with respect to brand information, brand presentation and brand image.

2.1.1.1. Transport

The transport activity includes regasification, storage and transport of gas in the strict sense through the basic high pressure gas pipeline network:

- **Regasification:** Natural gas is imported to Spain through a pipeline network (in gas form) and by gas tankers (in liquid form, hereon, liquefied natural gas). The regasification is the activity that involves the conversion of liquid natural gas, stored in cryogenic tanks generally at regasification plants, into a gaseous state, and then pumped into the national gas pipeline network.
- **Transport:** once the natural gas is imported or produced and, if necessary, regasified, it is injected in gas form into the high pressure gas pipeline transport network. The transport network crosses most regions in Spain and transports the natural gas to the major consumers, such as electricity plants and industrial customers and local distributors.

The transport network is owned mainly by Enagás, S.A., although certain Naturgy companies own a small proportion of it.

- **Storage:** facilities consist basically of underground tanks, which are necessary to ensure a constant supply of natural gas unaffected by seasonal changes and other demand peaks. These facilities also serve to fulfil the obligation established by Royal Decree 1766/2007 (28 December) to maintain minimum security reserves. Prevailing legislation allows unregulated underground storage facilities with third-party access, negotiated and previously authorised by the Spanish Government, although there are currently no such facilities.

The Resolution of the Secretariat of State for Energy (SEE) laying down the procedure for the assignment of basic underground storage capacity and injection and extraction rights was published on 1 April 2017.

2.1.1.2. Distribution

Natural gas is transported from the high pressure transport pipeline network to the final consumer through the medium and lower pressure transport pipeline network.

The distribution business is based on a system of administrative authorisations that carry no exclusive use rights. A zone distributor has preference to obtain authorisations for adjoining zones.

A distributor's activity is restricted to the expansion and management of distribution networks; it cannot market power because specifically authorised supply companies are entrusted with supplies, as mentioned in point 2.1.2.2.

2.1.1.3 Economic regime applicable to regulated activities

Law 18/2014 (17 October) established certain principles and regulations designed mainly to guarantee the gas system's economic and financial sustainability:

- The principle of the gas system's economic and financial sustainability is established, whereby any regulation relating to the sector that entails an increase in costs for the gas system or a reduction in revenue must also bring an equivalent reduction in other cost items or an equivalent increase in revenue to ensure a balance in the system.
- The principle of economic and financial sustainability means that the revenue generated from the use of the facilities must meet all system costs. Gas system revenue will be employed solely to remunerate the regulated activities performed to supply gas.
- As regards the gas system's accumulated deficit at 31 December 2014, it is being recognised. This deficit will be financed by facility owners over a 15-year period; annual payments will be included as a system cost and an interest rate will be recognised on similar terms to market rates.
- Annual mismatches between system costs and revenue are limited and may not exceed 10% of revenue payable for the period; the sum of the annual mismatch and recognised outstanding yearly payments may not exceed 15%. If

this sum is exceeded, tolls will be automatically revised to cover the portion that exceeds said limits. The portion of the mismatch which, without exceeding the limits, is not offset by the rise in tolls and charges, will be financed by the parties subject to the settlement system, in proportion to the remuneration applicable to them; they will be entitled to collect mismatch contributions over the following five years and an interest rate will be applied on market terms.

- The remuneration methodologies regulated in the natural gas sector will take into consideration the costs necessary for the activity to be performed by an efficient, well-managed company under the principle whereby the activity must be performed at the lowest possible cost to the system.
- Royal Decree-Law 1/2019, which updates the responsibilities of the CNMC, has changed the current arrangement into regulatory periods of six years to establish the remuneration of regulated activities and will apply as from the end of the current period which finalises on 31 December 2020.
- The remuneration system for transport, regasification and storage facilities is based on consistent principles: use of the asset's net value as a basis for calculating investment remuneration, inclusion of variable remuneration based on gas transported, regasified or stored by asset type, and elimination of all automatic review procedures for values and parameters based on price indices.
- With respect to new secondary transport facilities, remuneration now is included in the payment methodology for distribution facilities, linking remuneration to growth in customers and to new demand generated.
- Having regard to distribution facilities, remuneration is maintained for each distribution company and all its facilities based on the number of customers connected and the volume of gas supplied. Automatic reviews are eliminated, and the parametric remuneration formula is established to distinguish, in the remuneration category for supplies at pressures equal to or below 4 bars, between consumers with an annual consumption of less than 50 MWh and consumers with a higher consumption, so as to guarantee the adequacy of system revenue at all consumption levels, taking into account toll revenue in each case.
- In order to incentivise network expansion to non-gasified zones and bring remuneration into line with actual costs incurred by companies, different unit values are used depending on whether or not customers are in recently-gasified municipalities.

Order ETU/1283/2017 of 22 December 2017 established the remuneration for regulated gas sector activities for 2018 and Order TEC/1367/2018 of 24 December 2018 lays down the remuneration for 2019.

2.1.1.4 LPG supply

As well as natural gas distribution, Naturgy carries out the supply of piped liquefied petroleum gas (LPG), regulated by Law 34/1998 on the oil and gas industry. The MITECO establishes the selling rates for piped LPG for end consumers and the assignment prices of LPG at which it is purchased by piped LPG distributors, laying down the specific rates or a system for automatically calculating and updating them. These prices are published under monthly resolutions.

2.1.2. Unregulated activities

2.1.2.1. Supply

Taking into account the small volume of natural gas production in Spain, this section will centre on the international supply of natural gas.

Natural gas is supplied in Spain mainly by gas operators such as Naturgy under long-term contracts with gas producers. Although such supplies are not regulated, they are subject to two types of limit, basically to assure supply diversification and competition in the market: 1) no country can supply more than 60% of the gas imported into Spain; and 2) no business person or group can contribute as a whole natural gas for consumption in Spain that is greater than 70% of national consumption, excluding self-consumption.

2.1.2.2. Commercialisation

Pursuant to Law 12/2007 and its enabling regulations, natural gas is supplied exclusively by supply companies, the former tariff supply operations previously performed by distribution companies having been eliminated. The Law recognises that consumers connected at less than 4 bars who do not exceed a certain consumption threshold (50 MWh/year) are entitled to be supplied at a maximum price referred to as the social tariff or last-resort tariff (TUR).

Order TEC/1368/2018 of 20 December was published on 22 December 2018, amending Order ITC/1660/2009 of 22 June, and lays down the method for calculating the TUR, updating the calculation formula, which additionally incorporates raw materials costs, access tolls, supply costs and costs derived from supply security. Specifically, the parameters of the base gas formula used to determine the cost of the raw material are updated. The application of this new formula results in a reduction in the average annual cost of gas, which will be applicable from 1 January 2019.

During 2018, the TUR has evolved as follows:

- On 28 December 2017, the DGPEM Ruling of 26 December 2017 was published, entailing an average 6.2% rise in the TUR applicable as from 01 January 2018.
- On 31 March 2018, the DGPEM Ruling of 22 March 2018 was published, entailing an average 3.2% cut in the TUR with respect to the first quarter of 2018, applicable as from 1 March 2018.
- On 30 June 2018, the DGPEM Ruling of 28 June 2018 was published, entailing an average 3.4% rise in the TUR applicable as from 1 June 2018.
- On 29 September 2018, the DGPEM Ruling of 25 September 2018 was published, entailing an average 7.8% rise in the TUR applicable as from 1 October 2018.
- On 28 December 2018, the DGPEM Ruling of 26 December 2018 was published which envisaged an average 4.3% decrease in the TUR of 4.3% due mainly to lower recognized costs of gas acquisition derived from the application of Order TEC / 1368/2018 mentioned above applicable as from 1 January 2019.

Organised gas market

The organised gas market was set up under Law 8/2015 and was subsequently developed by Royal Decree 984/2015 and other enabling regulations. The organised gas market managed by MIBGAS began operating in December 2015 with an Iberian outlook, although until now only products with delivery on the Spanish side have been negotiated.

A resolution of the Council of Ministers dated 10 November 2017 established the obligation for the dominant operators in the natural gas industry, Naturgy and Endesa, to act as mandatory market makers in the organised gas market (MIBGAS). This obligation means that these operators must continuously present purchase and sale offers in the organised gas market, in order to increase market liquidity. The conditions and requirements for complying with this obligation are set out in the Resolution of the Secretary of State for Energy published on 13 December 2017.

In April 2018, MIBGAS Derivatives initiated futures trading in natural gas products with physical delivery on a monthly (with due dates longer than the following month), quarterly, semi-annual and annual basis. OMIClear acts as the clearing and settlement house for the transactions.

Under a Resolution dated 27 November 2017 a new winter action plan for the operation of the gas system was approved. The purpose of the plan is to guarantee supply in the event of an increase in demand derived from unexpected seasonal supply fluctuations and sudden cold spells. In general terms, it will be applicable from 1 November each year until 31 March of the following year.

In relation to the previous winter plan, the required reserves have been increased and their location has been limited to tanks in regasification plants.

On 26 May 2018 Royal Decree 335/2018 was published, amending various Royal Decrees that regulated the gas sector. The most salient aspects with regard to the supply activity are the following:

- Royal Decree 949/2001 is amended to include the definition of the structure of the tolls applied to various services included in Royal Decree 984/2015, such as entrance at the virtual balancing point (VBP) from the distribution network, exit from the VBP to the regasification plant or storage in the VBP, which currently did not have a defined toll structure. In addition, the toll structure for the regasification plants has been adapted, including those applicable to ship unloading, LNG storage, regasification, entry in the VBP from the transport network and ship reloading, including in the latter case the supply to ships using LNG as fuel. This new structure will not be applicable until the relevant figures are published.
- Royal Decree 1434/2002 is amended to regulate the procedure for disqualifying as supply company and transferring its customers to the supply company (that does not fulfil its obligations) of last resort.
- Royal Decree 984/2015 is amended in order to make contracts on exit from the VBP to the final consumer indefinite, seeking to facilitate the processes for changing supply company.

Order TEC/1367/2018 of 20 December was published on 22 December 2018 and established the tolls and fees associated with third party access to gas facilities and the remuneration of regulated activities for 2019. The tolls for loading LNG onto ships have been changed, the structure of which was published in Royal Decree 335/2018, reducing them considerably and making Spanish plants more competitive. Ship unloading tolls have been equalised for all regasification plants, a VBP access toll from distribution networks has been established which will be applicable to biogas at a zero rate and the other current tolls are maintained. These figures will be applicable until the CNMC publishes the new ones, and the other tolls whose structure was modified by Royal Decree 335/2018 have yet to be published.

Concerning supply security, Regulation (EU) 2017/1938 on measures to guarantee the security of the gas supply came into force on 1 November 2017. It lays down reporting requirements for Spanish and European natural gas companies with respect to relevant gas contracts, for supply security reasons. This Regulation also strengthens regional cooperation and lays down a solidarity mechanism which is applicable in the event of a supply crisis in a member State.

Vulnerability

Royal Decree-Law 15/2018 published on 6 October 2018 brought in the “Thermal Social Bond”, consisting of a single annual payment as direct assistance in paying for heating, hot water and cooking, to consumers that had availed themselves of the electricity social bond at 31 December the previous year, irrespective of the fuel they use, or support for savings actions or improvements in energy efficiency. The amount to be received will depend on the degree of vulnerability and the climate zone.

2.2. Regulation of the Electricity sector in Spain

Main characteristics of the electricity sector in Spain

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

The electricity sector has the following main features:

- It is a sector in which regulated and non-regulated activities coexist. The regulated activities consist of electricity transmission and distribution (as well as the operation of the system). The non-regulated activities comprise generation and sale of electricity.
- The principle of the electricity system's economic and financial sustainability is established, which must be in line with the measures taken by the Administration and other relevant parties, whereby any regulation relating to the sector that entails an increase in costs for the electricity system or a reduction in revenue must also bring an equivalent reduction in other cost items or an equivalent increase in revenue to ensure a balance in the system.

- Mismatches due to a revenue deficit are limited to the extent that they may not exceed 2% of revenues estimated for the reference period and cumulative liabilities due to mismatches may not exceed 5% of those revenues.
- Revenues in the electricity sector derive from access tolls and other regulated prices, specific tax measures and, exceptionally, from certain items in the National Budget.

In 2013, Law 15/2012, of December 27 on fiscal measures for energy sustainability was published, the principal aspects of which were as follows.

- A new tax on energy production by all the generation facilities at a rate of 7% was introduced:
- Two new taxes were regulated: the tax on production of nuclear fuel spent and radioactive residue that are the result of the nuclear generation of electricity and the tax on the storage of nuclear fuel generated and radioactive residue in central installations, with the aim of compensating society for the charges that it must bear as a result of this generation.
- A positive rate was established for the use of natural gas in electricity generation and electricity and heat cogeneration, previously regulated at a zero rate, and the tax rate on coal is increased. At the same time, specific tax rates are created for fuels and gas-oils employed in the production of electricity or in the cogeneration of electricity and usable heat.
- A new royalty was applied to public domain assets for the use or exploitation of continental waters for hydroelectric power generation, amounting to 22% of the economic value of hydro-electricity generated Royal Decree-Law 10/2017 published on 10 June 2017 increased the tax rate from 22% to 25.5%.

Revenues from these taxes cover the regulated costs in the electricity system.

- The principles to be taken into consideration in the remuneration methods for regulated activities are established: transport, distribution, renewables, cogeneration and waste.
- The remuneration calculation parameters will have a six-year term and will be reviewed prior to the start of the regulatory period taking into account the economic cycle, demand for electricity and an adequate return from these activities.
- A distinction is made between transport and distribution network access tolls and the charges that are necessary to cover other costs of the relevant system activities, which will be determined using methodology to be established by the Government; in general, tolls and charges will be reviewed annually or in the event of circumstances that have a material impact on regulated costs or on the calculation parameters employed.
- Small consumer voluntary prices (PVPC) are regulated and will be the same throughout Spain. These prices are defined in line with the prices previously referred to as last-resort tariffs, as the maximum prices that the reference supply companies may charge consumers that avail themselves of the prices. The last-resort tariff (TUR) has become the regulated price applicable to consumers classed as vulnerable and to consumers that do not meet requirements to apply the voluntary price for small consumers but are temporarily without a supply company in the free market.

The regulation of electricity activities in Spain

Electricity activities are divided into: 1) regulated activities: electricity transport and distribution; and 2) non-regulated activities: electricity generation and marketing.

2.2.1. Regulated activities

The regulated activities are characterised by the fact that access to them is subject to government authorisation, and remuneration for them is established by law, and undertaking these activities is subject to a series of specific obligations.

- Need for prior government authorisation: The undertaking of regulated activities requires prior administrative authorisation, which is regulated. In order to obtain this authorisation, the applicant must basically demonstrate its

legal, technical and economic capacity to exercise this activity. The abovementioned authorisation grants a legal monopoly in a given territory, which does not imply an exclusive right of use because of the third-party network access obligation.

- Remuneration established by legislation: Royal Decree 1047/2013, December 27, and Royal Decree 1048/2013, December 27, brought in remuneration methods applicable to the transmission and distribution activities, so as to ensure adequate remuneration and network development. The remuneration to be received is updated annually by ministerial order. The financial yield on assets during the first regulatory period, to 31 December 2019, is linked to the yield on government bonds plus a spread of 200 basis points.

Royal Decree-law of 1/2019 which updates the CNMC's powers has changed the current configuration. The CNMC is now responsible for establishing the methodology and values for the remuneration that will be published by means of a circular letter and will be applicable upon the termination of the current regulatory period.

The regulatory framework for the electricity industry in Spain has a procedure for settlement compensation amongst companies in the sector for net invoicing of electricity acquisition and other costs, so that each company receives the appropriate remuneration for their regulated activities.

- Subjection to specific obligations of third party access to the network and unbundling: The carrying out of the regulated activities is subject to specific obligations to ensure the development of competition in marketing. The two main obligations in this respect consist of permitting access by third parties to transport and distribution and the obligation to keep regulated and unregulated activities separate.

Royal Decree 1955/2000 regulates access by third parties to the grid, determining which persons will have access rights, how the application is made, the deadlines for the same, the grounds for rejection of access, as well as the rights and obligations of each person involved in the system.

The legislation establishes the duty of functional separation, which means not only accounting separation, in order to avoid cross-subsidization and increase the transparency of the calculation of rates, tolls and levies, and legal separation, through separate companies, but also the requirement of independent operation of the regulated subsidiary company in relation to the other companies in the group, including the separation of brand and brand image, as in the case of the natural gas sector.

2.2.1.1. Transmission

Electricity transmission links the plants with the distribution networks and specific final customers. The network is owned mainly by REE, although other companies, including Naturgy's subsidiary UFD Distribución de Electricidad, S.A., own a small proportion of the secondary transport network.

The current remuneration framework is determined by Electricity Sector Law 24/2013 and Royal Decree 1047/2013 (27 December), providing the new methodology for calculating electricity transmission remuneration, and Order IET/2659/2015 of 11th December which approved standard installations and unitary values of reference for investment, operation and maintenance by fixed asset, which will be used when calculating the remuneration to be paid to the owners of electricity transmission facilities.

Transmission remuneration is laid down annually by the Ministry, which recognises compensation for investment, operation and maintenance, calculated on the basis of the regulatory unitary values of investment, operation and maintenance plus an availability incentive. As already mentioned, Royal Decree-Law 1/2019 modifies this allocation in favor of the CNMC.

2.2.1.2. Distribution

The distribution of electricity includes all activities that bring electricity from the high tension grid to the final consumer.

The current remuneration framework is determined by Electricity Sector Law 24/2013 and Royal Decree 1048/2013 (27 December), providing the methodology for calculating electricity transmission remuneration, and Order IET/2660/2015

of 11th December which approved standard installations and unitary values of reference for investment, operation and maintenance by fixed asset and the unitary remuneration figures for other regulated tasks which will be used when calculating the remuneration to be paid to electricity distribution companies, establishing the definitions for natural growth and relevant power increase and compensation for use and reservation of facilities.

The remuneration is calculated annually by the Ministry and recognises compensation for investment and operation and maintenance of the distribution facilities, as well as other regulated services calculated on the basis of the unitary values approve by regulation, including incentives to reduce network losses, detect fraud and improve service quality. As of 2020, this task will correspond to the CNMC.

Tolls

On 27 December 2017 Order ETU/1282/2017 of 22 December was published, laying down the electricity access tolls for 2018. Under said Order, the access tolls remain unchanged. On 22 December 2018 Order TEC/1366/2018 of 20 December was published, laying down the electricity access tolls for 2019, which did not introduce any changes in tolls either.

2.2.2. Unregulated activities

2.2.2.1. Electricity generation

Law 24/2013 of 26 December on the Electricity Sector provides that the production of electrical energy is to be subject to the rules of free competition, although the commissioning, modification, temporary closure, transfer and final closure of facilities is subject to prior administrative authorisation. The remuneration for this activity derives from its participation in the electricity production market, made up of the forward, daily and intraday markets, unorganised markets and other services related to the security of the electricity system, such as adjustment and balancing services. In addition, production facilities may receive remuneration as capacity mechanisms that provide the system with an adequate coverage margin and encourage the availability of manageable power in the medium and long term.

Likewise, the Law contemplate the possibility of development of capacity mechanisms. This have been ruling by the former provisions that provided for an investment incentive, an incentive for environmental investment and an availability service. Specifically, this latter service was provisionally regulated by Order ITC/3127/2011 of 17 November and was extended annually until 2017. Order ETU/1133/2017 reduced the extension period of this service to six months (June 2018), in view of the imminent reform of the capacity mechanisms. In addition, it temporarily excluded hydroelectric plants from this service due to the scarcity of resources, given the dry hydrological conditions. Subsequently, Order TEC/1366/2018 of 20 December, laying down the electricity access tolls for 2019, revoked the availability service on a definitive basis.

Renewable, high efficiency cogeneration and waste facilities

For the installations prior to the publication of Royal Decree-Law 9/2013, , the Law establishes a remuneration system in addition to the remuneration for the sale of electricity generated in the production market and its objective is to cover the costs that cannot be recovered by the market plus a reasonable yield, which allows these technologies to compete on an equal basis with other technologies. Royal Decree 413/2014 of 6 June develops this system, stipulating the review of the remuneration parameters in regulatory periods of 6 regulatory semi-periods of 3 years or semi-annually for the parameters associated with the return on operations involving certain technologies. On 10 November 2017, the European Commission authorised this Spanish support scheme, concluding that it complies with the EU rules on state aid.

On an exception basis a specific remuneratory system is to be established by means of a competitive tender procedure to encourage production based on renewable energy sources, high-efficiency cogeneration and waste, when there exists an obligation to fulfil energy objectives derived from Directives or other European Union legislation, or when the introduction thereof entails a reduction in energy costs and dependence on external energy sources. Within this framework, during 2016 and 2017 the Ministry of Energy, Tourism and the Digital Agenda arranged various auctions to grant the specific remuneration regime to new renewable generation facilities.

The remuneration parameters applicable to 2018 are included in Order ETU/130/2017 of 17 February which updates the remuneration parameters for standard facilities for the purposes of their application to the regulatory semi-period 2017-2019; in Order ETU/360/2018 of 6 April which lays down the rates for remuneration on operations corresponding to the first half-year of 2018; and in Order TEC/1174/2018 of 8 November which establishes the remuneration parameters for standard facilities applicable to animal waste treatment and reduction facilities.

In addition, Royal Decree-Law 20/2018 of 7 December 2018, on urgent measures to foment economic competitiveness in the industry and commerce sectors in Spain, extended for an additional 2 years the term of remuneration on operations involving high efficiency cogeneration facilities that use renewable fuels or natural gas and that have surpassed their regulatory useful life after 1 January 2018.

Order TEC/1380/2018 of 20 December established the regulatory bases for the granting of investment aid in electricity production facilities using wind and photovoltaic technologies located in the non-mainland territories, co-financed with FEDER Community Funds.

Generation in non-mainland territories

Electricity generation in the energy systems of the non-mainland territories may receive remuneration which is additional to market revenues, which takes into account the particularities of these territories..

Contaminating emissions

The operation of fossil fuel plants is subject to the limits on contaminating emissions established by Directive 2010/75/EU on industrial emissions and national regulations. These limits mainly affect the operation of coal-fired plants that must restrict their operation to comply with the provisions of the transitional national plan applicable during the period from 1 January 2016 to 30 June 2020. The operation of these facilities after that date will require prior investment in desulphurisation and denitrification facilities or, failing that, the closure of the facility.

European integration of markets

Regarding markets, the progress made in the integration of the Iberian market with the markets of other European countries should be noted. Since 2014, the daily market has been integrated with the main European markets, and in April 2018 the Iberian continuous intraday market was integrated with the rest of Europe, coexisting for the present with auctions in the Iberian area (Spain and Portugal). In addition, work is being carried out to develop the regulations that will enable the integration of the balancing markets, scheduled for 2019.

2.2.2.2. Electricity supply

Supply is based on the principles of deregulated contracting and the customer's choice of provider. As a deregulated activity, supply is remunerated at a price freely agreed by the parties.

As mentioned above, as from 1 July 2009 consumers purchasing more than 10 Kw must be supplied by a free market retailer, while those consuming power equal to or lower than 10 Kw have the option to continue buying electricity under the regulated price (last-resort tariff). As from the Law 24/2013, this regulated tariff is referred to as the Small Consumer Voluntary Price (PVPC), the last-resort tariff (TUR) being the regulated price applicable to consumers classed as vulnerable and to consumers that do not meet requirements to apply the PVPC but are temporarily without a supply company in the free market.

The criteria for setting the last-resort tariff, now PVPC, have been regulated through successive legal provisions. Under the relevant legislation it must incorporate all supply costs, including energy production costs, access tolls and supply costs.

On 29 March 2014, Royal Decree 216/2014, March 28, was published, providing the methodology for calculating small consumer voluntary prices (PVPC) and the related legal regime for contracting. It determines the structure of small consumer voluntary prices, which will apply to low-voltage consumers with a contracted capacity of up to 10 kW. The Royal Decree also stipulates the procedure for calculating the cost of power generation, which will include the small consumer voluntary price.

The cost of power generation is calculated based on the daily market hourly price during the billing period. Billing is performed by the reference supply company based on actual readings and taking into consideration consumption profiles, except for supplies using metering equipment capable of telemetering and telemanagement, effectively integrated into the relevant systems, in which billing will be effected using hourly consumption values.

Alternatively, a consumer may contract a fixed power price for one year with the reference supply company.

Royal Decree 469/2016 of 18 November amended Royal Decree 216/2014 of 28 March and introduced the method for calculating the supply cost to be included in the PVPC and a unitary remuneration for the exercising of the activity, establishing a fixed term (€/kW) and variable term (€/kWh) structure. The supply margin will be reviewed every three years, the first review pertaining to the three-year period 2019-2021.

Vulnerability

Royal Decree-Law 7/2016 amended the wording of Article 45.4 of Law 24/2013 and implemented a new social bond funding scheme under which this public services obligation is only to be funded by parties engaging in electricity marketing, specifically the parent companies of corporate groups engaging in the sale of electrical energy or the companies carrying out this activity that do not form part of any group. The percentage distribution is calculated in proportion to the customers' quotas and will be calculated annually by the CNMC.

Accordingly, on 3 October 2017 and 27 December 2017 Order ETU/929/2017 and Order ETU/1288/2017 were published which ordered the reimbursement, by charge to the electricity system surplus, of the amounts paid by Gas Natural SDG, S.A. as social bond financing in 2014, 2015 and 2016, plus legal interest calculated as from date on which payment was made until the date of its reimbursement.

On 7 October 2017 Royal Decree 897/2017 was published which regulates vulnerable consumers, the social bond and other protection measures for domestic electricity consumers, in compliance with the provisions of Royal Decree Law 7/2016. Order ETU/943/2017 under which said Royal Decree was developed was published on 9 October. The most relevant aspects are:

- Three types of vulnerable consumer are defined according to the kind of income or other circumstances unrelated to income levels: vulnerable consumer, severe vulnerable consumer and severe vulnerable consumer at risk of social exclusion.
- The social bond provides a discount of 25% on the PVPC for vulnerable consumers and 40% for severe vulnerable consumers, up to a consumption limit.
- Supplies to severe vulnerable consumers will not be interrupted in the event that the social services of a public authority finance at least 50% of their bill. The remaining 10% must be co-financed by the supply companies.
- The criteria and procedures for qualifying for the social bond are revised in terms of income, number of minors in the home and other conditions. The supply company concerned is responsible for processing the application and verifying the requirements.
- The social bond is granted for a period of two years, except for large families in which it lasts until such status expires.
- The procedure for suspending supply in habitual residences is reviewed.

Royal Decree Law 15/2018 on urgent measures for the energy transition and the protection of consumers, above, amended Royal Decree-Law 7/2017. The most relevant aspects are:

- It mandates the Government to approve a "National Strategy against Energy Poverty" within six months.
- The social bond coverage and the consumption limit are extended.
- It adds three new categories of essential supplies (to date, only consumers at risk of social exclusion).

- The social bond and the assumption of the cost of co-financing severely vulnerable customers' expenses are considered a public service obligation, to which the non-payment of bills in the three new essential categories is added.
- It reinforces the penalty regime for supply companies that unjustifiably hamper access to the electricity social bond.
- As already mentioned, the thermal social bond is created which consists of direct assistance in paying for heating, hot water and cooking, irrespective of the fuel used, which will be financed out of the Central Government budget and whose beneficiaries will be consumers that already qualify for the electricity social bond at 31 December.

Under Order TEC/1226/2018 of 13 November, the final distribution percentages of the amounts to finance the social bonus and the cost of co-financing severely vulnerable consumers and the non-payment of bills under the essential vulnerable categories is set at 15.82% for the Naturgy Group.

Additionally, Royal Decree law 15/2018 introduced major changes that affect the supply activity, such as the prohibition of "door-to-door" sales (also applicable to the gas sector) and an obligation to include additional information in bills, as well as strengthening the disqualification procedure for fraudulent supply companies.

Additionally, this Royal Decree law repealed practically all existing regulations on electricity self-consumption, enabling shared self-consumption, repealing the charges and tolls for self-consumed energy and simplifying registration formalities. Awaiting regulatory development.

Order TEC/1366/2018 of 20 December laying down electricity access tolls for 2019 was published on 22 December 2018. The supply cost to be included in the PVPC calculation set for the period 2016-2018 will be maintained until the Order setting the cost for the period 2019-2021 is approved.

Energy efficiency

As regards energy efficiency in Spain, Royal Decree-Law 18/2014 stipulates the following:

- A national energy efficiency obligations system whereby gas and electricity supply companies, oil product wholesalers and liquefied petroleum gas wholesalers will be allocated an annual energy-saving quota (saving obligations). Aggregate saving obligations will be equal to the target allocated to Spain in Directive 2012/27/EU.
- The National Energy Efficiency Fund concerns economic and financial support mechanisms, technical assistance, training and information, or other measures to enhance energy efficiency in different sectors, which are necessary to achieve the Energy Efficiency Directive's objectives.
- The financial equivalence of the saving obligations will be determined annually based on the average cost of the support mechanisms, incentives and measures required to mobilise the investments necessary to fulfil the annual saving target, through actions by the National Fund, based on the findings of the technical analysis by the Institute for Energy Diversification and Saving.
- The Government is also authorised to establish and develop a final energy savings accreditation system, by issuing Energy Saving Certificates (ESC). Once launched, this will allow companies to progressively fulfil their saving obligations by directly promoting energy efficiency enhancement actions that fulfil the necessary guarantees.

A ministerial order stipulates annually each liable party's obligations to make contributions to the National Energy Efficiency Fund. Order ETU/257/2018 of 16 March laid down the obligations for 2018, amounting to Euros 26 million for Naturgy.

2.3. Regulation of the natural gas industry in Latin America

In Brazil, Mexico, Argentina and Peru the rates and remuneration of natural gas distribution companies are determined by the regulatory authorities. There are stable regulatory and tariff frameworks that lay down the procedures and formalities necessary for the regular review of rates and distribution margins. This tariff review is carried out every five years (except in Peru, where it is every four years) through the filing of the respective reports with the regulators. In Chile, gas network distribution concessionaire companies operate under a free tariff regime subject to a maximum rate of return for each

concession area. In the event that the average profitability for the preceding three years in a given concession area exceeds said maximum rate, the regulatory authority will initiate a rate-setting process. The regulatory framework that defines the supervision procedures are stable and annual.

In Mexico, all the geographical distribution areas developed by Naturgy (Monterrey, Nuevo Laredo, Toluca, Saltillo, DF and Bajío) have tariffs approved for the 2016-2020 five-year period. In addition, tariffs have been granted until 2020-21-22 for the Noroeste, Sinaloa and Valle de México zones, respectively. For the new distribution permits for Tabasco, Campeche and Mérida, the period ends in 2023. The permit for Península is currently being processed. The regulatory framework in Mexico is being adapted to the energy reform launched at the end of 2013, which has entailed the liberalisation of natural gas supply and marketing activities. For gas distribution, the remuneration methodology is expected to be simplified and made more flexible.

In Brazil, on 30 December 2013, the regulator for Río de Janeiro state approved the new rates applicable from 1 January 2014 to the end of 2017. In aggregate terms, unit revenue from this activity was maintained. The tariff review process for the next five-year period (2018-2022) commenced during the last quarter of 2017. The tariff review process was not concluded in 2018 and is now expected to be completed in May 2019 with the application of the new rates. In Brazil, the Sao Paulo state regulator is expected to approve new rates during 2019.

In Argentina, in 2015 and 2016 a tariff review process took place resulting in a resolution establishing new natural gas and propane distribution prices which was published on 30 March 2017, urging the regulator, Enargas, to publish the tariff lists resulting from the comprehensive tariff review. In addition, on 30 March 2017 Enargas resolution No. I/4354-17 was published, which approved the distribution tariff lists arising from the comprehensive tariff review of Gas Natural BAN, S.A. effective from 1 April 2017, and a rise in the average tariff of 123% compared with the tariff in effect prior to that date. This increase will be applied in stages over the first year of the five-year period (30% in April 2017, 40% in December 2017 and the remaining 30% in April 2018) together with a financial factor that complements it for the purposes of maintaining equivalence between this staged increase and the direct increase in the tariff.

The publication and enforcement of these tariffs gave rise to a traditional regulatory framework in which the tariff base is measured at restated accounting values that reasonably reflect fluctuations in prices relative to the economy and the restatement in local currency of investment that had deteriorated during the lapse in the licence. The determination of the required income has been reasonable. This includes the cost of capital, using a WACC which has been reasonably quantified for the regulator by an external consultant.

On 30 November Enargas approved Resolution No. 122, which lays down the tariff lists that will be applicable as from 1 December 2017. Under this resolution the rates applied since April 2017 have been updated for inflation for the period and the second agreed level, which entails an increase of approximately 61% with respect to the tariff applied since April 2017.

On 27 March 2018, Enargas approved Resolution 301, which approved, with effect from 1 April 2018, the tariff schedules that will be applicable as of said date. The approved tariff entails an increase of approximately 42.5% with respect to the tariff applied since December 2017, which recognises the third step of 30% of the tariff increase approved from 1 April 2017; inflation measured using the Domestic Wholesale Price Index; and the financial compensation granted to distributors to correct the effect of the staged increases during the first year of the five-year period. The new Tariff Table for the period April - September 2018, considering an exchange rate of 20,345 ARS/USD to reflect gas acquisition costs in tariffs.

Since April 2018 the Argentinian economy has undergone a number of changes in macroeconomic conditions that caused a sharp alteration in parity between the Argentinian peso and the US dollar, changing the economic circumstances taken into account in the Bases and Conditions and reflected in contracts with gas producers. This increase in the exchange rate (not recognised in the current Tariff Table) meant that producers had to be paid a gas price that far exceeded the price that could be passed on via tariffs.

In the context of the tariff adjustment as from October 2018 the Government Energy Secretariat issued Resolution 20 of 4 October 2018 which provided, on a transitory and extraordinary basis, that the differences between the gas price laid down in contacts and the gas price recognised in tariffs as from 1 April until 30 September 2018 should be recovered under a scheme of 24 quotas as from 1 January 2019, which must be arranged by ENARGAS. This measure was repealed by Resolution 41 of the same Government Energy Secretariat.

On 5 October 2018, Resolution ENRG 280/18 laid down the new tariff tables with effect from 8 October that reflect the adjustment for inflation pertaining the preceding six-month period. The adjustment to the distribution margin was 20%.

Finally, under Decree 1053/2018 of November 2018 the National Government assumed the payment, on an exceptional basis, of the daily differences accumulated monthly between the value of gas bought by the network natural gas distribution service provides and the value of natural gas included in the tariff tables in effect between 1 April 2018 and 31 March 2019, generated solely by fluctuations in the exchange rate and relating to volumes of natural gas delivered during that period, thereby clearing up the doubts caused by the Government Energy Secretariat Resolution 41/2018.

In Chile there is a free tariff regime subject to control over profitability. Tariffs are therefore set by the distributor, which is also the supply company. Annual profitability must be lower than a certain yield established in the recent Industry Law. The yield consists of the discount rate that equals the present value of the flows associated with the business margin (sales revenue less operating costs) with the value of the assets. In the event that the yield exceeds the established rate, the Law would oblige the Regulator to set mandatory rates for low consumption customers. In October 2018, the National Energy Commission (CNE) published the final results of the 2017 profitability check, determining the profitability of the companies Metrogas, S.A. and Gas Sur, S.A., calculated in accordance with the new Gas Law for each concession area. The results were below the 10.5% limit corresponding to 2017 (the limit established in the Law is 9%), and therefore the companies will continue operating within the supervised free tariff system.

In Peru, activity commenced during the last quarter of 2017. The applicable rates are defined in the concession contract and will be valid for eight years from the start of the activity, with subsequent four-yearly reviews.

2.4. Regulation of the international electricity sector

2.4.1. Generation

Naturgy, through its subsidiary Global Power Generation (GPG), is present as a generator in Mexico, Panama, Costa Rica, the Dominican Republic, Puerto Rico and recently in Chile, Brazil and Australia.

In Costa Rica and Puerto Rico, the group's generation operations are subject to the regime for Power Purchase Agreement (PPA) with the sector's domestic companies, Costa Rica Electricity Institute (ICE) and Puerto Rico Electric Power Authority (PREPA), respectively, these being public corporations that are vertically integrated and exclusively responsible for transport, distribution and marketing.

Generation under the PPA regime also exists in Mexico, with energy being sold to the Federal Commission for Electricity (CFE) and to end-customers under bilateral contracts. Surplus energy is sold on the market created under the energy reform carried out in 2015 and 2016. Additionally, the Bii Hioxo wind farm became operational during 2014, selling the power generated under bilateral contracts to final customers.

The liberalisation of the electricity market in Mexico continues. During 2018 the new method for calculating electricity rates was implemented. The energy market continues to become consolidated and medium-term auctions have been held. In addition, due to power supply problems with the National Electricity System in the summer of 2018, a reliability-based auction arrangement has been launched to supply energy when the electricity system so requires. Furthermore, the fourth long-term auction (focused mainly on renewable energies) scheduled for December 2018 was temporarily suspended by the new President of the Republic (who took office on 1 December 2018, for a period of 6 years). No date has yet been set for its activation.

In Panama and the Dominican Republic, electricity generated is sold under bilateral contracts with the distributors at market rates.

In Chile, GPG won a tender in August 2016 for generation under a long-term contract scheme (PPA) with distributors (20 years). To meet this commitment, GPG expects to carry out two projects (wind and solar) which will enter service in 2021 with a total installed capacity of approximately 330 MW.

In Australia, GPG has constructed and operated, since November 2018, a wind generation project through a 20-year contract, with regulated tariffs for energy injected into the system with an installed capacity of 91 MW. In 2018 GPG was

awarded 180 MW of generation capacity in a wind project expected to enter operation in the second half of 2020. In this case the contract consists of a 15-year bilateral Power Purchase Agreement at a regulated tariff.

Finally, GPG is also present in Brazil through four photovoltaic generation plants with a total capacity of 152 MW involving 20-year contracts for the sale of reserve energy to the Chamber for Commercialising Electrical Energy (CCEE). These projects became operational in 2017 and 2018.

In all these countries, electricity sector regulations are well-established and stable; legislation is developed and administered by independent regulators.

2.4.2. Distribution

In the countries in which Naturgy is present as a distributor, Argentina, Chile, Moldova and Panama, the distribution activity is regulated. The distributors have the function of transporting electricity from the transport network to the customer hook up points and also the function of supplying electricity at regulated rates, to regulated customers, who, based on their consumption volumes, cannot choose to be supplied by another supplier. As for the unregulated customers that choose to purchase electricity from another supplier, they must pay the regulated distribution toll for the use of the networks. In Moldova the supply function at regulated tariffs is carried out through a company which is unrelated to the distributor, in compliance with European Union requirements, as a member of the Energy Community.

The tariffs are revised periodically to reflect the variations in energy purchase prices and the transport tariffs, as well as the variation in economic indicators.

There are regulatory and tariff frameworks in these countries that lay down the procedures and paperwork necessary for the periodical revision of tariffs and distribution margins. The tariff review is carried out every four or five years.

In Moldova, new methodologies were approved in March 2018 for the calculation of distribution and regulated electricity supply rates that will be in force until March 2023. On 15 July 2016 the Regulator approved a Resolution containing the procedure for the recovery of deviations from energy prices that are not passed on to end customers as they should be, in a period of four years, from 2017 to 2020. The Resolution was published on 4 October 2016. In compliance with this Resolution, the 2017 and 2018 rates have included the relevant recovery of the deficit. The new distribution and supply rates for 2018 were published on 29 June 2018, applicable from 1 July 2018.

In Chile, the transmission activity is regulated under a known and stable framework. Law 20.936 was published on 20 July 2016, which amended some provisions concerning transmission activities under the General Law on Electricity Services and set up an Independent Coordination Body for the National Electricity System.

In this context, with respect to National Transmission and Zonal Transmission, new projects are awarded through tender processes, the amounts of which are paid over 20 years. Once that period expires, their valuation is subject to the regulations applicable to existing projects. If facilities in these segments are expanded, the Annual Investment Value is remunerated for 20 years (Investment Value resulting from a tender and rate in effect at the time of the award).

The existing transmission facilities are remunerated through a regulated tariff, which is determined every four years through a tariff study. The current Zonal Transmission tariffs have been set by Decree 6T-2017 of the Ministry of Energy, published in the Official Gazette on 5 October 2017, entering force on 1 January 2018 and terminating in December 2019.

In relation to energy distribution in Chile, Decree 11T-2016 was published on 24 August 2017, which lays down the tariff formulae applicable to electricity distribution end-customers for the period 2016-2020, as well as the amounts applicable to each distribution company with effect from 1 November 2016 to November 2020. Notwithstanding the above, on 28 September 2018 Decree No. 5T-2018 was published under which some of the parameters of the tariff formulae established in the aforementioned decree were updated in order to include the higher costs associated with the quality and service safety and supply standards and requirements laid down in the Technical Standard on Service Quality in Distribution Systems, published in December 2017.

In Panama, work on the tariff review commenced in 2017 and the new tariff list will come into effect in July 2018

Note 3. Basis of presentation and accounting policies

3.1 Basis of presentation

The consolidated annual accounts of Naturgy Energy Group, S.A. for 2017 were approved by the shareholders at a general meeting held on 27 June 2018.

The consolidated annual accounts for 2018, which were drawn up and signed by the Board of Directors of Naturgy Energy Group, S.A. on 29 January 2019, will be submitted, along with those of the investee companies to the approval of the respective General Meetings. It is expected that they will be adopted without any change.

The Consolidated annual accounts of Naturgy for 2018 have been prepared on the basis of the accounting records of Naturgy Energy Group, S.A. and the other companies in the group, in accordance with the provisions of International Financial Reporting Standards adopted by the European Union (hereinafter “IFRS-EU”), as per (EC) Regulation 1606/2002 of the European Parliament and Council.

In the preparation of these consolidated annual accounts the historical cost method has been used, although modified by the criteria for the recognition valued at fair value through profit or loss and other comprehensive income, derivative financial instruments, business combinations and defined benefit pension plans.

These consolidated annual accounts fairly present the consolidated equity and consolidated financial situation of Naturgy at 31 December 2018, and the consolidated results of its operations, the changes in the consolidated statement of comprehensive income, changes in consolidated equity and the consolidated cash flows of Naturgy for the year then ended.

The aggregates set out in these Consolidated annual accounts are stated in million euro, unless indicated otherwise.

3.2 New IFRS-EU and IFRIC interpretations

Rules that have come into force on January 1, 2018

As a result of their approval, publication and coming into force on 1 January 2018 the following standards, interpretations and amendments have been applied:

- IFRS 9, “Financial instruments”;
- IFRS 15, “Revenue from ordinary activities from contracts with customers”;
- IFRS 4 (Amendment), “Application of IFRS 9 Financial Instruments with IFRS 4 Insurance contracts”;
- Annual improvements to IFRS, Cycle 2014-2016;
- IFRS 2 (Amendment) , “Classification and measurement of share-based payments”;
- IAS 40 (Amendment), “Transfers of investment property”;
- IFRIC 22, “Transactions and advance payments in foreign currency”
- IFRS 15 (Amendment), “Clarifications of the standard”

The only standards, interpretations or amendments among the above that have a significant impact on the consolidated annual accounts are IFRS 9 and IFRS 15.

IFRS 9 - “Financial instruments”

IFRS 9 establishes the criteria for the classification, measurement and derecognition of financial assets and liabilities, introduces new rules for hedge accounting and provides a new model for the impairment of financial assets.

Naturgy chose not to adopt the new standard in advance, opting not to restate the comparative analysis for 2017, and reflecting the adjustment to the carrying amount of financial assets and liabilities in reserves at 1 January 2018. However, in order to facilitate the comparison of the figures for the 2018 and 2017, the financial assets are classified in Notes 9 and 10 based on the new categories.

The impacts derived from the initial application of IFRS 9 are as follows:

- a) Classification of financial assets: With respect to investments in equity instruments currently classified under IAS 39 as available-for-sale financial assets, whose changes in fair value are recognised in equity and are taken to income when they are transferred or when their impairment is recognised, upon initial application of IFRS 9 Naturgy use for these investments, except in the case of Medgaz which was maintained for trading, the option permitted by the Standard concerning the irrevocable classification in the new category of investments in equity instruments at fair value through other comprehensive income. Increases and decreases in the fair value of these assets will be recorded under Other accumulated comprehensive income, impairment losses will not be recognised in results and gains or losses will not be reclassified to the consolidated income state at the time of sale. In addition, in relation to financial assets that are debt instruments and are not derivatives, Naturgy holds such assets mainly in order to obtain contractual cash flows and therefore they continue being measured at amortised cost as from 1 January 2018.
- b) Exchange of debt instruments: Naturgy carried out refinancing operations in which, in accordance with IAS 39, there had been no substantial variations in the debt instrument and therefore the carrying amount of the liability had been adjusted based on the relevant costs and commissions, which were amortised over the remaining useful life of the adjusted liability. Under IFRS 9, in operations involving changes to financial liabilities it is necessary to determine the value of the cash flows of the new financial liability calculated using the effective internal rate of return of the old financial liability, recording the difference between the new and original carrying amounts in the consolidated income statement. The impact estimated at 1 January 2018 is a decrease of Euros 48 million in financial liabilities with the corresponding increase in deferred tax liabilities of approximately Euros 12 million.
- c) Impairment of financial assets: Naturgy applies the general expected loss model for financial assets with the exception of Trade and other receivables, for which the estimated simplified expected loss model is used. In this context, Naturgy has taken into account available information on past events (such as customer payment behaviour), current conditions and forward-looking factors (e.g. macroeconomic factors such as GDP, unemployment, inflation, interest rates, etc.) that might impact the credit risk of Naturgy's debtors. On the basis of the evaluations carried out at the effective date of the new standards, the impact at 1 January 2018 has been an increase in the impairment provision for financial assets of Euros 102 million with a corresponding increase in deferred tax assets of approximately Euros 26 million.
- d) Hedge accounting: Naturgy has chosen to apply the hedge accounting of IFRS 9, however, it has not made substantial modifications to its hedge model, confirming that its current hedging relationships qualify as hedges that continue with the adoption of IFRS 9. The group will record, in a separate equity item, the temporary value of the option contracts, the forward element of forward contracts and the base exchange rate differential in financial instruments in the event of their being excluded from the hedging relationship.
- e) Other adjustments: These include adjustments due to the adoption of IFRS 9 for companies carried by the equity method, mainly due to the application of the new financial asset impairment model based on expected credit losses.

In summary, the impact of the adoption of IFRS 9 on the consolidated balance sheet at 1 January 2018 is as follows:

	Amount (million euro)	Adjustments
Investments recorded using the equity method	(23)	e)
Non-current financial assets	(1)	c)
Deferred tax assets	26	c)
Non-current assets	2	
Trade and other receivables	(101)	c)
Current assets	(101)	
Equity attributed to the parent company	(50)	
Non-controlling interests	(13)	c)
Equity	(63)	
Non-current financial liabilities	(48)	b)
Deferred tax liabilities	12	b)
Non-current liabilities	(36)	

IFRS 15 - "Revenue from contracts with customers"

IFRS 15 lays down a new model for the recognition of revenue derived from contracts with customers, where the revenue must be recognised based on compliance with performance obligations towards customers. Revenue represents the transfer of committed goods or services to customers for an amount that reflects the consideration to which the entity expects to be entitled in exchange for said goods and services.

Additionally, it is provided that an asset will be recognised for the incremental costs of obtaining a contract with a customer if they are expected to be recovered.

Naturgy has chosen the retroactive method as the transition method for the first application of IFRS 15, with the accumulated effect of said application at 1 January 2018 being reflected in reserves, and has chosen not to restate the comparative figures for 2017.

In addition, the entity has decided to apply the practical solutions consisting of not regarding the financing component as material when the payment period is less than one year, not applying the standard retrospectively to contracts terminating before 1 January 2018 and recognising the costs of obtaining the contracts as an expense when the expected amortisation period is one year or less.

The impacts derived from the initial application of IFRS 15 are as follows:

- a) The internal revenue recognition policies for the different types of contracts with customers have been analysed, identifying the performance obligations, the determination of the calendar of satisfaction of these obligations, transaction price and allocation thereof, in order to identify possible differences with respect to the revenue recognition model under the new standard. No significant differences between them, or performance obligations that lead to the recognition of liabilities due to contracts with customers, have been detected.
- b) IFRS 15 requires the recognition of an asset for incremental costs incurred in obtaining such contracts with customers and which are expected to be recovered. They are amortised systematically in the consolidated income statement as the income related to the asset concerned is recognised, i.e. the average expected duration of contracts with customers, which varies from two to eight years. On the basis of the evaluations carried out at the effective date of the new standard, fees paid in prior years to obtain energy supply contracts with customers that are still in force at 1 January 2018, amounting to Euros 61 million, have been recognised under intangible assets, with the corresponding increase in deferred tax assets of approximately Euros 15 million.

Impact of the adoption of IFRS 15 on the consolidated balance sheet at 1 January 2018 is as follows:

	Amount (million euro)	Adjustments
Intangible assets	61	b)
Non-current assets	61	
Equity attributed to the parent company	46	b)
Equity	46	
Deferred tax liabilities	15	b)
Non-current liabilities	15	

Impact of IFRS 9 and IFRS 15 on the consolidated balance sheet at 1 January 2018

The effects on the consolidated balance sheet at 1 January 2018 and 31 December 2018 derived from the adoption of IFRS 9 and IFRS 15, explained above, are as follows:

Consolidated balance sheet (million euro)

	1.1.2018	IFRS 9	IFRS 15	Total adjustments	1.1.2018 IFRS 9 and IFRS 15
Assets					
Non-current assets	36,239	2	61	63	36,302
Current assets	11,083	(101)	-	(101)	10,982
Total assets	47,322	(99)	61	(38)	47,284
Equity and liabilities					
Equity attributed to the parent company	14,734	(50)	46	(4)	14,730
Non-controlling interests	3,571	(13)	-	(13)	3,558
Equity	18,305	(63)	46	(17)	18,288
Non-current liabilities	21,409	(36)	15	(21)	21,388
Current liabilities	7,608	-	-	-	7,608
Total equity and liabilities	47,322	(99)	61	(38)	47,284
	31.12.2018	NIIF 9	NIIF 15	Total ajustes	31.12.2018 NIIF 9 y NIIF 15
Assets					
Non-current assets	32,241	2	58	60	32,301
Current assets	8,428	(98)	-	(98)	8,330
Total assets	40,669	(96)	58	(38)	40,631
Equity and liabilities					
Equity attributed to the parent company	10,951	(47)	44	(3)	10,948
Non-controlling interests	3,659	(12)	-	(12)	3,647
Equity	14,610	(59)	44	(15)	14,595
Non-current liabilities	19,052	(37)	14	(23)	19,029
Current liabilities	7,007	-	-	-	7,007
Total equity and liabilities	40,669	(96)	58	(38)	40,631

Impact of IFRS 9 and IFRS 15 on the consolidated 2018 income statement

The effects on the 2018 consolidated income statement derived from the adoption of IFRS 9 and IFRS 15, explained above, are as follows:

	2018	NIIF 9	NIIF 15	Total adjustments	2018 NIIF9 y NIIF 15
Sales	24,339	-	-	-	24,339
Pocurements	(17,723)	-	-	-	(17,723)
Other operating income	166	-	-	-	166
Personnel costs	(1,010)	-	-	-	(1,010)
Other operating expenses	(1,850)	-	34	34	(1,816)
Gain/(loss) on disposals of fixed assets	21	-	-	-	21
Release of fixed assets grants to income and others	42	-	-	-	42
Gross operating results	3,985	-	34	34	4,019
Depreciation, amortisation and impairment expenses	(5,970)	-	(37)	(37)	(6,007)
Impairment of credit losses	(182)	3	-	3	(179)
Operating results	(2,167)	3	(3)	-	(2,167)
Net financial income	(688)	3	-	3	(685)
Profit/(loss) of entities recorded by equity method	(513)	-	-	-	(513)
Profit before taxes	(3,368)	6	(3)	3	(3,365)
Corporate income tax	780	(2)	1	(1)	779
Profit for the year from continuing operations	(2,588)	4	(2)	2	(2,586)
Profit for the year from discontinued operations, net of taxes	(10)	-	-	-	(10)
Consolidated profit for the year	(2,598)	4	(2)	2	(2,596)
Attributable to:					
the parent company	(2,823)	3	(2)	1	(2,822)
Non-controlling interests	225	1	-	1	226

With respect to the income statement at 31 December 2018, the application of IFRS 15 has entailed a decrease in operating expenses of Euros 34 million due to the recognition as assets of commercial costs for capturing customers and an increased amortisation charge of Euros 37 million due to the amortisation of the asset recognised in the initial application. Regarding IFRS 9, the impact on the consolidated income statement of the recognition of the impairment of financial assets based on the credit loss model has resulted in income amounting to Euros 3 million, while the impact of the new accounting treatment of operations for modifying financial liabilities, both those mentioned relating to previous years and the operation carried out in the current period (Note 9), have resulted in an increase in financial income of Euros 3 million. The impact on basic and diluted earnings per share is not significant.

Rules that have come into force on January 1, 2019

The standards, amendments and interpretations that will come into force for years commencing after 01 January 2019 and later years are described below.

Standards adopted by the European Union		Entry into force for years commencing
IFRS 16, "Leases"	New standard that replaces IAS 17.	1 January 2019
IFRS 9 (Revised), "Prepayment features with negative compensation"	Enables entities to measure at amortised cost some prepayable financial assets.	1 January 2019
IFRIC 23, "Uncertainty over income tax treatments"	Clarifies the recognition and valuation of IAS 12 in cases of uncertainty as to whether the tax authorities accept a certain tax treatment used by the entity.	1 January 2019
Standards issued by the IASB and yet to be adopted by the European Union		Entry into force for years commencing
IAS 19 (Amendment) "Plan amendment, curtailment or settlement":	These changes require the use of updated actuarial assumptions to determine the service costs for the current year and net interest for the remainder of the year.	1 January 2019
IAS 28 (Amendment), "Long-term interests in associates and joint ventures"	Clarifies the application of IFRS 9 to long-term interests in associates or joint ventures when the equity method is not used.	1 January 2019
Annual improvements to IFRS, Cycle 2015-2017	Minor changes to various standards.	1 January 2019
References to the IFRS Conceptual Framework (Amendment)	Ensure that the standards are consistent, include a new chapter on valuations, improve definitions and guidelines, and clarify areas such as prudence and the assessment of uncertainty.	1 January 2020
IFRS 3 "Business combinations" (amendment)	New definition of 'business'	1 January 2020
IAS 1 and IAS 8 (amendment) Definition of "materiality"	New definition of materiality, ensuring its consistency with all Standards	1 January 2020
IFRS 17, "Insurance contracts"	New standard that replaces IFRS 4.	1 January 2021

None of these standards or amendments has been applied early.

IFRS 16 - "Leases"

IFRS 16 "Leases" replaces IAS 17, IFRIC 4, SIC-15 and SIC-27 and lays down the principles for the accounting recognition of leases under a single balance sheet model for all leases. IFRS 16 enters force on 1 January 2019 and has not been adopted early.

IFRS 16 provides that lessees must recognise a financial liability in the consolidated balance sheet for the present value of the payments to be made over the remaining life of the lease and an asset for the right to use the underlying asset, which is valued based on the amount of the associated liability to which the initial direct costs incurred are added. In addition, there is a change in the policy for recognising the lease expense, which is recorded as a depreciation expense for the relevant asset and a financial expense due to the revaluation of the lease liability. In terms of the current accounting treatment of the lessor, the standard does not vary substantially and the lease must continue to be classified as an operating or financial lease depending on the degree of material transfer of the risks and rewards of ownership.

Naturgy has applied the following policies, estimates and criteria:

- The exemption from the recognition of leases in which the underlying asset is of low value (less than US\$ 5,000) and is short term (maturity less than or equal to 12 months) has been applied.
- The practical solution indicated in paragraph C3, Appendix C of IFRS 16 has been applied, which stipulates that it is not necessary to reassess whether a contract is, or contains, a lease at the date of initial application.
- It has been decided not to separately record the components that are not leases from those that are for those asset classes in which the relative importance of these components is not significant with respect to the total value of the lease.

- For transition purposes, it has been decided to apply the modified retrospective approach, on the basis of which no comparative figures from previous years will be restated.
- It has been decided to measure the initial right of use of the asset for an amount equal to the lease liability at 1 January 2019 for all lease agreements.
- An incremental effective interest rate has been applied with respect to funding by portfolio of similar assets, in relation to the lease, country and duration of the agreement. The weighted average of the incremental interest rate at the date of initial application was 2.6% in Spain and 8.7% in Latin America.
- To determine the term of the leases as the non-cancellable period, the initial term of each contract has been considered unless Naturgy has a unilateral extension or termination option and there is reasonable certainty that this option will be exercised, in which case the corresponding extension term or early termination will be taken into account.

The reasonably estimated impacts derived from the initial application of IFRS 16 at 1 January 2019 are as follows:

- Recognition of assets under the heading “Right of use assets” (non-current assets) in the amount of Euros 325 million and an increase in debt under the headings “Financial liabilities for non-current and current leases” of Euros 258 million and Euros 67 million, respectively. These basically relate to leases on offices, gas tankers, vehicles and land for energy use where generation plants are located, mainly wind and photovoltaic facilities.
- With respect to financial leases prior to the date of first application and which involve the chartering of gas tankers (Note 19), their accounting treatment remains unchanged in comparison with IAS 17. However, the carrying amount will be reclassified in the amount of Euros 1,134 million with respect to finance leases recorded under Property, plant and equipment (Note 7) to the new heading “Right of use assets” and financial lease liabilities, currently included under “Other current and non-current liabilities”, will be reclassified to the corresponding headings of “Current and non-current lease financial liabilities” (Note 19) for Euros 1,186 million and Euros 132 million, respectively.

In summary, the impact of the adoption of IFRS 16 on the consolidated balance sheet at 1 January 2019 is expected to be as follows:

	Amount (million euro)	Adjustments
Right of use assets	1,459	a) b)
Property, plant and equipment	(1,134)	b)
Non-current assets	325	
Equity attributed to the parent company	-	
Non-controlling interests	-	
Equity	-	
Financial liabilities for non-current leases	1,444	a) b)
Other non-current liabilities	(1,186)	b)
Non-current liabilities	258	
Financial liabilities for current leases	199	a) b)
Other current liabilities	(132)	b)
Current liabilities	67	

The estimated effects on the consolidated balance sheet at 1 January 2019 derived from the adoption of IFRS 16, explained above, are as follows:

Consolidated balance sheet (million euro)

	1.1.2019	IFRS 16	1.1.2019 IFRS 16
Assets			
Non-current assets	32,301	325	32,626
Current assets	8,330	-	8,330
Total assets	40,631	325	40,956
Equity and liabilities			
Equity attributed to the parent company	10,948	-	10,948
Non-controlling interests	3,647	-	3,647
Equity	14,595	-	14,595
Non-current liabilities	19,032	258	19,290
Current liabilities	7,004	67	7,071
Total equity and liabilities	40,631	325	40,956

The reconciliation between the operating lease commitments disclosed in “Contractual Commitments” of Note 35 at 31 December 2018 and the liabilities recognised at 1 January 2019 in the initial application of IFRS 16 is as follows:

	Amount (million euro)
Operating lease commitments at 31 December 2018 broken down in Note 35	476
Discounted using the corresponding interest rate	(79)
Short-term low-value leases	(37)
Adjustments resulting from different treatment of extension and termination options and others	(35)
Lease liabilities recognised at 1 January 2019	325

Estimated impacts that the application of IFRS 16 would have had on the consolidated income statement and consolidated cash flow statement for 2018 are:

- lower operating expenses and consequently a higher gross operating profit of Euros 78 million, as the operating lease payments were recorded under this heading of operating expenses, offset by an increased asset amortisation charge due to the recognised right of use of Euros 70 million and a higher charge for higher financial expenses relating to lease liabilities of Euros 11 million, meaning that the consolidated results for the year would not be significantly affected.
- an increase in cash flows from operating activities of Euros 78 million as a result of the increase in gross operating profit, offset by a decrease in cash flows from financing activities for the same amount since repayments of principal under lease contracts will be classified as cash flows from financing activities, meaning that cash generation is not affected.

3.3 Comparability

a) Discontinued operations

As a result of the divestments of the South African mining business described in Note 11 “Non-current assets and disposal groups of assets held for sale and discontinued operations”, the consolidated income statement for 2017 has been restated for purposes of comparison in compliance with IFRS 5.

A breakdown of the effects of the restatement on the consolidated income statement for 2017 is as follows:

2017 consolidated income statement

	2017	Application IFRS 5 (Note 11)	2017
Revenue	23,306	(99)	23,207
Procurements	(16,679)	51	(16,628)
Other operating income	238	(1)	237
Personnel expenses	(1,031)	22	(1,009)
Other operating expenses	(1,984)	15	(1,969)
Profit/(loss) on disposals of fixed assets	23	-	23
Release of fixed assets grants to income and other	42	-	42
Gross operating results	3,915	(12)	3,903
Depreciation, amortisation and fixed-asset impairment losses	(1,648)	27	(1,621)
Impairment due to credit losses	(155)	1	(154)
Operating profit/(loss)	2,112	16	2,128
Financial income	111	-	111
Financial expenses	(808)	1	(807)
Variations in fair value of financial instruments	(2)	-	(2)
Net financial income/(expense)	(699)	1	(698)
Profit/(loss) of companies measured under the equity method	14	-	14
Profit/(loss) before taxes	1,427	17	1,444
Corporate income tax	(190)	(5)	(195)
Profit/(loss) for the year from continuing operations	1,237	12	1,249
Profit for the year from discontinued operations, net of taxes	460	(12)	448
Consolidated profit/(loss) for the year	1,697	-	1,697
Attributable to:			
the parent company	1,360	-	1,360
From continuing operations	932	8	940
From discontinued operations	428	(8)	420
Non-controlling interests	337	-	337
Basic and diluted earnings per share in euros from continuing operations attributable to the equity holders of the parent company	0.93	0.1	0.94
Basic and diluted earnings per share in euros attributable to the equity holders of the parent company	1.36	-	1.36

b) Classification of Argentina as a hyperinflationary country

With effect from 1 July 2018, according to the criteria established by IAS 29 “Reporting in Hyperinflationary Economies”, the Argentinian economy should be treated as hyperinflationary with effects backdated to 1 January 2018. The financial information disclosed in previous years will not be restated.

The inflation rates used were the domestic wholesale price index (IPIM) until 31 December 2016 and the consumer price index (CPI) as from 1 January 2017.

The main impacts at 31 December 2018 have been as follows:

- An increase in equity as a result of applying the rise in inflation to the historic cost of non-monetary assets from the date of their acquisition or inclusion in the consolidated balance sheet and recording the relevant deferred tax liability.

The cumulative effect of the accounting restatement that corrects the effects of hyperinflation corresponding to financial years prior to 2018 is reflected under translation differences at the beginning of 2018.

- An adjustment to the income and expenses items to apply the rise in inflation from the date they were included in the income statement, as well as to reflect the losses derived from the net monetary position.
- The translation into euro of the figures thus adjusted in the consolidated financial statements applying the year end peso/euro exchange rate.

The main impacts on the consolidated financial statements a 31 December 2018 derived from these issues are as follows:

	Million euro
Revenue	(38)
EBITDA	10
Net financial income/(expense)	(14)
Net profits	(8)
Attributed equity	55
Investments	(4)

3.4 Accounting policies

The main accounting policies used in the preparation of these consolidated annual accounts have been as follows:

3.4.1 Consolidation

a) Subsidiaries

Subsidiaries are companies controlled by Naturgy. Naturgy controls an entity when, as a result of its involvement, it is exposed or entitled to variable returns and has the capacity to influence those returns through the power exercised in the entity.

Subsidiaries are fully consolidated as from the date on which control is transferred to Naturgy and are excluded from consolidation on the date on which this control ceases.

In order to account for the acquisition of subsidiaries the acquisition method is used. The cost of acquisition is the fair value of the assets delivered of the equity instruments issued and the liabilities incurred and borne on the date of the exchange, the fair value of any additional consideration that depends on future events (provided that they are likely to occur and can be reliably measured).

The intangible assets acquired through a business combination must be recognised separately from goodwill if they met the criteria for asset recognition, whether they are separable or they arise from legal or contractual rights and when their fair value can be reliably measured.

The identifiable assets acquired and the liabilities or contingent liabilities incurred or borne as a result of the transactions are initially stated at their fair value at the date of acquisition, irrespective of the percentage of the non-controlling interest.

For each business combination, Naturgy may opt to recognise any non-controlling interest in the acquiree at fair value or at the proportional part of the non-controlling interest of the recognised values of the net identifiable assets of the acquiree.

Acquisition costs are expensed in the year when they are incurred.

The surplus cost of the acquisition in relation to the fair value of Naturgy's shareholding in the net identifiable assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the consolidated income statement.

The measurement period for business combinations begins on the acquisition date and ends when Naturgy concludes that it cannot obtain further information on the events and circumstances that existed at the acquisition date. This period may not in any case exceed one year as from the acquisition date. During the measurement period, the business combination is deemed to be provisional and adjustments to the provisional amount will be recognised, if applicable, as if the business combination had been fully recognised on the acquisition date.

In a business combination achieved in stages, Naturgy values its prior interest in the target's equity at the fair value on the control date, recognising resulting gains or losses in the consolidated income statement.

Inter-company transactions, balances and unrealized gains on transactions between Naturgy companies are eliminated in the consolidation process. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

The shareholding of the minority shareholders in the equity and profit or loss of the subsidiary companies is broken down under "Non-controlling interests" in the consolidated balance sheet and "Profit attributable to non-controlling interests" in the consolidated income statement.

In relation to the acquisitions or sale of shareholdings without loss of control, the difference between the price paid or received and their net carrying value, or as the case may be, the result of their sale, is recorded as equity transactions and does not generate either goodwill or profits.

When an investment ceases to be consolidated due to a loss of control any interest retained in the entity is recalculated at fair value with the change in the carrying amount being recognised in the consolidated income statement. This fair value then becomes the initial carrying amount for the purposes of the subsequent recognition of the retained interest as an associate, jointly controlled entity or financial asset. In addition, any amount previously recognised in other comprehensive income in relation to the entity concerned is recorded as if the group had disposed of the related assets or liabilities directly.

The sale options given to minority shareholders of subsidiary companies in relation to shareholdings in these companies are stated at the current value of the reimbursement, i.e., their exercise price and are carried under "Other liabilities".

b) Joint Arrangements

Joint arrangements are understood as combinations in which there are contractual agreements by virtue of which two or more companies hold an interest in companies that undertake operations or hold assets in such a way that any financial or operating decision is subject to the unanimous consent of the partners.

A joint arrangement is classed as a joint operation if the parties hold rights to its assets and have obligations in respect of its liabilities or as a joint venture if the venturers hold rights only to the investee's net assets.

Interests in joint operations are accounted for by proportionate consolidation method and interests in joint arrangements are recorded under the equity method.

Under the equity method, interests in joint ventures are initially recognised at cost and are adjusted thereafter to reflect Naturgy's interest in gains and losses subsequent to the acquisition and movements in other comprehensive income.

At each reporting date, Naturgy determines whether there is objective evidence of the impairment of its investment in a joint venture. If impairment is identified, Naturgy calculates the amount of the impairment loss as the difference between the joint venture's recoverable amount and carrying amount, recognising it in the item "Profit/(loss) from equity-consolidated companies" in the consolidated income statement.

The assets and liabilities assigned to joint ventures are recorded in the consolidated balance sheet in accordance with their nature and based on Naturgy's percentage interest. The income and expenses from joint operations are reflected in the consolidated income statement in accordance with their nature and proportionally to Naturgy's percentage interest.

c) Associates

Associates are all entities over which Naturgy has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

Investments in associates are accounted for under the equity method.

d) Consolidation scope

Appendix I includes the investee companies directly and indirectly owned by Naturgy that have been included in the consolidation scope.

Appendix II lists the main consolidation scope changes in 2018 and 2017, the most relevant being as follows.

2018

In February 2018, following approval by the competition authorities, the sale of the gas distribution and supply companies in Italy was completed.

In March 2018, through its subsidiary Global Power Generation, Naturgy agreed to the acquisition of two solar photovoltaic projects in Brazil that began operating in December 2018 (Note 31).

In March 2018, following approval by the competition authorities, the sale of a 20% minority interest in the company Holding de Negocios de Gas, S.A., which owns the gas network assets in Spain, was completed.

In May 2018 the deadline expired for the acceptance of the public offering on Gas Natural S.A. ESP, thereby completing the sale of the remaining 41.9% of the gas distribution business in Colombia.

Kangra Coal Proprietary Limited, recognised as held for sale since May 2018 (Note 11), was sold in December 2018.

2017

In 2017 the main change in scope related to the sale of 17.2% of Gas Natural S.A. ESP and subsidiaries, reducing the percentage holding from 59.1% to 41.9%. As a result of losing the majority of voting rights and members of the Board of Directors, Gas Natural S.A. ESP ceased to control the company, which thereafter was regarded as an associate and carried using the equity method (Note 11).

3.4.2 Transactions in foreign currency

Items included in the financial statements of each of Naturgy's entities are measured using the currency of the primary economic environment in which the entity operates. The Consolidated financial statements are presented in Euros, which is Naturgy's presentational currency.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at the year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

The results and financial position of all Naturgy entities that have a functional currency different from the presentational currency are translated into the presentational currency as follows:

- Assets and liabilities for each Balance sheet presented are translated at the closing rate at the date of that balance sheet;
- Income and expenses for each Income statement are translated at monthly average exchange rates, unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions.
- All the currency translation differences are recognised in the Consolidated Statement of Comprehensive Income, and the cumulate amount under the heading Cumulative translation adjustments in equity.

Before being converted to euros the financial statements of group companies with the functional currency of a hyperinflationary economy are adjusted for inflation according to the procedure described below. Once restated, all of the items of the financial statements are converted to euro applying the year-end exchange rate. The figures for previous periods, which are given for comparative purposes, are not altered.

To determine the existence of hyperinflation, the group assesses the qualitative characteristics of the economic environment, as well fluctuations in inflation rates in the last three years. The financial statements of companies whose functional currency is that of an economy considered to be highly inflationary are adjusted to reflect changes in the purchasing power of the local currency, such that all items on the statement of Balance sheet that are not expressed in current terms (non-monetary items), are restated taking as reference a representative price index at the year end and all income and expenses, gains and losses, are restated on a monthly basis applying appropriate corrective factors. The difference between the initial amounts and the adjusted figures is taken to profit and loss.

The adjustments to goodwill and the fair value arising from the acquisition of a foreign company are treated as its assets and liabilities and are translated at the closing exchange rate.

The exchange rates against the euro (EUR) of the main currencies of Naturgy companies at 31 December 2018 and 2017 have been as follows:

	31 December 2018		31 December 2017	
	Closing Rate	Average Accumulated Rate	Closing Rate	Average Accumulated Rate
US Dollar (USD)	1.15	1.18	1.20	1.13
Argentinean Peso (ARS)	43.11	32.99	22.31	18.71
Brazilian Real (BRL)	4.44	4.31	3.97	3.61
Chilean Peso (CLP)	794.63	757.34	737.89	732.91
Mexican Peso (MXN)	22.49	22.71	23.67	21.34
Australian Dollar (AUD)	1.62	1.58	1.53	1.47

3.4.3 Intangible assets

a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of Naturgy's share of the net identifiable assets of the acquired subsidiary, joint arrangements or associates acquired, at the date of acquisition. Goodwill on acquisitions of subsidiaries or joint arrangements is included in Intangible assets while goodwill related to acquisitions of associates is recorded under Investments using the equity method.

Goodwill is not amortised and it is tested annually to analyse possible impairment losses. It is recognised in the consolidated balance sheet at cost value less cumulative impairment losses.

The impairment of goodwill cannot be reversed.

b) Concessions under IFRIC 12 and other similar concessions

This heading records the cost of acquisition of concessions if they are acquired directly from a public entity or similar, the fair value attributed to the concession in the event of being acquired as part of a business combination or the cost of construction and improvements of infrastructures assigned to concessions, in accordance with IFRIC 12 "Service concession agreements".

The aforementioned assets related to the service concession agreements under IFRIC 12 are those that the licensor controls the services that Naturgy (operator) must provide and the significant residual stake in the infrastructure at the end of the agreement, are set forth in this section in accordance with the accounting model for intangible assets based on the nature of the economic profits to be received by the operator. The income and expenses on construction services or infrastructure improvements are recognized for their gross amount. Given that concession agreements do not specify remuneration for these concepts, it is assumed that fair value of income corresponds to incurred costs without margin.

The assets included in this accounts are amortised on a straight-line basis over the duration of each concession, except in the case of the Maghreb-Europe pipeline, which, in order to properly reflect the expected consumption scheme for the future economic profits, is based on the value of gas transported during the life of the right of use, which represents accumulated amortisation that is no less than what would be the result of using a straight-line amortisation method.

Furthermore, the concessions for electricity distribution and transmission in Spain and Chile, and the concessions for the gas distribution in Chile acquired, all of them, basically as part of a business combination has no legal or any other type of limit. Accordingly, since we are dealing with intangible assets with an undefined life, they are not amortised, although they are tested for possible impairment annually as per that set out in Note 3.4.5.

c) Computer software

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

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

d) Research costs

Research activities are expensed in the consolidated income statement as incurred.

e) Customer acquisition costs

The incremental costs incurred directly to obtain customer contracts that reflect the commissions paid to obtain energy supply contracts with such customers and which are expected to be recovered over the expected duration of the contract are recorded as intangible assets.

Customer acquisition costs recognised as assets are amortised systematically in the consolidated income state over the average expected useful life of the contracts with customers, varying between two and eight years.

f) Other intangible assets

Other intangible assets mainly include the following:

- The cost of acquisition of the exclusive regasification rights at the regasification plant in Peñuelas (Puerto Rico), which are amortised on a straight-line basis until the end of their term (2025).
- The licence costs for renewable generation farms, mainly acquired as part of a business combination, which will be amortised on a straight-line basis over their useful lives.
- Gas supply contracts and other contractual rights purchased as part of a business combination, which are valued at fair value and amortised over the contract term that does not differ of expected consumption scheme.

There are no intangible assets with an undefined useful life apart from goodwill and the aforementioned concessions for electricity distribution and transmission and the concessions for gas distribution.

3.4.4 Property, plant and equipment

Property, plant and equipment are carried at cost less accumulated depreciation and any impairment provision.

a) Cost

All property, plant and equipment are presented at cost of acquisition or production, or the value attributed to the asset in the event that it was acquired as part of a business combination.

The financial cost for the technical installation projects until the asset is ready to be brought into use, form part of property, plant and equipment.

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

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

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

The non-extractable gas necessary as a cushion for the exploitation of the underground storage units of natural gas is recorded as Property, plant and equipment ("cushion gas"), and depreciated over the useful life of the underground storage deposit.

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

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

The future costs which Naturgy must meet in relation to the closure of certain facilities are included in the value of the assets at the restated value, including the respective provision (Note 3.4.17).

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

b) Depreciation

Assets are depreciated using the straight-line method, over their estimated useful life or, if lower, over the time of the concession agreement. Estimated useful lives are as follows:

	Estimated useful life years
Buildings	33-50
Gas tankers	25-30
Technical installations (pipeline network and transport)	20-40
Technical installations (hydro-electric plants)	14-65
Technical installations (thermal energy plants)	25-40
Technical installations (combined cycle gas turbine: CCGT)	35
Technical installations (nuclear energy plants)	40
Technical installations (wind farms)	25
Technical installations (electricity transmission lines)	30-40
Technical installations (electricity distribution network)	18-40
Computer hardware	4
Vehicles	6
Other	3-20

The hydro-electric plants are subject to the temporary administrative concession regime. Upon termination of the terms established for the administrative concessions, the plants revert to the Government in proper condition, which is achieved by stringent maintenance programs. The calculation of the depreciation charge for the hydro-electric plants differentiates between the different types of assets they have, distinguishing between the investments in civil works (which are depreciated on the basis of the concession period, or 100 years if there is no concession), electro-mechanical equipment (40 years) and the other fixed assets (14 years), taking into account, in any case, the use of the plant and the maximum term of the concessions (expiring between 2022 and 2063).

Government in proper condition, which is achieved by stringent maintenance programs. The calculation of the depreciation charge for the hydro-electric plants differentiates between the different types of assets they have, distinguishing between the investments in civil works (which are depreciated on the basis of the concession period, or 100 years if there is no concession), electro-mechanical equipment (40 years) and the other fixed assets (14 years), taking into account, in any case, the use of the plant and the maximum term of the concessions (expiring between 2022 and 2063).

Naturgy depreciates its nuclear energy plants over a useful life of 40 years which corresponds to the theoretical useful life of its main components. Operating licences for these plants usually have 10-year terms, it not being possible to request their renewal until near to the end of each licence. Nonetheless, in view of the optimal performance of these facilities and related maintenance programmes, the permits are expected to be renewed at least until a 40-year useful life is reached.

During the first quarter of 2017 Naturgy concluded the technical studies it was carrying out on the estimation of the useful life of combined cycle plants and, in line with the practice followed by the main operators in the industry, the useful life of the combined cycle plants has been changed on a prospective basis from 25 to 35 years, with effect from 1 January 2017. The effect of this estimated useful life change on "Depreciation, amortisation and impairment losses" in the 2017 consolidated income statement is a Euros 87 million reduction in the depreciation charge.

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

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount, i.e., when the asset is no longer useful such as due to a rerouting of the distribution pipeline (Note 3.4.5).

c) Exploration and production operations

Operating costs, excluding drilling costs, are recognised in the income statement as they arise, using the successful-efforts method. If, as a result of test drilling, proven reserves are found that justify commercial development, costs are transferred to investments in zones with reserves; otherwise, they are charged to the income statement.

Costs of investments in zones with reserves are capitalised and depreciated over the estimated commercial life of the gas field, based on the relationship between annual production and proven reserves at the start of the depreciation period. At the year end, or at any time when there is an indication that there may be asset impairment, the recoverable value is compared to their carrying value.

3.4.5 Non financial asset impairment losses

Assets are tested for impairment provided that an event or change in circumstances indicates that their carrying amount might not be recoverable. Additionally, goodwill and intangible assets not in use or with indefinite useful lives are tested at least annually for impairment.

When the recoverable amount is lower than the asset's carrying amount, an impairment loss is recognised in the consolidated income statement for the difference between both. The recoverable amount is calculated at the higher of an asset's fair value less costs of sale and value in use calculated by applying the discount cash flow method. Naturgy considers value in use as the recoverable amount, calculated as described below.

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

For those CGUs requiring impairment testing, cash flows have been based on the Strategic Plan approved by Naturgy updated in line with the most recent budgets, extrapolated to a total maximum of five years, on the basis of regulations and expectations regarding the development of the market based on available industry forecasts and historical experience of the performance of prices and output.

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

The parameters taken into account to determine the growth rates, which represent the long-term growth of each line of business, are in line with the long-term growth of the country, obtained from estimated inflation for the period 2021 to 2045 according to the Economist Intelligence Unit (EIU).

The parameters taken into account for the composition of the discount rates before taxes are as follows:

- Risk-free rate: taking into account the 10-year bond in the CGU reference market and studies by the European Central Bank and the Bank of Spain, among others.
- Market risk premium: premium based on studies by the European Central Bank and the Bank of Spain, among others.
- Deleveraged Beta: According to average of each sector in each case, obtained from Bloomberg.
- Local current interest rate swaps: 10-year swap, obtained from Bloomberg.
- Equity-debt ratio: Sector average.

The impairment loss of an asset, individually considered, is recognised in the consolidated income statement, reducing the carrying value of the asset to its recoverable amount. The depreciation charges for the asset are adjusted in future

periods in order to apportion the revised carrying amount of the asset, less its residual value, in a systematic manner over its remaining useful life.

An impairment loss is recognized for a CGU if its recoverable amount is less than the carrying amount. This loss is allocated a) firstly, to the goodwill, and then to the other CGU assets in proportion to their respective carrying values. These reductions are treated as impairment losses on individual assets. The carrying amount of an asset is not reduced below the higher of its recoverable value and zero dividing this amount of not allocated loss apportioned among the other CGU assets.

Impairment adjustments to the value of an assets recognised in previous periods, other than goodwill, may be reversed if and only if there is a change in the estimates used to determine the recoverable amount since the latest impairment loss was recognised.

3.4.6 Financial assets and liabilities

Financial assets

Naturgy classifies its financial assets based on their valuation category which is determined on the basis of the business model and the characteristics of the contractual cash flows, and only reclassifies financial assets when and only when it changes its business model for managing said assets.

Purchases and sales of investments are recognised on the trade date, which is the date on which Naturgy undertakes to purchase or sell the asset, classifying the acquisition under the following categories:

a) Financial assets at amortised cost

These are financial assets, not derivatives, which are held to collect contractual cash flows when those cash flows consist only of principal and interest payments. They include current assets, except for those maturing after twelve months as from the balance sheet date that are classified as non-current assets.

They are initially recorded at their fair value and then at their amortised cost using the effective interest rate method. Interest income from these financial assets is included in financial income. Any gain or loss that arises when they are derecognised is recognized directly in consolidated results and any impairment losses are recorded as a separate item in the consolidated income statement for the year.

b) Financial assets at fair value through profit or loss

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

Equity instruments classified in this category are recognised at fair value and any gain or loss arising from changes in fair value, or the proceeds of their sale, are included in the consolidated income statement.

The fair values of listed investments are based on listed prices (Level 1). In the case of shareholdings in unlisted companies, fair value is determined using valuation techniques that include the use of recent transactions between willing and knowledgeable parties, references to other instruments that are substantially the same and the analysis of discounted future cash flows (Levels 2 and 3). If recent available information is insufficient to determine fair value, or if there are a range of possible fair value measurements and the cost value is the best estimate within that range, the investments are recorded at their acquisition cost reduced by any impairment losses.

c) Equity instruments at fair value through other comprehensive income

These are equity instruments with respect to which Naturgy has made an irrevocable decision at the time of initial recognition to record them in this category. They are recognised at fair value and any increases or reductions arising from fair value fluctuations are recorded under other comprehensive income, except for dividends derived from these investments which are recognised under income for the year. Therefore no impairment losses are recognised in the income statement, and at the time of their sale, no gains or losses are reclassified to the consolidated income statement.

Fair value measurements recognised in these consolidated annual accounts are classified using a fair value hierarchy that reflects the relevance of the variables employed to perform the measurement. This ranking has three levels:

- Level 1: Valuations based on the quotation price of identical instruments in an official market. The fair value is based on quoted market prices at the balance sheet date.
- Level 2: Valuations based on variables that are observable for the asset or liability. The fair value of financial assets included in this category is determined using valuation techniques. These measurement techniques maximise the use of available observable market data inputs and rely as little as possible on entity-specific estimates made by Naturgy. If all significant inputs required to calculate the fair value are observable, the instrument is included in Level 2. If one or more of the significant inputs are not based on observable market data, the instrument is included in Level 3.
- Level 3: Valuations based on variables that are not based on observable market information.

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

Receivables assignment agreements are treated as factoring without recourse provided that the risks and rewards inherent in ownership of the financial assets assigned are transferred.

The impairment of financial assets is based on an expected loss model. Naturgy accounts for the expected loss and the changes therein at each reporting date to reflect the changes in credit risk from the date of initial recognition, without waiting for an impairment event to occur.

Naturgy applies the general expected loss model for financial assets with the exception of Trade and other receivable without a significant financial component, for which the simplified expected loss model is used.

The general model requires the recognition of the expected loss resulting from a default event in the coming 12 months or over the duration of the contract, depending on the evolution of credit risk on the financial asset since initial recognition in the balance sheet. In the simplified model, credit losses expected over the duration of the contract are recorded from the outset, taking into account available information on past events (such as customer payment behaviour), current conditions and forward-looking factors (macroeconomic factors such as GDP, unemployment, inflation, interest rates, etc.) that might impact the credit risk of Naturgy's debtors.

Financial liabilities

a) Financial liabilities at amortised cost

Borrowings are initially recognised at their fair value, net of any transaction costs incurred. Any difference between the amount received and the repayment value is recognised in the income statement during the period of repayment using the effective interest rate method, classifying financial liabilities as measured subsequently at amortised cost.

In the event of contractual modifications of a liability at amortized cost that does not result in derecognition, the contractual flows of the refinanced debt must be calculated maintaining the original effective interest rate, and the resulting difference will be recorded in the income statement on the date of said modification.

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

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

b) Financial liabilities at fair value through profit or loss

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

3.4.7 Derivatives and other financial instruments

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

Naturgy aligns its accounting with its management of financial risk. Risk management objectives and the hedging strategy are reviewed periodically and a description of the risk management objective pursued is carried out.

In order for each hedging operation to be considered effective, Naturgy documents that the economic relationship between the hedging instrument and the hedged asset is aligned with the risk management objective.

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

- Derivatives listed on an official market are calculated on the basis of their year-end quotation (Level 1).
- Derivatives that are not traded on official markets are calculated on the basis of the discounting of cash flows based on year end market conditions, based on market conditions as at Consolidated balance sheet date or, for some non-financial items, on best estimation on forward curves of said non-financial item (Level 2 and 3).

The fair values are adjusted for the expected impact of observable counterparty credit risk in positive valuation scenarios and the impact of observable credit risk in negative valuation scenarios.

Derivatives embedded in other financial instruments or in other host contracts are recorded separately as derivatives only when their financial characteristics and inherent risks are not strictly related to the instruments in which they are embedded and the whole item is not being carried at fair value through consolidated profit or loss.

For accounting purposes, the operations are classified as follows:

1. Derivatives eligible for hedge accountings

a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as fair value hedges are recognized in the income statement together with any changes in the fair value of the hedged items.

b) Cash flow hedge

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

When options contracts are used to hedge forecast transactions, the group only designates the intrinsic value of the options contract as the hedging instrument.

Amounts accumulated in equity are reclassified to the income statement in the periods when the hedged item will affect the consolidated income statement. However, if this amount is a loss, and for an amount that is not expected to be recovered, it will be immediately reclassified in the consolidated income statement as a reclassification adjustment.

Amounts accumulated in equity are transferred to the consolidated income statement in the period in which the hedged item affects profit or loss, as follows:

- If the hedged item subsequently results in the recognition of an asset, the amount accumulated in equity will be recognised in the initial cost of the asset.
- The gain or loss relating to the effective portion of interest rate swaps is recognised in the financial expense at the same time as the interest expense on the hedged loans.
- When a hedging instrument covers a forecast transaction, the accumulated amounts remain in equity until the forecast transaction takes place. If the forecast transaction does not occur, the amount accumulated in equity is immediately reclassified to income for the period.

c) Hedges of net foreign investments

The accounting treatment is similar to cash flow hedges. The variations in value of the effective part of the hedging instrument are carried on the consolidated balance sheet under “Cumulative translation differences”. The gain or loss from the non-effective part is recognised immediately under “Exchange differences” on the consolidated income statement. The accumulated amount of the valuation recorded under “Cumulative translation differences” is released to the consolidated income statement as the foreign investment that gave rise to it is sold.

2. Derivatives that do not qualify for hedge accounting

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

3. Energy purchase and sale agreements

During the normal course of its business Naturgy enters into energy purchase and sale agreements which in most cases include “take or pay” clauses, by virtue of which the buyer takes on the obligation to pay the value of the energy contracted irrespective of whether the buyer receives it or not. These agreements are executed and maintained in order to meet the needs of receipt of physical delivery of energy projected by Naturgy in accordance with the energy purchase and sale estimates made periodically, which are monitored systematically and adjusted always may be by physical delivery. Consequently, these are contracts for “own use” and therefore fall outside the scope of IFRS 9.

3.4.8 Non-current assets held for sale and discontinued activities

Naturgy classifies as assets held for sale all the assets and related liabilities for which active measures have been taken in order to sell them and if it is estimated that the sale will take place within the following twelve months.

Additionally, it considers discontinued activities the components (cash generating units or groups of cash generating units) that make up a business line or geographic area of operations which are significant and which can be considered separately from the rest, and which have been sold or disposed by other means or which meet the conditions to be classified as held-for-sale. Entities acquired solely for resale are also classed as discontinued operations.

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

In the event of delays caused by events or circumstances beyond Naturgy’s control and there is sufficient evidence that the commitment to the plan to sell those classified as held for sale is maintained, the classification is maintained even though the period to complete the sale is extended beyond one year.

Non-current assets held for sale are disclosed as follows on the consolidated balance sheet: the assets are carried under a single account “Non-current assets held for sale” and the liabilities are also carried under a single account called “Liabilities linked to non-current assets held for sale”. The profit or loss from discontinued activities is stated on a single line on the Consolidated income statement called “Profit for the year from discontinued operations net of tax”.

3.4.9 Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using weighted average cost.

Costs of inventories include the cost of raw materials and those that are directly attributable to the acquisition and/or production, including the costs of transporting inventories to the current location.

The nuclear fuel is valued on the basis of the costs actually incurred in its acquisition and preparation. The consumption of nuclear fuel is charged to the income statement on the basis of the energy capacity consumed.

Emission allowances are stated at the lower of weighted average acquisition price and net realisable value. When the allowances are delivered, they are derecognised against the provision recorded when the CO₂ emissions take place (Note 3.4.17).

Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. For raw materials, the group assesses whether or not the net realisable value of finished goods is greater than their production cost.

3.4.10 Share capital

Share capital is represented by ordinary shares.

Incremental costs directly attributable to the issue of new shares or options, net of tax, are deducted from equity as a deduction from Reserves.

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

Acquisitions of treasury shares are recorded at acquisition cost, deducted from equity until disposal. The Gains and losses on disposal of treasury shares are recognized under "Reserves" in the consolidated balance sheet.

3.4.11 Share-based payments

Share-based payments are measured and are liquidated in shares by reference to the fair value of the equity instruments granted on the grant date.

The resulting cost is recognised under Personnel expenses in the consolidated income statement as the services are rendered by the employees during relevant vesting period, with a balancing entry in Reserves items in the consolidated balance sheet.

The amounts recognised in consolidated equity are not subject to a subsequent reassessment due to trends in external market conditions.

3.4.12 Earnings per share

Basic earnings per share are calculated as a quotient between Consolidated profit for the year attributable to equity holders of the company and the average weighted number of ordinary shares in circulation during this period, excluding the average number of shares of the parent Company held by the group.

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

3.4.13 Borrowings and equity instruments

Borrowings and equity instruments issued by Naturgy are classified based on the nature of the issue.

Naturgy treats all contracts that represent a residual share in net assets as equity instruments.

Equity instrument issuance costs are presented as a deduction in equity.

3.4.14 Preference shares and subordinated perpetual debentures

The issues of preference shares and subordinated perpetual debentures are considered equity instruments if and only if:

- They do not include the contractual obligation for the issuer to repurchase them, under conditions involving certain amounts and at certain dates or determinable amounts and at determinable dates, or the right of the holder to demand their redemption.
- The payment of interest is at the discretion of the issuer.

In the case of issues of preference shares made by a subsidiary of the group, which comply with the above conditions, the amount received is classified on the consolidated balance sheet under “Non-controlling interest”.

3.4.15 Deferred income

This heading mainly includes:

- Capital grants relating basically to agreements with the Regional Governments for the gasification of municipalities and other investments in gas infrastructure, for which Naturgy has met all the conditions established, are stated at the amount granted. The imputed amounts are recognized in profit or loss in a systematic way over time according to the useful life of the corresponding asset, thus compensating the expense for the amortization provision.
- Income received for the construction of connection facilities for the gas or electricity distribution network (undertaken), which are recorded for the cash received, as well as assignments received for these facilities, which are recorded at their fair value, since both the cash and the facilities are received in consideration for an ongoing service of providing access to the network during the life of the facilities. As the nature of the performance obligation resulting from contracts with customers includes both the connection service and the continuous network access service, the amounts allocated are recognised in the income statement systematically over the duration of the contracts, which coincides with the useful lives of the facilities.

3.4.16 Provisions for employee obligations

a) Post-employment pension obligations and the likes

Defined contribution plans

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

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

The contributions made have been recorded under Personnel expenses on the consolidated income statement.

Defined benefit plans

For certain groups there are defined benefit liabilities relating to the payment of retirement pension, death and disability supplements, in accordance with the benefits agreed by the entity and which have been transferred out in Spain through single premium insurance policies under Royal Decree 1588/1999/15 October, which adopted the Regulations on the arrangement of company pension liabilities.

The liability recognised for the defined benefit pensions plans is the current value of the liability at the balance sheet date less the fair value of the plan-related assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial losses and gains arising from changes in actuarial assumptions or from differences between assumptions and reality are recognised directly in the equity item "Other comprehensive income", for the entire amount, in the period in which they arise.

Past-service costs are recognized immediately in consolidated income statement under Personnel expenses.

b) Other post-employment benefit obligations

Some of Naturgy's companies provide post-employment benefits to their employees. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment using an accounting methodology similar to that used for defined benefit pension plans. Actuarial gains and losses arising from changes in actuarial assumptions are charged or credited, directly in equity, to Other comprehensive income.

c) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for these benefits. Naturgy terminates the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits. In the event that mutual agreement is required, the provision is only recorded in those situations in which the Naturgy has decided to give its consent to voluntary redundancies once they have been requested by the employees.

3.4.17 Provisions

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

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

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

Naturgy has the obligation to dismantle certain facilities at the end of their useful life, such as those related to nuclear power plants and mines, as well as carry out environmental restoration where these are located. To do so, it is recorded under Property, plant and equipment the current value of the cost that these tasks would amount, which, in the case of nuclear plants, includes the time until ENRESA, the public entity takes charge of the dismantling and management of radioactive waste, with a counter-entry under provisions for liabilities and charges. This estimate is reviewed annually so that the provision reflects the current value of the future costs by increasing or decreasing the value of the asset. The variation in the provision arising from its financial restatement is recorded under "Financial expenses".

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

In order to cover the obligation concerning the delivery of CO₂ emission allowances for emissions made during the year, Current provisions record the CO₂ allowances to be delivered valued at acquisition cost for allowances purchased recorded under Inventories and, if not all necessary emission allowances are held, at fair value for allowances pending purchase.

3.4.18 Leases

1) Finance leases

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

Naturgy acts as a lessee under a number of finance lease agreements. These leases are capitalised at the lease's inception at the lower of the fair value of the leased property and the present value of the lease payments, including the purchase option. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The payment obligation arising from the lease, net of the finance charge, is recognised in liabilities in the consolidated balance sheet. The interest component of the finance charge is taken to the consolidated income statement over the term of the lease so as to produce a constant periodic rate of interest on the debt pending payment for each period. The property, plant and equipment acquired under finance leases are depreciated over the asset's useful life.

2) Operating leases

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

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

3.4.19 Income tax

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

Deferred taxes are recorded by comparing the temporary differences that arise between the taxable income on assets and liabilities and their respective accounting figures in the Consolidated annual accounts used the tax rates that are expected to be in force when the assets and liabilities are realised. No deferred tax liabilities are recognised for profits not distributed from the subsidiaries when Naturgy can control the reversal of the timing differences and it is likely that they will not reverse in the foreseeable future.

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

Deferred income tax assets and credit taxes are recorded only when there are no doubts as to their future recoverability through the future tax profits that can be used to offset timing differences and make credit taxes effective.

When tax rates change, deferred tax assets and liabilities are reestimated. These amounts are charged or credited to the consolidated income statement or to the item "Other comprehensive income for the year" in the consolidated statement of comprehensive income, depending on the account to which the original amount was charged or credited.

3.4.20 Revenue and expenses recognition

a) General

Revenues derived from contracts with customers must be recognised based on compliance with performance obligations with customers.

Revenue reflects the transfer of goods or services to customers at an amount that reflects the consideration to which Naturgy expects to be entitled in exchange for such goods or services.

Five steps are established for the recognition of revenue:

1. Identify the customer's contract(s)
2. Identify the performance obligations
3. Determine the price of the transaction
4. Allocate the transaction price to the performance obligations
5. Recognise the revenue according to the fulfilment of each obligation

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

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

Sales are stated net of tax and discounts and transactions between Naturgy companies are eliminated.

b) Revenues from the gas network acces

The remuneration of the regulated gas distribution activity is fixed for each distribution company for all its facilities according to the clients connected to them and the volume of gas supplied.

The remuneration of the regulated gas transport is fixed in respect of availability and continuity of supply of the companies owning transmission assets.

The provision of the distribution facilities to place the gas at the supply points is considered a single performance obligation so that the amount of the remuneration of the regulated gas transport and distribution activity is recorded as revenue on a straight-line basis since the service provided is similar over time.

The regulatory framework of the natural gas sector in Spain (2.1.) regulates a payment procedure for the redistribution amongst companies in the sector of the net turnover obtained, so that each company receives the remuneration recognised for its regulated activities.

At the date of preparation of these consolidated annual accounts, no final settlements from prior years are outstanding.

Order ETU/1977/2016 of 23 December recognised both the accumulated gas system deficit for 2014 and the mismatch between revenues and costs for 2015, which coincide with the amount approved in the respective final settlements for each year. Companies subject to the settlement system, which include Naturgy, are entitled to recover these amounts, as from 25 November 2016, in fifteen and five annual payments, respectively.

Order ETU/1283/2017 of 22 December recognises the mismatch between revenues and costs for 2016, which coincides with the amount approved in the final settlement for that year. Companies subject to the settlement system, which include Naturgy, re entitled to recover these amounts as from 1 December 2017, in fifteen annual payments.

In December 2017 the irrevocable assignment without recourse of the 2014 deficit and the mismatches for 2015 and 2016 took place (Note 9).

Order ETU/1367/2018 of 20 December recognises the mismatch between revenues and costs for 2017, which coincides with the amount approved in the final settlement for that year. Companies subject to the settlement system, which include Naturgy, will be entitled to recover these amounts as from 29 November 2018, in fifteen annual payments.

The above order also recognises, as parties subject to the settlement system, irrespective of the activity they engage in, the holders of collection rights relating to the deficit accumulated at 31 December 2014, and lays down the final interest rates applicable to the calculation of the annual amounts of the accumulated deficit at the end of 2014 and the annual amounts pertaining to the mismatches for years 2015, 2016 and 2017.

c) Gas sales revenues

Revenue includes the amount of both last-resort gas sales and free market sales, since the last-resort supplier and the free-market supplier are deemed to be a principal agent and not a commission agent for the supply made.

The exchanges of gas that do not have a different value and do not include costs that causes differences in value are not classified as transactions that generate revenues and are not included, therefore, in the income figure.

The amount of gas sales is recorded as income at the time of delivery to customers, based on the quantities supplied and including the estimate of energy supplied not yet calculated in customers' meters.

d) Revenues from the electricity network acces

The remuneration for the electricity distribution and transmission activity is established annually by the Ministry, recognising remuneration for investment and operation and maintenance.

The amount of the remuneration of the regulated electricity transmission and distribution activity is recorded as revenue on a straight-line basis since the service provided consists of making the assets available and, therefore, is similar over time.

The regulatory framework of the electricity sector in Spain (2.2) regulates a payment procedure for the redistribution amongst companies in the sector of the net turnover obtained, so that each company receives the remuneration recognised for its regulated activities.

The remuneration for electricity distribution is settled provisionally applying the 2016 figures until the respective Ministerial Orders that definitively determine the remuneration for 2017 and 2018 and the remuneration that would apply to date in FY 2019 are published.

At the date of formulation of these Consolidated annual accounts the final payments for the period 2014-2017 have not been published, although it is not expected that the final payments will generate significant differences in relation to the estimates made.

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

Following the publication of Electricity Sector Law 24/2013, December 26 (Note 2.2), temporary mismatches between electricity system revenues and costs are funded by the companies subject to the settlement system, including Naturgy, generating the right to recover the relevant amount over the following five years, including interest at a market rate. Consequently, the financing for the electricity system revenue deficit is recognised as a financial asset since, on the basis of this regulation, Naturgy is entitled to a reimbursement and there are no future contingent factors. In the period 2014 to 2018, following the reforms that were undertaken, there has been no income shortfall in the sector, according to the data on provisional settlements for those years.

e) Electricity sales revenues

Revenue includes the amount of electricity sales in both the PVPC market and the free market, since the last-resort supplier and the free-market supplier are deemed to be a principal agent and not a commission agent for the supply made. Consequently, power purchases and sales are recognised for the total amount. Nonetheless, power purchases and sales from the pool made by the group's generation and supply companies in the same time band are eliminated during the consolidation process.

The amount of electricity sales is recorded as income at the time of delivery to customers, based on the quantities supplied and including the estimate of energy supplied not yet calculated in customers' meters.

f) Other income

Naturgy has power generation capacity assignment contracts with the Federal Electricity Commission for its combined-cycle plants in Mexico (CFE), for a 25-year term as from the start date of commercial operations. These contracts stipulate a pre-established collection schedule for the assignment of power supply capacity. As Naturgy has the capacity to operate and manage the plants, sells the power at market prices and retains the rewards and risks of operations, taking relevant decisions that will affect future cash flows, these contracts represent provisions of services and are thus recognised on a percentage-of-completion basis over time.

Revenue from register of subscribers, which consist of the operation of coupling the gas reception facility to the network, as well as the verification income of facilities, is recognized at the time these actions are carried out since it is at that moment when the client obtains the benefits of the service provided and there is no associated future obligation.

The fees for the rental of meters and installations are recorded as income over the period of the provision of the rental service that constitutes the performance obligation

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

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

3.4.21 Cash Flow Statement

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

- a) Operating activities: activities that constitute ordinary group revenues, as well as other activities that cannot be qualified as investing or financing.
- b) Investing activities: acquisition, sale or disposal band other means of assets in the long-term and other investments not included in cash and cash equivalents.
- c) Financing activities: activities that generate changes in the size and composition of equity and liabilities that do not form part of operating activities.

3.4.22 Significant accounting estimates and judgements

The preparation of the Consolidated annual accounts requires the use of estimates and assumptions. The valuation standards that require a large number of estimates are set out below:

a) Intangible assets and property, plant and equipment (Notes 3.4.3 and 3.4.4)

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

b) Impairment of non-financial assets (Note 3.4.5)

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

Main assumptions used to determine the estimated recoverable value of non-financial assets are detailed in Note 5.

c) Derivatives and other financial instruments (Note 3.4.7)

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

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. Naturgy uses a variety of methods and makes assumptions that are based on market conditions existing at each consolidated balance sheet date. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows. The fair value of forward foreign exchange contracts is determined using quoted forward exchange rates at the consolidated balance sheet date. The fair value of commodity prices derivatives is determined using quoted forward price curves at the consolidated balance sheet date.

The carrying value less the expected loss provision of trade receivables are assumed to approximate their fair values. The fair value of financial liabilities for reporting purposes is calculated by discounting the future contractual cash flows at the current market interest rate to which Naturgy has access for similar financial instruments.

d) Provisions for employee benefits (Note 3.4.16)

A number of assumptions must be used to calculate pension costs, other costs of post-retirement benefits and other post-retirement liabilities. Naturgy estimates at each year end the provision necessary to meet its pension liabilities and the like, in accordance with the advice from independent actuaries. The changes affecting such assumptions may result in the recording of different amounts and liabilities. The most significant assumptions for the measurement of pension or post-retirement benefit liabilities are energy consumption by beneficiaries during retirement, retirement age, inflation and the discount rate employed. Social security coverage assumptions are also essential to determine other post-retirement benefits. Future changes to these assumptions will have an impact on future pension costs and liabilities.

e) Provisions (Note 3.4.17)

Naturgy makes an estimate of the amounts to be settled in the future, including amounts relating to, contractual obligations, outstanding litigation, future costs for dismantling and closure of certain facilities and restoration of land or other liabilities. These estimates are subject to the interpretation of current events and circumstances, projections of future events and estimates of their financial effects

f) Income tax (Note 3.4.19)

The calculation of the income tax expense requires interpretations of tax legislation in the jurisdictions in which Naturgy operates. The determination of expected outcomes of outstanding disputes and litigation requires the preparation of significant estimates and judgment. Naturgy evaluates the recoverability of the deferred income tax assets based

on estimates of future taxable income and the capacity to generate sufficient profits during the periods in which said deferred taxes are deductible. Deferred tax liabilities are recognised based on estimates of the net assets that will not be tax deductible in the future.

g) Revenue recognition (Nota 3.4.20)

Revenues from energy sales are recognized when the goods are delivered to the customer based on periodical meter readings and include the estimated accrual of the value of the goods consumed as from the date of the meter reading until the close of the period. Estimated daily consumption is based on historical customer profiles taking into account seasonal adjustments and other factors than can be measured and may affect consumption. Historically, no material adjustments have been made relating to the amounts recorded as unbilled income and none are expected in the future.

Certain aggregates for the electricity and gas system, including those relating to other companies which allow for the estimate of the overall settlement of the electricity system that must materialise in the respective final payments, could affect the calculation of the deficit in the payments for the electricity and gas regulated business in Spain.

Note 4. Segment financial information

An operating segment is a component that carries on business activities from which it may obtain ordinary revenue and incur costs, whose operating results are reviewed regularly by the Naturgy's Board of Directors when taking its operating decisions in order to decide on the resources that must be allocated to the segment and to evaluate its performance, in respect of which separate financial information is available.

The new Strategic Plan 2018-2022, approved by the Board of Directors on 27 June 2018, has determined a new segment model with full management responsibility and independence. As a result, the operating segments have been redefined based on the following criteria:

- Gas and Electricity:
 - Supply of gas, electricity and services: the objective is to manage a new integrated business model for gas, electricity and services, maximising the value of the portfolio by focusing on customers, with high growth potential in services and solutions.
 - International LNG supply: includes both the sale of liquefied natural gas and the sea transport business.
 - Electricity generation in Europe: includes both conventional generation (hydro, coal, nuclear and combined cycle plants) and renewable generation (wind, mini-hydro, solar and cogeneration), all of which are currently in Spain.
 - International electricity generation: includes the electricity generation facilities of Global Power Generation (GPG) in Latin America (Brazil, Chile, Costa Rica, Mexico, Panama, Dominican Republic and Puerto Rico, the latter consolidated using the equity method through EcoEléctrica LP) and Australia.
- EMEA Infrastructures:
 - Gas distribution Spain: encompasses the regulated gas distribution business in Spain.
 - Electricity distribution Spain: encompasses the regulated electricity distribution business in Spain.
 - Maghreb infrastructures: Manages the Maghreb - Europe gas pipeline.
- Latin America South Zone Infrastructures:
 - Gas and electricity distribution in Argentina.
 - Gas distribution in Brazil.
 - Gas distribution and supply and electricity distribution in Chile.
 - Gas distribution in Perú.

- Latin America North Zone Infrastructures:
 - Gas distribution in México.
 - Electricity distribution in Panamá.
- Rest. Basically includes the activity of Unión Fenosa Gas (consolidated by the equity method) and the gas storage business.

Net financial income and income tax expense are not allocated to the operating segments, since until 2018 both financing activities and the income tax effects were managed jointly although, as of 2019, it will be assigned according to the new organizational model that provides business with independent management

Segment results and investments for the periods of reference are as follows:

Segment financial information – Income statement

2018	Gas and Electricity					EMEA Infrastructures			
	Supply business	LNG	Gener. Europe	Gener. International	Total	Gas Networks Spain	Electricity Networks Spain	Maghreb Infr.	Total
Consolidated Revenue	11,144	3,409	348	897	15,798	1,158	812	74	2,044
Revenue between segments	1,806	120	-	20	1,946	96	43	236	375
Intersegment revenue	114	-	1,702	-	1,816	-	-	-	-
Revenue by segment	13,064	3,529	2,050	917	19,560	1,254	855	310	2,419
Segment procurements	(12,428)	(3,003)	(1,091)	(527)	(17,049)	(75)	-	-	(75)
Net personnel expenses	(134)	(23)	(140)	(39)	(336)	(118)	(94)	(6)	(218)
Other operating income/expenses	(338)	(7)	(408)	(62)	(815)	(177)	(131)	(16)	(324)
EBITDA	164	496	411	289	1,360	884	630	288	1,802
Depreciation/amortisation & impairment losses	(64)	(75)	(4,279)	(152)	(4,570)	(313)	(247)	(44)	(604)
Transfers to provisions	(75)	-	-	-	(75)	(7)	(5)	-	(12)
Operating results	25	421	(3,868)	137	(3,285)	564	378	244	1,186
Net financial income/(expense)	-	-	-	-	-	-	-	-	-
Results of equity-consolidated companies	-	-	19	21	40	-	-	-	-
Profit/(loss) before tax	-	-	-	-	-	-	-	-	-
Corporate income tax	-	-	-	-	-	-	-	-	-
Profit/(loss) for the year from continuing operations	-	-	-	-	-	-	-	-	-
Profit/(loss) for the year from discontinued operations	-	-	-	-	-	-	-	-	-
Profit/(loss) for the year	-	-	-	-	-	-	-	-	-

2017 (*)	Gas and Electricity					EMEA Infrastructures			
	Supply business	LNG	Gener. Europe	Gener. International	Total	Gas Networks Spain	Electricity Networks Spain	Maghreb Infr.	Total
Consolidated Revenue	10,440	2,535	272	875	14,122	1,136	830	72	2,038
Revenue between segments	1,762	94	-	17	1,873	125	43	232	400
Intersegment revenue	34	-	1,663	-	1,697	-	-	-	-
Revenue by segment	12,236	2,629	1,935	892	17,692	1,261	873	304	2,438
Segment procurements	(11,686)	(2,316)	(977)	(511)	(15,490)	(68)	-	-	(68)
Net personnel expenses	(110)	(21)	(147)	(37)	(315)	(94)	(130)	(6)	(230)
Other operating income/expenses	(391)	(16)	(432)	(68)	(907)	(211)	(140)	(19)	(370)
EBITDA	49	276	379	276	980	888	603	279	1,770
Depreciation/amortisation & impairment losses	(29)	(51)	(442)	(121)	(643)	(299)	(233)	(38)	(570)
Transfers to provisions	(68)	-	-	-	(68)	(8)	-	-	(8)
Operating results	(48)	225	(63)	155	269	581	370	241	1,192
Net financial income/(expense)	-	-	-	-	-	-	-	-	-
Results of equity-consolidated companies	-	-	14	58	72	-	1	-	1
Profit/(loss) before tax	-	-	-	-	-	-	-	-	-
Corporate income tax	-	-	-	-	-	-	-	-	-
Profit/(loss) for the year from continuing operations	-	-	-	-	-	-	-	-	-
Profit/(loss) for the year from discontinued operations	-	-	-	-	-	-	-	-	-
Profit/(loss) for the year	-	-	-	-	-	-	-	-	-

(*) The 2017 consolidated income statement has been restated in accordance with IFRS 5 (Note 3.3 and 11).

Segmental financial information – Assets, liabilities and investments

2018	Gas and Electricity					EMEA Infrastructures			
	Supply business	LNG	Gener. Europe	Gener. International	Total	Gas Networks Spain	Electricity Networks Spain	Infr. Magreb	Total
Operating assets (a)	3,219	1,670	5,705	2,051	12,645	3,921	5,127	164	9,212
Investments under equity method	-	-	126	271	397	-	7	-	7
Operating liabilities (a)	(1,673)	(357)	(973)	(207)	(3,210)	(684)	(938)	(13)	(1,635)
Investment in intangible assets (b)	36	-	12	1	49	9	23	5	37
Invest. in property, plant & equipment (c)	25	380	450	231	1,086	231	205	-	436
Business combinations (Note 31)	-	-	-	35	35	-	-	-	-

2017	Gas and Electricity					EMEA Infrastructures			
	Supply business	LNG	Gener. Europe	Gener. International	Total	Redes Gas España	Redes Elec. España	Infr. Magreb	Total
Operating assets (a)	3,227	991	7,500	1,796	13,514	4,068	5,090	238	9,396
Investments under equity method	-	-	116	358	474	-	7	-	7
Operating liabilities (a)	(1,639)	(193)	(405)	(131)	(2,368)	(838)	(1,025)	(16)	(1,879)
Investment in intangible assets (b)	1	-	7	-	8	15	35	11	61
Invest. in property, plant & equipment (c)	47	-	171	168	386	197	217	-	414
Business combinations (Note 31)	-	-	-	-	-	-	-	-	-

(a) There follows a breakdown of the reconciliation of “Operating assets” and “Operating liabilities” with consolidated “Total assets” and “Total liabilities”:

	2018	2017
Operating assets	31,150	33,338
Goodwill	3,215	4,760
Investments carried under the equity method	816	1,500
Non-current financial assets	910	1,219
Deferred tax assets	1,689	849
Non-current assets held for sale (Note 11)	202	1,682
Derivative financial instruments (see Note 11)	207	38
Public administrations (Note 10)	113	71
Current tax assets	185	178
Other current financial assets	428	462
Cash and cash equivalents	1,716	3,225
Total assets	40,631	47,322

Latin America North Infrastructures				Infraestructuras Latinoamérica Norte				Rest	Eliminations	TOTAL
Argentina	Brazil	Chile	Peru	Total	Mexico	Panama	Total			
379	1,046	6,116	9	7,550	845	1,067	1,912	580	(749)	31,150
14	-	38	-	52	2	-	2	358	-	816
(188)	(242)	(394)	(2)	(826)	(113)	(267)	(380)	(993)	742	(6,302)
46	54	17	13	130	7	4	11	54	-	281
2	6	321	-	329	74	99	173	16	-	2,040
-	-	-	-	-	-	-	-	-	-	35

Latin America South Infrastructures				Latin America North Infrastructures				Rest	Eliminations	TOTAL
Argentina	Brazil	Chile	Peru	Total	Mexico	Panama	Total			
187	1,199	6,603	41	8,030	786	960	1,746	1,430	(778)	33,338
21	-	36	-	57	9	-	9	953	-	1,500
(120)	(222)	(568)	(4)	(914)	(93)	(227)	(320)	(1,119)	783	(5,817)
46	113	10	19	188	6	3	9	123	-	389
2	7	299	-	308	109	107	216	69	-	1,393
-	-	-	-	-	-	-	-	-	-	-

	2018	2017
Operating liabilities	(6,302)	(5,817)
Equity	(14,595)	(18,305)
Non-current financial liabilities	(13,352)	(15,916)
Finance lease liabilities (Note 19)	(1,318)	(933)
Deferred tax liabilities	(2,149)	(2,312)
Liabilities related to non-current assets held for sale (Note 11)	(93)	(621)
Current financial liabilities	(2,079)	(2,543)
Derivative financial instruments (Notes 19 and 20)	(132)	(90)
Dividend payable (Note 19)	(37)	(45)
Public administrations (Note 20)	(541)	(593)
Current tax liabilities	(33)	(147)
Total liabilities	(40,631)	(47,322)

(b) Includes the investment in "Intangible assets" (Note 6), broken down by operating segment.

(c) Includes the investment in "Property, plant and equipment" (Note 7), broken down by operating segment.

Reporting by geographic area

Naturgy's assets, which include the operating assets described above, and the investments recorded using the equity method, are as follows based on their location:

	At 31.12.18	At 31.12.17
Spain	18,965	21,759
Rest of Europe	613	384
Latin American	11,674	11,962
Other	714	733
Total	31,966	34,838

The investments in property, plant and equipment and other intangible assets of Naturgy, as described above, assigned according to the location of the assets are as follows:

	At 31.12.18	At 31.12.17
Spain	1,437	820
Rest of Europe	1	38
Latin American	783	871
Other	100	53
Total	2,321	1,782

Note 5. Non financial asset impairment losses

Definition of Cash Generating Unit

Following the approval on 27 June 2018 of the new Strategic Plan 2018-2022 which has introduced a new industrial and business unit model, and due to the circumstances described in Note 5 Segment reporting” and the alignment of the new structure with the new vision and management method for the lines of business and cash flows under the new Strategic Plan, a new definition of the Cash Generating Units (CGU) has been introduced, as follows:

- Gas and Electricity:
 - Supply of gas, electricity and services: The commercial management of natural gas, electricity and services is carried out on a comprehensive basis, maximising the value of the portfolio by focusing on customers and with high potential for growth in services and solutions, for which there is a single CGU.
 - International LNG sales: There is considered to be a single CGU, since the supply of liquefied natural gas and the maritime transport activity are managed on a global level.
 - Electricity Generation Europe: It is considered that there is a CGU for conventional electricity generation (hydro, coal, nuclear and combined cycle plants) and another CGU for renewable electricity generation (wind, mini-hydro, solar and cogeneration) taking into account the new strategic vision of the Spanish electricity market, with a greater presence in renewables and greater volatility in hourly prices, which requires specialisation in the management of conventional and renewable generation focused, respectively, on cost adjustment and an increase in the installed capacity, in line with the reorganisation carried out.

In the past, these activities formed part of single CGU because they were managed and controlled jointly and centralised based on conditions of demand, where all power plants using different technologies played a major, complementary and necessary role in light of different market situations, providing the electricity required by customers at any given time. However, as a result of the auctions carried out during 2017 in which Naturgy

was awarded a total capacity of 971 MW for wind and solar energy, the generation of renewable electricity will increase from 8% in 2017 with respect to conventional generation to more than 30% in 2020, increasing the quantitative contribution of income, investments and results, which are increasingly affected by the availability of parks, the volatility of electricity prices and the revisions of supplements remuneration, all of which means that the cash inflows from said renewable generation assets are considered independent of those from conventional generation assets by the substantial increase in scale.

- International Electricity Generation: A CGU is understood to exist in each country in which there are operations (Brazil, Costa Rica, Mexico, Panama, Dominican Republic, Puerto Rico, Australia and Chile) since the businesses are subject to different regulatory frameworks and are managed independently.
- Maghreb Infrastructures:
 - Gas distribution in Spain: Is a single CGU as the development, operation and maintenance of the gas distribution network is managed jointly.
 - Electricity Distribution Spain: This makes up a single CGU since the network comprises a group of interrelated assets the development, operation and maintenance of which is managed jointly.
 - EMPL: Is a single CGU which manages the Maghreb - Europe gas pipeline.
- Latin America South Infrastructures: A CGU is understood to exist for each business and country in which there are operations since the businesses are subject to different regulatory frameworks. It includes the regulated gas distribution business in Argentina, Brazil, Chile and Peru and the regulated electricity distribution business in Argentina and Chile.
- Latin America North Infrastructures: A CGU is understood to exist for each business and country in which there are operations since the businesses are subject to different regulatory frameworks. It includes the regulated gas distribution business in Mexico and the regulated electricity distribution business in Panama.
- Rest: Basically includes the Unión Fenosa Gas CGU and the gas storage business.

In summary, and with respect to the previous year, in addition to various CGU relocations between segments, the Electricity Spain CGU has been divided into: i) Supply of electricity ii) Generation of conventional electricity; and iii) Generation of renewable electricity.

Information on recorded impairments

Following the approval of the new Strategic Plan 2018-2022, in 2018 impairment or write-downs of assets amounting to Euros 4,851 million were recorded, arising from the revaluation of future cash flow estimates based on said Plan or by other factors arising in the period, which are detailed as follows:

- Euros 3,929 million recorded under “Depreciation/amortization and impairment losses” on conventional power generation plants in Spain. This amount includes Euros 1,538 million for all goodwill (Note 6), Euros 118 million for intangible assets (Note 6), Euros 2,258 million relating to tangible fixed assets (Note 7) and Euros 15 million for Inventories (Note 12).

Due to the existence of impairment evidence, following the approval of the new Strategic Plan and taking into account external reports by analysts who regularly cover Naturgy tracking that indicate a value for the electricity business in Spain which is lower than the relevant carrying value, an impairment analysis has been carried out on the three CGUs that made up the Electricity CGU in Spain in previous years: conventional electricity generation, renewable electricity generation and electricity supply. Impairment was detected only with respect to the conventional electricity generation CGU in Spain.

The new assumptions and projections that affect these CGUs are based on the new Strategic Plan 2018-2022, approved by the Board of Directors following the last General Shareholders' Meeting which update those that had been used to date, and have been determined: i) in the light of the new sector variables for the next five-year period, ii) taking into account the uncertainty regarding the role of certain generation assets in the energy transition policy (coal, nuclear and combined cycles) and consequently the development of the associated risks, iii) considering the greater presence forecast in renewables, iv) considering the increasing volatility of prices in the electricity wholesale market and emission allowances and v) assessing the references provided by very recently announced transactions in conventional electricity generation assets in Spain.

The assumptions taken into consideration are the following:

	2018	2019	2020	2021	2022
Evolution of Spanish GNP	2.70%	2.20%	1.90%	1.70%	1.70%
Pool price €/MWh	58.5	56.8	54.8	51.3	50.3
Brent (USD/bbl)	75.3	75.5	71.0	67.8	65.6
Gas Henry Hub (USD/MMBtu)	2.9	2.8	2.7	2.7	2.7
Coal (API2 CIF ARA) (USD/t)	89.6	88	85.2	82.9	81.9
CO₂ €/t	14.0	16.1	16.3	16.6	17.0

The most sensitive aspects that are included in the new estimate of the recoverable amount determined according to the value in use and applying the methodology detailed in Note 3.4.5 are the following:

- Electricity generated. Market demand evolution has been estimated based on the consensus expressed by several international bodies. The share has been estimated based on Naturgy's market share in each technology and on the expected evolution of each technology's share of the total market, assuming an average year for hydro generation purposes. The main variation with respect to past projections is a decrease in conventional production in line with the expected future evolution of the conventional generation mix.
- Electricity price Market electricity prices used have been calculated using models that cross expected demand with supply forecasts, taking into account the foreseeable evolution of generation capacity in Spain, based on sector forecasts. The main variation with respect to the past projections is that, as a result of this analysis, price paths have been obtained which, as a result of the above-mentioned uncertainty over energy policy in Spain, have been adjusted downwards on average with futures curves and analysts' forecasts. The sources used for analysts' forecasts relate to IHS CERA.
- Fuel costs. Estimated by reference to long-term supply contracts concluded by Naturgy, the forecast evolution of price curves and market experience. The main variation with respect to past projections corresponds to an increase in the cost of emission allowances based on the evolution of futures curves and analysts' forecasts (IHS CERA).
- Operation and maintenance costs. Estimated from historical costs of managed park.
- Taxes laid down in Law 15/2012 (Note 2.2).
- Similarly, a long-term growth rate of 1.9% and a discount rate before taxes of 7.0% have been used for the conventional electricity generation CGU. The discount rate has been determined specifically for the new CGU based on the risks associated with it in a manner consistent with those considered in the estimates of future cash flows. In 2017 the long-term growth rate for the Electricity Spain CGU was 2.2%, while the pre-tax discount rate applied for said CGU was 6.3%.

The recoverable amount calculated as the value in use of the conventional electricity generation CGU, which is equivalent to its carrying value, was Euros 3.591 million. A sensitivity analysis was carried out independently for each of the following variations in the key assumptions:

- an increase in the discount rate of 50 basis points would increase impairment by Euros 333 million.
- a decrease in the growth rate of 50 basis points would increase impairment by Euros 258 million.

- a decrease in electricity output of 5% would increase impairment by Euros 203 million.
- an increase in fuel costs of 5% would increase impairment by Euros 364 million.
- a decrease in electricity prices of 5% would increase impairment by Euros 528 million.
- Euros 538 million relates to the impairment of the 50% interest in Unión Fenosa Gas recorded under the heading “Profit/(loss) from equity-consolidated companies”.

In 2014, Egyptian Natural Gas Holding (EGAS), an Egyptian public company, ceased to supply gas to Unión Fenosa Gas and stopped paying the utilisation fee for the Damietta liquefaction plant in Egypt. This led Unión Fenosa Gas to file various arbitration petitions, the progress of which is described in Note 35. As a result of impairment already arising prior to 2017, the recoverable value of Unión Fenosa Gas was approximately equivalent to its carrying value and therefore any negative variation in the assumptions meant that the recoverable value would be less than the carrying value.

The most significant matters included in the impairment test are as follows:

- Gas volumes to be supplied from each supply source. The main causes of the differences between the past and current cash flow projections are the decrease in the volumes of gas to be supplied from Egypt and to liquefying at the plant during the Strategic Plan 2018-2022 because the agreement with EGAS has still not materialised and due to the delays in coming to an agreement with EGAS that would enable the plant to be reactivated and supplies to recommence. Naturgy continues to be confident that the resolution of the arbitration processes will enable a commercial agreement to be reached, enabling the recommencement of gas supplies to the plant as swiftly as possible.
- Gas supply costs In accordance with the prices of the long-term contracts entered into by Unión Fenosa Gas and expected price fluctuations in spot markets based on the change in the composition of gas volumes affected by the situation in Egypt.
- Selling price of natural gas. Valued using predictive modelling based on the forecast performance of price curves and experience in the markets where Unión Fenosa Gas operates.
- A long-term growth rate of 1.9% (1.8% in 2017) and a pre-tax discount rate of 15.1% (13.4% in 2017) have been used.

The accumulated impairment at 31 December 2018 relating to the 50% interest in Unión Fenosa Gas amounts to Euros 1,166 million (Euros 628 million at 31 December 2017). At 31 December 2018, the recoverable amount calculated as the value in use of Unión Fenosa Gas, which is equivalent to its carrying value, was Euros 340 million (Note 8). A sensitivity analysis has been carried out for an increase in the discount rate of 50 basis points which would increase impairment by Euros 16 million.

- Euros 171 million recorded under “Depreciation/amortization and impairment losses” relates to computer software (Note 6), resulting from the review thereof under the new Strategic Plan 2018-2022 and taking obsolescence into account.
- Euros 34 million relating to the impairment of the 50% interest in the electricity generation company EcoEléctrica LP recorded under the heading “Profit/(loss) from equity-consolidated companies” as a result of the need to update, for impairment testing purposes, the assumptions concerning electricity production and electricity prices subsequent to the renewal scheduled for March 2022 of the Power Purchase Agreement (PPA) with the Puerto Rico Electric Power Authority (PREPA), which is conditional on the expected long-term evolution of the energy scenario. In addition, a pre-tax discount rate of 8.3% (6.5% in 2017) have been used.

At 31 December 2018, the recoverable amount calculated as the value in use of EcoEléctrica L.P., which is equivalent to its carrying value, was Euros 271 million (Note 8). A sensitivity analysis has been carried out for an increase in the discount rate of 50 basis points which would increase impairment by Euros 6 million.

- Euros 179 million relating to the impairment of capitalised costs in various gas distribution projects included in Latin America South Infrastructures for an amount of Euros 45 million recorded under the heading “Depreciation/amortisation and impairment losses” in Intangible Assets (Note 6) and other miscellaneous projects included under Remainder amounting to Euros 134 million due to their non-feasibility, of which Euros 86 million was recorded under the heading “Depreciation/amortization and impairment losses” under Property, plant and equipment (Note 7) and Euros 48 million recorded in Inventories (Note 12).

Additionally, prior to the approval of the new Strategic Plan 2018-2022, other impairments or write-downs of various assets for an amount of Euros 54 million have been recorded:

- Euros 30 million from the electricity generation business in the Dominican Republic recognised in March 2018 under the heading “Depreciation/amortization and impairment losses” in Property, plant and equipment (Note 7) as a result of the update for impairment testing purposes of the electricity production and electricity price assumptions that have been necessary in a scenario of growth in the generation park capacity with other technologies in that country. In addition, a long-term growth rate of 4.0% (4.0% in 2017) and a pre-tax discount rate of 13.8% (12.8% in 2017) have been used.

At 31 December 2018 the recoverable amount calculated as the value in use of the electricity generation CGU in the Dominican Republic, which is equivalent to its carrying value, was Euros 57 million. A sensitivity analysis has been carried out for an increase in the discount rate of 50 basis points which would increase impairment by Euros 2 million.

- Euros 24 million recorded in April and May 2018 under “Depreciation/amortization and impairment losses” in Property, plant and equipment (Note 7) corresponding to the impairment of capitalised costs in various projects included under Remainder due to their non-feasibility.

Information on other impairment tests performed

As regards the remaining CGUs or groups of CGUs that have been allocated goodwill or intangible assets with an indefinite useful life, in 2018 and 2017 the recoverable amounts, calculated according to the methodology described in Note 3.4.5, have been higher than the carrying values recorded in these consolidated annual accounts. The most sensitive aspects that are included in the projections used and which are based on industry forecasts and historical experience are as follows:

- Supply of gas, electricity and services:
 - Supply margin. Projections have been used on the evolution of the number of customers and unitary margins based on existing contracts and the knowledge of the markets in which it operates.
 - In addition, a long-term growth rate of 1.9% and a pre-tax discount rate of 6.8% have been used for this CGU. The discount rate has been determined specifically for the new CGU based on the risks associated with it in a manner consistent with those considered in the estimates of future cash flows. In 2017 the long-term growth rate for the Electricity Spain CGU was 2.2%, while the pre-tax discount rate applied for said CGU was 6.3%.
- Renewable electricity generation:
 - Electricity generated. Projections of hours of operation of each park consistent with their historical output and predictions based on historical records of similar parks have been used when there were no historical data.
 - Electricity price Market electricity prices used have been calculated using models that cross expected demand with supply forecasts, taking into account the foreseeable evolution of generation capacity in Spain, based on sector forecasts.
 - Remuneration. For facilities with a right to specific remuneration, this has been estimated based on the remuneration parameters for the established regulated income period.

- Operation and maintenance costs. Estimated from historical costs of managed park.
- Taxes laid down in Law 15/2012 (Note 2.2).
- In addition, a long-term growth rate of 1.9% and a pre-tax discount rate of 6.1% have been used for this CGU. The discount rate has been determined specifically for the new CGU based on the risks associated with it in a manner consistent with those considered in the estimates of future cash flows. In 2017 the long-term growth rate for the Electricity Spain CGU was 2.2%, while the pre-tax discount rate applied for said CGU was 6.3%.
- International Electricity Generation:
 - Operation and maintenance costs. Estimated on the basis of historical costs.
 - International electricity generation is managed under energy sale-purchase contracts through stable business models and which are not subject to fluctuation risks on the basis of market variables.
 - In addition, long-term growth rates of 2.1% - 4-0% (2.6% -4.0 % in 2017) and pre-tax discount rates of 7.9% - 14.8% (6.5% - 12.8% in 2017) have been used for these CGUs.
- Electricity distribution Spain:
 - Remuneration. Amount and increase in remuneration approved by the regulator.
 - Operation and maintenance costs. Estimated on the basis of the historical cost of the network managed.
 - Investments. Taking into account the necessary investments to maintain the regular use of the network and quality of supply.
 - In addition, a long-term growth rate of 1.2% (1.2% in 2017) and a pre-tax discount rate of 6.0% (5.2% in 2017) have been used for this CGUs.
- Latin America North and South Infrastructures:
 - Variations in rates. Valuation of rates in each country, based on existing regulatory conditions and rate reviews, taking into account the experience gained from previous rate reviews in each country.
 - Cost of raw materials and consumables. Estimated on the basis of predictive modelling based on an understanding of energy markets in each country.
 - Operation and maintenance costs. Estimated on the basis of the historical cost of the network managed.
 - Investments. Taking into account the necessary investments to maintain the regular use of the network and quality of supply.
 - In addition, long-term growth rates of 1.3% - 3.8% (1.6% -3.0 % in 2017) and pre-tax discount rates of 9.9% - 17.6% (8.8% - 17.0% in 2017) have been used for these CGUs.

Naturgy has carried out a sensitivity analysis of the unfavourable variations which, drawing on historical experience, may reasonably impact on the aforementioned sensitive parameters on which the recoverable amounts of these remaining CGUs have been determined. Specifically, the most significant sensitivity analyses performed were as follows:

	Increase	Decrease
Discount rate	50 basis points	-
Growth rate	-	50 basis points
Electricity generated	-	5%
Electricity price	-	5%
Fuel supply costs	5%	-
Rate/ remuneration performance	-	5%
Operating and maintenance costs	5%	-
Investments	5%	-

These sensitivity analyses performed separately for each basic assumption would not affect the conclusions drawn to the effect that the recoverable amount exceeds the carrying amount for each of these CGUs.

Note 6. Intangible assets

The movement in 2018 and 2017 in intangible assets is as follows:

	Conces- sions IFRIC 12	Other conces- sions and similar	Computer software	Other intangible assets	Subtotal	Good- will	Total
Gross cost	2,661	3,662	1,341	1,374	9,038	5,036	14,074
Sinking fund and impairment losses	(1,053)	(711)	(850)	(540)	(3,154)	-	(3,154)
Carrying amount at 1.1.2017	1,608	2,951	491	834	5,884	5,036	10,920
Investment (Note 4)	186	21	170	12	389	-	389
Amortisation charge	(86)	(42)	(131)	(65)	(324)	-	(324)
Currency translation differences	(165)	(111)	(7)	(7)	(290)	(110)	(400)
Reclassifications and other ⁽¹⁾	(468)	5	(29)	(6)	(498)	(166)	(664)
Carrying amount at 31.12.2017	1,075	2,824	494	768	5,161	4,760	9,921
Gross cost	1,662	3,489	1,430	1,371	7,952	4,760	12,712
Sinking fund and impairment losses	(587)	(665)	(936)	(603)	(2,791)	-	(2,791)
Carrying amount at 31.12.2017	1,075	2,824	494	768	5,161	4,760	9,921
Impact of application IFRS 15	-	-	-	61	61	-	61
Carrying amount at 1.1.2018	1,075	2,824	494	829	5,222	4,760	9,982
Investment (Note 5)	101	13	111	56	281	-	281
Amortisation charge	(59)	(47)	(127)	(115)	(348)	-	(348)
Impairment losses (Note 5)	(45)	-	(171)	(118)	(334)	(1,538)	(1,872)
Currency translation differences ⁽¹⁾	(56)	(142)	(4)	(3)	(205)	(4)	(209)
Business combinations	-	-	-	28	28	9	37
Reclassifications and other ⁽²⁾	(5)	(4)	2	(7)	(14)	(12)	(26)
Carrying amount at 31.12.2018	1,011	2,644	305	670	4,630	3,215	7,845
Gross cost	1,702	3,386	1,313	1,282	7,683	3,215	10,898
Sinking fund and impairment losses	(691)	(742)	(1,008)	(612)	(3,053)	-	(3,053)
Carrying amount at 31.12.2018	1,011	2,644	305	670	4,630	3,215	7,845

1. Includes effect of inflation in Argentina (Note 3.3).

2. Mainly includes transfers to "Non-current assets held for sale" at the date on which this classification is applied (Note 11).

Note 4 includes a breakdown of investments in intangible assets by segment.

IFRIC Concessions includes concessions regarded as intangible assets under IFRIC 12 “Service concession agreements” (Note 32).

The heading “Other concessions and similar” includes principally:

- The Maghreb-Europe pipeline concession (Note 32) amounting to Euros 131 million at 31 December 2018 (Euros 164 million at 31 December 2017).
- Indefinite useful life concessions per the following breakdown:

	31.12.2018	31.12.2017
Electricity distribution Spain	684	684
Electricity distribution Chile	1,004	1,097
Gas distribution Chile	795	856

The heading “Other intangible assets” mainly includes:

- Licences to renewable generation farms totalling Euros 185 million at 31 December 2018 (Euros 169 million at 31 December 2017). Includes Euros 22 million (Euros 21 million in 2017) from the business combination of Ibereólica Cabo Leones II S.A. and Euros 25 million from the business combination of Guimaranias (Note 31).
- The value of contracts activated under IFRS 15 amounting to Euros 60 million at 31 December 2018.
- The value of gas supply contracts and other contractual rights acquired as a result of the business combinations involving CGE for an amount of Euros 159 million at 31 December 2018 (Euros 165 million at 31 December 2017); Unión Fenosa for an amount of Euros 213 million at 31 December 2018 (Euros 358 million at 31 December 2017) and includes a Euros 118 million impairment as explained in Note 5, and Naturgy Energy (UK) Ltd for an amount of Euros 12 million at 31 December 2018 (Euros 13 million at 31 December 2017).

Movements in and the composition of goodwill by CGU are set out below:

	1.1.2018	Business Combinations	Currency translation differences	Transfer held for sale	CGU reclassification	Impair- ment	31.12.2018
Gas and Electricity	3,148	9	20		-	(1,538)	1,639
Electricity Spain	2,708	-	-	-	(2,708)	-	-
Conventional generation Spain	-	-	-	-	1,538	(1,538)	-
Renewable generation Spain	-	-	-	-	743	-	743
Supply of gas, electricity and services	16	-	-	-	427	-	443
International generation Mexico	420	-	21	-	-	-	441
International generation Chile	4	-	-	-	-	-	4
International generation Brazil	-	9	(1)	-	-	-	8
EMEA Infrastructures	1,070	-	-	-	-	-	1,070
Electricity distribution Spain	1,070	-	-	-	-	-	1,070
Latin America South Infrastructures:	386	-	(30)		-	-	356
Gas distribution Brazil	18	-	(1)	-	-	-	17
Gas distribution Chile	74	-	(6)	-	-	-	68
Electricity distribution Chile	294	-	(23)	-	-	-	271
Latin America North Infrastructures	144	-	6		-	-	150
Gas distribution Mexico	20	-	-	-	-	-	20
Electricity distribution Panama	124	-	6	-	-	-	130
Rest	12	-	-	(12)	-	-	-
Total	4,760	9	(4)	(12)	-	(1,538)	3,215

“CGU reclassification” includes, as a result of the redefinition of the CGUs indicated in Note 6, the reallocation of the goodwill of the Electricity Spain CGU to the Gas supply, electricity and services CGU, the Conventional electricity CGU and the Renewable electricity generation CGU, based on the relative values of the goodwill associated with the reorganised units, at 30 June 2018. An impairment analysis has been carried out for these CGUs, resulting in impairment only in the conventional electricity generation in Spain CGU for the entire goodwill amounting to Euros 1,538 million (Note 6).

At 31 December 2018, Naturgy records investment commitments totalling Euros 31 million relating basically to the development of the gas distribution network with concessions regarded as intangible assets under IFRIC 12.

The intangible assets include, at 31 December 2018, fully amortised assets still in use totalling Euros 665 million (Euros 529 million at 31 December 2017).

Note 7. Property, plant and equipment

The movements in the accounts in 2018 and 2017 under property, plant and equipment and their respective accumulated depreciation and provisions have been as follows:

	Land and buildings	Gas installations	Electricity generation plants	Plant for electricity transmission and distribution	Gas tankers	Other Property, plant and equipment	PPE under construction	Total
Gross cost	668	10,972	12,666	8,269	1,118	1,042	992	35,727
Sinking fund and impairment losses	(123)	(5,354)	(4,336)	(1,625)	(245)	(417)	-	(12,100)
Carrying amount at 1.1.17	545	5,618	8,330	6,644	873	625	992	23,627
Investment (Note 4)	25	315	140	297	-	46	570	1,393
Divestment	(19)	(2)	(3)	(3)	-	(5)	(4)	(36)
Amortisation charge	(22)	(391)	(522)	(322)	(52)	(61)	-	(1,370)
Currency translation differences	(6)	(121)	(211)	(160)	-	(60)	(51)	(609)
Reclassifications and other ⁽¹⁾	-	(43)	44	60	-	(10)	(402)	(351)
Carrying amount at 31.12.2017	523	5,376	7,778	6,516	821	535	1,105	22,654
Gross cost	644	11,020	12,454	8,405	1,118	987	1,105	35,733
Sinking fund and impairment losses	(121)	(5,644)	(4,676)	(1,889)	(297)	(452)	-	(13,079)
Carrying amount at 31.12.2017	523	5,376	7,778	6,516	821	535	1,105	22,654
Investment (Note 4)	13	314	96	258	380	36	943	2,040
Divestment	(19)	-	-	-	-	-	-	(19)
Amortisation charge	(34)	(398)	(421)	(349)	(67)	(70)	-	(1,339)
Impairment losses (Note 5)	(31)	-	(2,257)	-	-	(110)	-	(2,398)
Currency translation differences ⁽¹⁾	(8)	(21)	44	(42)	-	(11)	(53)	(91)
Reclassifications and other ⁽²⁾	-	54	240	56	-	(132)	(358)	(140)
Carrying amount at 31.12.2018	444	5,325	5,480	6,439	1,134	248	1,637	20,707
Gross cost	578	11,352	12,791	8,565	1,498	549	1,637	36,970
Sinking fund and impairment losses	(134)	(6,027)	(7,311)	(2,126)	(364)	(301)	-	(16,263)
Carrying amount at 31.12.2018	444	5,325	5,480	6,439	1,134	248	1,637	20,707

1. Includes effect of inflation in Argentina (Note 3.3).

2. Mainly includes transfers to “Non-current assets held for sale” at the date on which this classification is applied (Note 11).

Note 4 include a breakdown of investments in property, plant and equipment by segment.

In November 2018 Naturgy sold the building located in calle Goya, Madrid, for Euros 24 million, generating a capital gain before income tax of Euros 9 million (Note 27).

In November 2018 Naturgy sold the building located in calle Lérida, Madrid, for Euros 12 million, generating a capital gain before income tax of Euros 3 million. In addition, an operating lease without a purchase option was concluded with the acquiring company for a period of ten years which may be extended for a further five-year period. At the date of the transaction, the remaining useful life of the property transferred was considerably greater than the maximum lease period. In December 2017 it sold the building located in calle Ombú, Madrid, for Euros 26 million, generating a capital gain before income tax of Euros 15 million (Note 27).

The heading “Gas tankers” at 31 December 2018 includes the present value at the acquisition date of committed payments to charter gas tankers under finance leases (Note 19), net of depreciation. At 31 December 2018 Naturgy owns eight oil tankers under finance leases following the inclusion of two new vessels for Euros 380 million in 2018 (Note 19).

At 31 December 2017, the item “Other fixed assets” included, basically, the investments in the coalfield of the company Kangra Coal (Proprietary), Ltd. in South Africa and exploration and development costs. In 2018 Kangra Coal (Proprietary), Ltd was transferred to Assets held for sale (Note 11).

Set out below is a breakdown of fixed assets in course of construction by business area:

	31.12.2018	31.12.2017
Gas and Electricity	859	443
EMEA Infrastructures	92	93
Latin America South Infrastructures	612	493
Latin America North Infrastructures	63	69
Rest	11	7
Total	1,637	1,105

The increase in Gas and Electricity fixed assets under construction relates mainly to investments in wind and photovoltaic generation parks in Spain, Australia and Brazil.

At 31 December 2018, Naturgy had no significant real estate investments.

At 31 December 2018, property, plant and equipment include fully-depreciated assets still in use totalling Euros 2,150 million (Euros 2,059 million at 31 December 2017).

It is the Naturgy’s policy to take out insurance where deemed necessary to cover risks that could affect its fixed assets.

At 31 December 2018, Naturgy records investment commitments totalling Euros 621 million relating basically to the construction of new renewable generation facilities and the development of the gas and electricity distribution network.

The financial expenses capitalised in 2018 in fixed assets projects during their construction total Euros 8 million (Euros 8 million in 2017). The financial expenses capitalised in 2018 account for 1.1% of total financial costs on net borrowings (1.1% in 2017). The average capitalisation rate for 2018 and 2017 was 3.2% and 4.0%, respectively.

Note 8. Investments in companies

Associates and jointly-controlled entities

Set out below is a breakdown of equity-consolidated investments:

	At 31.12.18	At 31.12.17
Associates	57	49
Jointly-controlled entities	759	1,451
Total	816	1,500

Appendix I lists all the associates and jointly-controlled entities in which Naturgy holds an interest, stating their activity and the percentage of the shareholding and equity interest.

The most significant shareholdings are Unión Fenosa Gas and EcoEléctrica L.P. (Note 4).

Movements during 2018 and 2017 in equity-consolidated investments, including a breakdown of the most significant shareholdings, are as follows:

	Unión Fenosa Gas	EcoEléctrica, L.P.	Other jointly-controlled entities	Total jointly-controlled entities	Associates	Total
Value of shareholding at 1.1.2017	1,034	344	151	1,529	46	1,575
Investment	-	-	14	14	-	14
Divestment	-	-	(5)	(5)	-	(5)
Shares of profits/(losses)	(88)	58	38	8	6	14
Dividends received	-	-	(18)	(18)	-	(18)
Currency translation differences	(23)	(41)	(8)	(72)	-	(72)
Other comprehensive income	2	(3)	-	(1)	(1)	(2)
Reclassifications and other	-	-	(4)	(4)	(2)	(6)
Value of shareholding at 31.12.2017	925	358	168	1,451	49	1,500
Impact of application IFRS 9	(9)	(14)	-	(23)	-	(23)
Value of shareholding at 1.1.2018	916	344	168	1,428	49	1,477
Investment	-	-	1	1	-	1
Divestment	-	-	(2)	(2)	-	(2)
Shares of profits/(losses)	(583)	22	40	(521)	8	(513)
Dividends received	-	(107)	(29)	(136)	-	(136)
Currency translation differences ⁽¹⁾	5	12	(20)	(3)	-	(3)
Other comprehensive income	-	-	-	-	-	-
Reclassifications and other	2	-	(10)	(8)	-	(8)
Value of shareholding at 31.12.2018	340	271	148	759	57	816

1. Includes effect of inflation in Argentina (Note 3.3).

In 2018, impairment in the Unión Fenosa Gas shareholding amounting to Euros 538 million and in Ecoeléctrica, L.P. amounting to Euros 34 million (Note 5) was recognised.

In 2017 the investments related to a Euros 14 million capital increase in Nueva Generadora del Sur, S.A. (Note 30).

There follows a breakdown of assets, liabilities, revenue and results of Naturgy's main interests in jointly-controlled entities (by shareholding percentage):

	At 31.12.2018		At 31.12.2017	
	Unión Fenosa Gas	EcoEléctrica, L.P.	Unión Fenosa Gas	EcoEléctrica, L.P.
Non-current assets	780	229	1,392	261
Current assets	117	58	231	107
Cash and cash equivalents	62	7	65	40
Non-current liabilities	(397)	(4)	(565)	(3)
Non-current financial liabilities	(171)	-	(159)	-
Current liabilities	(160)	(12)	(133)	(7)
Current financial liabilities	(10)	-	(21)	-
Net assets	340	271	925	358
Net borrowings ¹	119	(7)	115	(40)

1. Net borrowings: Non-current financial liabilities+Current financial liabilities-Cash and cash equivalents.

	2018		2017	
	Unión Fenosa Gas	EcoEléctrica, L.P.	Unión Fenosa Gas	EcoEléctrica, L.P.
Revenue	843	141	723	151
Procurements	(762)	(63)	(692)	(55)
Personnel expenses	(9)	(4)	(8)	(4)
Other operating income/expenses	(23)	(12)	(13)	(12)
Gross operating results	49	62	10	80
Depreciation, amortisation and impairment losses	(69)	(14)	(102)	(16)
Impairment due to credit losses	(24)	9	-	(2)
Operating profit	(44)	57	(92)	62
Net financial income/(expense)	(18)	1	(21)	(1)
Results of equity-consolidated companies	5	-	1	-
Profit/(loss) before tax	(57)	58	(112)	61
Corporate income tax	11	(2)	20	(3)
Attributed to non-controlling interests	1		4	
Profit/(loss) attributed for the year from continuing operations	(45)	56	(88)	58
Impairment of shareholding (Note 5)	(538)	(34)	-	-
Share of profits	(583)	22	(88)	58

There are no contingent liabilities affecting interests in jointly-controlled entities.

The contractual commitments for the acquisition and sale of interests in joint ventures at 31 December 2018 and 31 December 2017 are as follows:

Acquisition	At 31 December 2018	At 31 December 2017
Energy purchases ⁽¹⁾	3,840	5,103
Energy transmission ⁽²⁾	117	120
Total contractual obligations	3,957	5,223

Sale	At 31 December 2018	At 31 December 2017
Energy sales ⁽³⁾	1,339	1,665
Provision of capacity assignment services ⁽⁴⁾	134	166
Total contractual obligations	1,473	1,831

1. Reflects long-term commitments to buy natural gas from Unión Fenosa Gas and EcoEléctrica L.P.

2. Includes operating costs associated with gas tanker chartering agreements with Unión Fenosa Gas under a financial lease arrangement.

3. Reflects long-term commitments to sell natural gas of Unión Fenosa Gas.

4. Reflects service provision commitments under power generation capacity assignment contracts from EcoEléctrica L.P. to Puerto Rico Electricity Power Authority.

Certain investment projects related to interests in jointly-controlled entities have been financed by means of specific structures (project finance) which include pledges on the shares in the project companies. At 31 December 2018, the outstanding balance of this type of financing totals Euros 210 million (Euros 237 million at 31 December 2017).

Joint ventures

Naturgy participates in different joint ventures that meet the conditions indicated in Note 3.4.1.b and which are described in Appendix I, section 3. The relevant interests in joint ventures at 31 December 2018 and 2017 are as follows:

	2018	2017
Comunidad de Bienes Central Nuclear de Almaraz	11.3%	11.3%
Comunidad de Bienes Central Nuclear de Trillo	34.5%	34.5%
Comunidad de Bienes Central Térmica de Anllares	66.7%	66.7%

The contribution from the joint operations to Naturgy's assets, liabilities, revenue and results is analysed below:

	A 31.12.18	A 31.12.17
Non-current assets	45	524
Current assets	87	95
Cash and cash equivalents	1	1
Non-current liabilities	(75)	(75)
Non-current financial liabilities	-	-
Current liabilities	(70)	(91)
Current financial liabilities	(10)	(11)
Net assets	(13)	453
Net borrowings ¹	9	10

1. Net borrowings: Non-current financial liabilities+Current financial liabilities-Cash and cash equivalents.

	2018	2017
Revenue	269	287
Operating expenses	(175)	(194)
Gross operating results	94	93
Depreciation, amortisation and impairment losses ⁽¹⁾	(498)	(61)
Operating profit	(404)	32
Net financial income/(expense)	-	-
Profit/(loss) before tax	(404)	32
Corporate income tax	101	(8)
Profit/(loss) attributed for the year from continuing operations	(303)	24

1. Includes generation asset impairment (Note 5)

Note 9. Financial assets

The breakdown of financial assets line classified according to their nature and account, is as follows:

At 31 December 2018	Fair value through other comprehensive income	Fair value through profit or loss	Amortised cost	Total
Equity instruments	262	85	-	347
Derivatives (Note 18)	11	7	-	18
Other financial assets	-	-	545	545
Non-current financial assets	273	92	545	910
Derivatives (Note 18)	6	24	-	30
Other financial assets	-	-	398	398
Current financial assets	6	24	398	428
Total	279	116	943	1,338

At 31 December 2017	Fair value through other comprehensive income	Fair value through profit or loss	Amortised cost	Total
Equity instruments	465	95	-	560
Derivatives (Note 18)	4	11	-	15
Other financial assets	-	-	644	644
Non-current financial assets	469	106	644	1,219
Derivatives (Note 18)	20	45	-	65
Other financial assets	-	-	397	397
Current financial assets	20	45	397	462
Total	489	151	1,041	1,681

Financial assets recognised at fair value at 31 December 2018 and at 31 December 2017 are classified as follows:

	31 December 2018				31 December 2017			
	Level 1 (listed price on active markets)	Level 2 (observable variables)	Level 3 (non-observable variables)	Total	Level 1 (listed price on active markets)	Level 2 (observable variables)	Level 3 (non-observable variables)	Total
Financial assets								
Fair value through other comprehensive income	-	17	262	279	-	24	465	489
Fair value through profit or loss	-	31	85	116	-	56	95	151
Total	-	48	347	395	-	80	560	640

The movement in equity instruments in 2018 and 2017, based on the method applied for calculating their fair value, is as follows:

	31 December 2018				31 December 2017			
	Level 1 (listed price on active markets)	Level 2 (observable variables)	Level 3 (non-observable variables)	Total	Level 1 (listed price on active markets)	Level 2 (observable variables)	Level 3 (non-observable variables)	Total
At 1 January	-	-	560	560	-	-	619	619
Additions	-	-	-	-	-	-	-	-
Changes recognised directly in equity	-	-	(181)	(181)	-	-	(54)	(54)
Changes recognised in income statement	-	-	(10)	(10)	-	-	-	-
Currency translation differences	-	-	-	-	-	-	(2)	(2)
Transfers and other ⁽¹⁾	-	-	(22)	(22)	-	-	(3)	(3)
At 31 December	-	-	347	347	-	-	560	560

1. In 2018 it corresponds to the transfer to hold for the sale of the stake in Richards Bay (Note 11).

Fair value through other comprehensive income

- Equity instruments:

Mainly includes the 85.4% interest in Electrificadora del Caribe, S.A. ESP (Electricaribe). On 14 November 2016 the Superintendencia for Residential Public Services of the Republic of Colombia (“the Superintendencia”) reported the government take-over of Electricaribe, a Naturgy investee, as well as the separation of the members of the governing body and the general manager, and their replacement by a special agent appointed by the Superintendencia. On 14 March 2017 the Superintendencia announced the decision to liquidate Electricaribe. On 22 March 2017 Naturgy initiated arbitration proceedings before the Court of the United Nations Commission for International Trade Law (UNCITRAL) and on 15 June 2018 it lodged a complaint in which it claimed approximately 1,600 USD million. On 4 December 2018 the Republic of Colombia submitted its answer to the complaint and filed a counterclaim for approximately 500 USD million, the viability of which is considered remote.

At 31 December 2017 this shareholding was valued at Euros 416 million, corresponding to its fair value at the date of the loss of control which did not differ from its carrying value, adjusted for exchange rate fluctuations.

At 31 December 2018 this interest is valued for an amount of Euros 253 million. Given the difficulty in assessing the fair value due to the specific situation of this asset, the shareholding in question was valued on the basis of last information of the audited financial statements available, which reflect an attributed equity value of 85.4% of the Euros 253 million shareholding, entailing the recognition of a decrease in the fair value of this investment is of Euros 163 million.

For this equity investment the option permitted by IFRS 9 was used to irrevocably classify it in the new category of “Equity instruments at fair value through other comprehensive income” (Note 3.2) and therefore this decrease in fair value has been recorded under “Other accumulated comprehensive income”.

Additionally, at 31 December 2017, the 2.23% interest was included in Richards Bay Coal Terminals Ltd, a company that operates a terminal for exporting of coal in South Africa which has been transferred to held for sale (Note 11) , amounting to Euros 22 million (Euros 40 million at 31 December 2017), the fair value of which was determined based on the sale price.

Fair value through profit and loss

- Equity instruments: the 14.9% holding in Medgaz, S.A., the company that operates the submarine pipeline between Algeria and Spain, for an amount of Euros 85 million (Euros 95 million at 31 December 2017), the fair value of which is determined based on the discounting of cash flows from future dividends.

Amortised cost

The breakdown at 31 December 2018 and 2017 is as follows:

	A 31.12.18	A 31.12.17
Commercial loans	47	41
Gas system income deficit financing	7	19
Deposits and guarantees deposits	104	135
Other loans	387	449
Other non-current financial assets	545	644
Commercial loans	30	70
Electricity system income deficit financing	95	91
Gas system income deficit financing	131	145
Dividend receivable	5	2
Other loans	137	89
Other current financial assets	398	397
Total	943	1,041

The breakdown by maturities at 31 December 2018 and 2017 is as follows:

Maturities	At 31.12.18	At 31.12.17
No later than 1 year	398	397
Between 1 year and 5 years	224	279
More than 5 years	321	365
Total	943	1,041

The fair values and carrying amounts of these assets do not differ significantly.

The heading “Gas system income deficit financing” includes the timing mismatches arising between gas system revenue and costs accumulated for 2017 and 2018 financed by Naturgy pursuant to Law 18/2014 in the amount of Euros 138 million (Euros 164 million at 31 December 2017). This amount will be recovered through the gas system settlements. The amount pending receipt following the settlements for the year generates a recovery right in the following five years for the remaining amount financed, plus interest at a market rate. The amount of this financing has been recognised in long term and short term items based on the estimated recovery period.

In December 2017 the irrevocable assignment without recourse of the 2014 deficit (nominal amount of Euros 315 million) and the mismatches for 2015 and 2016 (Euros 40 million) to various financial institutions took place, transferring all associated risks and rewards. All the balances at the date of the assignment were therefore derecognised.

The heading “Electricity system income deficit financing” includes the temporary mismatches between electricity system revenues and costs financed by Naturgy pursuant to Law 24/2013 of 26 December in the amount of Euros 95 million (Euros 91 million at 31 December 2017) and which generate a recovery right over the following five years and interest at a market rate. The amount of this financing has been entirely recognised as a short-term item on the understanding that it is a temporary mismatch that will be recovered through system settlements within one year.

“Commercial loans” mainly include the credits for the sale of gas and electricity installations. The respective interest rates (between 5% and 11% for loans from 1 to 5 years) are adjusted to market interest rates for this type of loans and duration.

The item “Deposits and guarantees deposits” basically include amounts deposited with the competent Public Administrations, under applicable legislation, in respect of guarantees and deposits received from customers when contracts are concluded to secure the supply of electricity and natural gas (Note 19).

“Other loans” includes, basically:

- A loan of Euros 145 million (Euros 174 million at 31 December 2017) for financing ContourGlobal La Rioja. S.L. for the sale of the Arrúbal combined cycle plant (La Rioja), which took place on 28 July 2011, of which Euros 22 million is classified under current assets (Euros 21 million in 2017). The loan, which is secured by the shares of this company and by its assets, bears annual interest at a market rate and matures in 2021.
- The value of generation concessions in Costa Rica that are deemed to be credits, pursuant to IFRIC 12 “Service concession arrangements” (Note 3.4.3.b and Note 32), in the amount of Euros 224 million (Euros 229 million at 31 December 2017), of which Euros 16 million is classified in current assets (Euros 13 million in 2017). These credits are classified in this item as they represent an unconditional right to receive cash in fixed or determinable amounts.

Derivatives

The variables upon which the valuation of the derivatives reflected under this heading are based and observable in an active market (Level 2).

Note 18 shows the details of the derivative financial instruments.

Note 10. Other non-current assets and trade and other receivables

The breakdown of “Other non-current assets” y “Current trade and other receivables”, at 31 december 2018 and 2017, classified by nature and category is as follows:

At 31 December 2018	Fair value through other comprehensive income	Amortised cost	Total
Derivatives (Note 18)	162	-	162
Other assets	-	172	172
Other non-current assets	162	172	334
Derivatives (Note 18)	45	-	45
Other assets	-	5,089	5,089
Current trade and other receivables	45	5,089	5,134
Total	207	5,261	5,468

At 31 December 2017	Fair value through other comprehensive income	Amortised cost	Total
Derivatives (Note 18)	-	-	-
Other assets	-	96	96
Other non-current assets	-	96	96
Derivatives (Note 18)	38	-	38
Other assets	-	4,956	4,956
Current trade and other receivables	38	4,956	4,994
Total	38	5,052	5,090

Financial assets recognised at fair value at 31 December 2018 and at 31 December 2017 are classified as follows:

Financial assets	31 December 2018				31 December 2017			
	Level 1 (listed price on active markets)	Level 2 (observable variables)	Level 3 (non-observable variables)	Total	Level 1 (listed price on active markets)	Level 2 (observable variables)	Level 3 (non-observable variables)	Total
Fair value through other comprehensive income	-	207	-	207	-	38	-	38
Fair value through profit and loss	-	-	-	-	-	-	-	-
Total	-	207	-	207	-	38	-	38

Fair value through other comprehensive income

Non-current derivative financial assets at fair value through other comprehensive income includes the market value of two contracts between the Australian group company Crookwell Development Pty Ltd (Crookwell) and the distributor ActewAGL (ACT) and the Australian group company Berrybank Development Pty Ltd (Berrybank) and the State of Victoria (Australia) whereby Crookwell and Berrybank undertake to sell on the market, at the spot price, the output from a plants owned by them and to settle with ACT and the State of Victoria the difference between the price of each delivery and a fixed price for a specific volume of MW. Both contacts cover the sale price of the plants' output for a period of 20 years in the first case and 15 years in the second, and have been recorded as a cash-flow hedging financial instrument.

Amortised cost

	At 31.12.18	At 31.12.17
Receivable, revenue from capacity services	146	85
Other loans	26	11
Other non-current assets	172	96
Trade receivables	5,187	4,910
Receivables with related companies (Note 32)	17	87
Provision for impairment due to debtor credit losses	(789)	(650)
Trade receivables	4,415	4,347
Public Administrations	113	71
Prepayments	85	81
Sundry receivables	291	279
Other receivables	489	431
Current income tax asset	185	178
Current trade and other receivables	5,089	4,956
Other non-current assets and trade and other receivables	5,261	5,052

The fair values and carrying amounts of these assets do not differ significantly.

The heading "Receivable, revenue from capacity services" relates to revenue yet to be billed in respect of the levelling of the term of the service contracts for electricity generation capacity assignment with the Mexican Federal Electricity Commission (Note 3.4.20.f).

In general, the outstanding invoices do not accrue interest as they fall due in an average period of 21

At 31 December 2018 the accumulated balances for electricity and gas sales yet to be invoiced are included under "Trade receivables" and amount to Euros 1,748 million (Euros 1,724 million at 31 December 2017).

Other financial assets

The movement in the impairment provision for debtor credit losses is as follows:

	2018	2017
At 31 December	(650)	(676)
First application IFRS9 (Note 3.2)	(101)	-
At 1 January	(751)	(676)
Provision for impairment due to credit losses	(179)	(155)
Write offs	136	123
Currency translation differences	5	14
Transfers and other ⁽¹⁾	-	44
At 31 december	(789)	(650)

1. In 2017 mainly included transfers to "Non-current assets held for sale" at the date on which this classification is applied (Note 11).

Note 11. Non-current assets and disposal groups of assets held for sale and discontinued operations

At 31 December 2018, non-current assets held for sale relate to the electricity generation business in Kenya and the distribution of electricity in Moldova.

At 31 December 2017 the gas distribution and sale business in Italy, gas distribution in Colombia electricity generation in Kenya and electricity in Moldova that were sold during 2018 were recorded as non-current assets held for sale.

On 1 and 22 February 2018, following approval by the competition authorities, the sale of the gas distribution and supply companies in Italy to the companies 2i Rete Gas and Edison, respectively, was completed. Additionally, on 18 April 2018 the assignment of the gas supply contract was completed. The total sale price amounted to Euros 766 million, generating a capital gain of Euros 188 million after taxes.

On 17 November 2017, Naturgy entered into a binding agreement with Brookfield Infrastructure for the sale of its 59.1% interest in Gas Natural SA ESP, a Colombian company engaged in the distribution and retail sale of gas, for 1,678,927 million Colombian pesos (Euros 468 million). The transaction was structured in two phases, the first of which was completed in December 2017 through successive sales operations on the Colombian stock exchange. Following that phase, Naturgy's percentage holding was reduced to 41.9% and control over Gas Natural S.A. ESP was lost. This investment was subsequently recorded using the equity method. On 28 May 2018, the acceptance period for the public offering on Gas Natural S.A. ESP expired, thereby completing the sale of the remaining 41.9% of the gas distribution business in Colombia for Euros 334 million, which was settled on 1 June 2018. This amount is equivalent to the carrying value of the dividends received and therefore there has been no impact on the consolidated income statement.

On 27 June 2018 Naturgy reached a preliminary agreement for the sale of its 70% interest in Kangra Coal Proprietary Limited (mining business in South Africa) to Menar Holding. The completion of the transaction took place in December 2018. The transaction represents an equity value of USD 28 million for 70% of Naturgy's shares. The conclusion of the transaction was subject to compliance with the terms and procedures laid down in Kangra's shareholders' agreement and the finalisation of the transaction was subject to the necessary regulatory approvals and competition authorisation. In May 2018, as the sale of this business was highly probable, these assets were classified as non-current assets held for sale. At that date, for the estimate of the fair value minus costs to sell required by IFRS 5, a Level 3 valuation was made taking into account the price of the sale offers received less costs to sell. Given that previously, in March 2018, an impairment of Euros 140 million had been foreseen, the result of the reduction in the carrying value of the resulting investment amounting to Euros 141 million did not have a significant additional impact, like the final sale of the company.

In addition, on 27 June 2017, Naturgy reached an agreement with AEP Energy Africa Limited for the sale of 100% of its shareholding in Iberafrica Power Limited, in Kenya. The transaction involved a total value (enterprise value) of USD 62 million. After regulatory and competition approvals, the transaction is expected to be executed in the first quarter of 2019. This investment had already been considered as held for sale at 31 December 2017. The fair value was determined based on the selling price less costs to sell. To estimate the fair value less costs to sell as required by IFRS 5, the level 3 valuation has been updated taking into consideration the prices of sale offers received less costs to sell, resulting in a decrease in the carrying amount of the investment of Euros 7 million, which is included in profits from discontinued operations net of taxes.

Finally, as a result of the strategic review of its business and positioning in various countries, Naturgy decided to carry out competitive sales processes for its electricity distribution business in Moldova, which was treated as held for sale at 31 December 2017. The Moldova sale has been delayed due to causes beyond the control of Naturgy. The commitment to sell the holding remains firm and therefore, as required by IFRS 5 (paragraph 9) at 31 December 2018 it continues to be recognised as held for sale. To estimate the fair value less costs to sell as required by IFRS 5, the level 3 valuation has been updated taking into consideration market variables and the progress of the sale process, resulting in a decrease in the carrying amount of the investment of Euros 73 million, which is included in profits from discontinued operations net of taxes in 2018.

As Naturgy has sold or has a firm commitment to sell these assets that are clearly identified, the process is under way and it is considered that the sale is highly probable, or the sale has already been completed, the accounting balances of these assets and liabilities were transferred to “Non-current assets held for sale” and “Liabilities related to non-current assets held for sale”, in accordance with IFRS 5 “Non-current assets held for sale and discontinued operations”. In addition, it was considered that these are discontinued operations as they are components classified as held for sale which represented a significant and separate line of business or area of operation. Therefore, all income and expenses pertaining to the these lines of business for 2018 and 2017 are disclosed under “Profit for the year from discontinued operations, net of taxes”.

The breakdown by nature of assets classified as held for sale and the associated liabilities is as follows at 31 December 2018 and 2017:

2018	Electricity distribution Moldova	International Electricity Kenya	Total
Intangible assets	1	-	1
Property, plant and equipment	64	41	105
Investments recorded using the equity method	-	-	-
Non-current financial assets	1	-	1
Deferred tax assets	1	-	1
Non-current assets	67	41	108
Inventories	-	8	8
Trade and other receivables	35	10	45
Other current financial assets	-	-	-
Cash and cash equivalents	41	-	41
Current assets	76	18	94
Total assets	143	59	202
Grants	9	-	9
Non-current provisions	1	-	1
Non-current financial liabilities	-	-	-
Deferred tax liabilities	1	9	10
Other non-current liabilities	-	-	-
Non-current liabilities	11	9	20
Current financial liabilities	3	30	33
Trade and other payables	33	2	35
Other current liabilities	-	5	5
Current liabilities	36	37	73
Total liabilities	47	46	93

2017	Gas distribution Italy	Gas distribution Colombia	Electricity distribution Moldova	Gas marketing Italy	International Electricity Kenya	Total
Intangible assets	597	-	6	35	-	638
Property, plant and equipment	26	-	116	3	43	188
Investments recorded using the equity method	-	327	-	-	-	327
Non-current financial assets	2	-	15	1	-	18
Deferred tax assets	25	-	-	6	-	31
Non-current assets	650	327	137	45	43	1,202
Inventories	1	-	-	31	8	40
Trade and other receivables	60	-	51	175	15	301
Other current financial assets	1	-	-	2	-	3
Cash and cash equivalents	86	-	49	1	-	136
Current assets	148	-	100	209	23	480
Total assets	798	327	237	254	66	1,682
Grants	-	-	9	-	-	9
Non-current provisions	6	-	-	2	-	8
Non-current financial liabilities	44	-	3	-	-	47
Deferred tax liabilities	20	-	2	-	9	31
Other non-current liabilities	-	-	-	19	-	19
Non-current liabilities	70	-	14	21	9	114
Current financial liabilities	219	-	3	69	37	328
Trade and other payables	40	-	29	90	4	163
Other current liabilities	11	-	-	-	5	16
Current liabilities	270	-	32	159	46	507
Total liabilities	340	-	46	180	55	621

Breakdowns by nature of the heading “Profit for the year from discontinued operations net of taxes” in the consolidated income statement for 2018 and 2017 are as follows:

2018	Gas distribution Italy	Gas distribution Colombia	Electricity distribution Moldova	Gas marketing Italy	International Electricity Kenya	Mining South Africa	Total
Revenue	7	-	237	36	17	41	338
Procurements	-	-	(198)	(30)	(7)	(21)	(256)
Other operating income	2	-	1	1	1	-	5
Personnel expenses	(1)	-	(7)	(2)	(1)	(11)	(22)
Other operating expenses	(3)	-	(13)	(1)	(4)	(8)	(29)
Release of fixed assets grants to income and other	-	-	-	-	-	-	-
Gross operating results	5	-	20	4	6	1	36
Fixed asset depreciation/amortisation	-	-	-	-	-	(13)	(13)
Impairment due to credit losses	-	-	-	(1)	-	-	(1)
Other results ⁽¹⁾	58	-	(73)	130	(7)	(141)	(33)
Operating profit/(loss)	63	-	(53)	133	(1)	(153)	(11)
Financial income	-	-	1	-	-	1	2
Financial expenses	-	-	(1)	-	(2)	(1)	(4)
Exchange differences	-	-	-	-	-	-	-
Net financial income/(expense)	-	-	-	-	(2)	-	(2)
Profit/(loss) on equity method companies	-	7	-	-	-	-	7
Profit/(loss) before taxes	63	7	(53)	133	(3)	(153)	(6)
Corporate income tax	(1)	-	(3)	(1)	(2)	3	(4)
Profit for the year after taxes from discontinued operations	62	7	(56)	132	(5)	(150)	(10)
Attributable to:							
The parent company	62	7	(56)	132	(4)	(110)	31
Non-controlling interests	-	-	-	-	(1)	(40)	(41)

1. Gas Distribution Italy and Gas Supply Italy include the capital gain on the sale of the interest. Electricity Distribution Moldova, International Electricity Kenya and Mining South Africa includes the reduction in the carrying amount of the investment to measure it at fair value less costs to sell.

2017	Gas distribution Italy	Gas distribution Colombia	Electricity distribution Moldova	Gas marketing Italy	International Electricity Kenya	Mining South Africa	Total
Revenue	85	745	203	140	53	99	1.325
Procurements	(1)	(511)	(162)	(91)	(25)	(51)	(841)
Other operating income	36	11	-	4	1	1	53
Personnel expenses	(12)	(14)	(7)	(6)	(2)	(15)	(56)
Other operating expenses	(49)	(89)	(16)	(25)	(8)	(22)	(209)
Release of fixed assets grants to income and other	-	-	-	-	-	-	-
Gross operating results	59	142	18	22	19	12	272
Fixed asset depreciation/amortisation	(18)	(13)	(6)	(1)	(8)	(27)	(73)
Impairment due to credit losses	-	(3)	-	(10)	-	(1)	(14)
Other results ⁽¹⁾	-	350	-	-	(24)	-	326
Operating profit/(loss)	41	476	12	11	(13)	(16)	511
Financial income	1	18	5	-	-	-	24
Financial expenses	(3)	(13)	(1)	-	(4)	(1)	(22)
Exchange differences	-	-	(1)	-	-	-	(1)
Net financial income/(expense)	(2)	5	3	-	(4)	(1)	1
Profit/(loss) on equity method companies	-	-	-	-	-	-	-
Profit/(loss) before taxes	39	481	15	11	(17)	(17)	512
Corporate income tax	(9)	(51)	(3)	(4)	(2)	5	(64)
Profit for the year after taxes from discontinued operations	30	430	12	7	(19)	(12)	448
Attributable to:							
the parent company	30	393	12	7	(14)	(8)	420
Non-controlling interests	-	37	-	-	(5)	(4)	28

1. Gas Distribution Colombia includes the capital gain on the sale of the shareholding and the impact of the fair-value measurement of the remaining interest. International Electricity Kenya includes the reduction in the carrying amount of the investment to measure it at fair value less costs to sell.

Total comprehensive income on this activity in the years ended 31 December 2018 and 2017 breaks down as follows:

2018	Gas distribution Italy	Gas distribution Colombia	Electricity distribution Moldova	Gas marketing Italy	International Electricity Kenya	Mining South Africa	Total
Consolidated profit/(loss) for the year	62	7	(56)	132	(5)	(150)	(10)
Other comprehensive income recognised directly in equity:							
Financial assets at fair value through other comprehensive income	-	-	-	-	-	(18)	(18)
Currency translation differences	-	-	9	-	-	(8)	1
Transfer to the income statement							
Currency translation differences	-	-	-	-	-	50	50
Total comprehensive income for the year	62	7	(47)	132	(5)	(126)	23

2017	Gas distribution Italy	Gas distribution Colombia	Electricity distribution Moldova	Gas marketing Italy	International Electricity Kenya	Mining South Africa	Total
Consolidated profit/(loss) for the year	30	430	12	7	(19)	(12)	448
Other comprehensive income recognised directly in equity:							
Currency translation differences	-	(13)	(6)	-	(4)	(12)	(35)
Transfer to the income statement							
Currency translation differences	-	13	-	-	-	-	13
Total comprehensive income for the year	30	430	6	7	(23)	(24)	426

The cash flows from discontinued operations included in the consolidated cash flow statements are:

2018 Cash flow from:	Gas distribution Italy	Gas distribution Colombia	Electricity distribution Moldova	Gas marketing Italy	International Electricity Kenya	Mining South Africa	Total
Operation	(14)	-	62	(6)	8	4	54
Investment	(1)	-	(19)	-	-	(1)	(21)
Financing	-	-	(51)	10	(8)	-	(49)

2017 Cash flow from:	Gas distribution Italy	Gas distribution Colombia	Electricity distribution Moldova	Gas marketing Italy	International Electricity Kenya	Mining South Africa	Total
Operation	42	88	53	13	8	11	215
Investment	(28)	(23)	(15)	(3)	(1)	(3)	(73)
Financing	-	(75)	(17)	(10)	(7)	-	(109)

Transactions between the companies making up the discontinued business with other group companies are not significant. Therefore, intragroup cash flows with the discontinued business are not significant.

Note 12. Inventories

The breakdown of Inventories is as follows:

	At 31.12.18	At 31.12.17
Natural gas and liquefied gas	498	388
Coal and fuel oil	53	62
Nuclear fuel	56	57
CO ₂ emission allowances	147	68
Raw materials and other inventories	96	145
Total	850	720

At 31 December 2018 Naturgy has commitments for the acquisition of inventories amounting to Euros 34 million (Euros 36 million at 31 December 2017) corresponding to nuclear fuel (Euros 35 million at 31 December de 2017). At 31 December 2017 there was also a figure of Euros 1 million related to CO₂.

Gas inventories basically include the inventories of gas deposited in underground storage units, sea transport, plants and pipelines.

In 2018 it includes inventory impairments of Euros 63 million (Note 5).

Note 13. Cash and cash equivalents

The breakdown of the line “Cash and cash equivalents” is as follows:

	At 31.12.18	At 31.12.17
Cash at banks and in hand	1,469	1,946
Short term investments (Spain and rest of Europe)	161	1,192
Short term investments (International)	86	87
Total	1,716	3,225

The investments in cash equivalents mature in less than three months and bear a weighted effective interest rate 0.78% at 31 December 2018 (1.64% at 31 December 2017).

At 31 December 2018 and 2017 there are no investments in sovereign debt, nor are there any significant restrictions on cash withdrawals.

All investments in “Cash and cash equivalents” are valued at amortised cost.

Note 14. Equity

The main elements of Equity are broke down as follows:

Share capital and share premium

The variations in 2018 and 2017 in the number of shares and share capital and share premium accounts have been as follows:

	Number of shares	Share capital	Share premium	Total
At 1 January 2017	1,000,689,341	1,001	3,808	4,809
Variation	-	-	-	-
At 31 December 2017	1,000,689,341	1,001	3,808	4,809
Variation	-	-	-	-
At 31 December 2018	1,000,689,341	1,001	3,808	4,809

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

The Company’s Board of Directors, which for these purposes may be substituted by the Executive Committee, for a maximum term of five years as from 20 April 2017, is empowered to increase share capital by Euros 500,344,670 through one or more cash payments at the time and in the amount that it deems fit, issuing ordinary, privileged or redeemable shares with or without voting rights, with or without a share premium, without requiring any further authorisation from the shareholders, with the possibility of agreeing, as appropriate, the full or partial exclusion of preferential subscription rights up to a limit of 20% of share capital at the date of this authorisation, and to alter the By-laws as required due to the capital increase or increases performed by virtue of said authorisation, with provision for an incomplete subscription, in accordance with the provisions of Article 297.1.b) of the Companies Act 2010.

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

The most representative holdings in the share capital of Naturgy Energy Group at 31 December 2018, in accordance with the public information available or the information released by the Company itself, are as follows:

	Interest in share capital %	
	2018	2017
- Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa" ⁽¹⁾	25.6	24.4
- Repsol, S.A.	-	20.1
- Global Infrastructure Partners III ⁽²⁾	20.0	20.0
- Rioja Bidco Shareholdings, S.L.U. ⁽³⁾	20.1	-
- Sonatrach	3.9	4.0

1. 20,4% direct holding through Criteria Caixa S.A.U and 5.2% indirect (holding 5.0% through Energía Boreal 2018, S.A. and 0.2% through other) .

2. Global Infrastructure Partners III, whose investment manager is Global Infrastructure Management LLC, holds its interest indirectly through GIP III Canary 1, S.à.r.l.

3. Company controlled by funds advised by CVC.

On 22 February 2018 Repsol, S.A. concluded an agreement with Rioja Bidco Shareholdings, S.L.U., a company controlled by funds advised by CVC, for the sale of 20.072% of the capital of Naturgy Energy Group, S.A. On 18 May 2018 the transaction was completed and Repsol, S.A. ceased to be the owner of said company.

All Naturgy shares are traded on the four official Spanish Stock Exchanges and the continuous market, and form part of Spain's Ibex 35 stock index.

Naturgy's share price at the end of 2018 is Euros 22.26 (Euros 19.25 at 31 December 2017).

Reserves and retained earnings

"Reserves" includes the following reserves:

	2018	2017
Legal reserve	200	200
Statutory reserve	100	100
Goodwill reserve	109	191
Other reserves and retained earnings	10,881	9,413
Voluntary reserve Naturgy Energy Group, S.A.	7,305	7,200
Other reserves and retained earnings	3,576	2,213
	11,290	9,904

At the annual general meeting held on 27 June 2018, the shareholders agreed to the transfer to Voluntary Reserves of Euros 82 million from the Goodwill Reserve.

Legal reserve

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

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

Statutory reserve

Under the articles of association of Naturgy Energy Group, S.A., 2% of net income for the year must be allocated to the statutory reserves until it reaches at least 10% of share capital.

Goodwill reserve

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

Other reserves and retained earnings

Relates basically to voluntary reserves for retained earnings.

Share-based payments

Within the framework of the new Strategic Plan 2018-2022 the Board of Directors, at meeting held on 31 July, approved a long term variable incentive plan (LTI) involving the Executive Chairman and 25 other executives. The main characteristics of the plan are as follows:

- The incentive covers the duration of the Strategic Plan 2018-2022, which is scheduled to expire in July 2023. It is directly related to the total yield obtained by the shareholders of Naturgy Energy Group S.A. in the period concerned.
- It is arranged through the acquisition of 8,639,595 shares in Naturgy Energy Group S.A. at a price of Euros 23.15 (see Treasury Shares) through a group company 100% owned. It has been endowed with resources (Euros 200 million), through a contribution of own funds made by Naturgy Energy Group, S.A. (Euros 100 millones) y financiación bancaria externa (Euros 100 million), with which has acquired the aforementioned shares.
- At the finalisation of the plan this company will obtain income derived from the receipt of the dividends attributed to its shares, the variation of the stock price and other income and expenses, mainly financial. At that time it will sell the shares required to return all the resources received for the acquisition of the shares and after settling all its obligations it will distribute any surplus among its members in the form of shares.
- This surplus will be received only if a minimum profitability threshold has been surpassed, considering a quotation of Euros 19.15 at the expiration of the (LTI) and assuming that all the dividends foreseen in the Strategic Plan 2018-2022 are distributed.
- If they leave the Company, the beneficiaries will only be entitled, in certain cases, to receive a part of the final incentive calculated in proportion to their length of service in the Company with respect to the duration of the plan.

The fair value of the equity instruments granted has been determined at the grant date using a Monte Carlo simulation valuation model with the following assumptions:

Share price on the grant date (euro/share)	23.15
Forecast share price volatility ⁽¹⁾	17.73%
Plan duration (years)	5
Expected dividends	6.26%
Risk-free interest rate	0.34%

1. Forecast volatility has been determined based on the historical volatility of the daily share price in the last year.

As a result of the time apportionment of the fair value estimate of the equity instruments granted over the term of the plan, an amount of Euros 4.5 million has been recorded in the consolidated income statement for 2018 under Personnel expenses, credited to “Reserves” in the consolidated balance sheet at 31 December 2018.

Treasury shares

Movements during 2018 and 2017 involving the treasury shares of Naturgy Energy Group, S.A. are as follows:

	Number of shares	Amount (million euro)	% Capital
At 1 January 2017	750,545	13	0.1
Acquisitions	7,623,586	147	0.8
Delivered to employees	(336,625)	(7)	(0.1)
Disposals	(8,037,506)	(153)	(0.8)
At 31 December 2017	-	-	-
Acquisitions	10,782,040	227	1.0
Acquisitions LTI coverage	8,639,595	200	0.9
Delivered to employees	(354,422)	(7)	-
Disposals	(5,029,881)	(99)	(0.5)
At 31 December 2018	14,037,332	321	1.4

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

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

In accordance with the resolutions adopted by the shareholders of Naturgy Energy Group, S.A. at the general meeting held on 20 April 2017, within the Share Acquisition Plan 2017-2018-2019, those relating to 2017 and 2018 addressed to Naturgy employees in Spain who decide voluntarily to take part in the Plan were set in motion. The Plan enables participants to receive part of their remuneration in the form of shares in Naturgy Energy Group, S.A., subject to an annual limit of Euros 12,000. During 2018, 354,422 of the Company's own shares were acquired for Euros 7 million to be handed over to the employees taking part in the Plan (336,625 own shares amounting to Euros 7 million in 2017).

In 2018 the proceeds on transactions involving Naturgy treasury shares amounted to a loss of Euros 0.4 million, recognised under “Other reserves” (Euros 0.5 million profit in 2017).

During 2018 Naturgy acquired 8,639,595 treasury shares at an average price of 23.15 euro per share for a total of Euros 200 million, the objective of which is to cover the potential delivery of shares derived from the increase in the value of the shares involved in the long-term variable incentive plan (see Share-based payments in this Note).

Within the Strategic Plan 2018-2022, The Board of Directors of Naturgy Energy Group, S.A. approved a treasury shares buy-back programme, which was published on 6 December 2018, with a maximum investment of Euros 400 million to 30 June 2019, representing approximately 1.8% of share capital, which may be redeemed if such is decided by the shareholders at the annual general meeting to be held in the first half of 2019. At 31 December 2018, a total of 5,397,737 treasury shares had been acquired under this programme at an average price of Euros 22.42 per share, representing a total cost of Euros 121 million.

At a meeting held on 29 January 2019, the Board of Directors of Naturgy Energy Group, S.A. agreed to propose to the general shareholders' meeting a capital reduction in Naturgy Energy Group, S.A. in the amount resulting from the sum of:

- a) Euros 3 million through the redemption of 2,998,622 treasury shares with a par value of Euro 1 each which had been acquired at the close of trading on 6 December 2018.
- b) the aggregate par valued, up to a maximum of Euros 16 million, of the 16,000,000 additional shares with a par value of one euro each which, where applicable, are acquired for redemption by the Company under the treasury share buyback programme approved by the Company under Regulation (EU) No. 596/2014 on market abuse and disclosed as price-sensitive information on 6 December 2018.

Movements during 2018 and 2017 involving the treasury shares of Compañía General de Electricidad, S.A. and CGE Gas Natural, S.A. are as follows:

	Number of shares		In million euro
	Compañía General de Electricidad, S.A.	CGE Gas Natural, S.A.	
At 1 January 2017	8,695,395	8,695,395	8
Acquisitions	6,466,178	5,373,555	9
Disposals and other	(8,695,395)	(8,695,395)	(8)
At 31 December 2017	6,466,178	5,373,555	9
Acquisitions	4,087,225	-	4
Disposals and other	(6,466,178)	(5,373,555)	(9)
At 31 December 2018	4,087,225	-	4

The shares recorded in 2016 were acquired following the merger in which Compañía General de Electricidad, S.A. was absorbed into Gas Natural Chile, S.A., as a result of which the shareholders of both companies obtained a right of withdrawal under which they were able to sell their shares to the company. This right was exercised by 44 shareholders holding 8,695,395 shares in Compañía General de Electricidad, S.A., equivalent to 0.4% of capital.

The shares recorded in 2017 were acquired from shareholders that held rights of withdrawal following the mergers by absorption of Transet, S.A., Emel Norte, S.A. and Emelat Inversiones, S.A. into Compañía General de Electricidad on 8 February 2017 and 27 July 2017, and following the merger by absorption of Gas Natural Chile, S.A. into CGE Gas Natural, S.A. on 31 May 2017.

On 30 November 2017 an extraordinary shareholders' meeting was held by Compañía General de Electricidad S.A. which approved the merger between the company and its subsidiaries CGE Distribución S.A., Compañía Nacional de Fuerza Eléctrica, S.A. and Empresa Eléctrica Atacama, S.A. As a result of this operation the shareholders of both companies were allowed a right of withdrawal, under which they could sell their shares to the company. This right was exercised by 60 shareholders holding 1,936,176 shares.

On 31 May 2018 an extraordinary shareholders' meeting was held which approved the merger by absorption of Empresa Eléctrica de Arica S.A., Empresa Eléctrica de Iquique S.A. and Empresa Eléctrica de Antofagasta S.A. into Compañía General de Electricidad S.A. As a result of this operation the shareholders of both companies were allowed a right of withdrawal, under which they could sell their shares to the company. This right was exercised by 66 shareholders holding 2,151,049 shares.

Treasury shares resulting from the right of withdrawal must be disposed of in the securities market within a maximum of one year, at the end of which they must be redeemed if they have not been sold. During 2018 capital was reduced as a matter of law since 6,466,178 treasury shares has not been subscribed within the term of one year as from their payment date.

Earnings per share

The earnings per share are calculated by dividing the net income attributable to the equity holders of the parent Company by the average weighted number of ordinary shares in circulation during the year.

	At 31.12.18	At 31.12.17
Profit attributable to equity holders of the parent company	(2,822)	1,360
Weighted average number of ordinary shares in issue	997,663,816	1,000,478,210
Earnings per share from continuing operations (in euro):		
- Basic	(2.86)	0.94
- Diluted	(2.86)	0.94
Earnings per share from discontinued activities (in euro):		
- Basic	0.03	0.42
- Diluted	0.03	0.42

The average weighted number of ordinary shares used in the calculation of earnings per share in 2018 and 2017 is as follows:

	2018	2017
Weighted average number of ordinary shares	1,000,689,341	1,000,689,341
Weighted average number of treasury shares	(3,025,525)	(211,131)
Weighted average number of shares in issue	997,663,816	1,000,478,210

The basic earnings per share coincide with the diluted ones, since there were no instruments that could be converted into ordinary shares during those years and at the end of the year 2018 the conditions to consider the actions corresponding to the incentive described in the section “Shares based payments” in the calculation of diluted earnings were not met.

Dividends

Set out below is a breakdown of the payments of dividends made in 2018 and 2017:

	31.12.18			31.12.17		
	% of Nominal	Euros per share	Amount	% of Nominal	Euros per share	Amount
Ordinary shares	140%	1.40	1,400	100%	1.00	1,001
Other shares (without voting rights, redeemable, etc.)	-	-	-	-	-	-
Total dividends paid	140%	1.40	1,400	100%	1.00	1,001
a) Dividends charged to income statement	140%	1.40	1,400	100%	1.00	1,001
b) Dividends charged to reserves or share premium account	-	-	-	-	-	-
c) Dividends in kind	-	-	-	-	-	-

Additionally, dividends paid to non-controlling shareholders in 2018 amounted to Euros 576 million (Euros 283 million in 2017). See “Non-controlling interests” in this Note, with which dividend payments have amounted to Euros 1,976 million (Euros 1,284 million in 2017).

2018

The proposal for the application of the result for the year 2017 approved by the General Shareholders Meeting held on 27 June 2018 included a complementary dividend of Euros 0.670 per share for a total of Euros 670 million, paid entirely in cash on 05 July 2018.

On 24 July 2018 the Naturgy Energy Group, S.A. Board of Directors approved the payment of an interim dividend out of 2018 profits of Euros 0.28 per share, for a total of Euros 280 million, paid on 31 July 2018.

Naturgy Energy Group, S.A. had sufficient liquidity to pay the dividend at the approval date in accordance with the Spanish Companies Act. The provisional liquidity statement drawn up by the Directors on 30 June 2018 is as follows:

Profit after tax	5,597
Reserves to be replenished	-
Maximum amount distributable	5,597
Forecast interim dividend payment	280
Cash resources	2,564
Undrawn credit facilities	6,555
Total liquidity	9,119

On 31 October 2018, the Company's Board of Directors resolved to pay an interim dividend of Euros 0.45 per share out of 2018 results for a total of Euros 450 million, which was paid on 27 November 2018 with respect to the outstanding shares at that date.

The Company had sufficient liquidity to pay out the dividend at the approval date, with the necessary liquidity to proceed to payment pursuant to the Spanish Companies Act. The provisional liquidity statement drawn up by the Directors on 30 September 2018 is as follows:

Profit after tax	5,542
Reserves to be replenished	-
Maximum amount distributable	5,542
Interim dividend 2018 profits	280
Forecast interim dividend payment	450
Cash resources	757
Undrawn credit facilities	6,551
Total liquidity	7,308

On 29 January 2019, the Board of Directors approved the following proposal for the distribution of the Company's net profit for 2018, for submission to the Annual General Meeting:

Available for distribution

Available for distribution 5,282

Distribution:

To dividends: the gross aggregate amount shall be equal to the sum of the following quantities:

- (i) Euros 730 million relating to the two interim dividends for 2018 paid by Naturgy Energy Group, S.A., equivalent jointly to Euros 0.73 per share by the number of shares that were not direct treasury shares on the relevant dates; and
- (ii) the amount obtained by multiplying Euros 0.57 per share by the number of shares that are not direct treasury shares on the date on which the registered shareholders entitled to receive the complementary dividend are determined.

The supplementary dividend will be paid through entities participating in Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U. (Iberclear), and the Board of Directors is expressly empowered to delegate its powers to the director(s) it deems so that they may perform all the actions required to carry out the distribution and, in particular, without limitation, so that they may (i) set the date on which the shareholders entitled to receive the dividend are determined and the date of payment; (ii) determine the definitive amount of the supplementary dividend, and (iii) designate the entity that is to act as payment agent.

To voluntary reserves Determinable amount obtained by subtracting the dividend amount from the distribution base.

Total distributed 5,282

This proposal for the distribution of profits prepared by the Board for approval by the Annual General Meeting includes as supplementary payment of Euros 0.57 per share for each qualifying share outstanding at the proposed date of payment, 20 March 2019. In this respect, in the event that at the time of distribution of the third and last payment of the proposed 2018 dividend (Euros 0.57 per share) the same number of treasury shares is maintained as at the 2018 year end (5,397,737 shares excluding shares covering the LTI, see section on Treasury shares), the amount applied to voluntary reserves would be Euros 3,985 million.

2017

The General Shareholders Meeting held on 20 April 2017 approved a complementary dividend of Euros 0.670 per share for a total of Euros 671 million, paid on 27 June 2017.

On 25 July 2017 the Board of Directors approved the payment of an interim dividend out of 2017 profits of Euros 0.330 per share, for a total of Euros 330 million, paid on 27 September 2017.

Other equity items

Movements in equity items break down as follows:

	Fair value financial assets	Hedging operations	Tax effect	Total asset and liability revaluation reserves	Currency translation differences	Total
1.1.2017	9	68	(23)	54	(183)	(129)
Change in value	(54)	(117)	13	(158)	(729)	(887)
Taken to income statement	-	2	1	3	13	16
Other	-	-	-	-	-	-
31.12.2017	(45)	(47)	(9)	(101)	(899)	(1,000)
Impact first application of new standards (Note 3.5)	(16)	-	2	(14)	-	(14)
31.12.2017	(61)	(47)	(7)	(115)	(899)	(1,014)
Change in value	(183)	(24)	2	(205)	(212)	(417)
Taken to income statement	-	100	(15)	85	50	135
Other	22	-	-	22	-	22
31.12.2018	(222)	29	(20)	(213)	(1,061)	(1,274)

The heading “Currency translation differences” includes the exchange differences described in Note 3.4.2 as a result of the euro’s fluctuation against the main currencies of Naturgy’s foreign companies. This heading also includes the effect of the restatement of the financial statements of companies in hyperinflationary economies.

Non-controlling interests

	Non-controlling interests
Balance at 0./01.2017	3,780
Total comprehensive income for the year	162
Distribution of dividends	(233)
Sale of Gas Natural, S.A. ESP (Note 11)	(73)
Payments return on other equity instruments	(58)
Other changes	(7)
Balance at 31.12.2017	3,571
Impact of first application of new standards (Note 3.5)	(13)
Balance at 01.01.2018	3,558
Total comprehensive income for the year	210
Distribution of dividends	(505)
Payments return on other equity instruments	(58)
Sale of 20% of gas distribution business in Spain without loss of control (Note 3.4.1)	458
Sale of Kangra Coal Proprietary Limited (Nota 11)	(9)
Other changes	(7)
Balance at 31.12.2018	3,647

The most significant movements for 2018 relate to:

- On 3 August 2017 Naturgy signed an agreement with a consortium formed by Allianz Capital Partners and Canada Pension Plan Investment Board to sell a 20% interest in the natural gas distribution business in Spain for an amount of Euros 1,500 million.

On 19 March 2018, once the necessary regulatory and competition approvals were completed, Naturgy transferred 20% of the shares in Holding de Negocios de Gas, S.A. to said consortium. As the transaction involves a sale of non-controlling interests not leading to a loss of control, it has been recorded as an equity transaction, entailing an increase of Euros 458 million in Non-controlling interests and an increase in Reserves of Euros 1,016 million.

- Derecognition of non-controlling interests corresponding to Kangra Coal Proprietary Limited (mining business in South Africa) as a result of the sale in December 2018 (Note 11).
- Other changes:

As a result of the redemption of treasury shares in Chile, the heading Non-controlling interests has been reduced by Euros 5 million.

The most significant movements for 2017 relate to:

- Derecognition of non-controlling interests pertaining to Gas Natural S.A. ESP due to the sale of 17.2% and loss of control at 31 December 2017 (Note 11).
- Other changes:

As a result of the redemption of treasury shares in Chile, the heading Non-controlling interests has been reduced by Euros 5 million.

Subordinated perpetual debentures

In previous years, Naturgy Finance, B.V. issued the following perpetual subordinated debentures for an aggregate amount of Euros 1,500 million.

Issuance	Nominal	Early redemption option	Coupon
November 2014	1,000	2022	4,125%
April 2015	500	2024	3,375%

Interest accrued on these debentures is not payable but rather is cumulative. Nonetheless, Naturgy must pay it if dividends are paid out or the decision to exercise the early redemption option is taken.

Although no contractual maturity has been established for these debentures, Naturgy Finance, B.V. has the option to redeem them early on the early redemption option date and subsequently, on every interest payment date.

Naturgy recognised the cash received in “Non-controlling interests” under equity in the consolidated balance sheet on the understanding that the issues did not meet the conditions to be considered as a financial liability, because Naturgy Finance B.V. does not have a contractual commitment to hand over cash or any other financial asset nor any obligation to exchange financial assets or liabilities; the circumstances whereby it would be obligated in this respect are entirely at the discretion of Naturgy Finance, B.V.

The interest accrued during 2018 and 2017 amounts to Euros 58 million and has been recognised in “Non-controlling interests” in the consolidated income statement for 2018 and 2017.

Preference shares

In 2005 Unión Fenosa Preferentes, S.A. carried out a preference share issue for a nominal amount of Euros 750 million, of which Euros 640 million was repurchased in 2015, the remainder still being in circulation.

Dividends are variable and non-cumulative, accruing interest at the 3-month Euribor plus a 1.65% spread. The dividend is paid per calendar quarter in arrears, subject to the existence of distributable profits in Naturgy, (considering as such the lower between the declared net profit of Naturgy and the net profit of Naturgy Energy Group, S.A. as guarantor) and the payment of a dividend by Naturgy Energy Group, S.A. In addition, Unión Fenosa Preferentes, S.A.U. has the option, but not the obligation, to pay the holders of the preference shares a benefit in kind by increasing their nominal value.

The shares are perpetual, with the option for the issuer to redeem them at nominal value.

Naturgy recognised the cash received in “Non-controlling interests” under equity in the consolidated balance sheet on the understanding that the issue did not meet the conditions to be considered as a financial liability, because Unión Fenosa Preferentes, S.A.U. does not have a contractual commitment to hand over cash or any other financial asset nor any obligation to exchange financial assets or liabilities; the circumstances whereby it would be obligated in this respect are entirely at the discretion of Unión Fenosa Preferentes, S.A.U.

Set out below is a breakdown of the most significant non-controlling interests:

Company	2018			2017		
	Attributed equity	Consolidated profit/(loss) for the year	Dividends and other remuneration	Attributed equity	Consolidated profit/(loss) for the year	Dividends and other remuneration
Metrogas, S.A.	545	24	29	596	27	15
Companhia Distribuidora de Gás do Rio de Janeiro, S.A.	145	17	24	176	41	25
Global Power Generation, S.A	105	1	32	84	(3)	14
Fuerza y Energía de Tuxpan S.A. de C.V.	116	10	-	101	9	-
Empresa de Distribución Eléctrica Metro Oeste, S.A.	92	(1)	-	89	8	-
Ecoeléctrica L.P.	75	6	31	102	17	-
Kangra Coal (Proprietary), Ltd	-	(35)	-	59	(2)	-
Europe Maghreb Pipeline, Ltd.	41	53	70	54	56	56
Gas Natural Mexico, S.A. de C.V.	44	1	7	61	7	1
Gas Natural, S.A. ESP	-	-	-	-	25	35
Ceg Río, S.A.	37	6	8	43	10	4
Aprovisionadora global de energía, S.A.	29	16	27	45	15	40
Nedgia Catalunya, S.A.	181	27	-	-	-	-
Nedgia Madrid, S.A.	53	9	-	-	-	-
Other companies (*)	572	32	289	549	67	42
Subtotal	2,035	166	517	1,959	277	232
Preference shares	110	2	1	110	2	1
Subordinated perpetual debentures	1,502	58	58	1,502	58	58
Other equity instruments	1,612	60	59	1,612	60	59
Total	3,647	226	576	3,571	337	291

* Includes in 2018 the payment dividends for an amount of Euro 265 million distributed by Holding de Negocios de Gas, S.A.

Dividends paid to non-controlling interests in 2018 amounted to Euros 576 million (Euros 283 million in 2017).

Set out below are financial highlights for the most significant non-controlling shareholdings (amounts at 100%):

Company	31 December 2018			31 December 2017		
	Total assets	Non-current liabilities	Current liabilities	Total assets	Non-current liabilities	Current liabilities
Metrogas, S.A.	1,986	(709)	(51)	2,138	(726)	(75)
Companhia Distribuidora de Gás do Rio de Janeiro, S.A.	787	(284)	(174)	853	(239)	(217)
Global Power Generation, S.A.	316	-	(74)	420	(4)	(80)
Fuerza y Energía de Tuxpan S.A. de C.V.	1,092	(131)	(56)	987	(117)	(43)
Empresa de Distribución Eléctrica Metro Oeste, S.A.	1,008	(291)	(399)	921	(321)	(294)
Ecoeléctrica L.P.	287	(4)	(12)	368	(3)	(7)
Kangra Coal (Proprietary), Ltd	-	-	-	295	(81)	(5)
Europe Maghreb Pipeline, Ltd.	186	(1)	(4)	256	(1)	(17)
Gas Natural Mexico, S.A. de CV	667	(237)	(138)	819	(202)	(211)
Gas Natural, S.A. ESP	-	-	-	-	-	-
Ceg Río, S.A.	234	(50)	(89)	271	(96)	(64)
Aprovisionadora global de energía, S.A.	108	(32)	(18)	151	(32)	(18)
Nedgia Catalunya, S.A.	1,207	(128)	(124)	-	-	-
Nedgia Madrid, S.A.	390	(46)	(59)	-	-	-

Appendix I contains a breakdown of Naturgy's investee companies, stating their activity and the percentage of the shareholding and equity interest.

The analysis performed to determine that Naturgy exercises control over the consolidated entities identified no cases requiring a complex judgement, since Naturgy is entitled to variable returns from its involvement in the investee and has the capacity to influence those returns through its power in the investee, based on Naturgy's representatives on the Board of Directors and its participation in significant decisions. Additionally, in general terms, there are no significant restrictions, such as protective rights, on Naturgy's capacity to access or utilise assets, or to settle liabilities.

Note 15. Deferred income

The breakdown and the movements under this heading in 2018 and 2017 have been as follows:

	Capital grants	Revenues from pipeline networks and branch lines	Other	Total
At 1.1.17	156	598	88	842
Amount received	4	48	2	54
Release to income	(10)	(25)	(7)	(42)
Currency translation differences	(2)	(3)	(2)	(7)
Assets and liabilities held for sale (Note 11)	(10)	-	-	(10)
Transfers and other	(17)	-	22	5
At 31.12.17	121	618	103	842
Amount received	1	52	4	57
Release to income	(9)	(24)	(9)	(42)
Currency translation differences (1)	-	2	8	10
Transfers and other	(3)	(1)	-	(4)
At 31.12.18	110	647	106	863

1. Others includes hyperinflation of Argentina (Note 3.3).

This heading mainly includes:

- Capital grants relating basically to agreements with the Regional Governments or other entities for the gasification or electrification of municipalities and other investments in gas infrastructure, for which Naturgy has met all the conditions established, are stated at the amount granted (Note 3.4.20).
- Income received for the construction of connection facilities for the gas or electricity distribution network (undertaken), which are recorded for the cash received, as well as assignments received for these facilities, which are recorded at their fair value, since both the cash and the facilities are received in consideration for an ongoing service of providing access to the network during the life of the facilities (Note 3.4.20).

Note 16. Provisions

The breakdown of provisions at 31 December 2018 and 2017 is as follows:

	At 31.12.18	At 31.12.17
Provisions for employee obligations	431	465
Other provisions	694	664
Non-current provisions	1,125	1,129
Current provisions	297	183
Total	1,422	1,312

Provisions for employee obligations

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

	2018			2017		
	Pensions and other similar obligations	Other obligations with personnel	Total	Pensions and other similar obligations	Other obligations with personnel	Total
At 1 January	455	10	465	479	10	489
Appropriations/reversals charged to income statement	24	(1)	23	23	9	32
Payments during the year	(28)	-	(28)	(29)	-	(29)
Currency translation differences	(11)	-	(11)	(10)	-	(10)
Changes recognised directly in equity	(15)	-	(15)	(5)	-	(5)
Transfers and other applications ⁽¹⁾	-	(3)	(3)	(3)	(9)	(12)
At 31 December	425	6	431	455	10	465

1. In 2017 mainly included transfers to "Non-current assets held for sale" at the date on which this classification is applied (Note 11).

Pensions and other similar obligations

The breakdown of the provisions for post-employment pension obligations by country is as follows:

Breakdown by country	At 31.12.18	At 31.12.17	At 01.1.2017
Spain ⁽¹⁾	311	342	368
Brazil ⁽²⁾	61	50	40
Chile ⁽³⁾	45	50	54
Mexico ⁽⁴⁾	6	11	11
Rest	2	2	6
Total	425	455	479

1) Pension plans and other post-employment benefits in Spain

Most of Naturgy's post-employment obligations in Spain consist of the contribution of defined amounts to occupational pension plan systems. Nevertheless, at 31 December 2018 and 31 December 2017, it held the following defined benefit obligations for certain groups of workers:

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

2) Pension Plans and Other post-employment benefits in Brazil

At 31 December 2018 and at 31 December 2017, the following benefits payable by Naturgy for certain employees in Brazil were still in effect:

- Defined post-employment benefits plan, covering retirement, death on the job and disability pensions and overall amounts.
- Post-employment healthcare plan.
- Other defined post-employment benefit plans that guarantee temporary pensions, life-time pensions and overall amounts depending on seniority.

3) Pension plans and Other post-employment benefits in Chile

At 31 December 2018 and at 31 December 2017, the following benefits payable by Naturgy for certain employees in Chile were still in effect:

- Termination benefits for employees due to retirement, dismissal or death, calculated based on length of service.
- Pension supplements for employees hired prior to 1992 in some electricity distribution companies.
- Length-of-service awards payable at 5, 10, 15, 20, 25 and 30 years of service.

4) Pension Plans and Other post-employment benefits in Mexico

At 31 December 2018 and at 31 December 2017, the following benefits payable by Naturgy for certain employees in Mexico were still in effect:

- Length-of-service award payable after 15 years of service
- Severance indemnity for employees without the service requirement, payable in the event of death at work, incapacity or redundancy.
- Severance indemnity equivalent to three months' salary plus 20 days' salary per year of service.
- Additional compensation only in the event of retirement equal to 1% of the base salary per year of service.

The breakdown of the provisions for pensions and liabilities, by country, recognised in the consolidated balance sheet and the fair value of the plan-related assets is as follows:

	2018				2017			
	Spain	Brazil	Chile	Mexico	Spain	Brazil	Chile	Mexico
Present value of obligations								
At 1 January	1,103	149	50	12	1,203	146	54	12
Service cost for the year	5	1	2	1	6	-	2	1
Interest cost	18	14	2	1	15	15	3	1
Changes recognised in equity	(47)	12	3	(6)	(47)	19	(1)	(1)
Benefits paid	(68)	(10)	(7)	-	(74)	(11)	(6)	-
Currency translation differences	-	(17)	(5)	-	-	(20)	(3)	(1)
Transfers and other	-	-	-	-	-	-	1	-
At 31 December	1,011	149	45	8	1,103	149	50	12
Fair value of plan assets								
At 1 January	761	99	-	1	835	106	-	1
Expected yield	11	9	-	-	9	11	-	-
Contributions	4	1	-	-	7	3	-	-
Changes recognised in equity	(21)	(2)	-	-	(29)	4	-	-
Benefits paid	(55)	(8)	-	1	(61)	(11)	-	-
Currency translation differences	-	(11)	-	-	-	(14)	-	-
Transfers and other	-	-	-	-	-	-	-	-
At 31 December	700	88	-	2	761	99	-	1
Provisions for pensions and similar obligations	311	61	45	6	342	50	50	11

The amounts recognised in the consolidated income statement for the above-mentioned pension plans are as follows:

	2018				2017			
	Spain	Brazil	Chile	Mexico	Spain	Brazil	Chile	Mexico
Service cost for the year	5	1	2	1	6	-	2	1
Past service cost	-	-	-	-	-	-	-	-
Interest cost	18	14	2	1	15	15	3	1
Expected return on plan assets	(11)	(9)	-	-	(9)	(11)	-	-
Total charge to the income statement	12	6	4	2	12	4	5	2

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

	2018				2017			
	Spain	Brazil	Chile	Mexico	Spain	Brazil	Chile	Mexico
1 to 5 years	1	-	-	-	2	-	-	-
5 to 10 years	16	-	26	1	22	2	28	3
More than 10 years	294	61	19	5	318	48	22	8
Provisions for pensions and similar obligations	311	61	45	6	342	50	50	11

The weighted average term of defined benefit commitments is as follows:

Years	2018				2017			
	Spain	Brazil	Chile	Mexico	Spain	Brazil	Chile	Mexico
Weighted average term of pension commitments	11.8	10.2	9.7	16.52	11.66	10.10	10.10	17.76

Movements in the liability recognised in the consolidated balance sheet are as follows:

	2018				2017			
	Spain	Brazil	Chile	Mexico	Spain	Brazil	Chile	Mexico
At 1 January	342	50	50	11	368	40	54	11
Charge against the income statement	12	6	4	2	11	4	5	2
Contributions paid	(17)	(3)	(7)	(1)	(19)	(3)	(6)	-
Changes recognised in equity	(26)	14	3	(6)	(18)	15	(1)	-
Transfers	-	-	-	-	-	-	1	(1)
Currency translation differences	-	(6)	(5)	-	-	(6)	(3)	(1)
Other	-	-	-	-	-	-	-	-
Business Combinations	-	-	-	-	-	-	-	-
Discontinued operations	-	-	-	-	-	-	-	-
At 31 December	311	61	45	6	342	50	50	11

The amount of cumulative actuarial gains and losses recognised directly in equity is negative by Euros 87 million in 2018 (Spain: negative by Euros 11 million, Brazil: negative by Euros 71 million, Chile: negative by Euros 3 million, and Mexico: negative by Euros 2 million). In 2017, the cumulative negative figure was Euros 102 million (Spain: negative by Euros 37 million, Brazil: negative by Euros 57 million, Chile: negative by Euros 4 million, and Mexico: negative by Euros 4 million).

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

	2018				2017			
	Spain	Brazil	Chile	Mexico	Spain	Brazil	Chile	Mexico
Financial assumptions	-	(3)	-	(2)	(23)	21	(2)	(1)
Demographic assumptions	-	-	-	-	-	-	-	-
Experience	(26)	13	3	(4)	5	1	1	-
Limits on assets	-	4	-	-	-	(7)	-	-
At 31 December	(26)	14	3	(6)	(18)	15	(1)	(1)

The main categories of assets, expressed as a percentage of the total fair value of the assets are as:

% of total	2018				2017			
	Spain	Brazil	Chile	Mexico	Spain	Brazil	Chile	Mexico
Shares	-	12%	-	-	-	14%	-	-
Bonds	100%	81%	-	100%	100%	79%	-	100%
Real estate and other assets	-	7%	-	-	-	7%	-	-

Real yields on the plan-related assets in 2018, relating basically to Spain and Brazil, have been Euros 21 million (Euros 21 million in 2017).

The main annual actuarial assumptions used were as follows:

	At 31.12.18				At 31.12.17			
	Spain	Brazil	Chile	Mexico	Spain	Brazil	Chile	Mexico
Discount rate ⁽¹⁾	0.3 a 2.39%	9.75%	2.05%	9.25%	0.0 a 2.25%	10.7%	1.9%	7.25%
Expected return on plan assets ⁽¹⁾	0.3 a 2.39%	9.75%	-	9.25%	0.0 a 2.25%	10.7%	-	7.25%
Future salary increases ⁽¹⁾	2.0%	5.55%	2.0%	5.5%	2.0%	7.7%	2.0%	5.5%
Future pension increases ⁽¹⁾	2.0%	4.5%	NA	3.4%	2.0%	5.5%	NA	3.4%
Inflation rate ⁽¹⁾	2.0%	4.5%	3.0%	4.0%	2.0%	5.5%	2.7%	4.0%
Mortality table	PERMF 2000	AT-2000	RV-2014	EMSSA 2009	PERMF 2000	AT-2000	RV-2014	EMSSA 2009
Life expectancy:								
Men								
Retired in the current year	22.9	20.5	19.4	22.7	22.9	20.45	18.36	22.56
Retiring within 20 years	42.9	37.9	37.0	39.7	42.7	37.94	35.57	39.53
Women								
Retired in the current year	27.4	23.0	24.1	25.1	27.4	23.02	23.24	25.04
Retiring within 20 years	48.8	41.4	42.8	44.9	48.6	41.44	41.89	44.81

1. annual

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

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

Benefits payable and estimated contributions to be made for 2018 in million euros are as follows:

	Benefits				Contributions			
	Spain	Brazil	Chile	Mexico	Spain	Brazil	Chile	Mexico
Post-employment	56	7	-	-	10	1	3	-
Post-employment medical	-	-	-	-	3	3	-	-
Long term	-	-	-	-	-	-	-	-
At 31 December	56	7	-	-	13	4	3	-

The following table includes the effect of a 1% variation in the inflation rate, a 1% change in the discount rate and a 1% change in the cost of healthcare over the provisions and actuarial costs:

	Inflation + 1%	Discount +1%	Healthcare +1%
Present value of obligations	110	(124)	20
Fair value of plan assets	10	(65)	-
Provision for pensions	90	(59)	20
Service cost for the year	1	(1)	-
Interest cost	3	8	1
Expected return on plan assets	-	(7)	-

Other obligations with personnel

Within the framework of the new Strategic Plan 2018-2022, a new long-term incentive plan has been implemented for Naturgy executives not included in the plan referred to in Note 14, the aim of which is to align the shareholders' interests, the materialization of the Strategic Plan and the executives' multi-year variable remuneration. This programme replaces the previous scheme, called PREMP, and is linked to the total return earned by the shareholders over the duration of the Strategic Plan, generating a collection right once the annual accounts for 2022 have been approved by the General Meeting, which will be collected in cash. At 31 December 2018 the provision for this commitment amounted to Euros 3 million.

At 31 December 2018 a provision has been recorded corresponding to the remuneration programmes 2016-2018 and 2017-2019 amounting to Euros 6 million (Euros 19 million at 31 December 2017 for the programmes 2015-2016, 2016-2018 y 2017-2019), of which Euros 3 million is classified as non-current in 2018 (Euros 10 million 2017).

Other current and non-current provisions

Movements in current and non-current provisions are as follows:

	Non-current provisions			Current provisions	Total
	Due to facility closure costs	Other provisions	Total		
At 1.1.17	414	345	759	158	917
Appropriations/reversals charged to income statement:					
– Appropriations due to financial update	6	2	8	-	8
– Appropriations charged to other results	-	16	16	125	141
– Reversals	(6)	(10)	(16)	-	(16)
Appropriations/reversals charged to fixed assets:					
Payments	(3)	(2)	(5)	(88)	(93)
Currency translation differences	(1)	(7)	(8)	(13)	(21)
Transfers and other (1)	(7)	(88)	(95)	1	(94)
At 31.12.17	408	256	664	183	847
Appropriations/reversals charged to income statement:					
– Appropriations due to financial update	7	16	23	-	23
– Appropriations charged to other results	-	52	52	222	274
– Reversals	(9)	(14)	(23)	-	(23)
Appropriations/reversals charged to fixed assets:					
Payments	(1)	-	(1)	(112)	(113)
Currency translation differences	(1)	(3)	(4)	(2)	(6)
Transfers and other	(23)	6	(17)	6	(11)
At 31.12.18	381	313	694	297	991

1. It mainly includes the transfer to “Non-current assets held for sale”, at the date on which this classification is applied (Note 11). In 2017 it also includes, in the amount of Euros 93 million, of the provision for the tax assessments related to export deductions in 2003-2005 as a result of the unfavourable judgement by the Supreme Court (Note 21), due to the offset made against balances to be refunded by the Spanish tax authorities.

The heading “Provisions due to facility closure costs” includes provisions for obligations arising from decommissioning, restoration and other costs related basically to electricity generation facilities.

The heading “Other provisions” mainly includes provisions recorded to cover obligations derived principally from tax claims, lawsuits and arbitration, insurance and other liabilities (Note 35). Provisions have been recorded during the year due to the development of certain civil, administrative and tax-related claims existing in various Group companies.

The item “Current provisions” relates mainly to CO₂ emissions estimated for the year in the amount of Euros 143 million at 31 December 2018 (Euros 66 million in 2017).

No provision for onerous contracts was deemed necessary at 31 December 2018 or 2017.

The estimated payment periods for the non current obligations provisioned in this item are Euros 368 million in between one and five years (Euros 215 million at 31 December 2017), Euros 151 million in between five and 10 years (Euros 98 million at 31 December 2017) and Euros 175 million after more than 10 years (Euros 351 million at 31 December 2017).

Note 17. Borrowings

The breakdown of borrowings at 31 December 2018 and 2017 is as follows:

	At 31.12.18	At 31.12.17
Issuing of debentures and other negotiable obligations	9,763	10,726
Borrowings from financial institutions	3,534	5,140
Derivative financial instruments (Note 18)	55	48
Other financial liabilities	-	2
Non-current borrowings	13,352	15,916
Issuing of debentures and other negotiable obligations	995	1,488
Borrowings from financial institutions	1,043	988
Derivative financial instruments (Note 18)	30	1
Other financial liabilities	11	66
Current borrowings	2,079	2,543
Total	15,431	18,459

Financial liabilities recognised at fair value at 31 December 2018 and at 31 December 2017 are classified as follows:

Financial liabilities	31 December 2018				31 December 2017			
	Level 1 (listed price on active markets)	Level 2 (observable variables)	Level 3 (non-observable variables)	Total	Level 1 (listed price on active markets)	Level 2 (observable variables)	Level 3 (non-observable variables)	Total
Fair value through profit or loss	-	-	-	-	-	-	-	-
Hedging derivatives	-	85	-	85	-	49	-	49
Total	-	85	-	85	-	49	-	49

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

	Carrying amount		Fair value	
	At 31.12.18	At 31.12.17	At 31.12.18	At 31.12.17
Issuing of debentures and other negotiable securities	9,763	10,726	10,529	11,776
Loans from financial institutions and other financial liabilities	3,534	5,142	3,570	5,176

Listed bond issues and other negotiable obligations are quoted in such a way that their fair value is estimated according to their quotation (Level 1). Of the borrowings from financial institutions and other financial liabilities, the fair value of the debts with fixed interest rates is determined which is estimated on the basis of discounted cash flows over the remaining terms of said debt. The discount rates were determined based on market rates available at 31 December 2018 and 31 December 2017 on borrowings with similar credit and maturity characteristics. These valuations are based on the quotation price of similar financial instruments in an official market or on observable information in an official market (Level 2).

The following tables describe consolidated gross borrowings by instrument at 31 December 2018 and 31 December

2017 and their maturity profile, taking into account the impact of the derivative hedges.

	2019	2020	2021	2022	2023	2024 and later years	Total
At 31 December 2018:							
Issuing of debentures and other negotiable securities							
Fixed	992	959	1,203	512	778	6,221	10,665
Floating	4	-	89	-	-	-	93
Institutional Banks and other financial institutions							
Fixed	95	115	158	125	91	1,143	1,727
Floating	131	131	90	70	36	29	487
Commercial Banks and other financial liabilities							
Fixed	128	226	177	297	228	7	1,063
Floating	729	367	181	42	77	-	1,396
Total Fixed	1,215	1,300	1,538	934	1,097	7,371	13,455
Total Floating	864	498	360	112	113	29	1,976
Total	2,079	1,798	1,898	1,046	1,210	7,400	15,431

	2018	2019	2020	2021	2022	2023 and later years	Total
At 31 December 2017:							
Issuing of debentures and other negotiable securities							
Fixed	1,426	1,234	1,137	1,436	768	6,150	12,151
Floating	63	-	-	-	-	-	63
Institutional Banks and other financial institutions							
Fixed	185	150	170	170	137	1,272	2,084
Floating	80	76	76	78	57	28	395
Commercial Banks and other financial liabilities							
Fixed	64	163	350	114	185	3	879
Floating	725	517	944	231	470	-	2,887
Total Fixed	1,675	1,547	1,657	1,720	1,090	7,425	15,114
Total Floating	868	593	1,020	309	527	28	3,345
Total	2,543	2,140	2,677	2,029	1,617	7,453	18,459

Had the impact of the derivatives on borrowings been excluded, the financial debt at fixed rate would amount to Euros 11,801 million at 31 December 2018 (Euros 13,008 million at 31 December 2017) and, at floating rates, Euros 3,545 million at 31 December 2018 (Euros 5,403 million at 31 December 2017).

The following table describes consolidated gross financial debt denominated by currency at 31 December 2018 and 31 December 2017 and its maturity profile, taking into account the impact of the derivative hedges:

	2019	2020	2021	2022	2023	2024 and later years	Total
At 31 December 2018:							
Euro debt	1,216	1,240	1,429	684	960	6,453	11,982
Foreign Currency Debt:							
US Dollar	394	24	97	106	1	2	624
Chilean peso	244	340	232	171	246	789	2,022
Mexican peso	102	48	89	44	-	120	403
Brazilian real	97	137	50	41	3	36	364
Colombian peso	1	-	-	-	-	-	1
Argentinian peso	25	9	1	-	-	-	35
Total	2,079	1,798	1,898	1,046	1,210	7,400	15,431

	2018	2019	2020	2021	2022	2023 and later years	Total
At 31 December 2017:							
Euro debt	1,634	1,626	1,863	1,864	1,411	6,710	15,108
Foreign Currency Debt:							
US Dollar	230	175	272	93	102	3	875
Chilean peso	414	194	334	71	62	689	1,764
Mexican peso	128	41	43	-	42	51	305
Brazilian real	108	89	157	-	-	-	354
Colombian peso	-	1	-	-	-	-	1
Argentinian peso	29	14	8	1	-	-	52
Total	2,543	2,140	2,677	2,029	1,617	7,453	18,459

Borrowings in euros in 2018 have borne an effective average interest rate of 2.32% (2.96% in 2017) while borrowings in foreign currency have borne an effective average interest rate of 6.58% in 2018 (6.03% in 2017) including derivative instruments assigned to each transaction.

At 31 December 2018, Naturgy has credit facilities totalling Euros 5,468 million (Euros 7,796 million at 31 December 2017), of which Euros 5,234 million has not been drawn down (Euros 7.283 million at 31 December 2017).

Bank borrowings totalling Euros 2,784 million (Euros 2,687 million at 31 December 2017) and bonds issued for an amount of Euro 50 millions are subject to the fulfilment of certain financial ratios.

Most of the drawn-down borrowings include a clause relating to a change in control, the activation of which depends on the simultaneity of some of the following events: the non-permanence of any of the current reference shareholders in a significant percentage; the loss of investment grade status from the Rating Agencies, or the incapacity to meet the financial obligations under the contract.

Specifically, the bonds issued, in a volume of Euros 9,708 million, could be redeemed in advance provided that such a change in control triggers a downgrade of more than two full notches in at least two of the three ratings that it had obtained, and all the ratings fall below investment grade, and provided that the rating agency states that the rating downgrade results from the change in control.

There are also loans for an amount of Euros 2,014 million that could be subject to early repayment in the event of a change in control (Euros 2,851 million at 31 December 2017). Most of this amount is linked to infrastructure financing with funds from the European Investment Bank that require a rating downgrade in addition to the change in control, and have special repayment terms that are longer than those relating to early termination events.

At the preparation date of these consolidated annual accounts, Naturgy is not in breach of its financial obligations or of any type of obligation that could give rise to the early maturity of its financial commitments.

Naturgy is in the process of optimising the financing assigned to each of the business units to increase visibility in the accounts and financial autonomy in the same currency as that in which the cash flows originate, and obtain greater flexibility.

We set out below the most relevant financial instruments:

Issuing of debentures and other negotiable securities

In 2018 and 2017 the evolution of the issues of debt securities has been as follows:

	At 31.12.2017	IFRS 9	At 1.1.2018	Issuances	Buy-backs or redemptions	Adjustments, exch. rates & other	At 31.12.2018
Issued in a European Union Member State which required the filing of a prospectus	10,958	(48)	10,910	6,478	(8,026)	(73)	9,289
Issued in a European Union Member State which did not require the filing of a prospectus	-	-	-	-	-	-	-
Issued outside a European Union Member State	1,256	-	1,256	389	(187)	11	1,469
Total	12,214	(48)	12,166	6,867	(8,213)	(62)	10,758

	At 1.1.2017	Issuances	Buy-backs or redemptions	Adjustments, exch. rates & other	At 31.12.2017
Issued in a European Union Member State which required the filing of a prospectus	10,262	6,694	(5,794)	(204)	10,958
Issued in a European Union Member State which did not require the filing of a prospectus	-	-	-	-	-
Issued outside a European Union Member State	1,399	-	(8)	(135)	1,256
Total	11,661	6,694	(5,802)	(339)	12,214

An analysis of the most relevant characteristics of the main issuance programmes for debentures and other negotiable securities by Naturgy is as follows, excluding the impact of accrued unpaid interest:

At 31 December 2018							
Programme/Company	Country	Year formalised	Currency	Programme limit	Drawn-down nominal amount	Available	Issuances per year
Euro Commercial Paper (ECP) programme							
Naturgy Finance B.V.	Netherlands	2010	Euros	1,000	-	1,000	6,478
European Medium Term Notes (EMTN) programme							
Gas Natural Capital Markets, S.A. and Naturgy Finance B.V.	Netherlands/Spain	1999	Euros	15,000	9,708	5,292	-
Negotiable bonds and Certificates Programme							
Empresa de Distribución Eléctrica	Panama	2010	USD	44	-	44	-
Metro-Oeste, S.A.	Brazil	2018	Brazilian real	25	25	-	30
Sobral I Solar energía SPE Ltda.	Brazil	2018	Brazilian real	25	25	-	29
Sertao I Solar energía SPE Ltda	Mexico	2011	Mexican peso	445	213	232	156
Gas Natural México S.A. de C.V.	Argentina	2015	Argentinian peso	12	-	12	-
Gas Natural BAN, S.A.	Chile	2015	Chilean peso	2,011	900	1,111	174
Grupo CGE							
At 31 December 2017							
Programme/Company	Country	Year formalised	Currency	Programme limit	Drawn-down nominal amount	Available	Issuances per year
Euro Commercial Paper (ECP) programme							
Naturgy Finance B.V.	Netherlands	2010	Euros	1,000	-	1,000	4,594
European Medium Term Notes (EMTN) programme and Naturgy Finance B.V.							
Gas Natural Capital Markets, S.A. and Naturgy Finance B.V.	Netherlands/Spain	1999	Euros	15,000	11,205	3,795	2,100
Empresa de Distribución Eléctrica	Panama	2010	USD	42	-	42	-
Metro-Oeste, S.A.	Mexico	2011	Mexican peso	422	180	242	-
Gas Natural México S.A. de C.V.	Argentina	2015	Argentinian peso	22	-	22	-
Gas Natural BAN, S.A.	Chile	2015	Chilean peso	1,924	771	1,153	-
Grupo CGE							

The breakdown of the nominal balance issued under the EMTN programme is as follows:

Issuance	Drawn-down nominal		Maturity	Coupon %
	31.12.2018	31.12.2017		
July 2009	339	500	2019	6,375
November 2009	590	631	2021	5,125
January 2010	579	686	2020	4,500
January 2010	-	513	2018	4,125
May 2011	237	500	2019	5,375
February 2012	-	586	2018	5,000
September 2012	355	434	2020	6,000
January 2013	462	600	2023	3,875
January 2013 ⁽¹⁾	204	204	2019	2,125
April 2013	491	750	2022	3,875
July 2013 ⁽²⁾	101	101	2023	3,974
October 2013	300	500	2021	3,500
March 2014	500	500	2024	2,875
May 2014	200	200	2023	2,625
January 2015	500	500	2025	1,375
April 2016	600	600	2026	1,250
April 2016	300	300	2021	0,515
January 2017	1,000	1,000	2027	1,375
April 2017	1,000	1,000	2024	1,125
October 2017	300	300	2029	1,875
November 2017	800	800	2025	0,875
January 2018	850	-	2028	1,500
Total	9,708	11,205		

1. CHF 250 million as nominal value.

2. NOK 800 million as nominal value

2018

In January 2018 Naturgy issued bonds under its EMTN programme for an amount of Euros 850 million maturing in 10 years and with a 1.5% coupon, the proceeds of which were used in a bond buy-back offer for Euros 916 million of debentures maturing between 2019 and 2023, which entailed a net disbursement of Euros 66 million.

On 22 October 2018, the company successfully repurchased bonds under its EMTN programme amounting to Euros 314 million with maturities between 2019 and 2021. Additionally, on 18 December 2018 a repurchase of Euros 19 million of a bond maturing in January 2020 with a coupon of 4.50% was completed.

In 2018 two bonds have matured for a total amount of Euros 1,099 million and with an average coupon of 4.59%.

In March 2018, Gas Natural México S.A. de C.V. issued Euros 156 million through 3-year bonds at floating interest consisting of the interbank interest rate (TIIE) plus 0.40%, and 7-year bonds with fixed interest of 8.89%.

In October 2018, Sobral I Solar Energia SPE S.A. and Sertao I Solar Energia SPE S.A. issued bonds amounting to Euros 59 million, of which Euros 30 million are at 15 years and 3 months at a floating interest rate consisting of the NTN-B rate (linked to the IPCA inflation rate) plus 1.95%, and the remainder at 14 years and 3 months at a variable interest rate consisting of the NTN-B plus 1.20%.

On 6 December 2018, Compañía General de Electricidad S.A, the Chilean subsidiary of Naturgy Energy Group, S.A.,

completed a bond issue for a total amount of 5 million Unidades de Fomento (UF), equivalent to Euros 174 million. The issue comprises two bond series: one series of 2 million UF (Euros 70 million) with a term of 7 years and an annual coupon of 1.95%, and another series of 3 million UF (Euros 104 million) with a term of 23 years and an annual coupon of 2.85%.

2017

In April 2017 bonds were issued under the EMTN programme for a value of Euros 1,000 million which was used to repurchase debentures amounting to Euros 1,000 million maturing in 2018, 2020 and 2021. In accordance with the applicable accounting criteria, the repurchase qualified as an exchange of debt, given that there had been no substantial changes in the debt instrument, so the carrying amount of the liability had been adjusted based on costs and commissions incurred.

However, according to the new interpretation under IFRS 9 in 2018, the carrying amount of the modification of the financial liability has been re-estimated (see Note 3.2).

Borrowings from financial institutions

European bank loans (commercial / institutional banks)

During 2018, Naturgy has used part of its cash surplus to repay practically all corporate bank financing, including Euros 1,660 million.

At 31 December 2018, bank borrowings include bank loans of Euros 102 million (Euros 1,644 million at 31 December 2017) while no credit lines had been utilised.

Concerning borrowings from institutional credit entities, the European Investment Bank (EIB) has granted financing to Naturgy in the amount of Euros 2,011 million which had been fully utilised at 31 December 2018 (Euros 2,240 million drawn down at 31 December 2017). In addition, borrowings are recorded from the Official Credit Institute (ICO) totalling Euros 200 million, arranged through loans maturing in 2029 at the latest (Euros 234 million at 31 December 2017).

Loans from Latin American credit institutions (commercial / institutional banks)

At 31 December 2018 borrowings from various Latin American financial institutions totalled Euros 2,264 million (Euros 2,012 million at 31 December 2017). The geographic breakdown of these loans is as follows:

Country	31.12.2018	31.12.2017
Chile	1,163	1,034
Panama	524	475
Brazil	314	354
Mexico	190	126
Peru	55	-
Colombia	1	1
Other	17	22
	2,264	2,012

All borrowings from credit institutions in Latin America at 31 December 2018, relate to commercial banks.

Note 18. Risk management and derivative financial instruments

Risk management

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

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

On 23 June 2016 UK voters supported the departure of their country from the European Union (“Brexit”). The referendum has caused significant uncertainty about the future of relations between the United Kingdom and the European Union, including the laws and regulations that will apply since the United Kingdom will determine which European laws it will replicate or replace in the event of its departure. The development of the negotiations has had and may continue to have adverse effects on global economic conditions and the stability of global financial markets.

Interest rate risk

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

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

Naturgy employs financial swaps to manage exposure to interest rate fluctuations, swapping floating rates for fixed rates.

The financial debt structure at 31 December 2018 and 2017 (Note 17), after taking into account the hedges arranged through derivatives, is as follows:

	At 31.12.18	At 31.12.17
Fixed interest rate	13,455	15,114
Floating interest rate	1,976	3,345
Total	15,431	18,459

The floating interest rate is mainly subject to the fluctuations of the EURIBOR, the LIBOR and the indexed rates of Mexico, Brazil, Argentina and Chile.

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

	Increase/decrease in interest rates (basis points)	Effect on profit before tax	Effect on equity before tax
2018	+50	(10)	52
	-50	10	(52)
2017	+50	(17)	133
	-50	17	(133)

Exchange rate risk

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

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

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

For open positions, the risks in investments in non-functional currencies are managed through financial swaps and foreign exchange fluctuation insurance within the limits approved for hedging instruments.

The non-Euro currency with which Naturgy operates most is the US Dollar. The sensitivity of the Naturgy's profits and consolidated equity ("Other equity items") to a 5% variation (increase or decrease) in the US dollar/euro exchange rate is as follows:

		Effect on profit before tax	Effect on equity before tax
2018	+5%	-	13
	-5%	-	(13)
2017	+5%	-	7
	-5%	-	(7)

Additionally, net assets of foreign companies that have a non-euro functional currency are subject to foreign exchange risk when their financial statements are translated to euros during the consolidation process. Exposure to risk countries where there is more than one exchange rate is immaterial. At 31 December 2018 Naturgy's equity denominated in Argentinian pesos totals Euros 155 million (Euros 44 million at 31 December 2017) representing a pre-tax impact on equity of Euros 8 million at 5% sensitivity (Euros 2 million at 31 December 2017).

Commodity price risk

A large portion of Naturgy's operating expenses are linked to gas purchased to supply customers or generate electricity at combined cycle plants. Therefore, Naturgy is exposed to the variation in commodity prices whose determination is basically subject to crude oil prices and those of its by-products and the prices of natural gas hubs.

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

In electricity and CO₂ emission allowances trading by Naturgy, risk is insignificant due to the low volume of transactions and the established limits placed, both on the amount and maturity date.

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

	Increase/decrease in the purchase price of gas	Effect on profit before tax	Effect on equity before tax
2018	+10%	-	(23)
	-10%	-	23
2017	+10%	-	(16)
	-10%	-	16

	Increase / decrease in the electricity sale price	Effect on profit before tax	Effect on equity before tax
2018	+10%	-	9
	-10%	-	(9)
2017	+10%	-	12
	-10%	-	(12)

Naturgy has no relevant investments in upstream businesses or commodities production, therefore a low price scenario in commodities would have no significant impact on asset values.

Business segment sensitivity to the prices of oil, gas, coal and electricity is explained below:

- Gas and electricity distribution. It is a regulated activity with revenue and profit margins are linked to distribution infrastructure management services rendered, irrespective of the prices of the commodities distributed. In any event, a fall in the price of gas could increase consumption, having a favourable impact on revenue and thus contributing to the stability of Naturgy's results.
- Gas and electricity. Profit margins on gas and electricity supply activities are directly affected by commodity prices. In this regard, Naturgy has a risk policy that stipulates the tolerance range, based on applicable risk limits, among other aspects. Measures employed to keep risk within the stipulated limits include active supply management, balanced acquisitions and sales formulae, and specific hedging so as to maximise the risk-profit relationship.

Credit risk

Credit risk is defined as the potential loss resulting from the possible nonfulfillment of the contractual obligations of counterparties with which the Group does business.

Naturgy performs solvency analyses on the basis of which credit limits are assigned and any necessary provisions are determined. Based on these models, the probability of customer default can be measured and the expected commercial loss can be kept under control. In addition, credit quality and portfolio exposure are monitored on a recurring basis to ensure that potential losses are within the limits provided for by internal regulations. This allows a certain capacity to anticipate events in credit risk management.

With regard to credit risk in relation to trade receivables, these are reflected in the consolidated balance sheet net of provisions for impairment due to expected credit losses (Note 10) estimated by Naturgy on the basis of available information on past events (such as customer payment behaviour), current conditions and forward-looking factors (e.g. macroeconomic factors such as GDP, unemployment, inflation, interest rates, etc.) that might impact the credit risk of Naturgy's debtors in accordance with the prior segregation of customer portfolios.

Credit risk relating to trade accounts receivable is historically limited given the short collection periods of customers that do not individually accumulate significant amounts before supply can be suspended due to non-payment, in accordance with applicable regulations.

With respect to other exposures to counterparties in transactions involving financial derivatives and the investment of cash surpluses, credit risk is mitigated by carrying out such operations with reputable financial institutions whose rating is equal or over "BB". No significant defaults or losses arose in 2018 or 2017.

The main guarantees negotiated are bank guarantees, guarantees and deposits. At 31 December 2018, Naturgy had received guarantees totalling Euros 39 million to cover the risk of large industrial customers (Euros 41 million at 31 December 2017). In 2018, bank guarantees amounting to Euros 4 million were enforced (Euros 2 million at 31 December 2017).

At 31 December 2018 and 2017 Naturgy did not have significant concentrations of credit risk. The risk of concentration is minimised through diversification, managing and combining various areas of impact. Firstly, by having a customer base that is broadly distributed on an international scale; secondly, a diverse product range, from energy supply to the implementation of tailored energy solutions; thirdly, there are different customer types, such as residential customers, self-employed entrepreneurs and small and large businesses in both the public and private sectors and in different segments of the economy.

An ageing analysis of financial assets and related expected losses at 31 December 2018 is set out below:

31 December 2018	Total	Current	0-180 days	180-360 days	More than 360 days
Expected loss ratio	15.0%	1.3%	20.2%	87.6%	95.3%
Trade receivables for sales and provisions of services	5,204	4,156	338	87	623
Expected loss	789	44	69	77	599

The impaired financial assets are broken down in Note 10.

Concerning supplier credit risk, the solvency of each supplier of products and services is guaranteed through the recurring analysis of their financial information, particularly prior to new engagements. To this end, the relevant assessment criteria are applied depending on the supplier's criticality in terms of service or concentration. This procedure is supported by control mechanisms and systems and supplier management.

Liquidity risk

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

Available cash resources at 31 December 2018 and 2017 are analysed below:

Liquidity source	Availability 2018	Availability 2017
Undrawn credit facilities (Note 17)	5,234	7,283
Undrawn loans	-	42
Cash and cash equivalents (Note 13)	1,716	3,225
Total	6,950	10,550

There is also additional capacity to issue debt in the capital markets unused for Euros 7,691 million (Note 17)..

The breakdown of the maturities of the financial liabilities at 31 December 2018 and 2017 is as follows:

	2019	2020	2021	2022	2023	2024 and later years	Total
At 31 December 2018							
Trade and other payables	(4,067)	-	-	-	-	-	(4,067)
Loans and other financial payables	(2,501)	(2,280)	(2,351)	(1,480)	(1,325)	(9,017)	(18,954)
Financial derivatives	-	(1)	-	4	(15)	(25)	(37)
Other liabilities	(202)	(125)	(118)	(110)	(104)	(732)	(1,391)
Total¹	(6,770)	(2,406)	(2,469)	(1,586)	(1,444)	(9,774)	(24,449)

	2018	2019	2020	2021	2022	2023 and later years	Total
At 31 December 2017							
Trade and other payables	(3,920)	-	-	-	-	-	(3,920)
Loans and other financial payables	(3,121)	(2,723)	(3,205)	(2,519)	(2,071)	(8,744)	(22,383)
Financial derivatives	62	6	(2)	(5)	-	(30)	31
Other liabilities	(93)	(149)	(73)	(51)	(51)	(541)	(958)
Total¹	(7,072)	(2,866)	(3,280)	(2,575)	(2,122)	(9,315)	(27,230)

1. The amounts are undiscounted contractual cash flows and, accordingly, differ from the amounts included in the balance sheet and in Note 17.

Capital management

The main purpose of Naturgy's capital management is to ensure a financial structure that can optimise capital cost and maintain a solid financial position, in order to combine value creation for the shareholder with the access to the financial markets at a competitive cost to cover financing needs.

Naturgy considers the following to be indicators of the objectives set for capital management: maintaining, after the acquisition of Unión Fenosa, a long-term leverage ratio of approximately 50%.

Naturgy's long-term credit rating is as follows:

	2018	2017
Moody's	Baa2	Baa2
Standard & Poor's	BBB	BBB
Fitch	BBB	BBB+

Its leverage rating is as follows:

	2018	2017
Net borrowings:	13,667	15,154
Non-current borrowings (Note 17)	13,352	15,916
Current borrowings (Note 17)	2,079	2,543
Cash and cash equivalents (Note 13)	(1,716)	(3,225)
Derivatives (Note 18)	(48)	(80)
Equity:	14,595	18,305
Equity holders of the Company (Note 14)	10,948	14,734
Non-controlling interests (Note 14)	3,647	3,571
Leverage (Net borrowings / (Net borrowings + Net equity))	48.4%	45.3%

Derivative financial instruments

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

	At 31.12.18		At 31.12.17	
	Assets	Liabilities	Assets	Liabilities
Hedging derivative financial instruments	180	100	15	48
Cash flow hedge				
- Interest rate	-	26	14	17
- Interest rate and foreign exchange rate	18	29	-	25
- Price of commodities	162	45	-	-
Fair value hedge				
- Interest rate and foreign exchange rate	-	-	1	6
Other financial instruments	-	-	-	-
Derivative financial instruments – non current	180	100	15	48
Hedging derivative financial instruments	61	98	99	85
Cash flow hedge				
- Interest rate	-	9	1	-
- Interest rate and foreign exchange rate	18	14	43	-
- Exchange rate	10	7	18	1
- Price of commodities	33	68	32	83
Fair value hedge				
- Interest rate and foreign exchange rate	-	-	-	-
- Exchange rate	-	-	5	1
Other financial instruments	14	19	4	6
- Price of commodities	8	19	4	6
- Exchange rate	6	-	-	-
Derivative financial instruments current	75	117	103	91
Total	255	217	118	139

The fair value of derivatives is determined based on observable variables in an active market (Level 2).

“Other financial instruments” includes the derivatives not qualifying for hedge accounting.

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

	2018		2017	
	Operating results	Financial results	Operating results	Financial results
Cash flow hedge	(50)	(55)	24	(23)
Fair value hedge	(6)	(5)	-	(15)
Other financial instruments	-	(2)	(3)	(2)
Total	(56)	(62)	21	(40)

The breakdown of derivatives at 31 December 2018 and 2017, their fair value and maturities of their notional values is as follows:

	Fair value	31.12.18 Notional value						Posteriores	Total
		2019	2020	2021	2022	2023			
Interest rate hedges:									
Cash flow hedges:									
Financial swaps (EUR)	(35)	95	844	63	141	91	1,392	2,626	
Options (EUR)	-	-	-	-	-	40	-	40	
Exchange rate hedges:									
Cash flow hedges:									
Foreign exchange insurance (USD)	4	278	-	-	-	-	-	278	
Foreign exchange insurance (GBP)	-	24	-	-	-	-	-	24	
Foreign exchange insurance (MXN)	(6)	167	-	-	-	-	-	167	
Foreign exchange insurance (AUD)	6	84	-	-	-	-	-	84	
Foreign exchange insurance (BRL)	(1)	54	-	-	-	-	-	54	
Fair value hedges:									
Foreign exchange insurance (BRL)	-	14	-	-	-	-	-	14	
Foreign exchange insurance (USD)	-	47	-	-	-	-	-	47	
Foreign exchange insurance (DHN)	-	5	-	-	-	-	-	5	
Foreign exchange insurance (EUR) ⁽¹⁾	-	52	-	-	-	-	-	52	
Interest rate and foreign exchange rate hedges:									
Cash flow hedges:									
Financial swaps (CHF)	16	204	-	-	-	-	-	204	
Financial swaps (NOK)	(27)	-	-	-	-	101	-	101	
Financial swaps (UF)	4	-	11	11	183	245	46	496	
Commodities hedges:									
Cash flow hedges:									
Commodities price derivatives (EUR)	(25)	270	7	-	-	-	-	277	
Commodities price derivatives (USD)	(22)	195	141	108	108	110	-	662	
Commodities price derivatives (AUD)	129	16	21	39	39	40	565	720	
Other:									
Commodities price derivatives (EUR)	(11)	7	-	-	-	-	-	7	
Commodities price derivatives (USD)	-	1	-	-	-	-	-	1	
Foreign exchange derivatives (USD)	6	439	-	-	-	-	-	439	
Total	38	1,952	1,024	221	471	627	2,003	6,298	

1. Arranged by companies using a functional currency other than the euro.

	Fair value	31.12.17 Notional value					Subsequent years	Total
		2018	2019	2020	2021	2022		
Interest rate hedges:								
Cash flow hedges:								
Financial swaps (EUR)	(9)	95	95	844	63	91	2,484	3,672
Financial swaps (USD)	1	228	-	-	-	-	-	228
Exchange rate hedges:								
Cash flow hedges:								
Foreign exchange insurance (USD)	8	647	-	-	-	-	-	647
Foreign exchange insurance (GBP)	-	30	-	-	-	-	-	30
Foreign exchange insurance (EUR) ⁽¹⁾	2	38	-	-	-	-	-	38
Foreign exchange insurance (COP)	(1)	54	-	-	-	-	-	54
Foreign exchange insurance (AUD)	-	-	42	-	-	-	-	42
Foreign exchange insurance (BRL)	8	60	-	-	-	-	-	60
Fair value hedges:								
Financial swaps (MXN)	-	-	-	-	-	-	-	-
Foreign exchange insurance (BRL)	-	19	-	-	-	-	-	19
Foreign exchange insurance (USD)	4	333	-	-	-	-	-	333
Foreign exchange insurance (DHN)	-	10	-	-	-	-	-	10
Foreign exchange insurance (EUR) ⁽¹⁾	-	69	-	-	-	-	-	69
Interest rate and foreign exchange rate hedges:								
Cash flow hedges:								
Financial swaps (CHF)	6	-	204	-	-	-	-	204
Financial swaps (MXN)	43	200	-	-	-	-	-	200
Financial swaps (NOK)	(25)	-	-	-	-	-	101	101
Financial swaps (COP)	-	-	-	-	-	-	-	-
Fair value hedges:								
Financial swaps (CLP)	(5)	-	-	-	160	-	-	160
Commodities hedges:								
Cash flow hedges:								
Commodities price derivatives (EUR)	20	149	8	-	-	-	-	157
Commodities price derivatives (USD)	(71)	342	115	9	9	18	24	517
Other:								
Commodities price derivatives (EUR)	(2)	4	-	-	-	-	-	4
Foreign exchange derivatives (USD)	-	-	-	-	-	-	-	-
Total	(21)	2,278	464	853	232	109	2,609	6,545

1. Arranged by companies using a functional currency other than the euro.

Note 19. Other current and non-current liabilities

The breakdown of this heading at 31 December 2018 and 2017 is as follows:

	At 31.12.18	At 31.12.17
Debt for finance lease contracts ⁽¹⁾	1,186	839
Deposits and guarantees deposits ⁽²⁾	210	206
Derivative financial instruments (see Note 18)	45	-
Other liabilities	99	165
Other non-current liabilities	1,540	1,210
Dividend payable	37	45
Expenses accrued pending payment	202	172
Debt for finance lease contracts (Note 1)	132	94
Derivative financial instruments (see Note 18)	11	2
Other liabilities ⁽³⁾	89	28
Other current liabilities	471	341
Total other liabilities	2,011	1,551

There are no significant differences between the carrying values and the fair values of the items in the account “Other non-current liabilities”.

1. Finance lease liabilities

The main finance lease liabilities recognised in this item at 31 December are as follows:

- In 2003 Naturgy acquired two gas transport tankers to transport liquefied natural gas with a capacity of 276,000 m³ through finance lease agreements. The duration of the contracts is 20 years, maturing in 2023.
- In 2007 and 2009 two 138,000 m³ tankers were acquired, together with Repsol, under 25-year time-charter agreements, extendable for consecutive 5-year periods. In 2014, Naturgy and Shell entered into an agreement, as part of the sale of the Repsol Group’s liquefied natural gas business, to obtain exclusive use of each of the two tankers, Naturgy using the tanker acquired in 2009 under a time charter expiring in 2029 and extendable for consecutive five-year periods.
- In March 2014, Naturgy acquired a 173,000 m³ tanker to carry liquefied natural gas under an 18-year finance lease expiring in 2032.
- In November 2016, Naturgy acquired two tankers to carry liquefied natural gas each with a capacity of 176.300 m³ under a 20-year finance lease expiring in 2036.
- In March and June 2018, Naturgy acquired two tankers to carry liquefied natural gas each with a capacity of 176.000 m³ each under a 20-year finance lease expiring in 2037.

Minimum lease payments are as follows:

	A 31.12.18			A 31.12.17		
	Nominal value	Discount	Present value	Nominal value	Discount	Present value
Less than 1 year	141	(9)	132	100	(6)	94
Between 1 and 5 years	564	(111)	453	402	(80)	322
More than 5 years	1,414	(681)	733	940	(423)	517
Total	2,119	(801)	1,318	1,442	(509)	933

The effective average interest rate on the liabilities for finance lease agreements at 31 December 2018 is 6.7% (6.6% at 31 December 2017).

2. Deposits and guarantees deposits

The item “deposits and guarantees deposits” basically includes amounts received from customers under contracts for the supply of electricity and natural gas, deposited with the competent Public Administrations (Note 10) as stipulated by law, and amounts received from customers to secure supplies of liquefied natural gas.

3. Other liabilities

This includes the purchase commitment (without a premium) made to Sinca Inbursa, S.A. de C.V. (Inbursa) on 22 September 2008 covering 14.125% of Gas Natural México, S.A. de C.V. and 14% of Sistemas de Administración, S.A. de C.V. The maturity date of this commitment is May 2019, when Inbursa will be able to offer all shares held at that time to Naturgy, which will be obligated to purchase them. The acquisition price will be the market value of each share, based on the investees' results. As a result of the commitment, this sale is recognized as a deferred payment and the repurchase commitment percentage is still allocated to the Parent company. The liability recognised in this item at 31 December 2018 totals Euros 69 million, representing the present value of the amount repayable (Euros 77 million at 31 December 2017).

Note 20. Trade and other payables

The breakdown at 31 December 2018 and 2017 is as follows:

	At 31.12.18	At 31.12.17
Trade payables	3,222	2,810
Trade payables with related parties (Note 33)	43	74
Amounts due to associates	2	1
Trade payables	3,267	2,885
Public Administrations	541	593
Derivative financial instruments (see Note 18)	76	88
Accrued wages and salaries	130	189
Other payables	20	18
Other payables	767	888
Current tax liabilities	33	147
Total	4,067	3,920

At 31 December 2018, Euros 38 million (Euros 110 million at 31 December 2017 paid in the first quarter of 2018) was recognised under the heading Accrued wages and salaries in relation to termination benefits resulting from agreements with employees to terminate their employment contracts, that will be paid in the first quarter of 2019.

The fair value and carrying value of these liabilities do not differ significantly.

Disclosure of deferrals of payment to suppliers Additional Provision 3 “Duty of disclosure” of Law 15/2010/5 July

The total amount of payments made during the year, with details of periods of payments, according to the maximum legal limit under Law 15/2010 of 5 July, which laid down measures against slow payers in Spain, is as follows:

	2018	2017
Total payments (Euro million)	13,457	12,256
Total payments outstanding (Euro million)	450	403
Average supplier payment period (days) ⁽¹⁾	22	25
Transactions paid ratio (days) ⁽²⁾	22	24
Transactions pending payment ratio (days) ⁽³⁾	23	34

1. Calculated on the basis of amounts paid and pending payment.

2. Average payment period in transactions paid during the year.

3. Average age, suppliers pending payment balance.

Note 21. Tax situation

Naturgy Energy Group, S.A. is the parent of Tax Consolidated Group 59/93, which includes all the companies resident in Spain that are at least 75% directly or indirectly owned by the parent company and that fulfil certain requirements, entailing the overall calculation of the group's taxable income, deductions and tax credits. The Tax Consolidated Group for 2018 is indicated in Appendix III.

The remaining Naturgy companies pay their taxes individually, in accordance with the schemes applicable to them.

Set out below is the reconciliation between "Income tax" recognised and the amount that would be obtained by applying the nominal tax rate in force in the parent company's country (Spain) to "Profit/(loss) before taxes" for 2018 and 2017:

	2018	%	2017¹	%
Profit/(loss) before tax	(3,365)		1,444	
Statutory tax	(841)	(25%)	361	25.0%
Effect of net results under equity method	128	3.8%	(4)	(0.3%)
Application of tax rates of foreign companies	(31)	(0.9%)	(27)	(1.9%)
Tax deductions	(11)	(0.3%)	(18)	(1.2%)
Remeasurement deferred taxes on mergers	(43)	(1.3%)	(117)	(8.1%)
Remeasurement deferred taxes due to tax reform	-	-	1	0.1%
Other items ⁽²⁾	19	0.6%	(1)	(0.1%)
Corporate income tax	(779)	(23.2%)	195	13.5%
Breakdown of current/deferred expense:				
Current-year tax	195		353	
Deferred tax	(974)		(158)	
Corporate income tax	(779)		195	

1. The 2017 consolidated income statement has been restated in accordance with IFRS 5 (Notes 3.3 and 11).

Part of the asset impairments and write-downs recorded in 2018 (Note 5) will be tax deductible in future periods and accordingly temporary differences have been identified, recognising deferred tax revenue in the amount of Euros 966 million.

On 30 November 2017, within the business reorganization and corporate streamlining process in Chile, Compañía General de Electricidad, S.A. carried out a vertical merger of its subsidiaries CGE Distribución, S.A., Compañía Nacional de Fuerza Eléctrica, S.A. and Empresa Eléctrica Atacama, S.A. The resulting goodwill was allocated to the value for tax purposes of the non-monetary assets received from the absorbed company (electricity distribution networks), equivalent to its carrying amount at the date of the operation, generating a decrease in deferred tax liabilities of Euros 117 million with a balancing entry under Corporate income tax in the consolidated income statement.

On 31 May 2018, following the business reorganization and corporate streamlining process in Chile, Compañía General de Electricidad, S.A. carried out a vertical merger of its subsidiaries Empresa Eléctrica de Arica, S.A., Empresa Eléctrica de Iquique, S.A. and Empresa Eléctrica de Antofagasta, S.A. The resulting goodwill was allocated to the value for tax purposes of the non-monetary assets received from the absorbed company equivalent to its carrying amount at the date of the operation, generating a decrease in deferred tax liabilities of Euros 43 million with a balancing entry under Corporate income tax in the consolidated income statement.

On 29 December 2017, Decree 1112/2017 on Tax Reform was published in Argentina which provides for a progressive reduction in income tax from 35% to 30% for 2018 to 2019 and 25% from 2020 onward. As a result, deferred taxes were revalued at the expected reversal rate, with a higher expense recorded under Corporate income tax in the consolidated income statement for an amount of Euros 1 million.

Income qualifying for the tax credit for reinvestment of extraordinary profits provided by Article 42 of the revised Corporate Income Tax Act introduced under Royal Decree-Law 4/2004 of March 5 (TRLIS) and the resulting investments made in previous periods are explained in the annual accounts for the relevant years. The relevant breakdown is as follows:

Year of sale	Amount obtained on the sale	Amount reinvested	Income qualifying for deduction	Year reinvested
2011	4	4	2	2011
2012	1	1	-	2012
2013	1	1	1	2013
2014	414	414	210	2014
Total	420	420	213	

The reinvestment was made in fixed assets used in business activities and was carried out by both the parent company the other companies included in the Consolidated Tax Group. by virtue of the provisions of article 75 of the Corporate Income Tax Act.

Income qualifying for the tax scheme for transfers of assets made in compliance with competition law (Additional Provision 4 of the revised CIT Act) and the investments in which it has been used in prior years are explained below:

Year of sale	Amount obtained on the sale	Amount reinvested	Capital gain	Capital gain included in tax base	Capital gain pending inclusion in tax base
2002	917	917	462	19	443
2003	141	141	79	-	79
2004	292	292	177	9	168
2005	432	432	300	1	299
2006	309	309	226	-	226
2007	105	105	93	-	93
2009	161	161	87	-	87
2010	799	799	560	-	560
2011	450	450	394	-	394
2012	38	38	32	-	32
Total	3,644	3,644	2,410	29	2,381

The reinvestment was made in fixed assets related to economic activities carried out by the transferring Company or any other company included in the Consolidated Tax Group. by virtue of the provisions of article 75 of the Corporate Income Tax Act.

The breakdown of the tax effect relating to each component of “Other comprehensive income” of the Consolidated Statement of Comprehensive Income for the year is as follows:

	At 31.12.18			At 31.12.17		
	Gross	Tax effect	Net	Gross	Tax effect	Net
Far value financial assets	(188)	-	(188)	(54)	-	(54)
Cash flow hedges	110	(24)	86	(111)	13	(98)
Currency translation differences	(193)	-	(193)	(890)	-	(890)
Actuarial gains and loss (Note 16)	15	(3)	12	5	-	5
Total	(256)	(27)	(283)	(1,050)	13	(1,037)

Set out below is an analysis of and movements in deferred taxes:

Deferred tax assets	Provisions for employee benefit obligations	Provision of depreciation of receivables and other provisions	Tax credits ¹	Depreciation/amortisation differences	Financial instruments and asset valuation	Other	Total
At 1.1.17	161	165	67	307	39	133	872
Charged/(credited) to income statement	26	26	(21)	(10)	2	3	26
Movements related to equity adjustments	-	-	-	-	8	-	8
Currency translation differences	(3)	(9)	(8)	(9)	14	(10)	(25)
Transfers and other ⁽²⁾	1	(2)	-	(25)	1	(7)	(32)
At 31.12.17	185	180	38	263	64	119	849
Impact IFRS 9 and IFRS 15	-	13	-	-	-	13	26
At 1.1.18	185	193	38	263	64	132	875
Charged/(credited) to income statement ⁽³⁾	25	396	(13)	388	3	17	816
Movements related to equity adjustments	(2)	(1)	-	-	12	(1)	8
Currency translation differences	(4)	(3)	(1)	3	(1)	(4)	(10)
Transfers and other ⁽²⁾	-	(2)	2	-	-	-	-
At 31.12.18	204	583	26	654	78	144	1,689

1. At 31 December 2018 and 2017 the tax credits mainly relate to tax loss carryforwards from various CGE companies basically generated by the application of the accelerated depreciation tax incentive. The recover of these credits is reasonably assured as they are not subject to any time limit and pertain to companies that historically generate recurring profits.

2. In 2018, it includes an increase in deferred tax assets due to impairment recognised in the year.

3. In 2018 and 2017 it mainly includes transfers to “held for sale” at the date on which this classification is applied (Note 11).

Deferred tax liabilities	Depreciation/ amortisation differences	Deferred gains	Business combination valuation ¹	Financial instruments and asset valuation	Other	Total
At 01/01/2017	835	209	1,322	44	99	2,509
Charged/(credited) to income statement ⁽²⁾	(119)	-	(40)	-	27	(132)
Business combinations (Note 31)	-	-	-	-	-	-
Movements related to equity adjustments	-	-	-	(3)	-	(3)
Currency translation differences	(21)	-	-	(12)	1	(32)
Transfers and other ⁽³⁾	(28)	(12)	5	2	3	(30)
At 31.12.17	667	197	1,287	31	130	2,312
Impact IFRS 9 and IFRS 15	-	-	-	-	27	27
At 1.1.18	667	197	1,287	31	157	2,339
Charged/(credited) to income statement ⁽²⁾	(104)	-	(81)	3	24	(158)
Business combinations (Note 31)	-	-	9	-	-	9
Movements related to equity adjustments	29	-	-	27	-	56
Currency translation differences	(12)	-	(40)	1	6	(45)
Transfers and other ⁽³⁾	(12)	-	(37)	(1)	(2)	(52)
At 31.12.18	568	197	1,138	61	185	2,149

1. The heading "Business combination valuation" includes the tax effect of the portion of the merger difference resulting from the absorption of Unión Fenosa, S.A. by Naturgy Energy Group, S.A. in 2009, allocated to net assets acquired, which will not have tax effects. It also includes the tax effect of the allocation of the acquisition price of CGE by Naturgy in 2014 and of various prior acquisitions completed by CGE.

2. In 2018, it includes the decrease in deferred tax assets resulting from impairment recognised in the year. The decrease in deferred tax liabilities of Euros 43 million in 2018 and Euros 117 million in 2017 resulting from the Compañía General de Electricidad merger operations mentioned above is included under "Depreciation/amortisation differences".

3. In 2018 and 2017 it mainly includes transfers to "held for sale" at the date on which this classification is applied (Note 11).

At 31 December 2018 the tax credits that have not been recorded totalled Euros 17 million (Euros 27 million at 31 December 2017).

In July 2018 tax inspection proceedings were instigated against Naturgy Energy Group, S.A. as the parent company of group 59/93 in relation to corporate income tax and as the parent company of group 273/08 with respect to VAT. The periods under inspection for corporate income tax purposes (tax consolidation regime) are from 2011 to 2015 and for VAT purposes (corporate group regime) from June 2014 to December 2015.

This notification interrupts the limitation period for assessing the taxes for the periods mentioned above with respect to the entire tax group for corporate income tax purposes and the VAT group for VAT purposes.

The inspection proceedings are not expected to significantly impact the group companies.

In accordance with Spanish tax legislation, at the date of preparation of these annual accounts, the Spanish group's returns for the last four years for the principal taxes to which it is subject and which are not involved in the above-mentioned tax inspection are open to inspection.

In general, the other Naturgy companies are open to inspection for the following periods:

Country	Period
Argentina	2012-2018
Brazil	2013-2018
Colombia	2015-2018
Chile	2014-2018
Italy	2013-2018
Mexico	2012-2018
Panama	2012-2018

On 3 November 2017 an unfavourable judgment was received from the Supreme Court in relation to the tax inspection assessments resulting from inspections on corporate income tax for 2003-2005, due to the application of the deduction for export activities. These assessments had been fully provided for (Note 16) and amounted to Euros 93 million, which has been fully offset by balances to be refunded by the Spanish tax authorities.

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

Naturgy has recorded provisions for obligations deriving from a number of tax claims. There are no lawsuits or uncertain tax treatments which are individually significant (Note 16).

Note 22. Revenue

The breakdown of this heading in the consolidated income statement for 2018 and 2017 is as follows, by category with the relevant operating segment reporting structure

2018	Gas and Electricity	EMEA Infrastructures	Latin America South Infrastructures	Latin America North Infrastructures	Other	Total
Sales of gas and access to distribution networks	6,430	1,178	2,781	541	-	10,930
Sales of electricity and access to distribution networks	5,052	792	2,137	768	-	8,749
LNG sales	3,409	-	-	-	-	3,409
Registrations and facility checks	40	26	11	14	-	91
Electricity generation capacity assignment	276	-	-	-	-	276
Rental of meters and instalations	338	33	10	-	-	381
Other income	253	15	140	40	55	503
Total	15,798	2,044	5,079	1,363	55	24,339

2017 ¹	Gas and Electricity	EMEA Infrastructures	Latin America South Infrastructures	Latin America North Infrastructures	Other	Total
Sales of gas and access to distribution networks	5,603	1,161	3,149	496	-	10,409
Sales of electricity and access to distribution networks	4,966	799	2,275	793	-	8,833
LNG sales	2,535	-	-	-	-	2,535
Registrations and facility checks	48	20	12	20	-	100
Electricity generation capacity assignment	288	-	-	-	-	288
Rental of meters and instalations	364	42	11	-	-	417
Other income	318	16	179	32	80	625
Total	14,122	2,038	5,626	1,341	80	23,207

1. The 2017 consolidated income statement has been restated, reclassifying to discontinued operations in accordance with IFRS 5 (Notes 3.3 and 11).

Reporting by geographic area

Naturgy's revenue by country of destination is analysed below:

	2018	2017 ¹
Spain	11,225	10,765
Rest of Europe	2,926	2,711
France	1,594	1,282
Portugal	527	416
Ireland	181	141
United Kingdom	159	150
Other Europe	465	722
Latin American	8,065	8,495
Chile	2,976	3,447
Brazil	1,695	1,883
Mexico	1,441	1,455
Panama	774	799
Argentina	723	574
Dominican Republic	146	118
Other Latin America	310	219
Other	2,123	1,236
China	420	63
India	359	372
Japan	299	153
Egypt	286	112
Pakistan	174	21
Other countries	585	515
Total	24,339	23,207

1. The 2017 consolidated income statement has been restated by reclassifying to discontinued operations (Note 3.3 and 11).

Note 23. Procurements

The breakdown of this heading for 2018 and 2017 is as follows:

	2018	2017¹
Energy purchases	15,425	14,279
Access to distribution networks	1,942	1,798
Other purchases and changes in inventories	356	551
Total	17,723	16,628

1. The 2017 consolidated income statement has been restated, reclassifying to discontinued operations in accordance with IFRS 5 (Notes 3.3 and 11).

Note 24. Other operating income

The breakdown of this heading for 2018 and 2017 is as follows:

	2018	2017¹
Other management income	165	236
Operating grants	1	1
Total	166	237

1. The 2017 consolidated income statement has been restated, reclassifying to discontinued operations in accordance with IFRS 5 (Notes 3.3 and 11).

The item "Other management income" includes income from services relating to the construction or improvement of concession infrastructures under IFRIC 12 in the amount of Euros 68 million (Euros 116 million in 2017); whose fair value is estimated by reference to the expenses incurred (Note 26), with no margin.

Note 25. Personnel expenses

The breakdown of this heading for 2018 and 2017 is as follows:

	2018	2017¹
Wages and salaries	702	751
Termination benefits	180	126
Social security costs	123	134
Defined contribution plans	36	44
Defined benefit plans (Note 16)	9	9
Share-based payments (Note 14)	5	-
Own work capitalised	(115)	(122)
Other	70	67
Total	1,010	1,009

1. The 2017 consolidated income statement has been restated, reclassifying to discontinued operations in accordance with IFRS 5 (Notes 3.3 and 11).

The average number of Naturgy employees was 13,945 in 2018 and 14,712 in 2017, analysed by category as follows:

	2018	2017 ¹
Executives	1,359	1,360
Middle management	2,708	2,620
Specialists	4,504	4,644
Workers	5,374	6,088
Total	13,945	14,712

1. Restated under IFRS 5 (Note 3.3 and 11).

The average number of employees in the year with disability equal to or greater than 33% is as follows, by category:

	2018	2017
Executives	6	8
Middle management	18	22
Specialists	82	82
Workers	82	114
Total	188	226

The number of Naturgy employees at the end of 2018 and 2017 broken down by category, gender and geographical area, is as follows:

	2018			2017 ¹		
	Men	Women	Total	Men	Women	Total
Executives	933	365	1,298	1,025	361	1,386
Middle management	1,884	565	2,449	2,160	585	2,745
Specialists	2,687	1,608	4,295	3,011	1,654	4,665
Workers	3,299	1,359	4,658	4,186	1,736	5,922
Total	8,803	3,897	12,700	10,382	4,336	14,718

1. Restated under IFRS 5 (Note 3.3 and 11).

	2018	2017 ¹
Spain	6,469	7,350
Rest of Europe	156	176
Latin American	5,895	7,039
Rest	180	153
Total	12,700	14,718

1. Restated under IFRS 5 (Note 3.3 and 11).

Both calculation of the average number of employees and the calculation of the number of employees at the end of Naturgy's financial year include the number of employees in the joint venture entities prorated by the percentage interest. At 31 December 2018, the number of employees at the year end of these entities stood at 189 (192 at 31 December 2017) and the average number of employees was 190 (191 at 31 December 2017).

In both the calculation of the number of employees at the year end and the calculation of the average number of employees, the employees of companies classified as discontinued operations (Note 11) and the employees of companies consolidated using the equity method have not been taken into account, in accordance with the following breakdown:

	2018		2017	
	Number of employees at year end	Average number of employees	Number of employees at year end	Average number of employees
Discontinued operations	786	1,453	2,053	2,055
Equity-consolidated companies	818	818	819	835

Note 26. Other operating expenses

The breakdown of this heading for 2018 and 2017 is as follows:

	2018	2017 ¹
Taxes	437	450
Operation and maintenance	368	359
Advertising and other commercial services	208	297
Professional services and insurance	143	180
Concession construction or improvements services (IFRIC 12) (Note 24)	68	116
Supplies	79	88
Services to customers	71	82
Other	442	397
Total	1,816	1,969

1. The 2017 consolidated income statement has been restated, reclassifying to discontinued operations in accordance with IFRS 5 (Notes 3.3 and 11).

Note 27. Profit/(loss) on disposals of fixed assets

In 2018 this heading included the capital gain of Euros 9 million from the sale of a building in calle Goya, Madrid, and other smaller sales in Spain and Chile.

In 2017, this heading included the capital gain of Euros 18 million from the sale of various buildings in Madrid (Note 7).

Note 28. Depreciation, amortisation and fixed-asset impairment losses

The breakdown of this heading in the consolidated income statement for the year 2018 and 2017 is as follows:

	2018	2017¹
Amortisation intangible assets (Note 6)	348	306
Depreciation of property, plant and equipment (Note 7)	1,326	1,315
Intangible asset and goodwill impairment (Notes 5 and 6)	1,872	-
PPE impairment (Notes 5 and 7)	2,398	-
Inventory impairment (Notes 5 and 12)	63	-
Total	6,007	1,621

1. La cuenta de pérdidas y ganancias consolidada del ejercicio 2017 se ha re-expresado reclasificando a operaciones interrumpidas en aplicación de la NIIF 5 (Notas 3.3 y 11).

Note 29. Net financial income/(expense)

The breakdown of this heading for 2018 and 2017 is as follows:

	2018	2017¹
Dividends	17	14
Interest income	19	19
Other	86	78
Total financial income	122	111
Cost of borrowings	(557)	(630)
Interest expenses pension plans	(14)	(14)
Other financial expense	(231)	(163)
Total financial expense	(802)	(807)
Variations in the fair value of derivate financial instruments (Note 18)	(5)	(2)
Net exchange differences	-	-
Net financial income/(expense)	(685)	(698)

1. The 2017 consolidated income statement has been restated, reclassifying to discontinued operations in accordance with IFRS 5 (Notes 3.3 and 11).

Note 30. Cash generated by operating activities and other cash-flow breakdowns

The breakdown of cash generated from operations in 2018 and 2017 is as follows:

	2018	2017
Profit/(loss) before tax	(3,365)	1,444
Adjustments to profit/(loss):	7,131	2,529
Depreciation, amortisation and impairment expenses (Notes 5, 6 and 7)	6,007	1,694
Other adjustments to net income:	1,124	835
Net financial income (Note 11 and 29)	685	697
Profit of entities recorded by equity method (Note 8 and 11)	513	(14)
Transfer of deferred income (Note 15)	(42)	(42)
Net variation in Provisions	(27)	8
Pre-tax profit/(loss) from discontinued activities net of capital gains and impairment (Note 11)	(5)	186
Changes in working capital (excluding the effects of adjustments in consolidation scope and exchange differences):	(208)	(155)
Inventories	(125)	(15)
Trade and other receivables	(392)	(176)
Trade and other payables	309	36
Other cash flows from operating activities:	(677)	(1,050)
Interest paid	(621)	(686)
Interest collected	23	26
Dividends received	184	48
Income tax paid	(263)	(438)
CASH FLOWS GENERATED FROM OPERATING ACTIVITIES	2,881	2,768

Payments on investments in group companies, associates and business units at 31 December 2018 and 2017 break down as follows:

	2018	2017
Acquisition of Guimaranias (Note 31)	27	-
Capital increase Nueva Generadora del Sur, S.A. (Note 8)	-	14
Total	27	14

Receipts due to divestments in group companies, associates and business units at 31 December 2018 and 2017 break down as follows:

	2018	2017
Sale Italy (Note 11)	746	-
Sale Kangra (Note 11)	20	-
Gas Natural, S.A. ESP (Note 11)	334	134
Other	9	2
Total	1,109	136

The breakdown of payments for the acquisition of equity instruments at 31 December 2018 and 2017 is as follows:

	2018	2017
Sale 20% Nedgia	1,500	-
Naturgy Energy Group, S.A. treasury shares (Note 14)	(309)	14
CGE treasury shares (Note 14)	(2)	(9)
Total	1,189	5

Movements in borrowings in 2018 2017 are set out below, disclosing separately the changes that generate cash flows from those that do not:

	Generate cash flow				Do not generate			At 31.12.2018
	At 31.12.2017	Impact IFRS 9 At	At 1.1.2018	Increase	Decrease	Currency translation differences	Transfers and others	
Issuing of debentures and other negotiable obligations	12,214	(48)	12,166	6,867	(8,213)	(51)	(11)	10,758
Borrowings from financial institutions	6,128	-	6,128	1,306	(2,728)	(129)	-	4,577
Derivative financial instruments	49	-	49	-	-	(1)	37	85
Other financial liabilities	68	-	68	170	(215)	(12)	-	11
Total	18,459	(48)	18,411	8,343	(11,156)	(193)	26	15,431

	Generate cash flow			Do not generate cash flow		At 31.12.2017
	At 1.1.2017	Increase	Decrease	Currency translation differences	Transfers and other ¹	
Issuing of debentures and other negotiable obligations	11,661	6,694	(5,802)	(60)	(279)	12,214
Borrowings from financial institutions	5,693	2,292	(1,466)	(240)	(151)	6,128
Derivative financial instruments	80	-	-	(11)	(20)	49
Other financial liabilities	168	331	(414)	(13)	(4)	68
Total	17,602	9,317	(7,682)	(324)	(454)	18,459

1. Mainly includes transfers to "Non-current assets held for sale" at the date on which this classification is applied (Note 11).

Other changes in cash and cash equivalents includes cash fluctuations due to changes in the consolidation scope and transfers held for sale

Note 31. Business combinations

2018

Guimarania Solar Spe

In March 2018, through its subsidiary Global Power Generation, Naturgy agreed to the purchase of the companies Guimarania I Solar Spe Ltda. and Guimarania II Solar Spe Ltda., two solar plants in Brazil, from Canadian Solar.

Guimarania Solar is an 83 MW photovoltaic project located in the state of Minas Gerais. The power generated by the projects, which will start operating at the end of 2018 after the planned investments, will be 165 GWh per year. These companies have also signed a 20-year energy reserve contract with Câmara de Comercialização de Energia Eléctrica (CCEE) under which the sale of the energy produced is reserved for the CCEE as the sole customer, at rates set in BRL and indexed to local inflation.

The total cost of the business combination amounted to Euros 35 million. Goodwill was calculated at Euros 9 million as the difference between the acquisition cost and interest in the fair value of the identifiable assets and liabilities existing at the transaction date.

The net assets acquired at 01 January 2018 and goodwill break down as follows:

Acquisition cost	35	
Fair value of the net assets	26	
Goodwill (Note 6)	9	
	Fair value	Carrying amount
Intangible assets (Note 6)	28	1
Other current assets	6	6
Cash and cash equivalents	1	1
Total assets	35	8
Deferred tax liabilities (Note 21)	9	-
Total liabilities	9	-
Fair value of the net assets acquired	26	
Acquisition price	35	
Cash and cash equivalents in subsidiary acquired	1	
Net acquisition cost	34	

In the purchase price allocation process, the assets were identified that could be revalued based on the balance sheet of Guimarania I Solar Spe Ltda. and Guimarania II Solar Spe Ltda. at 30 April 2018, relating to intangible assets represented by the value of the authorisations necessary to operate the facility. The deferred tax liabilities relating to the revaluations were also recognised.

These net assets of Guimarania I Solar Spe Ltda. and Guimarania II Solar Spe Ltda. were basically measured using the following methodology:

- The business was valued following the revenue approach and in particular, through the discounted cash flow method, based on Level 3 inputs as the data were not observable on the market.

- The main parameters used in the valuation were an IRR of 3.17% as the return required on the investment, and cash-flow projections based on income at the price agreed in the energy reserve contract and the distribution and maintenance costs typical of the business.

2017

No significant business combinations took place in 2017.

Note 32. Service concession arrangements

Naturgy manages a number of concessions containing provisions for the construction, operation and maintenance of facilities, as well as connection and power supply obligations during the concession period, in accordance with applicable regulations (Note 2). There follow details of the concession period and the period remaining to the expiration of concessions that are not indefinite:

Company	Activity	Country	Concession period	Initial remaining period
Gas Natural BAN, S.A.	Gas distribution	Argentina	35 (extendable 10)	9
Energía San Juan S.A.	Electricity distribution	Argentina	60	38
Companhia Distribuidora de Gás do Rio de Janeiro, S.A, Ceg Rio, S.A. and Gas Natural Sao Paulo Sul, S.A.	Gas distribution	Brazil	30 (extendable 20/30)	9-12
Unión Fenosa Generadora La Joya, S.A. and Unión Fenosa Generadora Torito, S.A.	Electricity generation	Costa Rica	20	4-12
Naturgy Generación S.L.U., S.A. and Naturgy Renovables, S.L.	Hydraulic power generation	Spain	14-65	4-45
Gas Natural México S.A. de C.V. and Comercializadora Metrogas S.A. de C.V.	Gas distribution	Mexico	30 (extendable 15)	9-20
Europe Maghreb Pipeline Ltd	Gas transportation	Morocco	25 (extendable)	3
Empresa Distribuidora de Electricidad Metro Oeste, S.A. and Empresa Distribuidora de Electricidad Chiriquí, S.A.	Electricity distribution	Panama	15	10
Gas Natural Perú, S.A.	Gas distribution	Peru	20-year extendable	16

As indicated in Note 3.4.3.b, Naturgy applies IFRIC 12 “Service concession arrangements”, the intangible asset model being applicable basically to the gas distribution activities in Argentina, Brazil and Peru, and to the electricity distribution activity in Argentina, while the financial asset model applies to the electricity generation business in Costa Rica.

The hydraulic power plant concessions in Spain (Note 3.4.4.b) fall out with the scope of IFRIC 12, due among other reasons to the fact that power selling prices are set in the market. The other international concessions fall out with the scope of IFRIC 12 because the grantor does not control a significant residual interest in the infrastructure at the concession end date and simultaneously determines the service price. Concession assets are still recognised in “Property, plant and equipment”.

Note 33. Information on transactions with related parties

Related parties are as follows:

- Significant Naturgy shareholders, i.e. those directly or indirectly owning an interest of 5% or more, and those who, though not significant, have exercised the power to propose the appointment of a member of the Board of Directors.

Based on this definition, the significant shareholders of Naturgy are Fundació Bancaria Caixa d'Estalvis i Pensions de Barcelona ("la Caixa"), Repsol, S.A. (Repsol) until 17 May 2018, Rioja Bidco Shareholdings, S.L.U. (controlled by the funds advised by CVC) since 18 May 2018, Global Infrastructure Partners III (GIP) and related companies.

- Directors and executives of the company, and their immediate families. The term "director" means with a member of the Board of Directors; "executive" means with direct dependence of the Executive President and the Internal Audit Director. Operations with directors and executives are disclosed in Note 34.
- Transactions between group companies form part of ordinary activities and are effected at arm's length. Group company balances include the amount that reflects Naturgy's share of the balances and transactions with companies consolidated under the equity method.

At 1 January 2018 Naturgy ceased to regard CaixaBank and the companies that make up its consolidated group as a related entity. However, CriteriaCaixa and its consolidated group continue to be regarded as a related party as the criteria laid down by international and commercial legislation have been maintained.

Aggregate transactions with significant shareholders are as follows (thousand euro):

2018	Significant shareholders				
	"la Caixa" group	Repsol group **	Rioja Bidco/CVC ***	GIP group	Group companies
Expense and Income (thousand euro)					
Financial expenses	-	-	-	-	6
Leases	-	-	-	-	6
Receipt of services	12	3,944	-	-	10,838
Purchase of goods ⁽¹⁾	-	160,003	-	-	355,707
Other expenses ⁽²⁾	-	-	-	-	-
Total expenses	12	163,947	-	-	366,557
Financial income	-	-	-	-	2,294
Leases	-	-	-	-	-
Provision of services	36	20,545	-	-	21,198
Sale of goods ⁽¹⁾	3,095	367,115	-	-	34,331
Other income	-	-	-	-	1,853
Total ingresos	3,131	387,660	-	-	59,676

2018	Significant shareholders				
	"la Caixa" group	Repsol group **	Rioja Bidco/CVC ***	GIP group	Group companies
Other transactions (thousand euro)					
Acquisition of property, plant and equipment, intangible assets or other assets ⁽³⁾	-	295	-	-	-
Financing agreements, loans and capital contributions (lender) ⁽⁴⁾	-	-	-	-	3,695
Sale of property, plant and equipment, intangibles or other assets ⁽⁵⁾	-	-	-	-	-
Financing agreements: loans and capital contributions (borrower) ⁽⁶⁾	-	-	-	-	-
Warranties and guarantees received	-	-	-	-	-
Dividends and other profits distributed ^(****)	346,808	-	281,202	280,193	-
Other operations ⁽⁷⁾	-	-	-	-	-

**** The "la Caixa" dividend includes Euros 22.516 thousand paid to Energía Boreal 2018, S.A.

2018	Significant shareholders				
	"la Caixa" group	Repsol group **	Rioja Bidco/CVC ***	GIP group	Group companies
Trade debtors and creditors (thousand euros)					
Trade and other receivables	137	-	-	-	16,765
Trade and other payables	-	-	-	-	42,734

*Since 1 January 2018 only transactions with Fundació la Caixa and CriteriaCaixa are reported.

** Until 17 May 2018.

***Since 18 May 2018.

2017	Significant shareholders			Group companies
	"la Caixa" group	Repsol group **	GIP group	
Expense and Income (thousand euro)				
Financial expenses	1,509	-	-	55
Leases	-	-	-	5
Receipt of services	11,955	14,045	-	10,426
Purchase of goods ⁽¹⁾	-	345,504	-	330,014
Other expenses ⁽²⁾	35,265	-	-	-
Total expenses	48,729	359,549	-	340,500
Financial income	653	-	-	154
Leases	-	-	-	-
Provision of services	559	38,629	-	21,430
Sale of goods ⁽¹⁾	22,971	817,607	-	44,812
Other income	-	-	-	2,296
Total income	24,183	856,236	-	68,692

Other transactions (thousand euro)	Significant shareholders			Group companies
	"la Caixa" group	Repsol group	GIP group	
Acquisition of property, plant and equipment, intangible assets or other assets ⁽³⁾	-	10,879	-	-
Financing agreements, loans and capital contributions (lender) ⁽⁴⁾	1,323,987	-	-	3,436
Sale of property, plant and equipment, intangibles or other assets ⁽⁵⁾	362,465	-	-	-
Financing agreements: loans and capital contributions (borrower) ⁽⁶⁾	119,541	-	-	-
Warranties and guarantees received	160,000	-	-	-
Dividends and other profits distributed	244,558	200,859	200,138	-
Other operations ⁽⁷⁾	1,030,014	-	-	-

Trade debtors and creditors (thousand euros)	Significant shareholders			Group companies
	"la Caixa" group	Repsol group	GIP group	
Trade and other receivables	481	68,970	-	17,286
Trade and other payables	-	42,755	-	31,219

1. Basically includes energy purchase and sale. In the case of group companies, basically corresponds to operations with Unión Fenosa Gas.

2. Includes contributions to pension plans, group insurance policies, life insurance and other expenditure.

3. Basically includes the purchase of LPG supply points under the agreement with Repsol Butano dated 30 September 2015, that are located in the area of influence of its existing distribution zones and which is completed as the relevant administrative authorisations are obtained.

4. Includes cash and cash equivalents.

5. Includes basically the assignment of debt claims (factoring without recourse) with "la Caixa" during the period.

6. At 31 December 2017, credit lines contracted with "la Caixa" amounted to Euros 569,000 thousand, of which no amounts have been utilised. At 31 December 2017, other loans amounted to Euros 119,541 thousand.

7. At 31 December 2017, the heading "Other transactions" with the "La Caixa" group includes Euros 915,920 thousand in respect of foreign exchange hedges and Euros 114,094 thousand in respect of interest rate hedges.

Note 34. Information on members of the Board of Directors and senior management personnel

Remuneration of the members of the Board of Directors

The remuneration policy for the members of the Board of Directors was approved at the General Shareholders' Meeting held on 27 June 2018 and is periodically reviewed and revised by the Board of Directors following a report from the Appointments and Remuneration Committee, in order to keep it aligned with the best practices in the reference market and with the objectives indicated in the Bylaws.

The amount accrued by the members the Board of Directors of Naturgy Energy Group, S.A., for belonging to the Board of Directors, Executive Committee (EC), Audit Committee (CA) and Appointments and Remuneration Committee (ARM), totalled Euros 4,412 thousand (Euros 4,668 thousand in 2017), broken down in euros as follows:

	Office	Board	EC	AC	ARC	Total
Mr. Francisco Reynés Massanet ⁽¹⁾	Executive Chairman	789,286	239,285	-	-	1,028,571
Mr. Isidro Fainé Casas ⁽²⁾	Chairman	60,714	60,714	-	-	121,428
Mr. Rafael Villaseca Marco ⁽²⁾	Chief Executive Officer	13,964	13,964	-	-	27,928
Mr. Ramón Adell Ramón	Coordinating Director	185,136	69,000	51,818	48,226	354,180
Mr. Enrique Alcántara-García Irazoqui	Director	156,500	-	51,818	-	208,318
Mr. Iñigo Alonso de Noriega ⁽⁴⁾	Director	27,823	-	-	5,498	33,321
Mr. Xabier Añoveros Trías de Bes ⁽⁸⁾	Director	69,000	-	21,818	-	90,818
Mr. Marcelino Armenter Vidal	Director	156,500	69,000	-	30,000	255,500
Mr. Mario Armero Montes ⁽⁸⁾	Director	69,000	-	-	-	69,000
Mr. Francisco Belil Creixell	Director	156,500	69,000	50,162	43,636	319,298
Ms. Benita María Ferrero-Waldner ⁽⁶⁾	Director	69,000	69,000	-	-	138,000
Mr. Alejandro García-Bragado Dalmau ⁽⁷⁾	Director	53,790	28,935	-	10,411	93,136
Ms. Cristina Garmendia Mendizábal ⁽⁸⁾	Director	69,000	-	16,657	10,411	96,068
Ms. Helena Herrero Starkie	Director	156,500	-	51,818	-	208,318
Mr. Josu Jon Imaz San Miguel ⁽³⁾	First Deputy Chairman	23,000	23,000	-	-	46,000
Mr. Guillermo Llopis García ⁽⁴⁾	Director	27,823	6,677	8,798	-	43,298
Mr. Miguel Martínez San Martín ⁽³⁾	Director	23,000	23,000	-	4,546	50,546
Mr. Rajaram Rao	Director	156,500	69,000	51,818	-	277,318
Rioja Bidco Shareholdings, S.L.U., Mr. Javier de Jaime Gujjarro ⁽⁶⁾	Director	103,823	16,322	-	33,226	153,371
Mr. Pedro Sainz de Baranda ⁽⁹⁾	Director	87,500	-	30,000	30,000	147,500
Mr. Claudi Santiago Ponsa ⁽⁹⁾	Director	87,500	-	-	30,000	117,500
Mr. Luis Suárez de Lezo Mantilla ⁽⁶⁾	Director	52,677	27,823	11,496	-	91,996
Theatre Directorship Services Beta, S.à.r.l., Mr. José Antonio Torre de Silva López de Letona ⁽⁶⁾	Director	103,823	16,322	35,161	-	155,306
Theatre Directorship Services Beta, S.à.r.l., Mr. Juan Arbide Estensoro (6) y ⁽⁶⁾		16,323	-	-	-	16,323
Mr. William Alan Woodburn	Director	156,500	69,000	-	43,636	269,136
		2,871,182	870,042	381,364	289,590	4,412,178

1. Since 6 February 2018.

2. Until 6 February 2018.

3. Until 6 March 2018.

4. From 6 March 2018 to 18 May 2018.

5. Until 18 May 2018.

6. Since 18 May 2018.

7. Until 21 May 2018.

8. Until 27 June 2018.

9. Since 27 June 2018.

In 2018, as in 2017, no amounts were received for other items.

At 31 December 2017, the Board of Directors consisted of 17 members. On 6 February 2018, the Board of Directors agreed to appoint a new Executive Chairman due to the departure of the former CEO and Chairman. As a result, the number of Board members was reduced to 16 persons.

Finally, on 27 June 2018, the General Shareholders' Meeting approved the reduction in the number of members of the Board of Directors 12 members. In addition, the Executive Committee was eliminated and the number of members of the Audit Committee was set at seven persons and the number of Appointments and Remuneration Committee members was set at seven persons.

Until 6 February 2018, the amounts accrued to the Chief Executive Officer for executive functions in respect of fixed remuneration, annual variable remuneration, multi-year variable remuneration and other items totalled Euros 130 thousand, Euros 115 thousand, Euros 898 thousand and Euros 4 thousand, respectively, in 2018 (Euros 1,285 thousand, Euros 1,131 thousand, Euros 757 thousand and Euros 16 thousand in 2017). He also received the agreed termination benefit of three years' total remuneration and compensation for the no-competition agreement of one year's total salary amounting to Euros 14,248 thousand. Contributions to pension plans and group insurance policies, together with life insurance premiums paid, totalled Euros 34 thousand in 2018 (Euros 321 thousand in 2017).

As from 6 February 2018, the amounts accruing to the Executive Chairman for executive functions carried out in respect of fixed remuneration, annual variable remuneration and other items amounted to Euros 809 thousand, Euros 2,097 thousand and Euros 11 thousand, respectively, in 2018.

Contributions to pension plans and group insurance policies, together with life insurance premiums paid, totalled Euros 490 thousand in 2018. Funds accumulated due to these contributions amount to Euros 360 thousand at 31 December 2018.

The Chairman's contract was approved by the Board of Directors on 6 February 2018 and provides for a fixed remuneration component, an annual variable component and a long-term incentive plan, as well as other welfare benefits.

At a meeting held on 31 July 2018 the Board of Directors approved a long-term variable incentive plan (LTI) in which the Executive Chairman and 25 other executives take part. It is arranged through the acquisitions of shares the main characteristics of which are described in Note 14. The new incentive requires the adaptation of the Remuneration Policy and the Executive Chairman's contract, which are subject to the suspensive condition of being approved by the shareholders in general meeting.

In the central scenario, the Executive Chairman would receive an amount of 125% of the total annual fixed remuneration, multiplied by the expected duration in years of the LTI. This central scenario envisages the distribution of all the dividends foreseen in the Strategic Plan 2018-2022. Additionally, to ensure this scenario it is required that the final quotation that in July 2023 is above the purchase price of the shares of Euros 23.15.

The Chairman's contract provides for an indemnity for termination or non-renewal as a director of two annual payments of the combined amount of total fixed remuneration, annual variable remuneration and 1.25 times total fixed remuneration (as long-term variable remuneration subject to having achieved the minimum profitability target under the LTI). The indemnity will not be payable in the event of the serious and culpable nonfulfillment of his professional obligations causing significant harm to Naturgy's interests. In addition, as consideration for a post-contractual no-competition agreement with a duration of one year, an indemnity equivalent to one year's full fixed remuneration is provided for.

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

The members of the Board of Directors are covered with the same liability policy that insures all managers and directors of Naturgy. The premium paid in 2018 by Naturgy, S.A. for the entire policy amounted to Euros 121 thousand (Euros 109 thousand in 2017).

Transactions with Directors

The Directors have the obligation to avoid conflicts of interest as established by the Board Regulations of Naturgy Energy Group, S.A. and Articles 228 and 229 of the Spanish Companies Law. Additionally, these articles require that conflicts of interest incurred by the board shall be reported in the annual accounts.

The Directors of Naturgy have not reported any conflict of interest to the Board of Directors that has to be notified.

In transactions with related parties (significant shareholders) that have been submitted for approval by the Board, subject to a favourable report of the Audit Committee, any directors linked to the related party involved have abstained.

During the years 2018 and 2017, the members of the Board have not carried out related transactions outside the ordinary course or transactions that are not conducted under normal market conditions with the company or group companies.

Senior management remuneration

For the sole purposes of the information contained in this section, “senior management personnel” refers to executives reporting directly to the Executive Chairman, excluding the Executive Chairman, whose remuneration has been included in the previous section, and to the Internal Audit Director.

At 31 December 2018, 13 people make up this group, without taking into account the Internal Audit Director (11 people at 31 December 2018), one of whom is a woman. During 2018 there were two new members in July and two departures in December.

Amounts accrued to executives in respect of fixed remuneration, annual variable remuneration, multi-year variable remuneration and other items totalled Euros 6,769 thousand, Euros 3,853 thousand, Euros 595 thousand and Euros 230 thousand, respectively, in 2018 (Euros 5,507 thousand, Euros 2,595 thousand, Euros 1,641 thousand and Euros 108 thousand, respectively, in 2017).

Contributions to pension plans and group insurance policies, together with life insurance premiums paid, totalled Euros 1,599 thousand in 2018 (Euros 2,564 thousand in 2017). Funds accumulated due to these contributions amount to Euros 23,309 thousand at 31 December 2017 (Euros 26,367 thousand at 31 December 2017).

On 31 July 2018 the Board of Directors approved a long term variable incentive plan (LTI) in which the Executive President and 25 other directors take part, instrumented through the acquisition of shares whose main characteristics are described in Note 14.

Advances amounting to Euros 30 thousand had been granted to management personnel at 31 December 2018 (zero at 31 December 2017). At 31 December 2018, Naturgy had not granted any new guarantees on loans to management personnel (Euros 754 thousand at 31 December 2017). Severance benefits received by senior management personnel leaving Naturgy amounted to Euros 6,493 thousand in 2018 (zero in 2017).

The contracts signed with the 11 directors contain a clause that establishes compensation between a fixed annual remuneration in some cases and three and a half annual remuneration in others, in certain cases of extinction of the relationship, which include certain situations of change in control, unfair dismissal or the cases contemplated in articles 40, 41 or 50 of the Statute of Workers. Likewise, 10 of these contracts contain a clause that establishes compensation equivalent to an annuity of fixed remuneration for post-contractual non-competition for a period of two years.

Note 35. Litigation, arbitration, guarantees and commitments

Litigation and arbitration

The companies in the Naturgy Group are involved in certain judicial and extrajudicial disputes within the ordinary course of their activities. At the date of preparation of these consolidated annual accounts, the main litigation or arbitration in which Naturgy companies are involved are the following:

Claims for PIS and COFINS taxes in Brazil

In September 2005, the Rio de Janeiro Tax Administration rendered ineffective the recognition that it had previously issued, in April 2003, for the offset of receivables in respect of PIS and COFINS sales taxes paid by Companhia Distribuidora de Gás do Rio de Janeiro - CEG, in which Naturgy holds an interest of 54.2%. The administrative court confirmed that ruling in March 2007 and the company filed an appeal at a contentious-administrative court (Justicia Federal do Rio de Janeiro). Subsequently, notification of a public civil action against CEG relating to the same events was received on 26 January 2009. The total amount of tax payable in dispute, including interest, amounted to BRL 386 million (Euros 87 million). In November 2015, the above-mentioned first-instance court issued a judgement partially allowing CEG's appeal and reducing the total amount to BRL 260 million (Euros 59 million). This reduction in the amount of the contingency will not be final until the possible appeals have been lodged, which could take another four years according to a preliminary estimate. Naturgy has appealed against the judgment and considers, together with the company's legal advisors, that even the reduced amount is unfounded.

Qatar Gas arbitration

In May 2015, Naturgy commenced an arbitration procedure against Qatar Liquefied Gas Company Limited in order, among other matters, to set the prices for gas supplies that it receives from said company. Naturgy has requested a price reduction and the supplier has requested an increase. The award was delivered on 3 February 2018 and contains various provisions that require negotiations between the parties, which have given rise to a second arbitration process.

Claim against Metrogas, S.A.

Transportadora de Gas del Norte S.A. lodged various complaints against Metrogas, S.A., a Chilean company 55.6% owned by Naturgy, before the civil and commercial courts of first instance in Argentina for supposed breach of contract in the transport of Argentinian gas to Chile during the Argentina gas crisis. In April 2017, Metrogas, S.A. received a judicial notice declaring a joinder of claims, meaning that the total amount stands at USD 227 million (Euros 189 million). The procedures are at the first instance stage.

Environmental incentive to coal plants in Spain

In 2007, the Spanish authorities introduced an environmental incentive to support the installation of new sulphur oxide filters in existing coal plants. In November 2017, the European Commission opened an investigation to determine whether this incentive complied with the European Union's state aid rules. In the event of an unfavourable result, the risk estimated in the consolidated financial statements, which does not include the period in which the plants were subject to the economic regime of Royal Decree 134/2010, could be as much as Euros 67 million.

Unión Fenosa Gas

In 2014, Egyptian Natural Gas Holding (EGAS), an Egyptian public company, ceased to supply gas to Unión Fenosa Gas, a company 50% owned by Naturgy, and stopped paying the utilisation fee for the Damietta liquefaction plant. This led to Unión Fenosa Gas instigating arbitration proceedings at various locations (Madrid, El Cairo and the CIADI) against this supplier, which requested the nullity of the contract, and against the Arab Republic of Egypt. In December 2017 the arbitration proceedings against EGAS conducted in Cairo concluded with a decision that confirmed the position of Unión Fenosa Gas concerning the nonfulfillment of the relevant obligations. In August 2018 a decision was made in the investment protection arbitration proceedings (ICSID) against the Arab Republic of Egypt, ordering it to pay USD 2,013 million after taxes and before interest. The decisions on the arbitration under way in Madrid have yet to be delivered. On

19 December 2018 Unión Fenosa Gas obtained confirmation of the award in the United Kingdom and expects to obtain confirmation in the United States. On 21 December 2018, the Arab Republic of Egypt submitted an appeal to the ICSID against the award and requested its suspension while the appeal proceedings last, as has been done.

Social Bond

The Supreme Court has ordered to reimbursement of the amounts contributed by Naturgy Energy Group, S.A. to the social bond for 2014 to 2016 (Euros 74 million) in accordance with Royal Decree-Law 9/2013. However, this decision has been appealed against by the government before the Constitutional Court. Though unlikely, said Court could revoke the Supreme Court ruling.

Electricaribe

On 14 November 2016 the Superintendence for Residential Public Services of the Republic of Colombia (“the Superintendence”) reported the government take-over of Electricaribe, a Naturgy investee, as well as the separation of the members of the governing body and the general manager, and their replacement by a special agent appointed by the Superintendence. On 14 March 2017 the Superintendence announced the decision to liquidate Electricaribe. On 22 March 2017 Naturgy initiated arbitration proceedings before the Court of the United Nations Commission for International Trade Law (UNCITRAL) and on 15 June 2018 it lodged a complaint in which it claimed approximately 1,600 MUSD. On 4 December 2018 the Republic of Colombia submitted its answer to the complaint and filed a counterclaim for approximately USD 500 million, the viability of which is considered remote (Note 9).

Naturgy’s consolidated balance sheet at 31 December 2018 includes provisions for litigation, based on the best estimate made using the information available at the date of preparation of these consolidated annual accounts on their progress and ongoing negotiations, which cover the estimated risks. Naturgy therefore considers that no significant liabilities will be derived from the risks described in the relevant section of this Note.

Guarantees

Guarantees furnished by Naturgy at 31 December 2018 and 2017 are as follows:

- Guarantees provided to third parties, basically for investment commitments, construction and distribution network expansion, tenders, bids and business contracts amounting to Euros 1,282 million (Euros 1,251 million at 31 December 2017).
- Guarantees relating to the economic obligations resulting from its participation in the Spanish gas system (MIBGAS) and the Spanish electricity system (MEFF and OMIE) for Euros 562 million (Euros 598 million at 31 December 2017).
- Financial guarantees relating to the guarantee for compliance with obligations under loans received by investee companies amounting to Euros 8 million (Euros 100 million at 31 December 2017). In addition, guarantees exist for compliance with obligations under loans received by investee companies amounting to USD 75 million (Euros 65 million).
- Guarantees for debt issues by group companies Gas Natural Capital Markets, S.A., Gas Natural Finance, B.V., Unión Fenosa Preferentes, S.A.U. and Gas Natural México S.A. de C.V. totalling Euros 11,531 million (Euros 12,879 million at 31 December 2017).
- Guarantees for obligations under gas purchase and transport contracts and the chartering of gas tankers of group companies Gas Natural Aprovisionamientos, S.A. and Gas Natural Europe, S.A.S.
- Irrevocable guarantee by Naturgy Energy Group, S.A. for all the liabilities and commitments of Naturgy Energy (UK) and its subsidiaries in Ireland at 31 December 2018 and 2017, in accordance with Article 357 of the 2014 Companies Act of Ireland, in order to file the consolidated financial statements of Naturgy instead of its separate financial statements on the basis of the exemption allowed under Section 1 (b) of said Act.

As the above guarantees are basically granted in order to guarantee the fulfilment of contractual obligations or investment commitments, the events that would lead to their execution, and therefore a cash disbursement, would be the nonfulfillment by Naturgy of its obligations in the ordinary course of its business, the probability of which is considered remote. Naturgy estimates that the liabilities not foreseen at 31 December 2018, if any, that could arise from guarantees furnished, would not be significant.

Contractual commitments

The following tables present the contractual commitments for purchases and sales at 31 December 2018:

At 31 December 2018							
Acquisition	Total	2019	2020	2021	2022	2023	and later years
Energy purchases ⁽¹⁾	83,664	7,677	7,765	7,729	6,709	6,494	47,290
Energy transmission ⁽²⁾	2,661	422	408	406	225	125	1,075
Investment ⁽³⁾	652	606	46	-	-	-	-
Operating leases ⁽⁴⁾	476	131	75	38	35	31	166
Nuclear fuel purchases	34	19	15	-	-	-	-
Total contractual obligations	87,487	8,855	8,309	8,173	6,969	6,650	48,531

At 31 December 2018							
Sale	Total	2019	2020	2021	2022	2023	y siguientes
Energy sales ⁽⁵⁾	16,271	3,602	2,449	1,760	1,065	846	6,549
Provision of capacity assignment services ⁽⁶⁾	3,282	260	307	276	279	291	1,869
Total contractual obligations	19,553	3,862	2,756	2,036	1,344	1,137	8,418

1. Basically reflects the long-term commitments for natural gas purchases amounting to Euros 83,630 million under gas supply contracts with take or pay clauses negotiated and held for “own use” (Note 3.4.7.3). Normally, these contracts are for 20-25 years, a minimum amount of gas to be purchased and revision mechanisms for prices indexed to international natural gas prices and regulated prices of natural gas in the countries of origin. The commitments according to these contracts have been calculated on the basis of natural gas prices at 31 December 2018.

This also includes long-term commitments to buy electricity, calculated based on prices at 31 December 2018.

2. Reflects the long-term commitments (20 to 25 years) for gas transport and electricity transmission calculated on the basis of prices at 31 December 2018. It also reflects operating costs associated with charter contracts for gas tankers under finance leases for the eight tankers currently in operation (Note 19).

3. Reflects investment commitments basically for the construction of renewable generation plants in Spain and Australia, the development of the distribution network and other gas infrastructures and the development of the electricity distribution network. (Note 6).

4. Mainly reflects the commitments for operating leases on ships which mature in 2021 and commitments under leases on land and buildings related to generation facilities.

It includes the rent of the “Torre del Gas” building owned by Torre Marenstrum, S.L., for which Naturgy has an operating lease without a purchase option until 2019 extendible at market value for successive periods of three years, on a discretionary basis for Naturgy and an obligatory basis for Torre Marenstrum S.L.

It also includes operating leases without a purchase option for five properties in Madrid (Avenida San Luis 77, Antonio López 193, Acanto 11-13, Avenida América 38 and calle Lérida) for a nine-year term which may be extended for five years except in the case of Avenida América 38 (Note 6).

The cost of these operating leases amounted to Euros 138 million in 2018 (Euros 116 million for 2017).

5. Basically refers to long-term commitments to sell natural gas under gas sale contracts, containing take-or-pay clauses, negotiated and held for “own use” (Note 3.4.7.3). The commitments have been calculated based on natural gas prices at 31 December 2018.

6. Reflects service provision commitments under power generation capacity assignment contracts in Mexico (Note 03/04/2020). The commitments made in these contracts have been calculated based on prices at 31 December 2018.

Note 36. Auditors' fees

Total fees for auditing and related services and other services in 2018 amounted to Euros 5,239 thousand (Euros 7,414 thousand in 2017).

The fees accrued in thousand euro by the different companies operating under the Ernst & Young (EY) brand in 2018 (PwC in 2017) are as follows:

	Thousand Euros					
	2018			2017 ¹		
	Ernst & Young, S.L.	Rest EY network	Total	PwC Auditores, S.L.	Rest PwC network	Total
Auditing services	1,728	2,682	4,410	2,249	1,217	3,466
Assurance services and services related to the audit ⁽²⁾	42	30	72	383	230	613
Other services ⁽²⁾	298	423	721	146	1,059	1,205
Total honorarios	2,068	3,135	5,203	2,778	2,506	5,284

1. The 2017 consolidated income statement has been restated, reclassifying to discontinued operations in accordance with IFRS 5 (Notes 3.3 and 11).

2. These headings include verification reports on non-financial information, comfort letters and advice on sustainability

Additionally, other audit firms have rendered the following services to group companies:

	Thousand Euros	
	2018	2017 ¹
Auditing services	36	1,468
Assurance services and services related to the audit	-	-
Other services	-	662
Total fees	36	2,130

1. The 2017 consolidated income statement has been restated, reclassifying to discontinued operations in accordance with IFRS 5 (Notes 3.3 and 11).

The calculation of auditor fees for the current and period and in the comparative analysis with the previous year does not take into account the fees relating to companies that have been reclassified to discontinued operations, amounting to Euros 141 thousand accrued by other audit firms (Euros 678 thousand from PwC and Euros 61 thousand from other audit firms at 31 December 2017, respectively).

Note 37. Environment

Environmental actions

Naturgy is aware of its activities' environmental impacts and therefore the company pays particular attention to the protection of the environment and the efficient use of natural resources to meet energy demand.

Responsible environment management is a strategic pillar for Naturgy and is structured around three strategic axes:

- Climate and air: contributing to the mitigation of climate change, the energy transition and the improvement of air quality.
- Circular economy: enhancing eco-efficiency in the use of resources to reduce negative environmental impacts.
- Natural capital and biodiversity: promoting the conservation of natural and cultural heritage in the areas of action.

To achieve this, environmental management is based on the ISO 14001 model, the correct functioning of which is audited externally each year, providing the tools required to optimise environmental management.

In climate and air, the main lines of action carried out in 2018 to reduce emissions are the replacement of carbon-intensive fuels by more sustainable fuels, renewable generation and the reduction of leak emissions in gas distribution networks.

During 2018 there has been a reduction in direct CO₂ emissions compared to 2017 as a result of two factors. Firstly, the meteorological conditions have led to an increase in renewable generation (hydroelectric and, to a lesser extent, wind power) and a reduction in coal generation, resulting in a reduction in CO₂ emissions. Secondly, the disinvestments in Kenya, in CO₂-intensive generation technologies and in Colombia (gas distribution) have also contributed to the reduction in greenhouse gas emissions.

In the circular economy, the lines of work are different. Firstly, energy efficiency improvement projects were carried out, both at our own facilities and at our customers', and initiatives were developed to reduce the consumption of various materials and consumables. Actions have also been taken to enhance waste recovery and reduce waste generation. With regard to water, measures have been taken to optimise water consumption, such as the actions taken at the Aceca combined cycle power plant to reduce consumption of clarified water. On a global level there was a decrease in 2018 compared to 2017, mainly due to lower demand for coal-fired power plants. It should finally be noted that innovation projects have been carried out in new energy models that are fully aligned with the circular economy. An example of this is the pilot plants to generate renewable gas from urban wastewater at the Arazuri (Navarra) or Bens treatment plants and the Metamorphosis project to convert waste treatment plants into bioenergy plants.

In 2018, Naturgy has conducted multiple actions in the natural capital and biodiversity area, all of which are aligned with the prevention, reduction in and compensation for our impacts, and the enhancement of the value of the natural surroundings.

Environmental activities undertaken in 2018 amounted to Euros 494 million (Euros 96 million in 2017), of which Euros 396 million relate to environmental investments and Euros 98 million relate to environmental management of facilities, excluding those derived from the coal market. The investments made include those relating to new renewable generation projects (Euros 314 million), mainly wind and photovoltaic farms which will contribute to reducing specific emissions of CO₂ and other atmospheric pollutants.

Finally, referring to possible contingencies, indemnities and other environmental risks that may be incurred by the company, third-party liability insurance policies are in place to cover any damage that might arise.

Emissions

In 2018, total consolidated CO₂ emissions from Naturgy's coal and combined cycle plants subject to regulations governing the European emission trading system totalled 9.1 million tonnes of CO₂ (11.2 million tonnes of CO₂ in 2017). This 2Mt decrease is due to the reduced operation of coal plants, since 2018 was a year with greater rainfall.

Naturgy devises a strategy each year for managing transfers to its CO₂ emission allowance coverage portfolio, acquiring them through its active participation in both the primary and secondary markets.

Note 38. Events after the balance sheet date

There have been no significant events subsequent to the closing and until the date of formulation of the consolidated annual accounts.

Appendix I Naturgy companies

1. Subsidiaries

Company	Country	Activity	Method of Consolidation (1)	Total % interest	
				% Controlling interest (2)	% Equity interest
Gas Natural BAN, S.A.	Argentina	Gas distribution	F.C.	70.0	70.0
Ceg Río, S.A.	Brazil	Gas distribution	F.C.	59.6	59.6
Companhia Distribuidora de Gás do Rio de Janeiro, S.A.	Brazil	Gas distribution	F.C.	54.2	54.2
Gas Natural Sao Paulo Sul, S.A.	Brazil	Gas distribution	F.C.	100.0	100.0
Gas Natural Redes GLP, S.A.	Spain	Gas distribution	F.C.	100.0	80.0
Gas Natural Transporte SDG, S.L.	Spain	Gas distribution	F.C.	100.0	80.0
Holdings de Negocios de Gas, S.A.	Spain	Gas distribution	F.C.	80.0	80.0
Nedgia Andalucía, S.A.	Spain	Gas distribution	F.C.	100.0	80.0
Nedgia Aragón, S.A.	Spain	Gas distribution	F.C.	100.0	80.0
Nedgia Balears, S.A.	Spain	Gas distribution	F.C.	100.0	80.0
Nedgia Castilla La-Mancha, S.A.	Spain	Gas distribution	F.C.	95.0	76.0
Nedgia Castilla y León, S.A.	Spain	Gas distribution	F.C.	90.1	72.1
Nedgia Catalunya, S.A.	Spain	Gas distribution	F.C.	100.0	80.0
Nedgia Cegas, S.A.	Spain	Gas distribution	F.C.	99.7	79.8
Nedgia Galicia, S.A.	Spain	Gas distribution	F.C.	68.5	54.8
Nedgia Madrid, S.A.	Spain	Gas distribution	F.C.	100.0	80.0
Nedgia Navarra, S.A.	Spain	Gas distribution	F.C.	100.0	80.0
Nedgia, S.A.	Spain	Gas distribution	F.C.	100.0	80.0
Nedgia Rioja, S.A.	Spain	Gas distribution	F.C.	87.5	70.0
Comercializadora Metrogas, S.A. de CV (3)	Mexico	Gas distribution	F.C.	100.0	85.0
Naturgy México, S.A. de C.V. (3)	Mexico	Gas distribution	F.C.	85.0	85.0
Naturgy Perú, S.A.	Peru	Gas distribution	F.C.	100.0	100.0
UFD Distribución Electricidad, S.A.	Spain	Electricity distribution	F.C.	100.0	100.0
Gas Natural Fenosa Furnizare Energie, S.R.L. (4)	Moldova	Electricity distribution	F.C.	100.0	100.0
Red Unión Fenosa, S.A. (4)	Moldova	Electricity distribution	F.C.	100.0	100.0
Empresa de Distribución Electrica Chiriquí, S.A.	Panama	Electricity distribution	F.C.	51.0	51.0
Empresa de Distribución Electrica Metro Oeste, S.A.	Panama	Electricity distribution	F.C.	51.0	51.0
Gas Natural Exploración, S.L.	Spain	Gas infrastructures	F.C.	100.0	100.0
Naturgy Almacенamientos Andalucía, S.A.	Spain	Gas infrastructures	F.C.	100.0	100.0
Petroleum Oil & Gas España, S.A.	Spain	Gas infrastructures	F.C.	100.0	100.0
Gas Natural Rigassificazione Italia, S.P.A.	Italy	Services	F.C.	100.0	100.0
Metragaz, S.A.	Morocco	Gas infrastructures	F.C.	76.7	76.7
Europe Maghreb Pipeline, Ltd.	United Kingdom	Gas infrastructures	F.C.	77.2	77.2
Natural Energy, S.A.	Argentina	Gas marketing	F.C.	100.0	100.0
Gas Natural Serviços, S.A.	Brazil	Gas marketing	F.C.	100.0	100.0
Naturgy Aprovisionamientos, S.A.	Spain	Gas marketing	F.C.	100.0	100.0
Naturgy LNG, S.L.	Spain	Gas marketing	F.C.	100.0	100.0
Sagane, S.A.	Spain	Gas marketing	F.C.	100.0	100.0
Gas Natural Europe, S.A.S.	France	Gas marketing	F.C.	100.0	100.0
Gas Natural Fenosa LNG GOM Limited	Ireland	Gas marketing	F.C.	100.0	100.0
Naturgy LNG GOM Limited	Ireland	Gas marketing	F.C.	100.0	100.0
Naturgy LNG Marketing Ltd	Ireland	Gas marketing	F.C.	100.0	100.0
Naturgy Servicios, S.A. de C.V. (3)	Mexico	Gas marketing	F.C.	100.0	85.0
Naturgy LNG Singapore Pte. Ltd	Singapore	Gas marketing	F.C.	100.0	100.0
Gas Natural Puerto Rico, Inc	Puerto Rico	Gas marketing	F.C.	100.0	100.0
Comercializadora Regulada Gas & Power, S.A.	Spain	Gas and electricity marketing	F.C.	100.0	100.0
Gas Natural Comercializadora, S.A.	Spain	Gas and electricity marketing	F.C.	100.0	100.0
La Energía, S.A.	Spain	Gas and electricity marketing	F.C.	100.0	100.0

Company	Country	Activity	Method of Consolidation (1)	Total % interest	
				% Controlling interest (2)	% Equity interest
Mataró Energía Sostenible, S.A.	Spain	Gas and electricity marketing	F.C.	51.1	51.1
Naturgy Iberia, S.A.	Spain	Gas and electricity marketing	F.C.	100.0	100.0
Naturgy Energy, Ltd	Ireland	Gas and electricity marketing	F.C.	100.0	100.0
Naturgy Ltd	Ireland	Gas and electricity marketing	F.C.	100.0	100.0
Naturgy Energy (UK), Ltd	United Kingdom	Gas and electricity marketing	F.C.	100.0	100.0
Berrybank Development Pty, Ltd	Australia	Electricity generation	F.C.	100.0	74.0
Crookwell Development Pty, Ltd	Australia	Electricity generation	F.C.	100.0	74.0
Ryan Corner Development Pty, Ltd	Australia	Electricity generation	F.C.	100.0	74.0
Global Power Generation Brasil Geracao de Energia Ltda	Brazil	Electricity generation	F.C.	100.0	75.0
Guimaranía I Solar Spe Ltda.	Brazil	Electricity generation	F.C.	100.0	75.0
Guimaranía II Solar Spe Ltda.	Brazil	Electricity generation	F.C.	100.0	75.0
Sertao i Solar Energía, SPE, Ltda	Brazil	Electricity generation	F.C.	85.0	63.8
Sobral i Solar Energía, SPE, Ltda	Brazil	Electricity generation	F.C.	85.0	63.8
GPG Solar Chile 2017 SpA	Chile	Electricity generation	F.C.	100.0	75.0
Iberólica Cabo Leones II, S.A.	Chile	Electricity generation	F.C.	51.0	38.3
Inca de Varas I	Chile	Electricity generation	F.C.	100.0	75.0
Inca de Varas II	Chile	Electricity generation	F.C.	100.0	75.0
Parque Eólico Vientos del Pacífico, S.p.A	Chile	Electricity generation	F.C.	100.0	75.0
Hidroeléctrica Rio San Juan S.A.S. ESP	Colombia	Electricity generation	F.C.	100.0	75.0
Almar Ccs, S.A.	Costa Rica	Electricity generation	F.C.	100.0	75.0
P.H. La Perla, S.A.	Costa Rica	Electricity generation	F.C.	100.0	100.0
Unión Fenosa Generadora La Joya, S.A.	Costa Rica	Electricity generation	F.C.	65.0	48.8
Unión Fenosa Generadora Torito, S.A.	Costa Rica	Electricity generation	F.C.	65.0	48.8
Boreas Eólica 2, S.A.	Spain	Electricity generation	F.C.	89.6	89.6
Corporación Eólica de Zaragoza, S.L	Spain	Electricity generation	F.C.	68.0	68.0
Energías Ambientales de Somozas, S.A.	Spain	Electricity generation	F.C.	97.0	97.0
Energías Especiales Alcoholeras, S.A., En Liquidación	Spain	Electricity generation	F.C.	82.3	82.3
Explotaciones Eólicas Sierra de Utrera, S.L.	Spain	Electricity generation	F.C.	75.0	75.0
Naturgy Wind, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Fenosa, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Naturgy Generación, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Naturgy Renovables Ruralia, S.L.U.	Spain	Electricity generation	F.C.	75.0	75.0
Naturgy Renovables, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Naturgy Wind 4, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Global Power Generation, S.A.	Spain	Electricity generation	F.C.	75.0	75.0
J.G.C. Cogeneración Daimiel, S.L.	Spain	Electricity generation	F.C.	97.6	97.6
P.E. Nerea, S.L.	Spain	Electricity generation	F.C.	95.0	95.0
P.E. Peñaroldana, S.L.	Spain	Electricity generation	F.C.	95.0	95.0
Sociedad de Tratamiento La Andaya, S.L., en liquidación	Spain	Electricity generation	F.C.	100.0	100.0
Societat Eòlica de l'Enderrocada, S.A.	Spain	Electricity generation	F.C.	79.8	79.8
Tratamiento Cinca Medio, S.L. en liquidación	Spain	Electricity generation	F.C.	90.0	90.0
Iberáfrica Power Ltd. (4)	Kenya	Electricity generation	F.C.	100.0	75.0
El Gritón Solar S.A. de C.V.	Mexico	Electricity generation	F.C.	80.0	60.0
Fuerza y Energía Bii Hioxo, S.A. de C.V.	Mexico	Electricity generation	F.C.	100.0	75.0
Fuerza y Energía de Hermosillo, S.A. de C.V.	Mexico	Electricity generation	F.C.	100.0	75.0
Fuerza y Energía de Naco Nogales, S.A. de C.V.	Mexico	Electricity generation	F.C.	100.0	75.0
Fuerza y Energía de Norte Durango, S.A de C.V	Mexico	Electricity generation	F.C.	100.0	75.0
Fuerza y Energía de Tuxpan, S.A. de C.V.	Mexico	Electricity generation	F.C.	100.0	75.0
Energía y Servicios de Panamá, S.A.	Panama	Electricity generation	F.C.	51.0	38.3
Generadora Palamara La Vega, S.A.	Dominican Rep.	Electricity generation	F.C.	100.0	75.0
Lignitos de Meirama, S.A.	Spain	Mining	F.C.	100.0	100.0
Naturgy Informática, S.A.	Spain	IT services	F.C.	100.0	100.0
United Saudi Spanish Power and Gas Services, LLC	Saudi Arabia	Engineering services	F.C.	100.0	78.8

Company	Country	Activity	Method of Consolidation (1)	Total % interest	
				% Controlling interest (2)	% Equity interest
Gas Natural Fenosa Engineering Brasil , S.A.	Brazil	Engineering services	F.C.	100.0	100.0
Gas Natural Fenosa Engineering, S.A.S.	Colombia	Engineering services	F.C.	100.0	100.0
Operación y Mantenimiento Energy Costa Rica, S.A.	Costa Rica	Engineering services	F.C.	100.0	75.0
Naturgy Engineering, S.L.	Spain	Engineering services	F.C.	100.0	100.0
GPG Ingeniería y Desarrollo de Generación, S.L.U.	Spain	Engineering services	F.C.	100.0	75.0
Operación y Mantenimiento Energy, S.A.	Spain	Engineering services	F.C.	100.0	75.0
Proyectos Balmes México, S.A. de C.V.	Mexico	Engineering services	F.C.	100.0	75.0
Spanish Israeli Operation and Maintenance Company, Ltd.	Israel	Engineering services	F.C.	100.0	100.0
Gas Natural Fenosa Ingeniería México, S.A. de C.V.	Mexico	Engineering services	F.C.	100.0	100.0
Gas Natural Fenosa Ingeniería y Desarrollo de Gen. México, S.A. de C.V.	Mexico	Engineering services	F.C.	100.0	75.0
GPG Energía México, S.A. de C.V.	Mexico	Electricity generation	F.C.	100.0	75.0
Unión Fenosa Operación México S.A. de C.V.	Mexico	Engineering services	F.C.	100.0	75.0
Gas Natural Fenosa Engineering Panamá, S.A.	Panama	Engineering services	F.C.	100.0	100.0
Gas Natural Fenosa Technology INC	Puerto Rico	Engineering services	F.C.	100.0	75.0
Operations & Maintenance Energy Uganda Ltd	Uganda	Engineering services	F.C.	100.0	75.0
Natural Re, S.A.	Luxembourg	Insurance	F.C.	100.0	100.0
Naturgy Alfa Investments, S.A.U	Spain	Financial services	F.C.	100.0	100.0
Naturgy Capital Markets, S.A.	Spain	Financial services	F.C.	100.0	100.0
Naturgy Participaciones, S.A.U.	Spain	Financial services	F.C.	100.0	100.0
Unión Fenosa Preferentes, S.A.U.	Spain	Financial services	F.C.	100.0	100.0
Naturgy Finance, B.V.	Netherlands	Financial services	F.C.	100.0	100.0
Clover Financial and Treasury Services, DAC.	Ireland	Financial services	F.C.	100.0	100.0
Natural Servicios, S.A.	Argentina	Services	F.C.	100.0	100.0
Gas Natural do Brasil, S.A.	Brazil	Services	F.C.	100.0	100.0
Gas Natural Servicios Económicos, S.A.S.	Colombia	Services	F.C.	100.0	100.0
Gas Natural Servicios Integrales, S.A.S.	Colombia	Services	F.C.	100.0	100.0
General de Edificios y Solares, S.L.	Spain	Services	F.C.	100.0	100.0
Administración y Servicios ECAP, S.A. de C.V.	Mexico	Services	I.G.	100.0	100.0
Administradora de Servicios de Energía México, S.A. de CV (3)	Mexico	Services	I.G.	100.0	85.0
Energía y Confort Administración de Personal, S.A. de C.V. (3)	Mexico	Services	F.C.	100.0	85.0
Sistemas de Administración y Servicios, S.A. de C.V. (3)	Mexico	Services	I.G.	85.0	85.0
Gas Natural Fenosa Servicios Panamá, S.A.	Panama	Services	I.G.	100.0	100.0
Inversiones Hermill, S.A.	Dominican Rep.	Services	I.G.	100.0	100.0
Gas Natural SDG Argentina, S.A.	Argentina	Holding company	I.G.	100.0	100.0
Invergás, S.A.	Argentina	Holding company	I.G.	100.0	100.0
Global Power Generation Australia Pty, Ltd.	Australia	Holding company	I.G.	98.7	74.0
Global Power Generation Chile, S.p.A.	Chile	Holding company	I.G.	100.0	75.0
Naturgy Distribución Latinoamerica, S.A.	Spain	Holding company	I.G.	100.0	100.0
Naturgy Electricidad Colombia, S.L.	Spain	Holding company	I.G.	100.0	100.0
Naturgy Gas and Power, S.L.U.	Spain	Holding company	F.C.	100.0	100.0
Naturgy Infraestructuras EMEA, S.L.	Spain	Holding company	F.C.	100.0	100.0
Naturgy Inversiones Internacionales, S.A.	Spain	Holding company	F.C.	100.0	100.0
La Propagadora del Gas, S.A.	Spain	Holding company	F.C.	100.0	100.0
Naturgy Acciones, S.L.U.	Spain	Holding company	F.C.	100.0	100.0
Unión Fenosa Minería, S.A.	Spain	Holding company	F.C.	100.0	100.0
Gas Natural Fenosa Minería, B.V. (4)	Netherlands	Holding company	F.C.	100.0	100.0
GPG México Wind, S.L.U.	Spain	Holding company	F.C.	100.0	75.0
GPG México, S.L.U.	Spain	Holding company	F.C.	100.0	75.0
First Independent Power (Kenya), Ltd. (4)	Kenya	Holding company	F.C.	100.0	75.0
Unión Fenosa México, S.A. de C.V.	Mexico	Holding company	F.C.	100.0	75.0
Distribuidora Eléctrica de Caribe, S.A.	Panama	Holding company	F.C.	100.0	100.0

Company	Country	Activity	Method of Consolidation (1)	Total % interest	
				% Controlling interest (2)	% Equity interest
Generación Eléctrica del Caribe, S.A.	Panama	Holding company	F.C.	100.0	75.0
Buenergía Gas & Power, LLC	Puerto Rico	Holding company	F.C.	95.0	71.3
CGE Group:			F.C.		
Compañía General de Electricidad, S.A.	Chile	Electricity distribution	F.C.	95.8	95.8
Agua Negra S.A.	Argentina	Electricity distribution	F.C.	100.0	95.8
Energía San Juan S.A.	Argentina	Electricity distribution	F.C.	100.0	95.8
Los Andes Huarpes S.A.	Argentina	Electricity distribution	F.C.	98.0	95.8
CGE Argentina S.A.	Chile	Electricity distribution	F.C.	100.0	95.8
CGE Magallanes S.A.	Chile	Electricity distribution	F.C.	99.9	95.7
Empresa de Transmisión Eléctrica Transemel S.A.	Chile	Electricity distribution	F.C.	100.0	95.8
Empresa Eléctrica de Magallanes S.A.	Chile	Electricity distribution	F.C.	55.2	52.8
Energy Sur Ingeniería, S.A.	Chile	Services	F.C.	55.0	52.7
Sociedad de Computación Binaria S.A.	Chile	Services	F.C.	100.0	95.8
Transformadores Tusan S.A.	Chile	Services	F.C.	100.0	95.8
TV Red S.A.	Chile	Services	F.C.	90.0	47.6
CGE Gas Natural, S.A.	Chile	Holding company	F.C.	92.3	92.3
Aprovisionadora Global de Energía, S.A.	Chile	Gas distribution	F.C.	60.2	55.6
Gas Sur S.A.	Chile	Gas distribution	F.C.	100.0	92.3
Innergy Holdings S.A.	Chile	Gas distribution	F.C.	60.0	55.4
Innergy Soluciones Energéticas S.A.	Chile	Gas distribution	F.C.	100.0	55.4
Innergy Transportes S.A.	Chile	Gas distribution	F.C.	100.0	55.4
Metrogas S.A.	Chile	Gas distribution	F.C.	60.2	55.6
Gasoducto del Pacífico (Argentina) S.A.	Argentina	Gas infrastructures	F.C.	56.7	52.4
Gasoducto del Pacífico S.A.	Chile	Gas infrastructures	F.C.	60.0	55.4
Centrogas S.A.	Chile	Services	F.C.	100.0	55.6
Empresa Chilena de Gas Natural, S.A.	Chile	Services	F.C.	100.0	55.6
Financiamiento Doméstico S.A.	Chile	Services	F.C.	99.9	55.5
GN Holding Argentina Comercializadora, S.A.	Argentina	Holding company	F.C.	100.0	92.3
GN Holding Argentina, S.A.	Chile	Holding company	F.C.	100.0	92.3
CGE Servicios, S.A.	Chile	Services	F.C.	100.0	100.0

1. Consolidation method: F.C. Full Consolidation, P.C. Proportionate Consolidation, E.M. Equity Method

2. Parent company's interest in the subsidiary.

3. The shareholding percentage relating to legally owned shares and to the share buy-back commitment at the percentages stated in Note 19, which are also allocated to the Parent company.

4. Companies recognised as held for sale

2. Joint ventures

Company	Country	Activity	Method of Consolidation ⁽¹⁾	Total % interest	
				% Controlling interest ⁽²⁾	% Equity interest
UF Gas Group:					
Unión Fenosa Gas, S.A.	Spain	Gas marketing	E.M.	50.0	50.0
Segas Services, S.A.E.	Egypt	Gas infrastructures	E.M.	100.0	40.7
Spanish Egyptian Gas Company S.A.E.	Egypt	Gas infrastructures	E.M.	80.0	40.0
Nueva Electricidad del Gas, S.A.U, En Liquidación	Spain	Gas infrastructures	E.M.	100.0	50.0
Unión Fenosa Gas Exploración y Producción, S.A.U.	Spain	Gas infrastructures	E.M.	100.0	50.0
Unión Fenosa Gas Comercializadora, S.A.	Spain	Gas marketing	E.M.	100.0	50.0
Unión Fenosa Gas Infraestructuras B.V.	Netherlands	Holding company	E.M.	100.0	50.0
Gas Natural Vehicular del Norte Asociación en Participación ⁽³⁾	Mexico	Gas distribution	E.M.	51.3	43.6
Eléctrica Conquense, S.A.	Spain	Electricity distribution	E.M.	46.4	46.4
Eléctrica Conquense de Distribución, S.A.	Spain	Electricity distribution	E.M.	100.0	46.4
CH4 Energía S.A. de C.V. ⁽³⁾	Mexico	Gas marketing	E.M.	50.0	42.5
ENER RENOVA, S.A.	Chile	Electricity generation	E.M.	40.0	40.0
Cogeneración del Noroeste, S.L.	Spain	Electricity generation	E.M.	40.0	40.0
Desarrollo de Energías Renovables de la Rioja, S.A.	Spain	Electricity generation	E.M.	36.3	36.3
Desarrollo de Energías Renovables de Navarra, S.A.	Spain	Electricity generation	E.M.	50.0	50.0
ENER Renova España, S.L.	Spain	Electricity generation	E.M.	40.0	40.0
Energías Eólicas de Fuerteventura, S.L.	Spain	Electricity generation	E.M.	50.0	50.0
Infraestructuras Eléctricas La Mudarra, S.L	Spain	Electricity generation	E.M.	39.6	36.6
Molinos de la Rioja, S.A.	Spain	Electricity generation	E.M.	33.3	33.3
Molinos del Cidacos, S.A.	Spain	Electricity generation	E.M.	50.0	50.0
Montouto 2000, S.A.	Spain	Electricity generation	E.M.	49.0	49.0
Nueva Generadora del Sur, S.A.	Spain	Electricity generation	E.M.	50.0	50.0
P.E. Cinseiro, S.L.	Spain	Electricity generation	E.M.	50.0	50.0
Sociedad Gestora de Parques Eólicos Andalucía, S.A.	Spain	Electricity generation	E.M.	21.0	21.0
Toledo PV, A.E.I.E	Spain	Electricity generation	E.M.	33.3	33.3
Ghesa Ingeniería y Tecnología, S.A.	Spain	Engineering services	E.M.	41.2	41.2
EcoEléctrica Holding, LLC.	Puerto Rico	Holding company	E.M.	50.0	35.6
EcoEléctrica, L.P.	Puerto Rico	Electricity generation	E.M.	100.0	35.6
EcoEléctrica LLC	Puerto Rico	Holding company	E.M.	100.0	35.6
CGE Group:					
Gascart S.A.	Argentina	Gas distribution	E.M.	50.0	46.2
Gasnor S.A.	Argentina	Gas distribution	E.M.	97.4	46.2
Gasmarket S.A.	Argentina	Gas distribution	E.M.	50.0	46.2
Empresa de Distribución Eléctrica de Tucumán S.A.	Argentina	Electricity distribution	E.M.	80.5	47.9
Compañía Eléctrica de Inversiones S.A.	Argentina	Electricity distribution	E.M.	90.0	47.9
Empresa Jujeña de Energía S.A.	Argentina	Electricity distribution	E.M.	90.0	43.1
Empresa Jujeña de Sistemas Energéticos Dispersos S.A.	Argentina	Electricity distribution	E.M.	90.0	43.1
Norelec S.A.	Argentina	Electricity distribution	E.M.	50.0	47.9
Dimater, S.A.	Argentina	Electricity distribution	E.M.	100.0	47.9
Empresa de Construcción y Servicios, S.A.	Argentina	Electricity distribution	E.M.	100.0	47.9
Energética del Norte, S.A.U.	Argentina	Electricity distribution	E.M.	100.0	47.9
Noanet, S.A.	Argentina	Electricity distribution	E.M.	100.0	47.9
Gasoductos GasAndes, S.A. (Argentina)	Argentina	Gas infrastructures	E.M.	47.0	26.1
Andes Operaciones y Servicios S.A.	Chile	Gas infrastructures	E.M.	50.0	27.8
Gas Natural Producción, S.A.	Chile	Gas infrastructures	E.M.	36.2	33.4
Gasoductos GasAndes, S.A. (Chile)	Chile	Gas infrastructures	E.M.	47.0	26.1
GNL Chile S.A.	Chile	Gas infrastructures	E.M.	33.3	18.5

1. Consolidation method: FC. Full Consolidation, PC. Proportionate Consolidation, E.M. Equity Method

2. Parent company's interest in the subsidiary.

3. The shareholding percentage relating to legally owned shares and to the share buy-back commitment at the percentages stated in Note 19, which are also allocated to the Parent company.

3. Jointly-controlled assets and operations

Company	Country	Activity	Method of Consolidation ⁽¹⁾	Total % interest	
				% Controlling interest ⁽²⁾	% Equity interest
Bezana / Beguenzo	Spain	Gas infrastructures	PC.	55.6	55.6
Boquerón	Spain	Gas infrastructures	PC.	4.5	4.5
Casablanca	Spain	Gas infrastructures	PC.	9.5	9.5
Chipirón	Spain	Gas infrastructures	PC.	2.0	2.0
Gas Natural West África, S.L.	Spain	Gas infrastructures	PC.	40.0	40.0
Montanazo	Spain	Gas infrastructures	PC.	17.7	17.7
Rodaballo	Spain	Gas infrastructures	PC.	4.0	4.0
Tánger Larache	Morocco	Gas infrastructures	PC.	24.0	24.0
Central Térmica de Anllares, A.I.E.	Spain	Electricity generation	PC.	66.7	66.7
Centrales Nucleares Almaraz-Trillo, A.I.E.	Spain	Electricity generation	PC.	19.1	19.1
Comunidad de bienes Central Nuclear de Almaraz (Grupo I y II)	Spain	Electricity generation	PC.	11.3	11.3
Comunidad de bienes Central Nuclear de Trillo (Grupo I)	Spain	Electricity generation	PC.	34.5	34.5
Comunidad de bienes Central Térmica de Aceca	Spain	Electricity generation	PC.	50.0	50.0
Comunidad de bienes Central Térmica de Anllares	Spain	Electricity generation	PC.	66.7	66.7
Eólica Tramuntana 21, S.L.	Spain	Electricity generation	PC.	60.0	60.0
Eólica Tramuntana 22, S.L.	Spain	Electricity generation	PC.	60.0	60.0
Eólica Tramuntana 23, S.L.	Spain	Electricity generation	PC.	60.0	60.0
Eólica Tramuntana, S.L.	Spain	Electricity generation	PC.	65.8	65.8
UTE ESE Clece - Gas Natural	Spain	Services	PC.	50.0	50.0

1. Consolidation method: FC. Full Consolidation, PC. Proportionate Consolidation, E.M. Equity Method

2. Parent company's interest in the subsidiary

4. Associates

Company	Country	Activity	Method of Consolidation ⁽¹⁾	Total % interest	
				% Controlling interest ⁽²⁾	% Equity interest
Qalhat LNG S.A.O.C.	Oman	Gas infrastructures	E.M.	7.4	3.7
Sistemas Energéticos La Muela, S.A.	Spain	Electricity generation	E.M.	20.0	20.0
Sistemas Energéticos Mas Garullo, S.A.	Spain	Electricity generation	E.M.	18.0	18.0
Sociedade Galega do Medioambiente, S.A.	Spain	Electricity generation	E.M.	49.0	49.0
Bluemobility System, S.L. En Liquidación	Spain	Services	E.M.	20.0	20.0
CER's Commercial Corp	Panama	Services	E.M.	25.0	18.8
Kromschroeder, S.A.	Spain	Services	E.M.	44.5	44.5
Torre Mareostrum, S.L.	Spain	Services	E.M.	45.0	45.0

1. Consolidation method: FC. Full Consolidation, PC. Proportionate Consolidation, E.M. Equity Method

2. Parent company's interest in the subsidiary

Appendix II Variations in consolidation scope

The main consolidation scope changes during 2018 were as follows:

Company name	Operation category	Effective date of operation	Voting rights acquired / eliminated (%)	Voting rights after the operation (%)	Consolidation method after the operation
Compañía General de Electricidad, S.A.	Redemption own shares	1 February	0.3	97.3	Full
Gas Natural Italia S.P.A.	Disposal	22 February	100.0	-	-
Nedgia, S.P.A.	Disposal	22 February	100.0	-	-
Gas Natural Vendita Italia, S.P.A.	Disposal	22 February	100.0	-	-
Cilento Reti Gas, S.R.L.	Disposal	22 February	60.0	-	-
Guimaranía I Solar Spe Ltda.	Acquisition	16 March	100.0	100.0	Full
Guimaranía II Solar Spe Ltda.	Acquisition	16 March	100.0	100.0	Full
Holdering de Negocios de Gas, S.A.	Disposal	19 March	20.0	80.0	Full
Global Power Generation Brasil Geração de Energia Ltda.	Incorporation	3 April	100.0	100.0	Full
Tratamiento Cinca Medio, S.L. En liquidación	Acquisition	5 April	10.0	90.0	Full
Tratamiento Almazán, S.L. En liquidación	Acquisition	5 April	10.0	100.0	Full
Sociedad de Tratamiento La Andaya, S.L. en liquidación	Acquisition	5 April	5.0	65.0	Full
Sociedad de Tratamiento Hornillos, S.L. en liquidación	Acquisition	5 April	5.6	100.0	Full
Gasoducto del Pacífico (Cayman) Ltd. en liquidación	Liquidation	16 April	56.7	-	-
Societat Eòlica de l'Enderrocada, S.A.	Capital reduction	10 May	0.2	79.8	Full
Serviconfort Colombia, S.A.S.	Disposal	1 June	100.0	-	-
Gas Natural, S.A. ESP	Disposal	1 June	41.9	-	-
Gas Natural del Oriente, S.A. ESP	Disposal	1 June	54.5	-	-
Gas Natural Cundiboyacense, S.A. ESP	Disposal	1 June	77.5	-	-
Gas Natural Servicios, S.A.S.	Disposal	1 June	100.0	-	-
Gas Natural del Cesar, S.A. ESP	Disposal	1 June	62.2	-	-
Compañía General de Electricidad, S.A.	Merger	30 June	1.5	95.8	Full
Gas Natural Fenosa Ingeniería y Desarrollo de Gen., S.A. en liquidación	Liquidation	1 July	100.0	-	-
Energética del Norte, S.A.	Incorporation	2 July	47.9	47.9	Equity
Compañía Española de Industrias Electroquímicas, S.A.	Disposal	31 July	100.0	-	-
Soluziona Technical Services, Llc. en liquidación	Liquidation	30 September	100.0	-	-
Compañía General de Electricidad, S.A.	Merger	1 October	0.1	95.9	Full
Naturgy Alfa Investments, S.A.U	Incorporation	10 October	100.0	100.0	Full
Gas Natural Fenosa Ingeniería y Desarrollo de Gen., S.A.S. en liquidación	Liquidation	29 October	100.0	-	-
Naturgy Infraestructuras EMEA, S.L.	Incorporation	7 November	100.0	100.0	Full
Palencia 3 Investigación Desarrollo y Explotación, S.L.	Liquidation	14 November	63.9	-	-
Eólica Tramuntana, S.L.	Capital increase	28 November	5.8	65.8	Proportionate
Gas Natural Fenosa Ingeniería y Desarrollo de Gen., S.A. En Liquidación	Disposal	30 November	100.0	-	-
Naturgy Gas and Power, S.L.U.	Incorporation	12 December	100.0	100.0	Full
Kangra Coal (Proprietary), Ltd.	Disposal	14 December	100.0	-	-
Unión Fenosa South Africa Coal (Proprietary), Ltd	Disposal	14 December	100.0	-	-
Welgedacht Exploration Company Ltd	Disposal	14 December	100.0	-	-
Sociedad de Tratamiento La Andaya, S.L. en liquidación	Acquisition	20 December	35.0	100.0	Full

The main changes in the consolidation scope in 2017 were as follows:

Company name	Operation category	Effective date of operation	Voting rights acquired / eliminated (%)	Voting rights after the operation (%)	Consolidation method after the operation
Línea Trasmisión Cabo Leones, S.A.	Disposal	1 January	50.0	-	-
Proyectos Balmes México, S.A. DE CV.	Incorporation	1 January	100.0	100.0	Full
Naturgy LNG Singapore PTE. LTD.	Incorporation	1 January	100.0	100.0	Full
Vayu Energy, B.V.	Liquidation	28 February	100.0	-	-
Arte Contemporáneo y Energía, A.I.E.	Liquidation	26 April	100.0	-	-
Lanzagorta y Palmes 2, S.L.	Acquisition	7 June	100.0	100.0	Full
Compañía General de Electricidad, S.A.	Capital increase	1 July	0.3	96.9	Full
Compañía General de Electricidad, S.A.	Redemption own shares	30 November	0.1	97.0	Full
CGE Gas Natural, S.A.	Capital increase	1 July	5.7	91.7	Full
CGE Gas Natural, S.A.	Redemption own shares	11 December	0.4	92.1	Full
Global Power Generation Australia Pty, Ltd.	Acquisition	5 July	1.7	98.7	Full
Parque Eólico Vientos del Pacífico, S.p.A	Acquisition	7 July	100.0	100.0	Full
GPG Solar Chile 2017, S.p.A.	Acquisition	21 August	100.0	100.0	Full
Agua Negra S.A.	Capital increase	25 September	3.1	100.0	Full
Energía San Juan S.A.	Capital increase	25 September	3.1	100.0	Full
Los Andes Huarpes S.A.	Capital increase	25 September	3.5	100.0	Full
El Gritón Solar S.A. de C.V.	Acquisition	26 October	80.0	80.0	Full
Naturgy Renovables Ruralia, S.L.U.	Acquisition	20 November	24.0	75.0	Full
Operación y Mantenimiento Energy Mexico, S.A. de C.V. en Liquidación	Liquidation	6 December	100.0	-	-
Infraestructuras Eléctricas La Mudarra, S.L.	Acquisition	13 December	2.8	36.6	Equity
Castrios, S.A.	Disposal	14 November	33.3	-	-
Inmobiliaria Parque Nuevo S.A.	Liquidation	10 November	50.0	-	-
Gas Natural, S.A. ESP	Disposal	22 December	17.2	41.9	Equity
Inimo Ingeniería, S.L.	Acquisition	27 December	100.0	100.0	Equity

Appendix III Naturgy Tax Group companies

The companies in the Naturgy Tax Group are as follows:

Naturgy Energy Group, S.A.	Naturgy Generación, S.L.U.
Boreas Eólica 2, S.A.	Naturgy Iberia, S.A.
Comercializadora Regulada Gas & Power, S.A.	Naturgy Informática, S.A.
Energías Ambientales de Somozas, S.A.	Naturgy Infraestructuras EMEA, S.L.
Energías Especiales Alcoholeras, S.A.	Naturgy Inversiones Internacionales, S.A.
Europe Maghreb Pipeline, Ltd.	Naturgy Participaciones, S.A.U.
Explotaciones Eólicas Sierra de Utrera, S.L.	Naturgy Renovables, S.L.U.
Fenosa, S.L.U.	Naturgy Wind 4, S.L.U.
Gas Natural Comercializadora, S.A.	Naturgy Wind, S.L.U.
Gas Natural Exploración, S.L.	Nedgia Andalucía, S.A.
Gas Natural Fenosa LNG, S.L.	Nedgia Aragón, S.A.
Gas Natural Fenosa Renovables Ruralia, S.L.U.	Nedgia Balears, S.A.
Gas Natural Redes GLP, S.A.	Nedgia Castilla La-Mancha, S.A.
Gas Natural Transporte SDG, S.L.	Nedgia Catalunya, S.A.
General de Edificios y Solares, S.L.	Nedgia Cegas, S.A.
Global Power Generation, S.A.	Nedgia Madrid, S.A.
GPG Ingeniería y Desarrollo de Generación, S.L.U.	Nedgia Navarra, S.A.
GPG México Wind, S.L.U.	Nedgia, S.A.
GPG México, S.L.U.	Operación y Mantenimiento Energy, S.A.
Holdig de Negocios de Gas, S.A.	P.E. El Hierro, S.L.
J.G.C. Cogeneración Daimiel, S.L.	P.E. Montamarta, S.L.
La Energía, S.A.	P.E. Nerea, S.L.
La Propagadora del Gas Latam, S.L.U.	P.E. Peñaroldana, S.L.
La Propagadora del Gas, S.A.	Petroleum Oil & Gas España, S.A.
Lignitos de Meirama, S.A.	Sagane, S.A.
Naturgy Alfa Investments, S.A.U.	Sociedad de Tratamiento Hornillos, S.L.
Naturgy Almacenamientos Andalucía, S.A.	Sociedad Parque Eólico Mouriños, S.L.U.
Naturgy Aprovisionamientos, S.A.	Societat Eòlica de l'Enderrocada, S.A.
Naturgy Capital Markets, S.A.	Tratamiento Cinca Medio, S.L.
Naturgy Distribución Latinoamerica, S.A.	Tratamiento de Almazán, S.L.
Naturgy Electricidad Colombia, S.L.	UFD Distribución Electricidad, S.A.
Naturgy Engineering, S.L.	Unión Fenosa Minería, S.A.
Naturgy Gas and Power, S.L.U.	Unión Fenosa Preferentes, S.A.U.

Annual Consolidated Financial Report 2018

Director's Report

1. Main milestones and key figures	Page 166
2. Market context, risks and opportunities	Page 170
3. Corporate governance	Page 176
4. Business performance and results	Page 183
5. Forecast Group performance	Page 210
6. Sustainable innovation	Page 219
7. Non-financial statement	Page 222
7.1 Business model and value creation	Page 223
7.2 Commitment to results	Page 229
7.3 Service excellence	Page 230
7.4 Responsible environmental management	Page 236
7.5 Interest in people	Page 244
7.6 Health and safety	Page 255
7.7 Responsible supply chain	Page 261
7.8 Social commitment	Page 267
7.9 Integrity and transparency	Page 273
7.10 Table of contents	Page 282
Annex I. Additional information	Page 284
Annex II. Alternative performance metrics	Page 286
Annex III. Glossary of non-financial indicators	Page 289
Annex IV. About this report	Page 291
Annex V. Independent verification report	Page 294
Annex VI. Annual corporate governance report	Page 297
Annex VII. Report on independent review of ICFR	Page 371

1. Main milestones and key figures

1.1. Main milestones in 2018

January to March

- Naturgy issued Euros 850 million in 10-year bonds paying 1.5%, the proceeds from which were used to tender for Euros 916 million in bonds maturing between 2019 and 2023.
- Publication of the first report in compliance with Decree-Act 18/2017 on non-financial and diversity disclosures, which transposed into Spanish law European Directive 2014/95 as regards disclosure of non-financial and diversity information and requires companies to report on environmental, social and governance issues.
- On 1 and 22 February 2018, following approval by the competition authorities, the sale of the gas distribution and supply companies in Italy for Euros 766 million was completed, resulting in a capital gain of Euros 188 million after taxes.
- On 6 February 2018, following the resignation of Mr. Rafael Villaseca Marco as Managing Director of the company, the Board of Directors of Naturgy appointed Mr. Francisco Reynés Massanet as Executive Chairman. Additionally, Mr. Isidro Fainé Casas resigned as a director and was appointed Honorary Chairman of Naturgy.
- On 22 February 2018, Repsol reached an agreement to sell its 20.072% stake in the capital of Naturgy Energy Group, S.A. to Rioja Bidco Shareholdings, S.L.U., a company controlled by funds advised by CVC; the deal was completed in May 2018.
- Top Employers 2018 recognition due to having some of the highest standards in work conditions.
- Naturgy, through subsidiary Global Power Generation (GPG), acquired two solar photovoltaic projects in Brazil in March 2018. The development of these projects, located in the state of Minas Gerais and with a total capacity of 83 MW, represented an investment of over Euros 95 million; they entered commercial operation on 12 December 2018.
- On 19 March 2018, following approval by the competition authorities, a minority 20% stake in the company Holding de Negocios de Gas, S.A., which owns gas network assets in Spain, was sold to a consortium of long-term infrastructure investors comprising Allianz Capital Partners and Canada Pension Plan Investment Board for Euros 1.5 billion, resulting in a capital gain of Euros 1 billion.

April to June

- The volunteer programme with the Red Cross that commenced in 2017 concluded in June 2018, having attained a total of 481 Naturgy volunteers; 437 families were assisted in person, 108 express refurbishments were performed, and another 1,080 households received energy efficiency kits and energy advice workshops.
- The sale of the remaining 41.9% of the gas distribution business in Colombia for Euros 334 million, i.e. its net carrying amount net of dividends received, was completed on 1 June 2018.
- On 27 June 2018, the Shareholders' Meeting approved the distribution of income consisting of allocating Euros 1,001 million out of 2017 income to dividends. That is a dividend of Euros 1 per share, of which Euros 0.33 per share was paid as an interim dividend in cash on 27 September 2017 and the remaining Euros 0.67 per share, also in cash, on 5 July 2018.
- The Shareholders' Meeting also approved the Business Plan 2018-2022, which establishes a new industrial and business unit model, providing for the continuity of the businesses and markets in the future, and updating the main premises and business projections.
- On 27 June 2018, Naturgy reached an outline agreement to sell its 70% stake in Kangra Coal (a mine in South Africa) to Menar Holding. The sale was completed in December 2018.
- Additionally, on 27 June 2018, Naturgy reached an agreement to sell its 100% stake in Iberafrica Power, in Kenya, to AEP Energy Africa Limited; the sale is expected to be completed the first quarter of 2019.
- In June, Naturgy was awarded the "Empresa más igual" seal by the Madrid regional government.

July to September

- In July 2018, the company obtained the Bequal plus certificate, which recognises companies with excellent management of people in terms of diversity of ability.
- In September 2018, Naturgy concluded the agreement to renew and extend the gas supply contract with Sonatrach to 2030 under better terms.
- On 3 September 2018, Unión Fenosa Gas (UFG), the company that owns the Damietta plant in Egypt and is owned 50% by Naturgy, received an arbitration award in its favour from the International Centre for Settlement of Investment Disputes (ICSID), an agency of the World Bank, resolving the dispute presented in 2014; the arbitrators ruled against the Arab Republic of Egypt for failure to supply to UFG's liquefaction facilities in Damietta.
- On 11 September 2018, the Government of Victoria in Australia announced the award to GPG of a total of 180 MW of power generating capacity in a wind project located approximately 150 km from the city of Melbourne.
- In September 2018, the Dow Jones Sustainability Index (DJSI) ranked Naturgy as the world leader in the Gas Utilities sector for the second consecutive year; the company was also certified as world leader in the multiutilities segment by FTSE4GOOD.
- In September 2018, the women's leadership programmes "Take The Lead" and "Hazte Visible" granted Naturgy the Talent Mobility 2018 award.

October to December

- In October 2018, the company was awarded the "Equality in employment" seal by Spain's Ministry of the Presidency, Relations with Parliament and Equality in recognition of the implementation of equal opportunity policies through comprehensive, measurable equality plans that produced concrete results.
- The Solidarity Fund for Energy Rehabilitation was launched in October 2018; the funds were allocated to energy refurbishment of dwellings selected by NGOs with which the company has cooperation agreements.
- On 19 October 2018, Naturgy completed a Euros 314 million bond tender.
- On 6 December 2018, Compañía General de Electricidad, S.A., a subsidiary of Naturgy Energy Group, S.A. in Chile, completed a bond issue for a total of Euros 5 million Unidades de Fomento (UF), equivalent to approximately Euros 176 million.
- On 6 December 2018, Naturgy Energy Group S.A. resolved to conduct a share buyback programme in accordance with the announcement made in the Business Plan 2018-2022 that was presented on 28 June 2018; the shares may be retired if the Shareholders' Meeting to be held in the first half of 2019 so decides.
- On December 2018 Naturgy was awarded the EFR "Family-friendly enterprise" seal by Fundación Más Familia for its contribution to its employees' work-life balance.

Financial performance (Euros million)

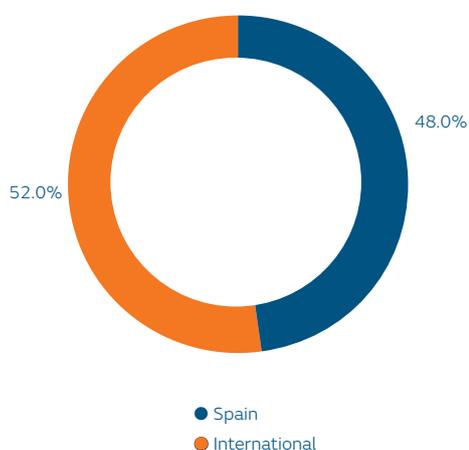
Notes to financial information

- Naturgy's financial disclosures contain magnitudes and metrics drafted in accordance with International Financial Reporting Standards (IFRS) and others that are based on the Group's disclosure model, referred to as Alternative Performance Metrics (APM), which are viewed as adjusted figures with respect to those presented in accordance with IFRS. The attached annex includes a glossary of terms with the definition of the APMs.
- The consolidated income statement and operating figures for 2017 have been re-stated due to the discontinuation of the mining business in South Africa in application of IFRS 5.

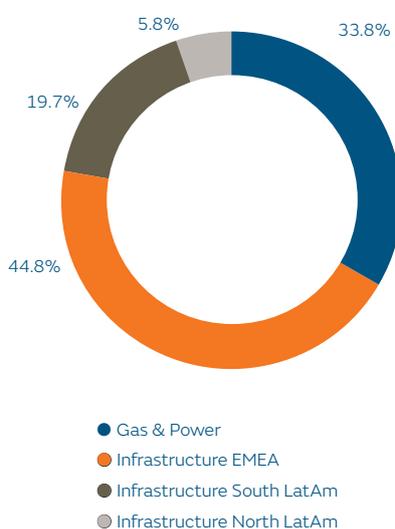
Main financial aggregates

	2018	2017	%
Revenue	24,339	23,207	4.9
Ebitda	4,019	3,903	3.0
Income attributable to equity holders of the parent	(2,822)	1,360	-
Capex	2,321	1,782	30.2
Net financial debt (at 31/12)	13,667	15,154	(9.8)
Free Cash Flow after minorities	3,054	746	-

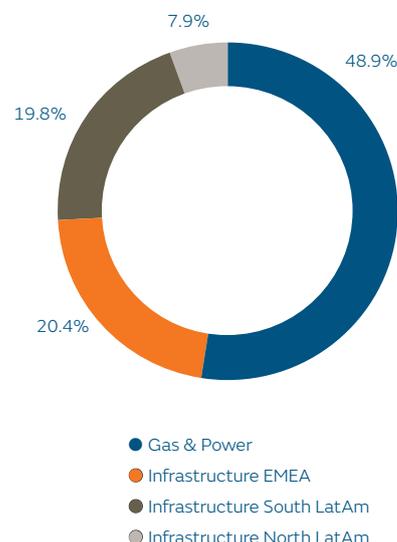
Ebitda by geography 2018 %



Ebitda by business 2018 %



Capital expenditure by business in 2018 %



Note: -5% other activities.

Main financial ratios

	2018	2017
Leverage	48.4%	45.3%
Ebitda / Net debt Cost	7.5x	6.4x
Net financial debt / Ebitda	3.4x	3.9x
Net financial debt / Ebitda (IFRS 16)	3.8x	4.2x

Main stock market ratios and shareholder remuneration

	2018	2017
Total n° of shares ('000)	1,000,689	1,000,689
Average no. of shares ('000) ¹	998,966	1,000,478
Share price at 31/12 (Euros)	22.26	19.25
Market capitalisation at 31/12 (Euros million)	22,275	19,263
Earnings per share (Euros) ¹	(2.83)	1.36
Dividend paid	1,400	1,001

1. Calculated considering the weighted average number of shares during the year.

1.2. Operational performance

Distribution	2018	2017
Gas distribution (GWh)	449,259	460,014
Electricity distribution (GWh)	54,920	53,670
Gas distribution connections ('000)	10,605	10,491
Electricity connection points ('000)	7,569	7,447
Gas distribution network (km)	119,998	116,181
Length of electricity transmission and distribution network (km)	215,532	214,399

Gas	2018	2017
Gas supply (GWh)	237,379	237,945
LNG International (GWh)	140,669	122,086
Total gas supply (GWh)	378,048	360,031

Electricity	2018	2017
Installed capacity in Spain (MW)	12,479	12,716
Installed capacity in rest of world (MW)	3,093	2,732
Total installed capacity (MW)	15,572	15,448
Net production in Spain (GWh)	28,307	27,953
Net production in rest of world (GWh)	18,351	18,436
Total net production (GWh)	46,658	46,389

1.3. Environmental and social performance

Environment	2018	2017
Emission factor (t CO ₂ /GWh)	342	388
GHG emissions (M tCO ₂ e) ¹	18.3	20.5
Emissions-free installed capacity (%)	27.5	26.4
Emissions-free net production (%)	24.9	19.6
Interest in people	2018	2017
No. of employees ²	12,700	14,718
Training hours per employee	49.9	38.4
Men/women (%)	69/31	71/29
Health and safety	2018	2017
No. of accidents leading to days lost	28	45
Frequency	1.0	1.3
Commitment to society and integrity	2018	2017
Economic value distributed (Euros million)	23,413	22,402
No. of notifications received by the Ethics Committee	199	141

1. GHG: greenhouse gases, measured as tCO₂ equivalent (scope 1).

2. Does not include the number of employees at discontinued operations (786 persons in 2018 and 2,053 persons in 2017)

2. Market context, risks and opportunities

2.1. Market context

Reduction of CO₂ emissions and expansion of renewable energy, with natural gas as a key contributor.

The Paris Agreement (2015 XXI United Nations Climate Change Conference, or COP 21) seeks to minimise the impact of climate change, entailing a reduction in emissions that is only possible if there is a long-term transformation in energy. This energy transformation may be an opportunity, since it will require increased investment, but it will also reshape the appeal of businesses and investments alike.

Although there is no single path to achieving the climate goals, the most ambitious scenarios pose significant challenges for fossil fuels.

Due to falling capital costs, renewables are consolidating their leadership and will be the fastest-growing primary energy source in the medium and long term. Renewables are expected to expand from 2% of primary energy demand in 2016 to 6% by 2040.

Natural gas is expected to account for 20% of the primary energy mix in 2040, as it is the main energy source that is compatible with the climate commitments.

Growing electricity demand and energy efficiency

In terms of final energy consumption, electricity will expand by 62%, from total worldwide demand of 21,000 TWh in 2016 to 34,000 TWh in 2040. Development of the emerging economies will require increased use of electrical applications (motors, cooling systems, information technology, etc.), while greater electrification of homes and transportation, coupled with digitalisation, will drive growth of electricity as a final energy source.

Electricity's share of total energy demand is expected to rise from 19% in 2016 to 23% in 2040.

Big data and data analytics

Digitalisation in the energy sector, such as the development of applications and services that transform the relationship with customers due to greater connectivity, will enable demand management to be optimised (smart devices) and the portfolio of products and services to be expanded.

The number of connected devices is expected to increase by 27 billion between 2017 and 2020. Sales via digital channels are expected to increase by over 1 trillion USD in the same period.

2.2. Risks

2.2.1. Risk management model

Naturgy's risk management model seeks to ensure that the company's performance is predictable in all aspects that are of relevance to its stakeholders. This requires establishing the risk tolerance by setting limits for the main risk categories. In this way, the company can anticipate the consequences of certain risks and be perceived in the market as a sound, stable company, with all the benefits that entails.

Naturgy has a framework integrating the vision of governance, risks and compliance so as to provide a 360° view of the group's processes, existing controls and the associated risks.

Risk management bodies

Guaranteeing the predictability and sustainability of the company's operational and financial performance is a key aspects of risk management at Naturgy, and is supported by a number of bodies with clearly identified areas of responsibility.



Audit Committee

Supervises the company's internal control and risk management systems. Its function is to identify the various types of risk and the measures implemented to mitigate them, and to address them in the event that they materialise in the form of actual damage.

Risk Committee

Entrusted with determining and reviewing the company's target risk profile. It ensures that the risk profile is aligned with the company's strategic position and it also safeguards stakeholders' interests. It also exercises oversight to ensure that the entire organisation understands and accepts its responsibility for identifying, assessing and managing the main risks.

Risk Control Units

In charge of monitoring and reporting risks and ensuring that they fall within the limits defined in the target risk profile by the Risks Committee. Three units in particular stand out:

- Risks and Insurance: Identifies, monitors and tracks the Group's overall risk profile based on a definition of policies and metrics in coordination with the business units. Supports the Risk Committee in determining and monitoring the overall risk profile.
- Gas & Power Risks: Oversees and proposes measures to mitigate risks on the basis of Group policy, reducing volatility to achieve the target rate of return.
- Internal audit: Reviews and tracks the internal control system established by Senior Management and evaluates the operational risks linked to the processes. Supports the Audit Committee in its supervisory functions.

Businesses

In charge of managing risk in all their areas of action. They identify trends and positions that may entail risk and report them to the Risk Units. They also apply the guidelines and criteria established by the Risk Units.

Business, Corporate and Project units

Responsible for applying the general principles established in the Risk Control and Management Policy and for risk management in their areas of responsibility, observing, reporting, managing and mitigating risks.

Risk categories

Each business unit has specific information on the main types of risk that may affect it. The goal is to facilitate decision-making, which is positive for the company since it enhances profitability, predictability and efficiency.

The system addresses basically three categories of risk:

- **Market risk**, understood as the uncertainty related to commodity prices, exchange rates and interest rates, which may impact the company's balance sheet, its procurement costs or its ability to raise funding in the capital markets. It is measured using two yardsticks: in the short term, focused on the income statement, and in the long term, focused on enterprise value, including the capacity to generate cash flow and its stability, variations in the funding structure, and volatility in the applicable discount rates.
- **Credit risk**, i.e. the risk to the financial solvency of the company's receivables. It also incorporates the short-term measurement of returns on placing cash surpluses with financial institutions, the aim being to select the most efficient portfolios.
- **Operating risk**, i.e. the possibility of financial losses as a result of failures in processes, internal systems or other factors. It enables risk to be measured objectively, which is decisive for raising awareness within the company and for improving management of exposure, all of which have an essential impact on the reinsurance market's perception of Naturgy's operational excellence.

2.2.2. Main risks

Risk type	Description	Management approach	Metric	Trend	
Market risks					
Commodity prices	Gas	Volatility in the international markets that set gas prices.	Physical and financial hedges. Portfolio management.	Stochastic	▲ Decoupling of long-term contracts from hub prices.
	Electricity	Volatility in the Spanish and Portuguese electricity markets.	Physical and financial hedges. Optimisation of the power generating fleet.	Stochastic	▲ Penetration by renewables with zero marginal cost and intermittent production.
Volume	Gas	Mismatch between gas supply and demand.	Optimisation of contracts and assets worldwide.	Deterministic/ Stochastic	◀▶ Aggregate demand pressure in Spain in a context of energy efficiency.
	Electricity	Reduction of the available thermal gap. Uncertainty about volume of hydroelectric output.	Optimisation of the balance between supply and generation.	Stochastic	▲ Aggregate demand pressure in Spain in a context of energy efficiency.
Regulatory	Exposure to regulatory review of the criteria and returns recognised for regulated activities.	Heightened intensity of communication with regulatory bodies. Adjusting efficiencies and investments to recognised rates.	Scenarios	▲	Different business units at different stages of maturity.
Exchange rate	Volatility in international currency markets.	Geographic diversification. Hedging via local currency funding and derivatives. Monitoring of the net position.	Stochastic	◀▶	Uncertainty about growth prospects in Latin America.
Interest rate and credit spread	Volatility in funding rates.	Financial hedges. Diversification of funding sources.	Stochastic	◀▶	Uncertainty about the interest rate scenario.

Risk type	Description	Management approach	Metric	Trend
Tax	Ambiguity or subjectivity in the interpretation of current tax regulations, or due to a material amendment of same.	Queries to independent expert bodies. Engagement of top level advisory firms. Adoption of the Code of Best Tax Practices. Recognition of provisions on a prudential basis.	Scenarios	◀▶ Different business units at different stages of maturity.
Credit risk				
Credit	Uncertainty about performance of bad debt ratios as a result of the economic cycle.	Analysis of customer solvency to define specific contractual conditions. Debt collection process.	Stochastic	◀▶ Pursues efficiency in debt collection.
Operational risk				
Operational: insurable risks	Accidents, damage and non-availability of Naturgy assets.	Continuous improvement plans. Optimisation of total cost of risk and of hedges.	Stochastic	▲ Growing tension in the insurance market in the face of natural catastrophes.
Operational: image and reputation	Impaired perception of Naturgy by stakeholders.	Identification and tracking of potential reputational events. Transparency in communication.	Scenarios	◀▶ Stabilisation of MERCO index score.
Operational: environment	Harm to the natural and/or social environment. Evolution of environmental regulation.	Emergency plans at facilities with risk of environmental accident. Specific insurance policies. End-to-end environmental management.	Scenarios	▼ Implementation of an Integrated Management System that is audited and certified each year by AENOR.
Operational: climate change	Changes in environmental factors as a result of climate change. Regulation aimed at combating it.	Corporate positioning vis-à-vis climate change.	Stochastic/ Scenarios	▲ Uncertainty about policy developments to encourage energy efficiency.

Metrics used:

- **Stochastic:** production of trend lines for the main magnitudes, taking the maximum deviation from the benchmark scenario to be the risk, within a pre-set confidence interval. Those magnitudes are generally Ebitda, earnings after taxes, cash flow and value.
- **Scenarios:** analysis of the impact with respect to the benchmark scenario of a limited number of possible incidents.

Financial risks (interest rate, exchange rate, commodity prices, credit risk, liquidity risk) are discussed in Note 18 to the Consolidated Financial Statements.

2.3. Opportunities

Naturgy's main opportunities are as follows:

- **Renewable generation:** Increase renewable capacity internationally, given that renewable energies are cost-competitive and considering Naturgy's presence in growth markets.
- **Generation mix:** Naturgy's generating fleet, which is dominated by CCGTs, has the necessary flexibility to adapt to different market situations and is a valuable asset for seizing opportunities related to volatility in prices and demand volume in the gas and electricity markets.
- **Portfolio of natural gas and LNG procurements:** Management of gas pipelines, stakes in plants and the fleet of LNG carriers make it possible to meet the needs of the Group's various businesses in a flexible, diversified way by optimising for different energy scenarios. Naturgy is one of the world's leading LNG operators and a key player in the Atlantic and Mediterranean.
- **A balanced structural position in businesses and regions,** many of them with stable flows that are independent of commodity prices, making it possible to optimise the capture of energy demand growth and maximise new business opportunities in new markets.
- **Technological development and innovation:** Naturgy focuses on research, development and innovation as a means of generating a reliable, sustainable energy supply.

3. Corporate governance

Attached as an annex and forming an integral part of this Directors' Report is the Annual Report on Corporate Governance 2018, as required by article 526 of the Capital Companies Act.

3.1. Corporate Governance Model

Naturgy is governed in accordance with the principles of efficiency and transparency in line with the main recommendations and standards in this area, and it adopts advanced corporate governance practices for this purpose.

The corporate governance terms of reference comprise basically:

- Articles of Association (updated in 2018)
- Regulations of the Board of Directors and its committees (updated in 2018)
- Regulations of the General Meeting of Shareholders (updated in 2018)
- Human Rights Policy
- Code of Ethics (updated in 2015)

On 6 February 2018, following the resignation of Mr. Rafael Villaseca Marco as Managing Director of the company, the Board of Directors of Naturgy appointed Mr. Francisco Reynés Massanet as Executive Chairman. Additionally, Mr. Isidro Fainé Casas resigned as a director and was appointed Honorary Chairman of Naturgy.

On 22 February 2018, Repsol, S.A. reached an agreement to sell its 20.072% stake in the capital of Naturgy Energy Group, S.A. to Rioja Bidco Shareholdings, S.L.U., a company controlled by funds advised by CVC. The transaction was completed on 18 May 2018, with the result that Repsol, S.A. ceased to be a shareholder of the company.

Following that transactions, the main shareholders of Naturgy as of 31 December 2018 are as follows:

	Stake %	
	2018	2017
- Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona."la Caixa" ¹	25.6	24.4
- Repsol, S.A.	-	20.1
- Global Infrastructure Partners III ²	20.0	20.0
- Rioja Bidco Shareholdings, S.L.U., ³	20.1	-
- Sonatrach	3.9	4.0

1. A 20.4% direct stake via Criteria Caixa S.A.U. and a 5.2% indirect stake (holding 5.0% through Energía Boreal 2018, S.A. and 0.2% through other).

2. Global Infrastructure Partners III, which is managed by Global Infrastructure Management LLC, holds its stake indirectly via GIP III Canary 1, S.à.r.l.

3. Controlled by funds advised by CVC.

Following the changes in ownership structure, on 27 June 2018 the Shareholders' Meeting approved the reduction in the number of members of the Board of Directors to 12. Additionally, the Executive Committee was eliminated and the number of members of the Audit Committee and of the Appointments and Remuneration Committee was set at 7 in both cases.

As a result of those changes, the following directors stepped down:

- Mr. Isidro Fainé Casas (Chairman), on 6 February 2018.
- Mr. Rafael Villaseca Marco (Managing Director), on 6 February 2018.
- Mr. Alejandro García-Bragado (proprietary director, representing Criteria), on 21 May 2018.
- Mr. Josu Jon Imaz San Miguel (proprietary director, representing Repsol), on 6 March 2018.
- Mr. Luis Suárez de Lezo Mantilla (proprietary director, representing Repsol), on 18 May 2018.
- Mr. Iñigo Alonso de Noriega (proprietary director, representing Repsol), appointed on 6 March 2018 until 18 May 2018.
- Mr. Guillermo Llopis Garcia (proprietary director, representing Repsol), appointed on 6 March 2018 until 18 May 2018.
- Mr. Mario Armero Montes (proprietary director, representing GIP), on 27 June 2018.
- Theatre Directorship Services Beta, S.à.r.l., Mr. Juan Arbide Estensoro (proprietary director, representing CVC), appointed on 18 May 2018 until 27 June 2018.
- Ms. Cristina Garmendia Mendizabal (independent), until 27 June 2018.
- Ms. Benita María Ferrero-Waldner (independent), until 27 June 2018.
- Mr. Xavier Añoveros Trias de Bes (independent), until 27 June 2018.

And the following new directors were appointed:

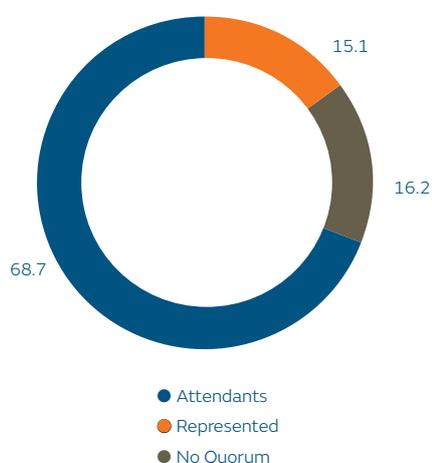
- Rioja Bidco Shareholdings, S.L.U., Mr. Javier de Jaime Guijarro (proprietary director, representing CVC), appointed on 18 May 2018.
- Theatre Directorship Services Beta, S.à.r.l., Mr. José Antonio Torre de Silva López de Letona (proprietary director, representing CVC), appointed on 18 May 2018.
- Mr. Pedro Sainz de Baranda (independent), appointed on 27 June 2018.
- Mr. Claudio Santiago Ponsa, appointed on 27 June 2018.

3.2. Shareholders' Meeting

Any person who is a shareholder of record five days before the Shareholders' Meeting is entitled to attend the Meeting.

Attendance at the 2018 Shareholders' Meeting (%): 83.8%

Attendance at the 2018 Shareholders' Meeting %



3.3. Board of Directors

The Board of Directors of Naturgy operates via plenary meetings and committees, in accordance with the requirements of the Capital Companies Act. Accordingly, the Board of Directors of Naturgy has an Audit Committee and an Appointments and Remuneration Committee, whose functions are as set out in the Act.

Until 27 June 2018, the Board had an Executive Committee, which was responsible for deciding on the issues most closely related to operations over which the Board has competence. In the framework of the Action Plan implemented by the Board of Directors as a result of the self-assessment performed in 2017, the size of the Board of Directors and the existence of the Executive Committee were reconsidered in 2018. After the reduction of the number of members of the Board of Directors to 12, it was no longer considered necessary to maintain that Committee since the aforementioned number guarantees agility in the decision-making process.

In 2018, the Board of Directors undertook an in-depth debate on strategy which crystallised in the approval of the Business Plan 2018-2020.

The other main issues that were considered are as follows:

- Monthly, six-monthly and annual oversight and review of business performance.
- Approval of the accounts, and other actions required by accounting and/or securities market regulations.

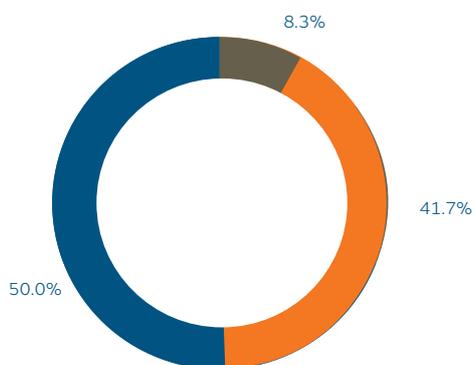
- Budgets, finance plan, capital expenditure plan and other actions related to activities planning and to financial discipline.
- Efficiency plan.
- Examination of the Company's main risks and its control systems.
- Actions in connection with corporate governance: in addition to the normal reports (annual corporate governance report, annual report on remuneration, etc.), as a result of a performance assessment of the Board of Directors and its committees this year a Corporate Governance Action Plan was drawn up and approved, in line with best practices in the area of corporate governance. This resulted in material changes in this area, such as a review to simplify all corporate regulations, reduce the number of directors, and eliminate the Executive Committee.
- Notice of the Shareholders' Meeting, including the proposal to appoint new directors and a dividend proposal.
- Corporate Social Responsibility and health and safety issues.

Composition of the Board of Directors and its committees (at 31 December 2018)

Board of Directors		Audit Committee	Appointments and Remuneration Committee	Category of director	Seniority on Board
Executive Chairman	Mr. Francisco Reynés Massanet			Executive	6/02/2018
Lead director	Mr. Ramón Adell Ramón	Director	Chairman	Independent	18/06/2010
Director	Mr. Enrique Alcántara-García Irazoqui	Director		Independent	18/06/2010
Director	Mr. Marcelino Armenter Vidal		Director	Proprietary	21/09/2016
Director	Mr. Francisco Belil Creixell	Chairman	Director	Independent	14/05/2015
Director	Ms. Helena Herrero Starkie	Director		Independent	04/05/2016
Director	Mr. Rajaram Rao	Director		Proprietary	21/09/2016
Director	Rioja Bidco Shareholdings, S.L.U., Mr. Javier de Jaime Guijarro		Director	Proprietary	18/05/2018
Director	Mr. Pedro Sainz de Baranda	Director	Director	Independent	27/06/2018
Director	Mr. Claudio Santiago Ponsa		Director	Independent	27/06/2018
Director	Theatre Directorship Services Beta, S.à.r.l., Mr. José Antonio Torre de Silva López de Letona	Director		Proprietary	18/05/2018
Director	Mr. William Alan Woodburn		Director	Proprietary	30/09/2016
Secretary (not a director)	Mr. Manuel García Cobeleda	Secretary (not a director)	Secretary (not a director)	N/A	29/10/2010

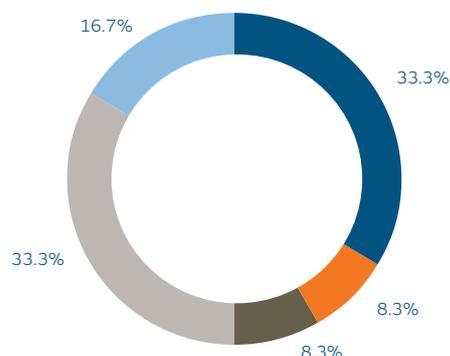
Board of Directors profile %

Type of Director



- Independent
- Proprietary
- Executive

Skills



- Industrial engineering and energy
- Finance, accounting and audit
- Legal and administration
- Management
- IT & International management

Board of Directors activities and performance

Number of meetings of the Board of Directors and its committees

	Board of Directors	Executive Committee	Audit Committee	Appointments and Remuneration Committee
2018	14	2	7	11
2017	15	3	10	5

3.4. Management structure

Following the appointment of Mr. Francisco Reynés Massanet as Executive Chairman on 6 February, the group's organisation structure was redesigned, including the elimination of the Executive Committee.

A new and simplified organisational structure was defined comprising four business units (Gas and Power, Infrastructure EMEA, Infrastructure South Latin America (LatAm) and Infrastructure North LatAm) and a leaner corporate structure was adopted, the goal being for the businesses to operate autonomously with full responsibility for their bottom line, leaving corporate functions to focus on value-added processes and on ensuring centralised control.

Senior Management is defined as meaning the executives who report directly to the Executive Chairman, Mr. Francisco Reynés Massanet. As of 31 December 2018, it comprised the following executives:

Business Units

Mr. Manuel Fernández Álvarez: Gas and Power.

Ms. Rosa María Sanz García: Infrastructure EMEA.

Mr. Antonio Gallart Gabás: Infrastructure South LatAm.

Mr. José García Sanleandro: Infrastructure North LatAm.

Corporate Units

Mr. Carlos J. Álvarez Fernández: CFO.

Mr. Antonio Basolas Tena: Strategy & Development.

Mr. Manuel García Cobaleda: Company Secretary and Secretary of the Board of Directors.

Mr. Jordi García Tabernero: Communication and Institutional Relations.

Mr. Antoni Peris Mingot: Resources.

Mr. Jon Ganuza Fernández de Arroyabe: Control.

Mr. Steven Fernández Fernández: Capital Markets.

Projects

Mr. José M^a Egea Krauel: PIPE project.

Mr. Miguel Aller: LEAN project.

3.5. Remuneration policy

Board of Directors

The annual report on director remuneration was presented as a separate item for a consultative vote at the Shareholders' Meeting in 2018.

Directors' remuneration for their membership of the Board and its committees consists solely of fixed amounts determined on the basis of the positions they hold.

The remuneration system was amended in 2018:

- On 6 February 2018, the Board of Directors adopted a material change in the Company's management and administration structure by approving the appointment of a new Executive Chairman and the resignation of the former Chairman and CEO, with the result that the contractual relationship with the previous CEO was terminated on 6 February.
- As part of the process of simplifying corporate governance, the Shareholders' Meeting on 27 June 2018 decided to reduce the size of the Board to 12 members and to abolish the Executive Committee, which resulted in a redistribution and overall reduction of the directors' remuneration for performing non-executive functions.
- In accordance with the provisions of article 9 of the Bylaws and in the framework of the approval of the Business Plan by the Board of Directors on 27 June 2018, the Board resolved, at a meeting on 31 July, to replace the pre-existing multi-year variable remuneration system with a long-term incentive which, since it requires the approval of the Shareholders' Meeting, is subject to the condition precedent that it be authorised by the 2019 Shareholders' Meeting.

These decisions were adopted by the Board of Directors following recommendations in this connection by the Appointments and Remuneration Committee; external legal advice was obtained for the implementation of the new long-term incentive plan and its submission to the Shareholders' Meeting.

Remuneration for membership of the Board of Directors and its committees (Euros/year):

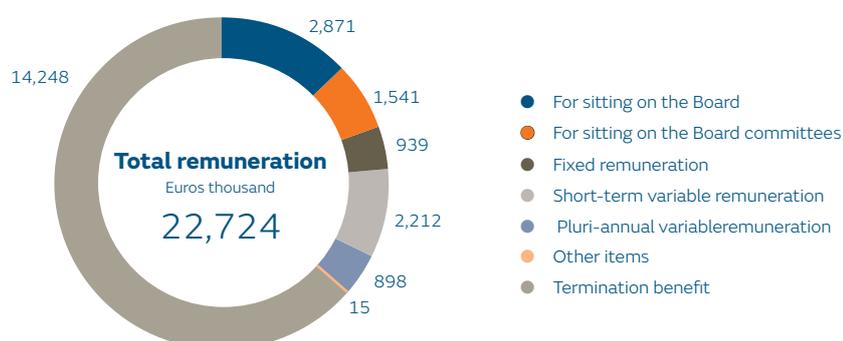
	From 27 June 2018	Up to 27 June 2018
Chairman of the Board of Directors	1,100,000	550,000
Director	175,000	126,500
Lead director	30,000	30,000
Committee chairman	90,000	-
Committee member	60,000	-
Chairman of the Executive Committee	Not applicable	550,000
Member of the Executive Committee	-	126,500
Member of the Appointments and Remuneration Committee	-	25,000
Member of the Audit Committee	-	40,000

Following those changes, the remuneration policy for the Executive Chairman, in respect of his executive functions, is based on the following:

Item	Objective	Criteria
Fixed remuneration annual basis	Remunerate the level of responsibility attached to these functions.	Ensure that the remuneration is competitive vis-à-vis comparable companies.
Annual variable remuneration	Link remuneration with the company's performance in the short term.	Based on 100% of the total fixed annual remuneration, multiplied by the degree to which the goals were actually achieved in the year. Achievement is capped at 150%. No remuneration is payable if goal achievement is less than 80%. The goals and weightings are expected to be established by the Board of Directors at a meeting on 5 March 2019.
Long-term incentive plan	Strengthen the commitment to achieving the goals set out in the strategic plans.	Related to the return obtained by shareholders in the period of reference, which coincides substantially with that of the Business Plan 2018-2022.
Other items	Safeguard the company's benefits.	Health, life insurance and disability. Energy rebate, company vehicle.

The remuneration is supplemented by pension plans and a group health insurance policy.

Total remuneration earned by the Board of Directors in 2018, by type Euros '000

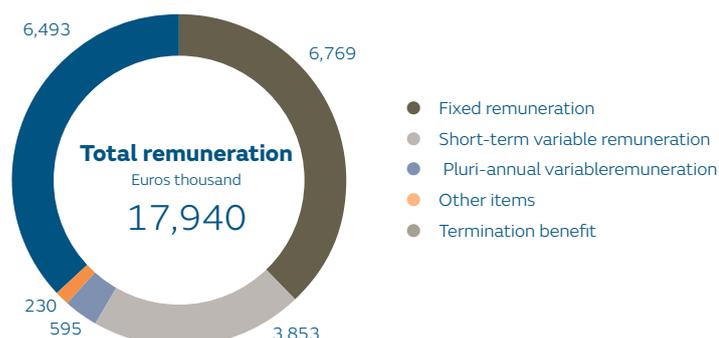


Senior Management

The general remuneration policy for Senior Management is determined by the Board of Directors on the basis of a proposal by the Appointments and Remuneration Committee.

The remuneration model contains the same components as above for the Executive Chairman's executive functions.

Total remuneration earned by the Management Committee and head of Internal Audit¹ in 2018, by type Euros '000



¹ In accordance with CNMV Circular 5/2013, for the purposes of remuneration, senior management includes executives who report directly to the company's chief executive and also the head of internal audit.

4. Business performance and results

4.1 Executive summary

Year 2018 has been marked by a number of key corporate events:

- On 6 February 2018, Francisco Reynés Massanet was appointed as Executive Chairman of the company.
- On 22 February 2018, Repsol reached an agreement to sell its entire 20.1% stake in the capital of Naturgy to Rioja Bidco, a company controlled by funds advised by CVC and in which Corporacion Financiera Alba holds a 25.7% stake. The transaction was completed on 18 May 2018.
- On 28 June, Naturgy presented its new Strategic Plan 2018-2022 which laid the foundations of its value creation strategy, positioning the company for the energy transition.

During the year, Naturgy has made steady progress on the development of its value creation strategy founded on 4 key pillars:

1. Simplicity & accountability:

Throughout the year, Naturgy undertook relevant changes in its corporate governance based on a leaner structure and simpler corporate regulations, leading to a more agile decision-making process. The board of directors was reduced from 17 to 12 members, with 6 proprietary directors (Criteria Caixa, GIP and Rioja 2 each), 5 independent directors and the Executive Chairman.

Additionally, the company changed its organisational structure with a new reporting perimeter consisting of 4 main business units including: (i) Gas and Power, (ii) Infrastructure EMEA, (iii) Infrastructure South LatAm and (iv) Infrastructure North LatAm. This has allowed Naturgy to simplify its management structure and reinforce the accountability of the different businesses. As part of this process, the company reduced the number of subsidiaries and replaced most of its subsidiary Board Directors by joint administrators, while scaling down support functions at the corporate level and reallocating some of these, based on strict functional needs, into each of the business units.

Furthermore and as part of the new strategic plan, Naturgy carried out an asset valuation review, consistent with its new Strategic plan assumptions, which translated into an impairment of Euros 4,851 million, in an effort to provide a more transparent and realistic value of its asset base. Additionally, and prior to the approval of the plan, other impairments were recorded for Euros 54 million.

2. Optimization:

During 2018, Naturgy achieved substantial progress in its optimization efforts.

The Company increased the visibility and de-risked its businesses as shown by the agreement to renew and extend its gas procurement contract with Sonatrach up to 2030 under improved terms, or the favourable ICSID award in the arbitral procedure initiated by Union Fenosa Gas in Egypt, which should allow to reach a comprehensive agreement that will re-establish the value of the company's investment in the region.

Furthermore and as part of the new strategic plan, Naturgy launched a new efficiency plan targeting Euros 500 savings in opex by 2022. During 2018, Naturgy accelerated such program and incurred Euros 180 million capture costs which will result in a reduction of its ordinary opex base going forward.

In 2018 the ordinary opex base has been reduced by approximately Euros 200 million euros compared to 2017.

During 2018, the Company also made progress on its capital structure optimization. In this sense part of its excess cash was used to amortize all of its bank-funded corporate debt, including Euros 1,270 million denominated in euros, as well as Euros 390 million denominated in USD. Additionally, Naturgy completed Euros 333 million bond repurchases at the holdco level and refinanced / issued new debt in Latin America (Latam) for an aggregate amount of approximately Euros 1,073 million, including new bond issuances of Euros 389 million and new banking debt / refinancing of Euros 684 million, consistent with its financing strategy of reducing debt at the corporate level and maximizing financing into the business units

3. Capital discipline:

Naturgy is fully committed to the capital discipline and Golden Rules of investment established in its Strategic Plan 2018-2022.

Consistent with Naturgy's targeted growth in renewables during the Strategic Plan 2018-2022, the company continued to develop the wind and solar projects awarded last year in the Spanish auctions, investing approximately Euros 382 million during the year 2018. During 2019, the Company expects to start operating over 900 MW of additional renewable capacity.

Additionally during 2018, Global Power Generation (GPG) was awarded a 180 MW wind farm project in Australia, which will entail a total investment of AU\$259 million (equivalent to approximately Euros 166 million) and is expected to contribute an Ebitda of approximately Euros 22 million once fully operational. The project, which fully complies with the investment and profitability criteria established by Naturgy in its Strategic Plan 2018-2022, allows the company to reinforce its presence in stable economies, increase the predictability of its cash flows, and raise its exposure to renewable energy sources.

Moreover, the Company acquired two solar photovoltaic projects in Minas Gerais (Brazil). The development of these projects which total 83 MW of capacity, required approximately Euros 95 million investment and came into operation in December 2018.

Finally during 2018, Naturgy completed the disposal of its businesses in Italy and Colombia, as well as the 20% minority stake in Nedgia, receiving proceeds of Euros 2,600 million in aggregate. The Company continues to progress on the various disposal processes of non-core businesses, following the business positioning criteria established in its Strategic Plan 18-22.

4. Shareholder remuneration:

The Company has started delivering on its shareholder remuneration targets.

As part of its new Strategic Plan 2018-2022, Naturgy increased its shareholder remuneration policy. Dividends increased by 30% to Euros 1.30/share in 2018, with a 5% minimum annual increase thereafter, irrespective of operating performance. Moreover, a share buy-back program of up to Euros 400 million p.a. (in the absence of inorganic opportunities meeting the “Golden Rules” of investment) was started.

As part of its new shareholder remuneration policy, Naturgy completed a payment of Euros 0.28/share corresponding to the 2018 first interim dividend on 31 July'18 and a payment of Euros 0.45/share corresponding to the 2018 second interim dividend on 31 October, setting the pace for the minimum committed dividend of Euros 1.30/share against 2018 earnings.

In addition, since the beginning of its strategic plan and until the closing of 2018, Naturgy invested Euros 121 million to buy back shares part of its planned Euros 400 million buy-back per annum until the end of June 2019.

Finally and as part of the new strategic plan, Naturgy set up a new long term incentive plan (LTIP) to fully align shareholders' interests, execution of the Strategic Plan and the managers' long term variable pay. The new LTIP is exclusively linked to total shareholders return and guarantees a full alignment of shareholders' interests with the top managers of the company.

2018 Results

- Business performance during 2018 has been marked by the strong performance of Gas & Power, which was partly offset by non-recurrent items and the negative impact of exchange rates evolution.
- Ebitda in 2018 reached Euros 4,019 million after non-ordinary effects. Stripping these out, ordinary Ebitda rose 11.8% to Euros 4,413 million mainly supported by the improvement in the Gas & Power business unit as well as stability in the Infrastructure businesses which together more than offset the negative Euros 218 million FX impact.
- Net income in 2018 amounted to Euros 2,822 million negative mainly as a result of the Euros 4,905 million asset write-down conducted in the first half of the year. Excluding this impact and other non-ordinary items, ordinary Net income rose 57.0% to Euros 1,245 million driven by higher activity, lower depreciation, and lower financial expenses resulting from the group's debt optimization.
- During 2018 Naturgy has invested Euros 2,321 million, up 30.2% vs. 2017. More than 70% of capex has been deployed in growing the company's asset base through the development of new renewable capacity across the different geographies, the addition of two new LNG tankers acquired under finance leases, and other revenue-generating projects.
- Free cash flow after minorities rose from Euros 746 million to Euros 3,054 million, reflecting the company's increased focus on cash flow generation and the completion of the various disposals processes during the period.
- As of 31 December 2018, Net Debt amounted to Euros 13,667 million, down 9.8% vs. 31 December 2017. The decline in Net Debt/LTM Ebitda to 3.4x from 3.9x in 2017 together with the improvement in Ebitda/Cost of net financial debt to 7.5x from 6.4x at the end of last year, underline the reinforcement of the company's financial solidity in 2018.
- All in all, these 2018 results illustrate Naturgy's progress towards the successful implementation of its 2018-2022 Strategic Plan.

4.2 Key comparability factors and non-ordinary items

Perimeter changes

The following transactions were completed in 2018:

- The disposal of the remaining 41.9% of the gas distribution business in Colombia for Euros 334 million, equal to its carrying amount, net of the dividends received, with no impact on the consolidated income statement.
- The disposal of the gas distribution and supply business in Italy, together with the transfer of the gas supply contract, for Euros 766 million, generating a capital gain of Euros 188 million after taxes recognised under “Income from discontinued operations” in the consolidated income statement.
- The sale of a 20% minority stake in the gas distribution business in Spain for Euros 1,500 million, which resulted in an increase of Euros 1,016 million in the “Equity” caption in the consolidated balance sheet.

Non-ordinary items

The non-ordinary items are summarized below:

Euros million	Ebitda		Net income	
	2018	2017	2018	2017
Gas transport cost & procurement retroactivity	(50)	20	(38)	15
Chile non-ordinary expenses	(44)	-	(28)	-
Restructuring costs	(180)	(126)	(137)	(99)
Asset write-down	-	-	(3,824)	-
Discontinued operations and non-controlling interests ¹	-	-	49	494
Chile mergers tax effect	-	-	42	116
Others	(120)	61	(131)	41
Total	(394)	(45)	(4,067)	567

1. Including Euros 188 million post-tax capital gain from Italian disposal and impairments in Kangra, Moldova and Kenya for Euros 104 million, Euros 73 million and Euros 5 million respectively.

- At the Ebitda level, non-ordinary impacts amount to Euros 394 million negative, the most important of which correspond to capture costs (Euros 180 million) due to the implementation of the efficiency plan.

Other non-ordinary impacts include gas supply and transportation costs (Euros -50 million), non-ordinary fire prevention costs, trial and penalties in Chile (Euros -44 million) and others provisions (Euros -120 million), primarily relating to an existing litigation in process pending resolution as well as other provisions and one-off regularizations.

- At the Net income level, non-ordinary items amount to Euros 4,067 million negative, primarily driven by the asset write-down announced during the Strategic Plan presentation.

Foreign exchange impact

Exchange rate fluctuations in the period are summarized as follows:

2018	Accumulated Average	% Change	Ebitda	Net income
€/USD	1.18	4.4	(34)	(17)
€/MXN	22.71	6.6	(13)	(3)
€/BRL	4.31	19.7	(46)	(10)
€/ARS ¹	43.11	130.9	(107)	(67)
€/CLP	757.34	3.4	(15)	(4)
Others	-	-	(3)	(2)
Total	-	-	(218)	(103)

1. Exchange rate as at 31 December 2018 as a consequence of considering Argentina as a hyperinflationary economy

Hyperinflation in Argentina

According to the criteria established by IAS 29 “Financial Information in Hyperinflationary Economies”, the Argentine economy should be considered as hyperinflationary with retroactive effects as of 1 January 2018. The financial information presented in previous years will not be re-stated.

The inflation rates used were the domestic wholesale price index (IPIM) until 31 December 2016 and the consumer price index (CPI) as of 1 January 2017.

The main impacts as of 31 December 2018 are detailed as follows:

- An increase in shareholders' equity as a result of applying the change of inflation to the historical cost of non-monetary assets from their acquisition or incorporation date in the consolidated balance sheet and the corresponding deferred tax liability.
- An adjustment to the different items of income and expenses to apply the change of inflation from the date they were incorporated into the income statement, as well as to reflect the losses derived from the net monetary position.
- The translation into euros of the figures thus adjusted in the consolidated financial statements applying the closing exchange rate of the Argentine peso against the euro.

The main impacts in the consolidated financial statements at 31 December 2018 derived of the aspects previously mentioned are as follows:

	Million Euros
Net sales	(38)
Ebitda	10
Financial result	(14)
Net income	(8)
Shareholder's equity	55
Capex	(4)

4.3 Analysis of the consolidated results

Net Sales

	2018	% r/total	2017	% r/total	% 2018/2017
Gas & Power	19,560	80.4	17,692	76.2	10.6
Gas, power and services sales	13,064	53.7	12,236	52.7	6.8
International LNG	3,529	14.5	2,629	11.3	34.2
Europe power generation	2,050	8.4	1,935	8.3	5.9
International power generation	917	3.8	892	3.8	2.8
Infrastructure EMEA	2,419	9.9	2,438	10.5	(0.8)
Spain gas networks	1,254	5.2	1,261	5.4	(0.6)
Spain electricity networks	855	3.5	873	3.8	(2.1)
Magreb Infrastructure	310	1.3	304	1.3	2.0
Infrastructure LatAm South	5,080	20.9	5,695	24.5	(10.8)
Chile electricity	2,137	8.8	2,382	10.3	(10.3)
Chile Gas	738	3.0	1,022	4.4	(27.8)
Brazil Chile	1,565	6.4	1,811	7.8	(13.6)
Argentina Gas and Electricity	635	2.6	479	2.1	32.6
Peru Gas	5	-	1	-	-
Infrastructure LatAm North	1,367	5.6	1,343	5.8	1.8
Mexico Gas	596	2.4	546	2.4	9.2
Panama Electricity	771	3.2	797	3.4	(3.3)
Rest	220	0.9	343	1.5	(35.9)
Consolidation adjustments	(4,307)	(17.7)	(4,304)	(18.5)	0.1
Total	24,339	100.0	23,207	100.0	4.9

Net sales totalled Euros 24,339 million in 2018, up 4.9% with respect to 2017, mainly driven by higher volumes and prices in the gas business.

Ebitda

	2018	% r/total	2017	% r/total	% 2018/2017
Gas & Power	1,360	33.8	980	25.1	38.8
Gas, power and services sales	164	4.1	49	1.3	-
International LNG	496	12.3	276	7.1	79.7
Europe power generation	411	10.2	379	9.7	8.4
International power generation	289	7.2	276	7.1	4.7
Infrastructure EMEA	1,802	44.8	1,770	45.3	1.8
Spain gas networks	884	22.0	888	22.8	(0.5)
Spain electricity networks	630	15.7	603	15.4	4.5
Magreb Infrastructure	288	7.2	279	7.1	3.2
Infrastructure LatAm South	791	19.7	859	22.0	(7.9)
Chile electricity	243	6.0	293	7.5	(17.1)
Chile Gas	211	5.3	223	5.7	(5.4)
Brazil Chile	223	5.5	282	7.2	(20.9)
Argentina Gas and Electricity	118	2.9	65	1.7	81.5
Peru Gas	(4)	(0.1)	(4)	(0.1)	-
Infrastructure LatAm North	232	5.8	273	7.0	(15.0)
Mexico Gas	161	4.0	169	4.3	(4.7)
Panama Electricity	71	1.8	104	2.7	(31.7)
Rest	(166)	(4.1)	21	0.5	-
Total	4,019	100.0	3,903	100.0	3.0

Consolidated Ebitda in the period amounted to Euros 4,019 million, 3.0% more than in 2017.

The negative effect of the evolution of the foreign exchange impact of Euros -218 million is matched basically with the positive evolution in the Gas&Power business. Stripping out non-ordinary effects, ordinary Ebitda grew by 11.8%.

Net income

The depreciation, amortisation and impairment expenses at 31 desember 2018 amounted Euros 6,007 million (Euros 1,621 million in the exercise 2017) because of the impairment of assets of Euros 4,333 million booked in the second quarter of the year.

Impairment of credit losses amounted Euros 179 million through the Euros 154 million of the previuos year, an increase of 16.0%.

EBIT in 2018 amounted to Euros 2,167 million negative as a result of the previously discussed impairment booked in the second quarter of the year.

Financial result

Euros million	2018	2017	Variation (%)
Net debt cost	(538)	(611)	(11.9)
Other financial expenses/income	(147)	(87)	69.0
Financial result	(685)	(698)	(1.9)

The Financial result improved 1.9% driven by lower rates on new issues used to refinance maturing debt or redeem bonds, and to the cancellation of bank debt compensated by the increase in other expenses due to substitutions and inflation. The average cost of gross financial debt is 3.1% (vs. 3.4% in 2017), and 87% of the debt is at fixed rates.

Equity-accounted affiliates

Equity-accounted affiliates contributed Euros -513 million in 2018 mostly as a result of the impairment of Union Fenosa Gas (Euros -538 million) and of the holding in Ecoelectrica (Euros -34 million).

Income tax

The effective tax rate as of 31 December 2018, without taking into account all the non-ordinary impacts of the impairments and the decrease of the deferred taxes due to the Chilean mergers, was 21.5%, flat vs. 2017.

Income from discontinued operations

In 2018, income from discontinued operations amounted to Euros 10 million negative, as detailed below:

	2018	2017
Colombia gas	7	430
Italy	194	37
Kenya	(5)	(19)
Moldova	(56)	12
Kangra	(150)	(12)
Total	(10)	448

The income of Italy includes Euros 188 million after-tax capital gain on its disposal.

The income of Moldova includes a write-down of Euros 73 million and the Kangra another one for Euros 141 million because of the departures procedures finished or in progress.

Non-controlling interest

The non-controlling interest breakdown is as follows:

	2018	2017	Variation (%)
EMPL	(54)	(56)	(3.6)
Nedgia	(57)	(7)	-
Other interest	(55)	(214)	(74.3)
Other equity instruments	(60)	(60)	-
Total	(226)	(337)	(32.9%)

In other interest are included: International Power Generation, gas distribution companies in Chile, Brazil, Mexico and Argentina, and the electricity distribution companies in Chile and Panama

In other equity instruments are included accrued interest on perpetual subordinated notes.

Net income

Net income in 2018 amounted to Euros 2,822 million negative. Excluding non-ordinary items, Net income grew 57.0% to Euros 1,245 million in 2018 (Euros 793 million in 2017) that represents an increase of the 57.0%.

4.4 Analysis of the balance sheet

Investments

The breakdown of the investments by type is as follows:

	2018	2017	%
Intangible and PPE investments	2,321	1,782	30.2
Financial investments	35	44	(20.5)
Gross Investments	2,356	1,826	29.0
Divestments and others	(2,640)	(229)	-
Total Investments	(284)	1,597	(117.8)

The investments in power, plant and equipment (PPE) and intangible assets amounted to Euros 2,321 million, with an increase of the 30.2% respect previous year, mainly for the increase in renewable in Spain and international level and the acquisition of two new LNG tankers under a financial lease.

The breakdown for business activities of the power, plant and equipment investments and intangible investments is as follows:

	2018	2017	% 2018-2017
Gas & Power	1,135	394	1.9
Gas, power and services sales	61	48	27.1
International LNG	380	-	-
Europe power generation	462	178	-
International power generation	232	168	38.1
Infrastructure EMEA	473	475	(0.4)
Spain gas networks	240	212	13.2
Spain electricity networks	228	252	(9.5)
Magreb Infrastructure	5	11	(50.0)
Infrastructure LatAm South	459	496	(7.5)
Chile electricity	207	229	(9.6)
Chile Gas	131	80	63.0
Brazil Chile	60	120	(50.0)
Argentina Gas	41	37	10.8
Argentina Electricity	7	11	(36.4)
Peru Gas	13	19	(31.6)
Infrastructure LatAm North	183	225	(18.7)
Mexico Gas	80	115	(30.4)
Panama Electricity	103	110	(6.4)
Rest	71	192	(63.0)
Total	2,321	1,782	30.2

Maintenance capex in 2018 amounted to Euros 683 million, compared to Euros 853 million in 2017, a 19.9% reduction driven by maintenance capex optimization in the infrastructure businesses and rest of activities as well as FX impact.

Growth capex in 2018 represented over 70% of total capex, and amounted to Euros 1,638 million, up from last year's Euros 929 million. It mainly includes the following:

- Euros 380 million for the acquisition under financial lease of two gas carriers.
- A total of Euros 382 million have been invested during the period in the construction of different renewable projects in Spain (wind and solar), with 32,6 MW already put in operation in 2018 in the Canary Islands and other 929 MW expected to come into operation before 2020.
- Euros 106 million correspond to the acquisition and development of solar projects in Brazil, with 85 MW coming into operation in 4Q18.
- Lastly, Euros 75 million have been invested during the period in the construction of 96 MW of wind capacity in Australia, which came into operation in 4Q18.

Additionally, 180 MW of wind capacity in Australia and 324 MW of wind and solar capacity in Chile will be developed before 3Q20-1Q21 respectively.

Divestments

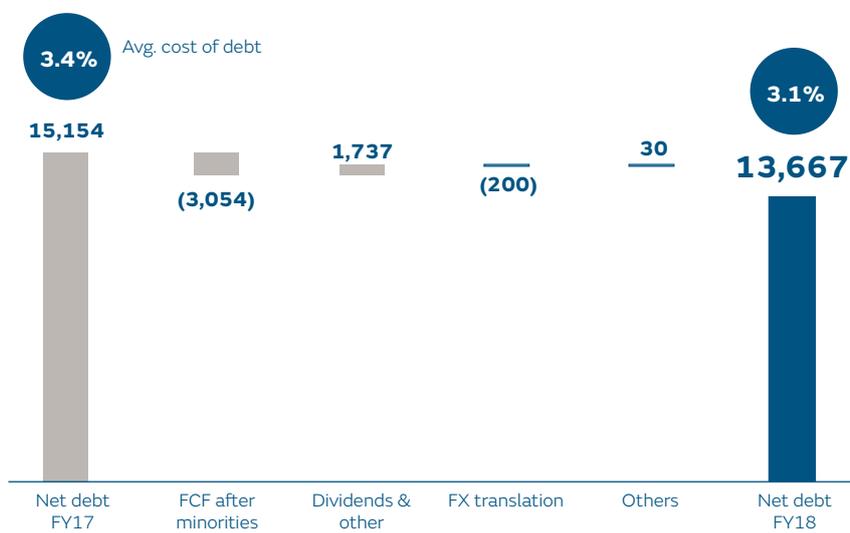
Divestments include the sale of the businesses in Italy for Euros 746 million, the proceeds from the sale of a 20% non-controlling stake in Nedgia (Euros 1,500 million) and the proceeds from the sale of the remaining 41.9% stake in the gas distribution business in Colombia (Euros 334 million).

Debt and financial management

- Naturgy is progressing on the optimization of its capital structure as outlined in its 2018-2022 Strategic Plan.
- In January 2018, the company completed a liability management exercise at the holdco with the issuance of a Euros 850 million 10-year bond with a coupon of 1.5% and Euros 916 million notes repurchase. Additionally, two bonds of Euros 1,099 million in aggregate with an average coupon of 4.59% matured in 2018.
- During the last quarter of 2018, the company completed Euros 333 million bond repurchases at the holdco with maturities spanning from 2019 to 2021.
- Furthermore, the company used part of its excess cash to amortize all of its bank-funded holdco debt, including Euros 1,270 million denominated in euros, as well as Euros 390 million denominated in USD.
- The company is in the process of optimizing the financing allocated into each of the business units in order to increase accountability and funding autonomy in the same currency where cash flows are originated, and gain increased flexibility. In this respect, the Company refinanced / issued new debt in Latin America for an aggregate amount of approximately Euros 1,073 million, including new bond issuances of Euros 389 million and new banking debt / refinancing of Euros 684 million.

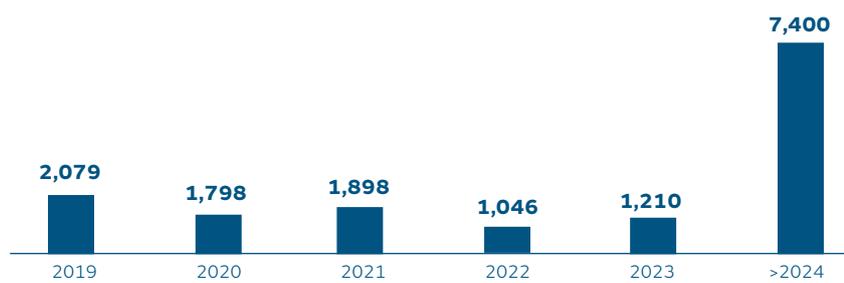
Net debt evolution

The evolution of the net debt from 31 December 2017 to 31 December 2018 has been as follow:



Net debt maturities

The net debt maturities are as follows:



The evolution of the principal ratios applied referent to the Net financial debt is as follows:

		2018	2017
Ebitda/Net financial cost	Times	7.5	6.4
Net financial debt / Ebitda	Times	3.4	3.9
Net financial debt / Ebitda (IFRS 16)	Times	3.8	4.2

The detail of the net financial debt, the average financial cost of the gross debt and the % of fixed gross debt for country and currency is as follows:

		Group		Chile	Brazil	Argentina	Peru	Mexico	Panama	Holding and others	
		Dic'18	Dic'17	CLP	USD	BRL	ARS	USD	MXN	USD	EUR/USD
Net financial debt	MEuros	13,667	15,154	1,995	14	244	(34)	55	367	506	10,520
Average cost of gross debt	%	3.1	3.4	5.9	3.8	7.9	40.9	4.6	8.6	4.1	2.3
% Fixed (Gross debt)	%	87	88	72	-	-	1	-	53	59	95

Credit rating

Naturgy's long-term and short-term credit rating is as follows:

Agency	Short-term	Long-term
Fitch	F2	BBB
Moody's	P-2	Baa2
Standard & Poor's	A-2	BBB

Liquidity and capital

At 31 December 2018, cash and cash equivalents together with available bank finance totalled over Euros 6,950 million, providing the company with sufficient liquidity to cover its debt maturities for more than 24 months, with the following breakdown: :

Liquidity source	Limit	Drawn-down	Available
Undrawn credit facilities	5,468	(234)	5,234
Undrawn loans	-	-	-
Cash and cash equivalents	-	-	1,716
Total	5,468	(234)	6,950

Additionally, at 31 December 2018, the company had Euros 7,691 million available in the form of shelf registrations for financial instruments, including Euros 5,292 million in the Euro Medium Term Notes (EMTN) programme, Euros 1,000 million in the Euro Commercial Paper (ECP) programme, and a combined Euros 1,399 million in the stock market certificates programmes on the Mexico Stock Exchange, the commercial paper programme on the Panama Exchange, the marketable bonds programme in Argentina and the bond lines in Chile.

The breakdown of working capital at 31 December is as follows:

Breakdown of working capital at 31 December	2018	2017
Current operating assets ¹	5,799	5,536
Current operating liabilities ²	(4,468)	(4,069)
	1,331	1,467

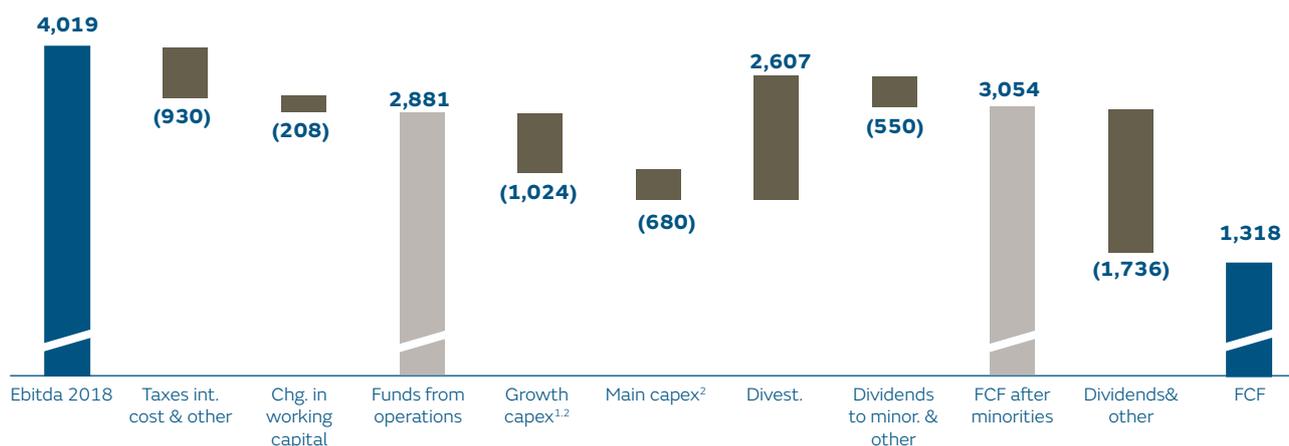
1 Includes inventories, trade receivables and other receivables.

2 Includes trade payables, other payables and other current liabilities, not including dividends payable.

Naturgy takes an average of 22 days to pay suppliers.

Cash flow

The evolution of the free cash flow of the 2018 is as follows:



1. Without considering Euros 380 million corresponding to two LNG vessels acquired under financial leasing.

2. Net of assignments

Analysis of contractual obligations and off-balance sheet transactions

The breakdown of contractual obligations, off-balance sheet transactions and contingent liabilities of Naturgy is set out in note 35 to the consolidated financial statements.

4.5 Analysis of results by segment

Gas & Electricity

Supply of gas, electricity and services

This business includes wholesale gas procurement and supply in the Spanish liberalised market, the supply of gas and electricity and of other products and services related to retail supply in the Spanish liberalised market, supply of gas at the last resort tariff (TUR) in Spain and supply of electricity at the small consumer voluntary price (PVPC) in Spain.

Results

	2018	2017	%
Net sales	13,064	12,236	6.8
Procurement	(12,428)	(11,686)	6.3
Gross margin	636	550	15.6
Other revenues	10	20	(50.0)
Net personnel expenses	(134)	(110)	21.8
Taxes	(63)	(62)	1.6
Other expenses	(285)	(349)	(18.3)
Ebitda	164	49	-
Depreciation, amortisation and operating provisions	(139)	(97)	43.3
Operating income	25	(48)	-

Ebitda rises as a result of higher gas margins from higher prices and the positive impact from the new gas procurement contract agreement with Sonatrach and lower opex.

Main aggregates

The main aggregates in the supply of gas, electricity and service activity are as follows:

	2018	2017	%
Gas sales (GWh)	237,379	237,945	(0.2)
Industrial clients	160,779	155,026	3.7
Residential Spain	27,740	25,381	9.3
Electricity	17,112	20,788	(17.7)
Third parties	31,749	36,749	(13.6)
Electricity sales (Gwh)	35,437	35,640	(0.6)
Liberalized market	30,384	30,587	(0.7)
PVPC	5,053	5,053	-
Residential contracts (Spain) (thousands, a 31/12)	11,470	11,719	(2.1)
Gas	4,174	4,241	(1.6)
Electricity	4,490	4,605	(2.5)
Services	2,806	2,873	(2.3)
Number contracts per client	1.52	1.52	-
Market share of gas contracts (Spain)	53.3	54.4	(1.2) p.p.

Gas sales remained stable in the year 2018 driven by growth in the Spanish residential and industrial segments (up 9.3% and 3.7% respectively) which compensated for lower sales to CCGT (-17.7%) and third parties (-13.6%).

Power supply sales also remained stable vs. 2017; while margins experienced significant downward pressure during 1H18 as a result of fixed-price sales contracts set on forward prices below current pool prices, the measures taken to replace them with variable or indexed contracts allowed for margin recovery in the second half of the year.

Supply

In June, Sonatrach and Naturgy strengthened their relationship by extending the contracts for the purchase of Algerian gas until the end of the next decade; their alliance ensures a stable supply of gas to Spain.

The renewal of the contracts enables Naturgy to maintain a very large volume and ensures an optimal mix of natural gas (NG) and liquefied natural gas (LNG) in its inputs.

The first shipment of LNG under the long-term contract signed with the Russian company Yamal LNG was unloaded on 21 June 2018. This is the first of a total of 37 shiploads that will reach south-western Europe each year until 2041. This contract expands Naturgy's portfolio of strategic suppliers and reinforces the diversity of supply in this region of Europe with the first long-term contract for the supply of LNG from Russia.

Market situation

Demand for gas in Spain amounted to 347,539 GWh in 2018 (349,223 GWh in 2017): 55,670 GWh for the residential market (52,082 GWh in 2017), 230,286 GWh for the industrial market and for the third-party supply (221,787 GWh in 2017) and 61,583 GWh for the electricity market (75,354 GWh in 2017).

Electricity demand in mainland Spain amounted to 248,987 GWh in 2018 (248,631 GWh in 2017) an increase of 0.1% with respect to the same period of 2017 according to Red Eléctrica de España (REE) balances.

Movements in the main gas, electricity and related market price indices are as follows (annual cumulative data):

	2018	2017	%
Brent (USD/bbl)	71.0	54.3	30.8
Henry Hub (USD/MMBtu)	3.0	3.1	(3.2)
NBP (USD/MMBtu)	8.1	5.8	39.7
TTF (€/MWh)	22.0	17.0	29.4
Arithmetic mean daily market price (€/MWh)	58.0	53.6	8.2
Coal API 2 CIF (USD/t)	91.9	84.5	8.8
CO ₂ EUA (€/ton)	15.9	5.8	174.1

LNG International

This includes trading of liquefied natural gas in international markets and maritime transportation.

Results

	2018	2017	%
Net sales	3,529	2,629	34.2
Procurement	(3,003)	(2,316)	29.7
Gross margin	526	313	68.1
Other revenues	2	3	(33.3)
Net personnel expenses	(23)	(21)	9.5
Taxes	-	-	-
Other expenses	(9)	(19)	(52.6)
Ebitda	496	276	79.7
Depreciation, amortisation and operating provisions	(75)	(51)	47.1
Operating income	421	225	87.1

Ebitda in the LNG business amounted to Euros 496 million in 2018, a 79.7% increase year-on-year.

Main aggregates

	2018	2017	%
Gas sales (GWh)	140,669	122,087	15.2
Shipping fleet capacity (m ³)	1,293,040	940,440	37.5

Naturgy's shipping fleet has expanded during the period with the addition of two LNG tankers which have supported the increase in volumes.

Sales increased 15.2% vs. 2017 supported by the entry of Sabine Pass and the first shipments of Yamal LNG.

Global LNG demand has remained strong on the back of continued appetite from Asia, which in turn has supported significant gas price increases relative to 2017.

Europe Power Generation

Includes power generation in Spain, also conventional and renewable.

Results

	2018	2017	%
Net sales	2,050	1,935	5.9
Procurement	(1,091)	(977)	11.7
Gross margin	959	958	0.1
Other revenues	16	20	(20.0)
Net personnel expenses	(140)	(147)	(4.8)
Taxes	(247)	(262)	(5.7)
Other expenses	(177)	(190)	(6.8)
Ebitda	411	379	8.4
Depreciation, amortisation and operating provisions	(4,279)	(442)	-
Operating income	(3,868)	(63)	-

Ebitda in 2018 increases an 8.4% as compared with 2017, mainly driven by lower thermal and higher hydro generation together with greater wholesale prices. These impacts were partially offset by higher CO₂ prices, which reduced thermal margins, and the suspension of capacity payments for CCGTs since the month of July.

Main aggregates

The key figures of Naturgy's generation business in Spain are as follows:

Installed capacity

	2018	2017	%
Installed capacity (MW):	12,479	12,715	(1.7)
Generation:	11,325	11,569	(2.1)
Hydroelectric	1,954	1,954	-
Nuclear	604	604	-
Coal	1,766	2,009	(12.1)
CCGTs	7,001	7,001	-
Renewable and cogeneration output:	1,179	1,147	2.8
Wind	1,012	979	3.3
Small hydroelectric	109	110	(0.5)
Cogeneration and other	58	58	(36.8)

Electric energy produced and Electricity sales.

	2018	2017	%
Electric energy produced (GWh):	28,307	27,953	1.3
Generation:	25,736	25,668	0.3
Hydroelectric	3,359	1,126	-
Nuclear	4,431	4,578	(3.2)
Coal	3,694	5,953	(37.9)
CCGTs	14,252	14,011	1.7
Renewable and cogeneration output:	2,571	2,285	12.5
Wind	1,958	1,800	8.8
Small hydroelectric	549	407	34.9
Cogeneration and other	64	77	(17.1)
Market share of generation	17.4	17.1	0.3 pp

Renewable generation increased by 12.5% during the period, while hydro production saw a 3.0-fold rise, thus reducing the overall thermal production by 8.8%, most notably coal, which was directly impacted by rising costs.

Naturgy continues to increase its renewable exposure through the development of its 667 MW of wind and 250 MW of solar projects awarded in the Spanish auctions. As such, the capacity into operation at year-end 2018 has reached 1,179 MW.

Generation International (GPG)

This area encompasses the international generation assets and holdings in Brazil (commercial operation in September 2017), Mexico, Puerto Rico, Dominican Republic, Panama and Costa Rica and the power generation projects in Australia and Chile, as well as assets operated for third parties via group company O&M Energy.

Results

	2018	2017	%
Net sales	917	892	2.8
Procurement	(527)	(511)	3.1
Gross margin	390	381	2.4
Other revenues	10	12	(16.7)
Net personnel expenses	(39)	(37)	5.4
Taxes	(3)	(4)	(25.0)
Other expenses	(69)	(76)	(9.2)
Ebitda	289	276	4.7
Depreciation, amortisation and operating provisions	(152)	(121)	25.6
Operating income	137	155	(11.6)

Ebitda for 2018 amounts to 289 Euro million, with a 4.7% increase. Growth was supported by the start of the Sobral I and Sertao I solar farms in Brazil from September 2017, together with better margins of excess energy sales in Mexico, and higher wind resource. The above were partially offset by a negative evolution of exchange rates vs. previous year (Euros 17 million).

	2018	2017	Change (%)	FX	Adjusted change (%)
Mexico	243	258	(5.8)	(14)	(0.4)
Rest	46	18	-	(3)	172.2
Total	289	276	4.7	(17)	10.9

Main aggregates

Installed capacity

	2018	2017	%
Installed capacity (MW):	3,093	2,732	13.2
Mexico (CC)	2,289	2,109	8.5
Mexico (wind)	234	234	-
Brazil (solar)	153	68	-
Costa Rica (hydroelectric)	101	101	-
Panama (hydroelectric)	22	22	-
Dominican Republic (oil-fired)	198	198	-
Australia (wind)	96	-	-

Naturgy, through subsidiary Global Power Generation (GPG), acquired two solar photovoltaic projects in Brazil in March 2018 with a total capacity of 83 MW, which entered commercial operation on 12 December 2018.

Also, in November 2018 entered commercial operation the wind farm Crookwell II in Australia.

Electric energy produced and Availability factor

	2018	2017	%
Electric energy produced (GWh):	18,351	18,436	(0.5)
Mexico (CC)	15,923	16,340	(2.6)
Mexico (wind)	701	656	6.9
Brazil (solar)	155	48	-
Costa Rica (hydroelectric)	330	369	(10.6)
Panama (hydroelectric)	94	98	(3.7)
Dominican Republic (oil-fired)	1,092	925	18.1
Australia (wind)	56	-	-
Availability factor (%)			
Mexico (CC)	92.1	96.6	(4.8)
Costa Rica (hydroelectric)	93.5	97.5	(4.0)
Panama (hydroelectric)	87.0	90.5	(3.5)
Dominican Republic (oil-fired)	90.2	92.1	(1.9)

Infrastructure EMEA

Gas distribution Spain

This area includes remunerated gas distribution and transportation as well activities that are charged for outside the regulated distribution system (meter rental, customer connections, etc.), and the piped liquefied petroleum gas (LPG) business.

Results

	2018	2017	%
Net sales	1,254	1,261	(0.6)
Procurement	(75)	(68)	10.3
Gross margin	1,179	1,193	(1.2)
Other revenues	40	39	2.6
Net personnel expenses	(118)	(94)	25.5
Taxes	(28)	(27)	3.7
Other expenses	(189)	(223)	(15.2)
Ebitda	884	888	(0.5)
Depreciation, amortisation and operating provisions	(320)	(307)	4.2
Operating income	564	581	(2.9)

Ebitda in 2018 decreases 0.5% amounting to 884 Euro million driven by the demand growth and good operating performance, lower opex coming from efficiency improvements which were sufficient to compensate for the impact of lower meter rental revenues (Euro-40 million) and, to a lesser extent, lower LPG margins.

Main aggregates

Main aggregates in gas distribution Spain business are as follows:

	2018	2017	%
Sales – TPA (GWh)	197,313	195,586	0.9
Distribution network (km)	56,124	53,369	5.2
Increase in connection points (thousand)	31	58	(46.0)
Connection points (thousand) (at 31/12)	5,403	5,371	0.6

Gas sales and connection points grew by 0.9% and 0.6% respectively, mostly driven by demand growth in the residential market

Electricity distribution Spain

The electricity distribution business in Spain includes regulated distribution of electricity and network services for customers, basically connections and hook-ups, metering and other actions associated with third-party access to Naturgy's distribution network.

Results

	2018	2017	%
Net sales	855	873	(2.1)
Procurement	-	-	-
Gross margin	855	873	(2.1)
Other revenues	26	26	-
Net personnel expenses	(94)	(130)	(27.7)
Taxes	(30)	(29)	3.4
Other expenses	(127)	(137)	(7.3)
Ebitda	630	603	4.5
Depreciation, amortisation and operating provisions	(252)	(233)	8.2
Operating income	378	370	2.2

Ebitda for the year amounts to Euros 630 million. Opex savings due to the application of efficiency plans have been compensated with lower asset remuneration.

Main aggregates

	2018	2017	%
Sales – TPA (GWh)	32,698	32,039	2.1
Connection points (thousand) (at 31/12)	3,740	3,721	0.5
ICEIT (minutes)	46	47	(0.3)

Infrastructure Magreb

This area refers to operation of the Maghreb-Europe gas pipeline.

Results

	2018	2017	%
Net sales	310	304	2.0
Procurement	-	-	-
Gross margin	310	304	2.0
Other revenues	-	-	-
Net personnel expenses	(6)	(6)	-
Taxes	-	-	-
Other expenses	(16)	(19)	(15.8)
Ebitda	288	279	3.2
Depreciation, amortisation and operating provisions	(44)	(38)	15.8
Operating income	244	241	1.2

Ebitda for 2018 increased by 3.2% due to the tariff increase and volume growth, making up for the negative impact of the US Dollar devaluation relative to the Euro (Euros -14 million).

Main aggregates

The main aggregates in international gas transportation are as follows:

	2018	2017	%
Gas transport-EMPL (GWh):	117,526	100,371	17.1
Portugal-Morocco	41,263	38,787	6.4
Spain (Naturgy)	76,263	61,584	23.8

Infrastructure Latin America South

This refers to the regulated gas distribution business in Argentina, Brazil, Chile and Peru and the electricity distribution in Argentina and Chile. In Chile also includes the gas supply activity and the electricity transmission activity.

Gas distribution in Argentina

Results

	2018	2017	%
Net sales	513	355	44.5
Procurement	(316)	(201)	57.2
Gross margin	197	154	27.9
Other revenues	31	35	(11.4)
Net personnel expenses	(15)	(29)	(48.3)
Taxes	(22)	(27)	(18.5)
Other expenses	(83)	(87)	(4.6)
Ebitda	108	46	134.8
Depreciation, amortisation and operating provisions	(15)	(10)	50.0
Operating income	93	36	158.3

Ebitda increases by 134.8% over same period in previous year supported by the final application of the new tariff framework and demand increase, which more than offset the negative Euro 107 million FX impact.

The application of IAS29 had a positive Euro 10 million impact in Ebitda.

Since April 2018 the Argentinian economy has undergone a number of changes in macroeconomic conditions that caused a sharp alteration in parity between the Argentinian peso and the US dollar, changing the economic circumstances taken into account in the Bases and Conditions and reflected in contracts with gas producers. This increase in the exchange rate (not recognised in the current Tariff Table) meant that producers had to be paid a gas price that far exceeded the price that could be passed on via tariffs.

Finally, under Decree 1053/2018 of November 2018 the National Government assumed the payment, on an exceptional basis, of the daily differences accumulated monthly between the value of gas bought by the network natural gas distribution service provides and the value of natural gas included in the tariff tables in effect between 1 April 2018 and 31 March 2019, generated solely by fluctuations in the exchange rate and relating to volumes of natural gas delivered during that period, thereby clearing up the doubts caused by the Government Energy Secretariat Resolution 41/2018.

Main aggregates

The main aggregates in this area are as follows:

	2018	2017	%
Gas activity sales (GWh)	76,287	72,084	5.8
Gas sales	30,651	30,127	1.7
TPA	45,636	41,957	8.8
Distribution network (km)	26,179	25,865	1.2
Increase in connection points (thousand)	14	19	(26.5)
Connection points (thousand) (at 31/12)	1,665	1,651	0.8

Gas sales in the period grew 5.8% across all customer segments.

Gas distribution Brazil

Results

	2018	2017	%
Net sales	1,565	1,811	(13.6)
Procurement	(1,217)	(1,387)	(12.3)
Gross margin	348	424	(17.9)
Other revenues	39	84	(53.6)
Net personnel expenses	(31)	(42)	(26.2)
Taxes	(4)	(3)	33.3
Other expenses	(129)	(181)	(28.7)
Ebitda	223	282	(20.9)
Depreciation, amortisation and operating provisions	(75)	(69)	8.7
Operating income	148	213	(30.5)

Ebitda decreased 20.9% on the back of lower demand and a negative FX effect (Euros 46 million).

The absence of negative retroactive tariff adjustments present in previous periods (Euros +15 million) and the higher sales in the automotive gas segment were offset by lower sales in the power generation and industrial segments as a result of lower thermal power plant utilization and production adjustments due to the macroeconomic situation.

Main aggregates

	2018	2017	%
Gas activity sales (GWh)	72,079	89,080	(19.1)
Gas sales	58,866	74,344	(20.8)
TPA	13,213	14,736	(10.3)
Distribution network (km)	7,678	7,536	1.9
Increase in connection points (thousand)	27	53	(49.9)
Connection points (thousand) (at 31/12)	1,116	1,090	2.4

Electricity distribution and transmission Chile

Includes the activities of electricity transmission and distribution activities.

Results

	2018	2017	%
Net sales	2,137	2,382	(10.3)
Procurement	(1,592)	(1,795)	(11.3)
Gross margin	545	587	(7.2)
Other revenues	24	13	84.6
Net personnel expenses	(128)	(131)	(2.3)
Taxes	(7)	(8)	(12.5)
Other expenses	(191)	(168)	13.7
Ebitda	243	293	(17.1)
Depreciation, amortisation and operating provisions	(166)	(152)	9.2
Operating income	77	141	(45.4)

2018 Ebitda reached Euros 243 million, with a 17.1% decrease mainly as a result of lower revenues from prior years' regularizations and other demand impacts, as well as a negative Euros 10 million FX impact.

Main aggregates

	2018	2017	%
Electricity activity sales (GWh)	15,082	14,573	3.5
Electricity sales	12,220	13,182	(7.3)
TPA	2,862	1,391	-
Connection points (thousand) (at 31/12)	2,928	2,857	2.5
Electricity transmitted (GWh)	14,636	14,403	1.6
Transmission network (km, at 31/12)	3,528	3,528	-

At the operating level, the business experienced growth both in electricity sales (2.6%) and connection points (2.5%).

Gas distribution and supply Chile

Includes the activities of gas distribution and supply.

Results

	2018	2017	%
Net sales	738	1,022	(27.8)
Procurement	(441)	(722)	(38.9)
Gross margin	297	300	(1.0)
Other revenues	5	11	(54.5)
Net personnel expenses	(29)	(28)	3.6
Taxes	(2)	(2)	-
Other expenses	(60)	(58)	3.4
Ebitda	211	223	(5.4)
Depreciation, amortisation and operating provisions	(57)	(49)	16.3
Operating income	154	174	(11.5)

Ebitda decreases by 5.4% respect to previous year, with a negative Euros 8 million FX impact.

Main aggregates

	2018	2017	%
Gas distribution sales (GWh)	10,957	10,933	0.2
Gas commercialization sales (GWh)	4,761	5,192	(8.3)
TPA (GWh)	29,686	29,522	0.6
Distribution network (km)	7,557	7,211	4.8
Increase in connection points (thousand)	24	18	31.3
Connection points (thousand) (at 31/12)	626	602	3.9

In addition, the decrease in residential and commercial demand was offset by higher sales to other segments and higher unitary margins in the residential and commercial segments.

Infrastructure Latin America North

This refers to the regulated gas distribution business in Mexico and the electricity distribution business in Panama.

Gas distribution Mexico

Results

	2018	2017	%
Net sales	596	546	9.2
Procurement	(352)	(305)	15.4
Gross margin	244	241	1.2
Other revenues	10	12	(16.7)
Net personnel expenses	(28)	(26)	7.7
Taxes	(1)	(1)	-
Other expenses	(64)	(57)	12.3
Ebitda	161	169	(4.7)
Depreciation, amortisation and operating provisions	(79)	(56)	41.1
Operating income	82	113	(27.4)

The positive evolution of the business, driven by a higher tariff indexation, together with growth in supply sales margins was not sufficient to compensate for the negative FX impact of Euros 11 million and from higher opex as a result of a commercial repositioning.

Main aggregates

	2018	2017	%
Gas activity sales (GWh)	58,178	57,617	1.0
Gas sales	21,284	21,166	0.6
TPA	36,894	36,451	1.2
Distribution network (km)	22,461	21,940	2.4
Increase in connection points (thousand)	23	115	(80.4)
Connection points (thousand) (at 31/12)	1,796	1,773	1.3

Electricity distribution Panama

Results

	2018	2017	%
Net sales	771	797	(3.3)
Procurement	(644)	(634)	1.6
Gross margin	127	163	(22.1)
Other revenues	3	2	50.0
Net personnel expenses	(13)	(13)	-
Taxes	(5)	(6)	(16.7)
Other expenses	(41)	(42)	(2.4)
Ebitda	71	104	(31.7)
Depreciation, amortisation and operating provisions	(39)	(37)	5.4
Operating income	32	67	(52.2)

Ebitda in 2018 decreases by 31.7% affected by milder weather and a Euros 5 million negative FX impact which was partly compensated by growth in connection points

Main aggregates

	2018	2017	%
Electricity sales (GWh):	5,178	5,107	1.4
Electricity sales	4,888	4,956	(1.4)
TPA	290	151	90.9
Connection points (thousand) (at 31/12)	669	641	4.2

5. Forecast Group performance

5.1 Foundations of strategy

The new Business Plan 2018–2022, unveiled in London on 28 June 2018, establishes the group's business model, which is focused on value creation.

Naturgy is focused on responding to its own industrial model, based on:

- Treating the energy transition as an opportunity.
- Being a flexible, competitive company.
- Transforming via digitalisation.
- Placing the customer at the centre of the model.

Treating the energy transition as an opportunity

Naturgy believes that natural gas and renewable energies will play a very important role in the transition to energies that produce lower CO₂ emissions, as needed to meet the targets set in the 2015 Paris Agreement on climate change.

As a result, the following lines of action have been established:

- Triple renewable installed capacity by 2022
- Leverage Naturgy's lead in combined cycle plants and in the global LNG market
- Develop the use of natural gas in transportation
- Develop renewable gas.

Moreover, Naturgy's infrastructure assets will play a vital role over the next few years in the process of electrification and improvement of energy efficiency, supporting greater electrification and greater penetration by gas in countries where the company already operates.

Being a flexible, competitive company

Solid, tangible levers have been defined for achieving the efficiency goals set out in the Business Plan:

- Organisation: the businesses will be autonomous units with full responsibility for their results, while seeking to optimise company personnel. To this end, a number of changes have been implemented at the organisational level in both corporate governance and the organisational structure in order to facilitate decision-making and the business units' autonomy and responsibility, while always guaranteeing control by the parent company.
- Process re-engineering: reviewing service contracts with suppliers, establishing new cooperation relations with suppliers where necessary to achieve automation or outsource non-core tasks.
- Asset management: search for best practices to optimise asset maintenance based on predictive models and centres of excellence.

Naturgy presented an efficiency plan and undertook to cut annual operating expenses by Euros 500 million by 2022.

Transforming via digitalisation

The following key levers for digitalisation have been defined for 2022:

- Customer relations: 75% of services to be provided via digital channels and 20% penetration via Internet of Things (IoT).
- Processes and operations: Over 80% automation of internal processes and operations.
- Remote control of assets: Achieve 80% coverage of assets with sensors and remote control by 2022, from 56% in 2017.
- Advanced analysis techniques: Data-driven management to be implemented in over 90% of processes Group-wide. The main projects to be undertaken in this connection will be in the following areas: develop predictive models for asset maintenance; use models to pursue customer segmentation, predict churn and apply advanced pricing approaches.

These projects will drive the Group's transformation via digitalisation.

Placing the customer at the centre of the model

Enhance our commitment to the customer by placing them at the centre of Naturgy's strategy based on:

- A single customer experience model
- Defining services and solutions that provide added value to the customer
- Improve customer segmentation
- Innovation and digitalisation

Key factors in this connection are technological innovation such as smart apps, smart meters, remote control, autoproduction of electricity, energy storage, etc.

5.2 Value creation

The main objective of the new Business Plan 2018-2022 is to guide the company towards value creation and lay the foundations for the Group's new industrial model. Naturgy's commitment to value creation is underpinned by four basic pillars: simplicity and accountability, optimisation, discipline in investment, and shareholder remuneration.

Simplicity and Accountability

1. Corporate governance and organisation structure

In terms of corporate governance, a major change was the reduction in the number of members in the Board of Directors from 17 to 12 (the executive chairman, six proprietary directors and five independents). Internal governance rules will also be simplified to achieve a more efficient structure and to make decision-making more agile.

The organisation structure has been simplified into four business units (Gas and Power, Infrastructure EMEA, Infrastructure South LatAm and Infrastructure North LatAm), with leaner corporate functions in order to ensure that the businesses operate autonomously and with full responsibility for their results, enabling the parent company to focus on value-added processes and on ensuring centralised oversight.

A new Opex & Capex Committee was created with the task of ensuring the execution of the company's efficiency plan and for fulfilling the discipline in capital expenditure envisaged in the Business Plan.

With these changes, Naturgy has simplified its corporate governance to streamline decision-making and redesigned its organisational structure to attribute greater autonomy and responsibility to the individual businesses.

2. Strategic positioning

Naturgy defines its strategic positioning on the basis of the following criteria:

	Where to invest	Where to divest
Markets	<ul style="list-style-type: none"> ● Big markets with strong growth potential. ● Where Naturgy has a significant market share or critical mass. ● That offer legal certainty. ● Stable macroeconomic environments (e.g. the EU, North America, OECD). 	<ul style="list-style-type: none"> ● Markets that are small and/or offer little growth potential. ● High regulatory risk. ● Highly concentrated. ● Volatile macroeconomic environments.
Businesses	<ul style="list-style-type: none"> ● Electricity or gas grids. ● Sale of electricity under contract. ● Customer services. ● Controlling stakes. 	<ul style="list-style-type: none"> ● Low level of integration or synergy with the rest of the Group. ● Unhedged volatility. ● Non-controlling stakes.
Profitability	<ul style="list-style-type: none"> ● Above hurdle rate. 	<ul style="list-style-type: none"> ● Low hurdle rate.

A total of Euros 5.3 billion of expenditure in growth capex have been identified, and Euros 300 million are expected to be realised through divestments in addition to those already performed.

Naturgy will also work to balance the weight of its businesses in its mix of activities and will be more ambitious to increase the contribution by regulated activities and by electricity. In the future, the company expects that at least 70% of its business will be linked to regulated activities (currently 52%), with half related to electricity (currently 40%). It also expects to increase exposure to services to about 10%, reinforcing its commitment to the customer.

Simplicity and Accountability



Rebalancing of portfolio: more cash flow visibility and lower volatility

Additionally, on the basis of developments in the markets where it operates and in line with the assumptions and foundations of the new Business Plan, Naturgy reviewed the value of its assets, which resulted in a one-time impairment in the amount of Euros 4,851 million before taxes, booked in 2018. This impairment had no impact on shareholder remuneration and it will be accretive from 2019 because of the lower depreciation charge.

Optimisation

Financial strategy will focus on reducing Opex, optimising Capex and applying strict discipline in investments, pursuing organic development.

Under the Business Plan 2018-2022, the company will continue to optimise the businesses with additional efficiency measures, with the commitment to cut annual operating expenses by Euros 500 million in 2022. These efficiencies will be focused on an analysis of the company's non-core activities and on the assignment of the operational functions within each of the business units, all supported by the ongoing digitalisation processes.

Naturgy plans to cut group-level capex by Euros 200 million per year with respect to the average in 2015-2017, while increasing the percentage of investment allocated to organic growth in comparison with previous years. In average terms, the goal is for 63% of capital expenditure to be allocated to growth in 2018-2022 vs. an average of 54% in 2015-2017.

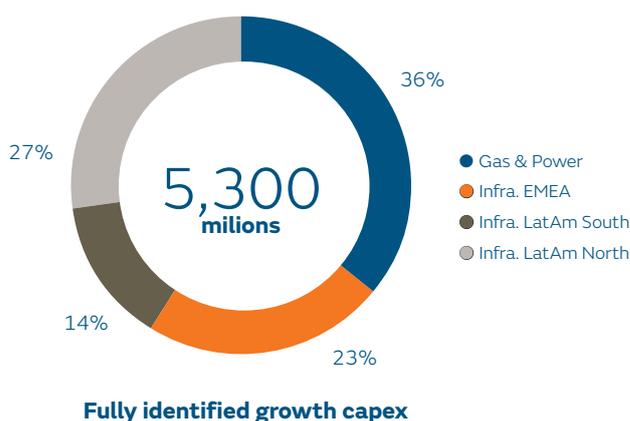
Disciplined investment

Four golden rules were defined to ensure value creation and profitable growth in both organic and inorganic investments:

1. Establishment of a hurdle rate of return, setting minimum profitability targets for businesses, activities and countries so as to ensure value creation.
2. A clear positioning focused on target markets and businesses.
3. Industrial leadership via controlled subsidiaries.
4. Risk management, minimising the volatility of commodity prices and exchange rates.

Applying these rules, Naturgy plans to invest Euros 8.4 billion over the next five years, of which Euros 5.3 billion will be allocated to growth, increasing the proportion of growth capex to 63% of the total in the period:

Growth capex by business (€M)



Financial discipline will enhance free cash flow so as to sustain attractive shareholder remuneration.

Shareholder remuneration

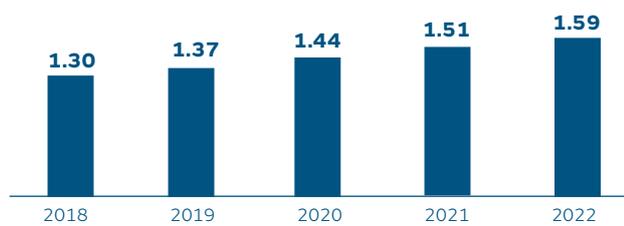
The company will increase the dividend charged to 2018 earnings by 30% to Euros 1.30 per share.

Under the Business Plan 2018-2022, Naturgy made a commitment to its shareholders to increase the cash dividend by at least 5% per year until the end of the period and to pay dividends in three instalments:

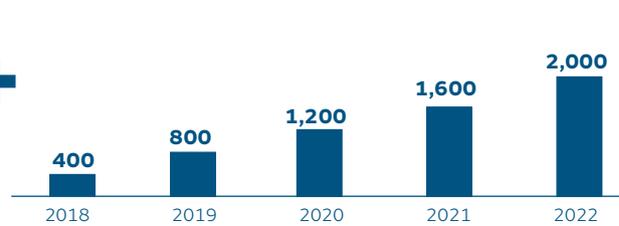
1. At the end of the first half of the year (20% of the total dividend)
2. At the end of the third quarter (35%)
3. After the Shareholders' Meeting (the remaining 45%)

To reinforce the new shareholder remuneration policy, in the event that the company cannot find inorganic investments that meet the hurdle rate, it can allocate a maximum of Euros 2 billion to buying back own shares, capped at Euros 400 million per year.

Dividends (€/share)



Share buy-back (Up to €2,000M)



5.3 Individual business prospects

Naturgy's key financial targets for 2022 are as follows

Key financial targets for 2022 (milions of euros)



The business goals set in the Business Plan are summarised below:

	Gas & Power	Infr. EMEA	Infr. LatAm South	Infr. LatAm North
Asset base 2018	~9,200	~9,800	~7,300	~1,500
EBITDA 2022	~1,700	~1,600	~1,200	~400
Total capex 18-22	~2,700	~2,300	~2,300	~1,000

The growth prospects for the individual businesses, as defined in the Business Plan 2018-2022, are as follows:

Gas & Power

The Business Plan 2018-2022 targets Ebitda of Euros 1.7 billion per year, with capex amounting to Euros 2.7 billion in the period 2018-2022. This will be driven by organic growth and higher efficiency in exploiting assets. The goals and opportunities defined for each of the units in this business are as follows:

	Opportunities	Goals (EurosM)
Gas, power and services sales	• Define a new integrated commercial model	EBITDA 2022 = 549
	• Maximise value by focusing on customers.	Capex 18-22 = 452
	• Exploit the strong growth potential of the services and solutions business.	74% growth capex
International LNG	• Diversified, flexible portfolio of procurement contracts.	EBITDA 2022 = 422
	• Sales secured under contract with end customers.	Capex 18-22 = 392
	• Entry into attractive new markets, such as the Floating Storage Regasification Unit (FSRU), small-scale solutions and bunkering.	100% growth capex
European Power Generation	• Double the volume of renewable energy while cutting total costs.	EBITDA 2022 = 507
	• Increase CCGT load factor.	Capex 18-22 = 1.296
	• Adjust cost of conventional generating fleet.	64% Growth capex
International generation	• Expand in renewables.	EBITDA 2022 = 270
	• Generate recurring cash flow.	Capex 18-22 = 568
		68% growth capex

Infrastructure EMEA

The Ebitda target for this business is around Euros 1.645 billion, with capex in the period 2018-2022 totalling about Euros 2.310 billion. The goals and opportunities defined for each of the units in this business are as follows:

	Opportunities
Spain gas networks	<ul style="list-style-type: none"> Pursue organic growth by exploiting the scope for expanding gas penetration. Limit the business's regulatory risk. Increase efficiency via digital transformation.
Spain electricity networks	<ul style="list-style-type: none"> Work towards a more flexible, digitalised distribution system. Future capex to offset regulatory risks. Pursue efficiency via digitalisation.
EMPL	<ul style="list-style-type: none"> Revenues guaranteed until the concession expires (2021). Negotiations advancing to renew Maghreb-Europe gas pipeline concession.

Infrastructure South LatAm

The Ebitda target for this business is around Euros 1.2 billion, with total capex of about Euros 2.3 billion in the period 2018-2022. The goals and opportunities defined for each of the units in this business are as follows:

	Opportunities	Goals (EurosM)
Chile Electricity	<ul style="list-style-type: none"> Distribution: the regulatory model is expected to improve in 2020 to capture updates in technology and service quality. Transmission: improvements expected due to grid upgrades and new regulations to address the bottleneck produced by the growth of renewable energy. 	EBITDA 2022 = 436 Capex 18-22 = 1,105 60% growth capex
Chile Gas	<ul style="list-style-type: none"> Organic growth via greater penetration and higher demand for heating. Drive gas exchanges between Argentina and Chile via existing pipelines. 	EBITDA 2022 = 245 Capex 18-22 = 497 85% growth capex
Brazil Gas	<ul style="list-style-type: none"> Organic growth through increasing penetration in the gas market as well as seeking new concessions. Leverage the huge growth potential of the services business. 	EBITDA 2022 = 322 Capex 18-22 = 399 57% growth capex
Argentina Gas	<ul style="list-style-type: none"> Organic growth underpinned by grid upgrades and implementation of new networks, expanding the grid in the territory. Leverage the huge growth potential of the services business. 	EBITDA 2022 = 159 Capex 18-22 = 323 41% growth capex

Infrastructure North LatAm

The Ebitda target for this business is around Euros 400 million, with capex totalling about Euros 1 billion in the period 2018-2022. The goals and opportunities defined for each of the units in this business are as follows

	Opportunities	Goals (EurosM)
Mexico Gas	<ul style="list-style-type: none"> Organic growth through greater penetration in the gas market and new concessions. Strong growth potential in services via new customers and the existing customer base. 	EBITDA 2022 = 247 Capex 18-22 = 616 22% growth capex
Panama Electricity	<ul style="list-style-type: none"> Strong growth is projected against a backdrop of moderate risk to the country's economy, with remuneration stable in USD. The tariff review for 2019-2022 is expected to be positive. Significant improvement in operational efficiency and lower power losses. Capture competitive advantages in services and solutions. 	EBITDA 2022 = 146 Capex 18-22 = 341 30% growth capex

5.4 Financial strategy

To support the business strategy, the finance strategy targets net debt at end-2022 at the same level as end-2017 (Euros 16.4 billion, per IFRS 16) as strong cash flow will make it possible to distribute dividends (Euros 6.9 billion) and allocate Euros 2 billion to share buybacks or inorganic growth opportunities.

Finance policy will focus on maintaining the rating and leverage while managing the debt structure to make it more effective. The debt structure will be diversified, prioritising access to capital markets and institutional funds, with at least 70% of debt at fixed cost while seeking “natural” hedges by ensuring that subsidiaries are funded in the currency in which they generate cash flows.

Each business unit will be provided with the necessary liquidity and the necessary level of indebtedness to operate autonomously.

6. Sustainable innovation

Risks and management approach

Naturgy views innovation as the function that enables it to guide and drive the necessary developments, access them and apply them effectively in pursuit of its objectives. It recognises that properly orienting, implementing and applying strategic innovation are vital to obtaining competitive advantages in the markets and achieving sustainable development of its activity.

Consequently, the company applies an innovation model that is aligned with the businesses and contributes to the objectives of the Strategic Plan, it monitors developments outside the plan and anticipates disruptions in the energy model that may change the rules of the game. It does this through a solid culture of innovation, with open collaboration initiatives, intrapreneurship programmes and other tools to promote innovation.

Analysis of 2018 results

Innovation vision

La compañía continúa apoyándose en 5 grandes bloques su actividad de Innovación:

- Social Innovation, working to mitigate situations of energy vulnerability since 2014 through preventative measures, agreements with local and regional governments, and awareness-raising activities, including participation in forums and round tables on poverty. As part of the Vulnerability Plan, a number of measures were stepped up in 2018: the Solidarity Fund for Energy Rehabilitation and the Social Employment Program.
- Innovation in Marketing. This area includes all the company's efforts to get to know its customers' actual specific needs, and to ensure that they have access to cutting-edge products that make their everyday lives easier. A major ongoing initiative is the CeX (Customer Experience) project, under which the company is applying a new methodology that is primarily customer-centric. The principal project in 2018 was the Clear Communication Project, the goal being to convey relevant information to customers in a clear and simple form.
- Innovation in Organisation. This area refers to actions aimed at meeting emerging needs with respect to new business models, resulting in a new work organisation and steps to minimise risks and increase quality and safety within the organisation's practices.
- Product Innovation. The FutureSisens Project provides smart flow monitoring in renewable gas plants. In particular, the project aims to develop flow sensors that are energy-autonomous or use very little energy and are capable of measuring flows in natural gas distribution networks (medium and low pressure).
- Process Innovation A notable project in this area was the optimisation of the hydroelectric generating fleet by applying machine learning in combination with traditional optimisation approaches, as well as cloud computing solutions, in models for operating the hydroelectric generation fleet in the electricity market.

The goal is to achieve more advanced analytical models in an AWS environment that allow for growth in revenues by detecting and seizing new market opportunities within a process of continuous improvement.

In 2018, a total of Euros 63 million were spent on innovation (Euros 99 million in 2017), as indicated below:

(million euro)	2018	2017
Investment in innovation	63	99

Innovation Plan

The innovation plan is structured through four strategic innovation areas: Energy Transition, Digitalisation, Customer-Centric and New business models, within which the following priorities were defined:

Sustainable mobility

Naturgy identifies sustainable mobility as a key component of strategic innovation within its positioning in environmentally friendly energies. As a leading energy company, it will play a fundamental role in the process of transforming mobility models, where renewable natural gas and electricity are the main vectors.

In 2018, we have developed the COFAST project, which consists of a new standardised integrated solution for fast charging stations for electric vehicles. The electricity for the charging stations will be supplied by small-scale natural gas-fired cogeneration plants.

Smart Client

In the Smart Client area, Naturgy is committed to the digital transformation of its customers as the key to achieving the objective of evolving our energy model towards a more efficient, decarbonised and decentralised one in which the concept of consumer will evolve towards a more active role in which their participation makes it possible to achieve those goals. The new active consumer will focus on three axes: distributed generation and autoproducer solutions, digital solutions and IoT products, and data analytics, making it possible to enhance customer segmentation and get to know customers better in order to offer them personalised recommendations, products and services, and also to optimise asset efficiency and operations. One of the most notable projects in 2018 was GrowSmarter, an IoT solution for residential customers, and a pilot test of a number of photovoltaic and energy storage solutions for residential and tertiary customers has begun.

In the area of Energy Efficiency Solutions, activities focused on the development of new integrated energy solutions, based on high-efficiency renewable technologies, that can be designed and operated optimally (in both energy and monetary terms) for the development of Near-Zero Energy Buildings. One of the projects in 2018 was ReUseHeat, which aims to demonstrate heat recovery technologies in urban environments; Naturgy implemented a pilot project at a hospital in Madrid.

Distributed generation and autoproduction

The purpose of the distributed generation and autoproduction line in 2018 was to create tools and resources to support the development of products based on photovoltaic generation and batteries for end customers, as well as projects such as GrowSmarter. Apart from technological developments in the field of photovoltaics and batteries, Naturgy's main contribution in this connection is its vision of the customer, which is a key element when designing control systems that maximise the value to be extracted from these solutions.

Accordingly, it continues to pilot-test commercial solutions in the Autoproduction Laboratory. The goal is to provide the business with technical and economic information about new products that are available in the market. To this end, a cost/benefit analysis methodology has been developed that uses simulation tools developed in-house, such as GENPER and OBAMA, as well as laboratory tests to measure the benefits for specific customer categories. In cooperation with manufacturers and the IREC technology centre, the laboratory also developed an energy manager for Naturgy to optimise battery usage that is compatible with a number of commercial solutions.

Renewables and storage

Naturgy is committed to a balanced energy mix in the group's assets, in which emission-free technologies account for a growing share of its total installed capacity. Innovation in this area focuses on three main lines of action:

- Storage solutions, which facilitate greater grid integration of intermittent renewable electricity, oriented towards further enhancing the quality and reliability of the supply.
- Advanced management of generation facilities (wind, hydroelectric, solar): with initiatives for smart monitoring of assets, application of new technologies for environmental oversight and security, better communication and remote monitoring systems, predictive tools, etc.
- Evaluation of new renewable generation technologies: marine, offshore wind, geothermal, gas-renewable hybridisation, etc.

One of the projects implemented in 2018 was the continuation of activities at the PV Photovoltaic Solar Laboratory in Durango (Mexico), where photovoltaic modules, structures and associated equipment are pilot-tested in order to analyse, monitor and optimise key operational parameters and indicators.

Renewable Gas and Liquefied Natural Gas

As part of Naturgy's commitment to evolve towards a low carbon economy, the company has been working for several years to promote renewable gas by participating in a number of projects, both in Spain and elsewhere in Europe, whose objective is to obtain renewable natural gas from renewable resources, and apply processes to obtain gas of a sufficient quality for injection into the natural gas grid so that it can be used for industrial, mobility, residential and power generation applications. Implementing these innovation projects makes it possible to study how the available technologies work, identify their advantages, and develop new technologies so as to optimise and reduce their production costs.

The company also continues to pursue innovation projects in the area of Liquefied Natural Gas (LNG), with a focus on three lines of action: optimisation of the LNG logistics chain (small scale), development of LNG as a cleaner, more efficient fuel for transport (bunkering), and development of LNG metering.

Some of the principal projects in this area are the Renewable Gas Unit, a joint project of Naturgy and EnergyLab in cooperation with the Bens waste water treatment plant, which has resulted in the commissioning of a biogas upgrading plant located at the WWTP, in order to produce biomethane; and Life Methamorphosis, in which the company developed and implemented the Methagro business line to produce high quality biomethane from agro-industrial waste and other organic waste materials.

Advanced asset management

The goal of this innovation effort is to maximise asset performance using advanced data analysis and new operational strategies in order to:

- Increase asset efficiency, reliability and flexibility.
- Identify new strategies for the optimised asset exploitation.
- Optimise maintenance in the field.

Using new technologies to not only avoid assets' obsolescence but also incorporate new elements that enhance their competitiveness and capacity to generate value in a highly complex environment.

During 2018, the GALA project focused on advanced control of overhead power lines (high voltage and medium voltage) in order to optimise and improve the periodic examinations required by regulation and establish an optimised felling and pruning plan for 2020.

7. Non-financial statement

This Non-financial statement information was drawn up in line with the requirements of Act 11/2018, of 28 December, on non-financial disclosures and diversity, approved by the Spanish Congress on 13 December 2018, which amends the Commercial Code, the consolidated text of the Capital Companies Act approved by Legislative Royal Decree 1/2010, of 2 July, and Act 22/2015, of 20 July, on Auditing, in connection with non-financial disclosures and diversity (from Royal Decree-Act 18/2017, of 24 November).

It was drafted on the basis of the Sustainability Reporting Guidelines issued by the Global Reporting Initiative (GRI), which also serve as a reference for drafting the Corporate Responsibility Report that is published each year and which, this year, complements and elaborates upon these non-financial disclosures.

In this context, through the non-financial disclosures, Naturgy seeks to provide information on environmental, social, personnel human rights issues that are germane to the company in the pursuit of its business activities.

The content of this report was selected and drafted on the basis of the outcome of the materiality analysis carried out at the beginning of 2018 (See Annex III, About this Report).

For each question set out in the Act, the materiality for the company, the policies and risks associated with each one, and the benchmark indicator used for monitoring and evaluating it are set out below.

7.1 Business model and value creation

7.1.1. Business model

Naturgy is an integrated energy group supplying gas and electricity to almost 18 million customers. It focuses on the gas distribution and supply and on generating, distributing and supplying electricity. It also operates other business lines, such as energy services, which enhance the diversification of activities and revenues, staying at the forefront of new market trends, meeting customers' specific needs and offering them an integrated service not confined to selling energy.

Naturgy's mission is:

To meet the needs of...	With vision...	Based on our values
Our shareholders	Offering increasing sustainable profitability	> Commitment to results > Customer-oriented > Sustainability
Our customers	Being leaders in continuous growth and with a multinational presence, offering high-quality products that respect the environment	
Our employees	Offering opportunities for professional and personal development	> Interest in people > Social responsibility
Society	Contributing positively through a commitment to global citizenship	> Integrity

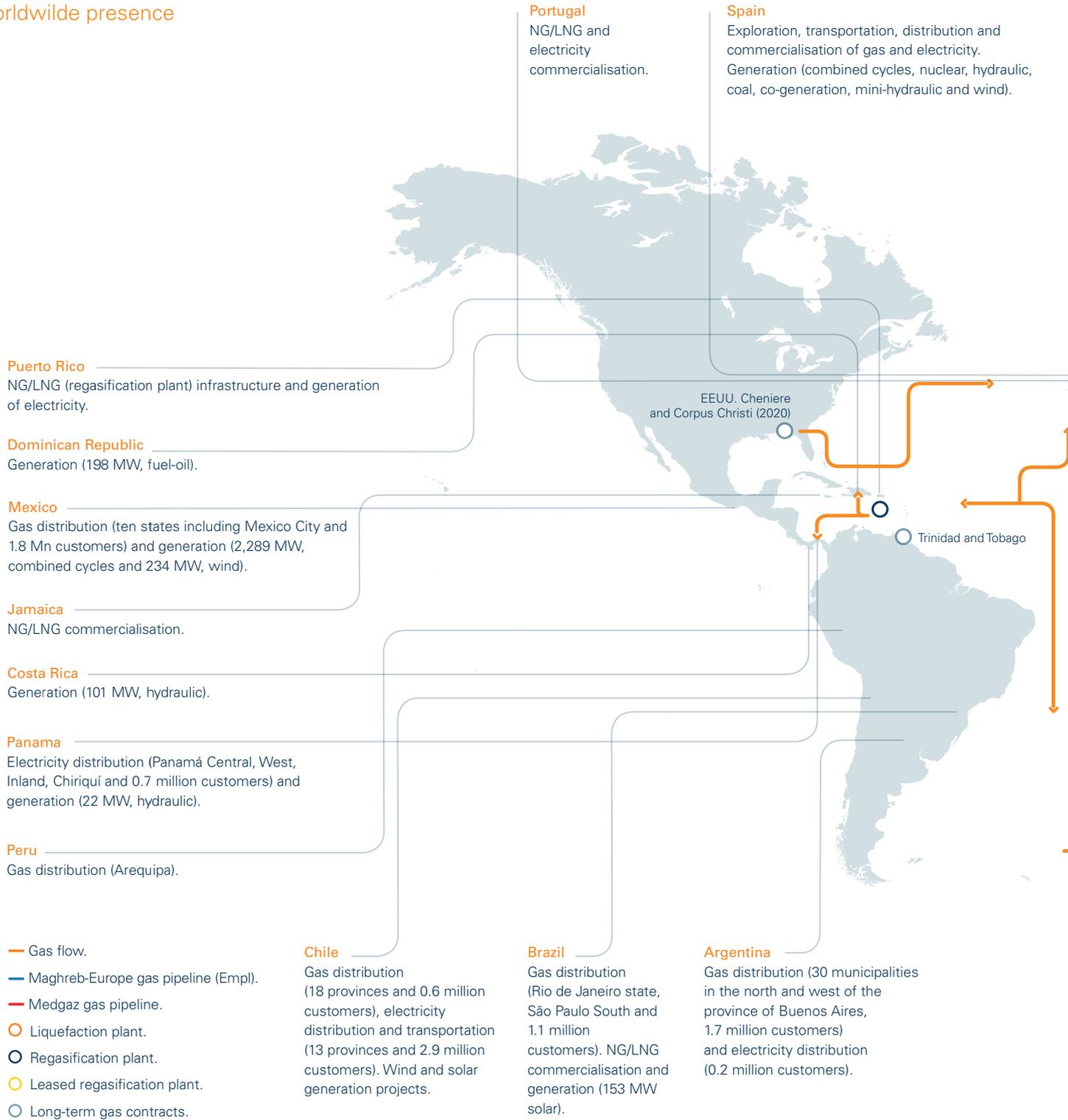
Naturgy's business model is implemented through a number of companies in Spain, elsewhere in Europe, and in Latin America and Africa, and is underpinned by the following main businesses:

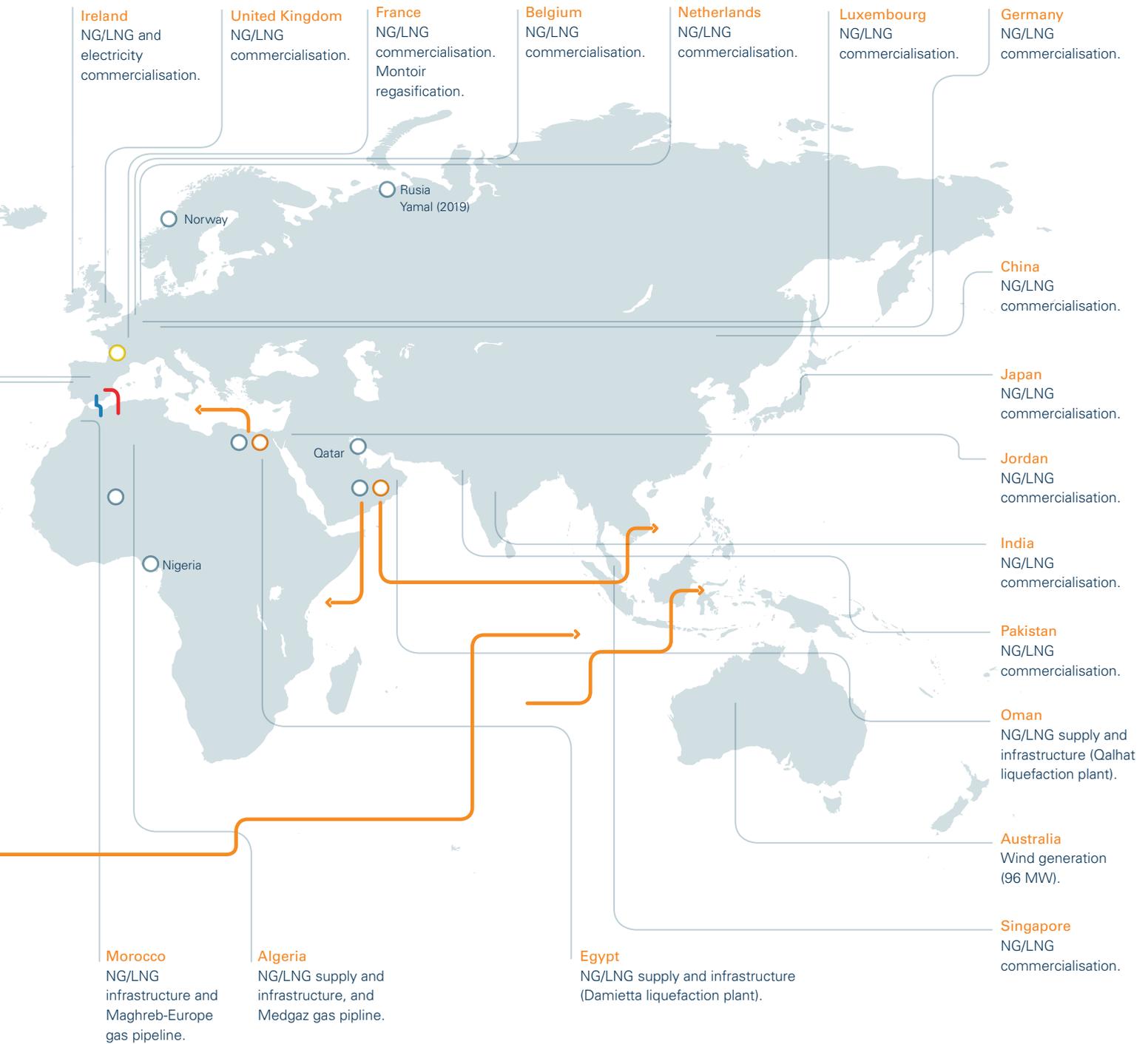
Gas & Power	34% of EBITDA: Spain, Europe and Latin America
Infrastructures EMEA	45% of EBITDA: Spain and Africa
Infrastructures Latam South	20% of EBITDA: Latin America
Infrastructures Latam North	6% of EBITDA: Latin America

Note: -5% other activities

Throughout the value chain, Naturgy's business model stands apart as a leader in the gas sector and a key player in the electricity sector, in both cases ensuring a regular supply of gas and electricity, which is essential to providing a quality service and fulfilling the company's social mission; providing a broad range of value-added services and fostering sustainable innovation to drive development.

Worldwide presence





NB: Does not include the power distribution business in Colombia as the stake in Electricaribe ceased to be consolidated as at 31/12/2016 nor in the gas distribution in Italy and Colombia, electricity distribution in Moldova, electricity generation in Kenya and mining in South Africa business because they have been reclassified to discontinued operations.

Business lines

Leadership in the gas business

	Networks	Gas		
	Gas distribution	Infrastructures	Procurement	Supply
	10.6 million distribution connections 119,998 km of network	Eight LNG carriers Two transportation pipelines, Maghreb-Europe (EMPL) and Medgaz	~ 30 bcm supply portfolio	378 TWh of gas supplied
Our positioning	<p>Spain</p> <p>Leader in Spain with a 69% market share, distributing natural gas to more than 1,000 municipalities in nine autonomous regions and 5.4 million customers.</p>	<p>Eight LNG carriers (1.3 Mm³)</p> <p>Management of the main gas pipeline supplying the Iberian Peninsula, the Maghreb-Europe pipeline (EMPL), and a 14.9% interest in the Medgaz pipeline.</p>	<p>Business model based on the diversification and flexibility that have made Naturgy a global operator with a strong international profile.</p>	<p>Unique access to markets: almost 11 million customers and LNG sales in numerous countries worldwide.</p>
	<p>Latin American</p> <p>Latin America's top distributor, catering for more than 5.2 million customers.</p> <p>Presence in Argentina, Brazil, Chile, Mexico and Peru and in six of the ten largest Latin American cities.</p>	<p>Interest in one regasification plant (Ecoeléctrica) and two liquefaction plants (Damietta and Qalhat).</p> <p>Proprietary storage capacity of 0.5 bcm and leased capacity of 1 bcm.</p>	<p>Naturgy has procurement contracts with suppliers worldwide, both in a gaseous state (NG) and in the form of liquefied natural gas (LNG).</p>	<p>A global operator with the flexibility to tap markets offering attractive margins.</p> <p>39% market share in Spain.</p> <p>Competitive supply to combined cycle plants (CCGT).</p>
Our strength	Naturgy has an outstanding position in the markets where it operates, affording it an platform for organic growth, in terms both of attracting new customers in municipalities with gas and of expanding networks to areas without gas.	<p>Naturgy has an integrated gas infrastructure aimed to afford the business considerable stability, making its operations more flexible and enabling it to transport gas to the best business opportunities.</p> <p>Its storage capacity is seeking to ensure a constant supply, avoiding the impact of seasonal fluctuations or peaks in demand.</p>	Its diversified procurements portfolio enables it to tap value-added markets.	<p>Naturgy has a diversified portfolio of end customers, and supplies gas both in Spain and internationally.</p> <p>Its positioning in international markets is seeking to obtain higher margins through trading.</p> <p>Naturgy is a leader in dual fuel supply and it offers a broad range of value-added services.</p>

Standard-bearer in the electricity business

	Networks	Electricity	
	Electricity distribution	Generation	Supply
	7.6 million supply connections 215,532 km of network	15.6 GW of power generation capacity	35.4 TWh supplied
Our positioning	<p>Spain The third-largest operator in the Spanish market, where it distributes electricity to 3.7 million customers.</p> <p>Latin America Presence in Argentina, Chile and Panama (3.8 million customers).</p>	<p>Spain Capacity of 12.5 GW, with a significant presence in five technologies: 7 GW CCGT, 2 GW hydroelectric, 1.7 GW coal, 1.2 GW renewable and 0.6 GW nuclear power. Naturgy has a market share of 17.4% in non-renewable generation and 2.1% in renewable generation.</p> <p>International Capacity of 3.1 GW: 2.3 GW CCGT (Mexico), 0.2 GW oil-fired (Dominican Republic), 0.1 GW hydroelectric power (Costa Rica and Panama) and 0.5 GW renewables (Mexico, Australia and Brazil).</p>	<p>Leader in the mainstream consumer and residential segments, with a total market share of 14.0% in Spain. One of the main traders in the Spanish market. A dual supply and a broad range of value-added services.</p>
Our strength	<p>Naturgy is a leader in the markets where it operates. Naturgy is one efficient operator in terms of operation and maintenance costs in the electricity distribution business.</p>	<p>The company has considerable know-how in the generation technologies that operates and its infrastructure can adapt to the needs of each energy model and to the reality of each country. The company's good positioning in Spain and Latin America will enable it to make the best of investment opportunities in generation.</p>	<p>Being a leader in the combined supply of natural gas and electricity affords the company major advantages, such as lower service costs, integrated customer care and lower acquisition costs, not to mention greater customer loyalty.</p>

7.1.2. Value creation and sustainable management

The long-term commitment to value creation and sustainable management is specified in the Corporate Responsibility Policy, which provides the common framework for action that guides the company's socially responsible conduct; it was approved and updated by the Board of Directors in December 2015, based on international best practices and the recommendations enshrined in the Code of Good Governance of Listed Companies.

This policy undertakes eight commitments to the company's stakeholders:

1. Commitment to results
2. Service excellence
3. Responsible environmental management
4. Interest in people
5. Health and safety
6. Responsible supply chain
7. Social commitment
8. Integrity and transparency

These commitments are horizontal and are present throughout the company's business process, based on the generation of economic, social and environmental wealth.

Naturgy has all the essential kinds of capital with which to develop its business model, which is based on the responsible and sustainable management of all the resources it uses.

	 Financial	 Human	 Manufactured	 Environmental	 Social
Our capitals	<ul style="list-style-type: none"> Sustainable cash generation. Free cash flow = 3,054 M€ Strict financial discipline. Leverage = 48.4% 	<ul style="list-style-type: none"> Professional development and talent management. Diversity and equal opportunities. Extending principles to supplier chain. 	<ul style="list-style-type: none"> Investment and maintenance in gas and electricity distribution networks. Sustainable innovation. Operation development of electricity production capacity. 	<ul style="list-style-type: none"> Environmentally-friendly products and services. Energy efficiency. Undertaking to reduce emissions. 	<ul style="list-style-type: none"> Relations and dialogue with stakeholders. Guarantee of supply
	<p>For further information on the strategic planning cycle, please see the "Forecast group performance" chapter, page 210.</p> 				
	<p>Corporate Governance</p> <p>Our commitments</p> <ul style="list-style-type: none"> Commitment to results. Service excellence. Responsible management of the environment. Interest in people. Health and safety. Responsible supply chain. Commitment to society. Integrity and transparency. 				
Our results	<ul style="list-style-type: none"> Dividends policy. Pay-out: 1,400 M€ Meeting financial targets. Ordinary Ebitda: 4,413 M€ Ordinary net profit: 1,245 M€ 	<ul style="list-style-type: none"> Corporate University and training plans % Staff trained: 91.0 Retaining talent. Voluntary rotation: 2.5 Health and safety. Accident frequency index: 1.00 	<ul style="list-style-type: none"> Gas distribution: 449,259 GWh Electricity distribution: 54,920 GWh Gas supply: 378,048 GWh Net production: 46,658 GWh 	<ul style="list-style-type: none"> Direct GHG emissions : 18.3 MtCO₂ eq. CO₂ emissions/ generation: 342 tCO₂/GWh 	<ul style="list-style-type: none"> Economic value distributed : 23,413 M€ Social investment: 11 M€
Our stakeholders	<ul style="list-style-type: none"> Shareholders 	<ul style="list-style-type: none"> Employees 	<ul style="list-style-type: none"> Customers 	<ul style="list-style-type: none"> Customers Society 	<ul style="list-style-type: none"> Society

Following approval of the new Corporate Responsibility Policy and based on the recommendations of the CNMV's Code of Good Governance in connection with corporate responsibility, the Board of Directors approved the 2016-2020 Sustainability Plan in February 2017 which translates the commitments undertaken into specific actions and allows its compliance to be monitored by the Board of Directors and the Remuneration Committee. The action lines relating to each commitment have been fully aligned with the Strategic Plan and with the individual plans for each of the Group's business areas and departments.

7.2. Commitment to results

What resources are relevant to this commitment?

Financial
Human
Social

How do we measure our performance?

EBITDA
Net profit
Investments
Indebtedness
Pay-out

What this means for Naturgy?

In a challenging environment, Naturgy' acts with the goal to maintain a solid financial and business profile. Naturgy's business model looks for a balance between regulated contracted activities and unregulated ones while applying a strict financial policy.

What is our commitment?

- To protect our existing businesses while laying the foundations for future growth.
- To continue with the financial track of Naturgy.

Analysis of the 2018 results

The analysis of the consolidated and Naturgy's business results of the 2018 exercise are included in the section Business performance and results of this report.

Sustainability indices, green bonds and sustainable funding

Presence in socially responsible investing indices and ratings

The company occupies significant positions in the leading sustainability indices on the strength of its environmental, social and governance (ESG) performance metrics. Naturgy has been part of the Dow Jones Sustainability Index uninterruptedly for the last 14 years, and in 2018 it ranked first in the world in the Gas Utilities sector for the second consecutive year. The company has also been a member of FTSE4GOOD since the index was created in 2001, and ranks as world leader in the Multiutilities sector. During 2018, Naturgy was assessed by rating agencies Oekom, Sustainalytics and Vigeo. The company is included in the three variants of the Euronext Vigeo index: World 120, Europe 120 and Eurozone 120. Naturgy has also obtained the highest rating — AAA — from MSCI and is included in the MSCI Global Climate Index and MSCI ESG Leaders Index.

In 2018, Naturgy was recognised as a world leader for its action against climate change through inclusion in CDP's Climate Change A List. The company obtained the highest possible score in this climate change index in recognition of its action to reduce emissions, mitigate climate risks and develop a low carbon economy.

Green bonds and sustainable funding

In 2017, Naturgy developed a reference framework for the issuance of green bonds to fund renewable energies. Under this framework, on 15 November 2017, Naturgy issued a green bond for an amount of Euros 800 million, maturing in May 2025. The issue pays an annual coupon of 0.875%. The bonds were issued at 99.77% of par. Additionally, in 2017 the company's auditors certified compliance with the commitments acquired in the framework, and Naturgy's Green Bonds Committee met in December 2018 to assess the suitability and progress with the projects and the degree to which project development conformed to the objectives set in the issue.

In addition, in order to cover its funding needs and in line with its progress in sustainability, in 2017 Naturgy arranged a sustainable loan with ING Wholesale Banking for a total amount of Euros 330 million for 4 years, with the possibility of a one-year extension, whose cost is partially indexed to the company's environmental, social and governance (ESG) performance, as assessed by independent rating agency Sustainalytics, which issues a report and a rating in this connection.

The score by the agency improved in the first credit review, with the result that the interest rate was reduced.

7.3. Service excellence

What does it mean for Naturgy? Risks and management approach

The customer is the centre of operations at Naturgy. Through active dialogue, the company will provide speedy and efficient service which, as well as complying with the legal and profitability requirements, meets the customer's needs.

If the company fails to provide quality products and services, has a customer service that can be improved, and lacks communicative fluidity with the customer, it runs the risk of the customer requesting to finalise the contract or submitting complaints.

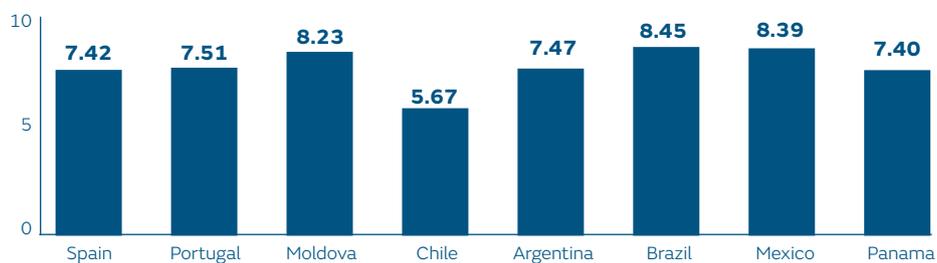
The failure to adapt or lack of flexibility in light of the current context of sector decarbonisation and digitalisation could lead to inefficiencies and losses of market share.

What is our commitment?

- Working towards ongoing improvement of safety, reliability and competitiveness of all products and services, offering the highest possible level of quality in accordance with the best available techniques.
- Fostering active and two-way communication that allows us to understand the expectations and opinions of customers and to adapt the responses of Naturgy to their needs.
- Facilitating relationships with customers through simple and efficient operations.
- Providing innovative products and services that encourage energy efficiency and which contribute towards the sustainability of society.
- Furnishing the customer with a differential value through products and services that adapt to each segment and to their needs.
- Applying technological innovation and the technical enhancements available as a means of maintaining an efficient, safe and sustainable supply.

How do we measure our performance?

Overall satisfaction with service quality



* Chile has been calculated based on a 1-7 scale, unlike other countries which used a 0-10 scale.

What are our main milestones in 2018?

- Raising awareness of the centrality of the customer to our business
- Advanced CeX training, to enhance the customer's experience with the company
- Greater dissemination of knowledge about the sector, company and products and services
- Consolidation of personal experimentation of the customer reality
- Visible commitment: management commitment to put the customer first
- Recognition / Pride at belonging: proud to work at Naturgy
- Evolution of travel and measurement to find out how the customer rates us when covering an energy need with the company
- COMeX consolidation: to position the marketers in the heart of the distributors
- Roll-out of the Partners programme: extending the pride of collaboration to collaborating companies

What are our goals for 2019?

- New paperless digital model in the provision of the Servigas and Servielectric maintenance services
- Billing digitalisation
- Greater digital self-management in the customers' area of the website
- Evolution of the model of efficient customer measurement, at least sufficient
- Contribution of the Customer Experience to the Business
- Annual Customer Experience Action Plan
- Clear Communication Project customised by client
- Optimal management of complaints
- Introduction of the Global Customer Experience Policy
- Evolution of data analytics to improve customer service

Analysis of the 2018 results

The customer as the focal point

In 2018 the company began a new stage with an overhauled brand that reflects the corporate transformation, an evolution resulting from 175 years' experience and which supports our commitment with the customer to adapt ourselves to both the present and the future.

This new stage reasserts our Customer Centricity vocation as the basic pillar of the 2018-2022 Strategic Plan, placing the customer as the focal point of all decisions in order to offer an excellent service in a simpler, more innovating, more digital, nearer and more environmentally friendly way.

Our value proposal is to offer our customers simple, close at hand and practical solutions that help the customer on a daily basis, supporting ourselves through digitalisation and innovation, in order to provide excellence in service.

Quality and reliability of the service

Maintenance of the gas and electricity facilities is an essential aspect within Naturgy's mission to achieve a level of quality and reliability of the service that satisfies customers and enables us to comply with the regulatory requirements of the countries where we operate and with the most demanding standards of the industry. The aim of maintenance is to improve the safety and reliability of gas and electricity networks, and to maintain a high level of service quality.

Naturgy employs modern and innovative methods and work equipment that are included in safe and efficient work and operation procedures. The company also encourages close collaboration with contractor companies in the permanent quest to achieve best practices in the development of its activity.

A set of inspection and assessment actions are carried out, which help to define the corresponding preventive and mitigation measures to ensure a safe and ongoing supply, maximising the useful life of assets, and which are included in the Maintenance Plan for each type of facility.

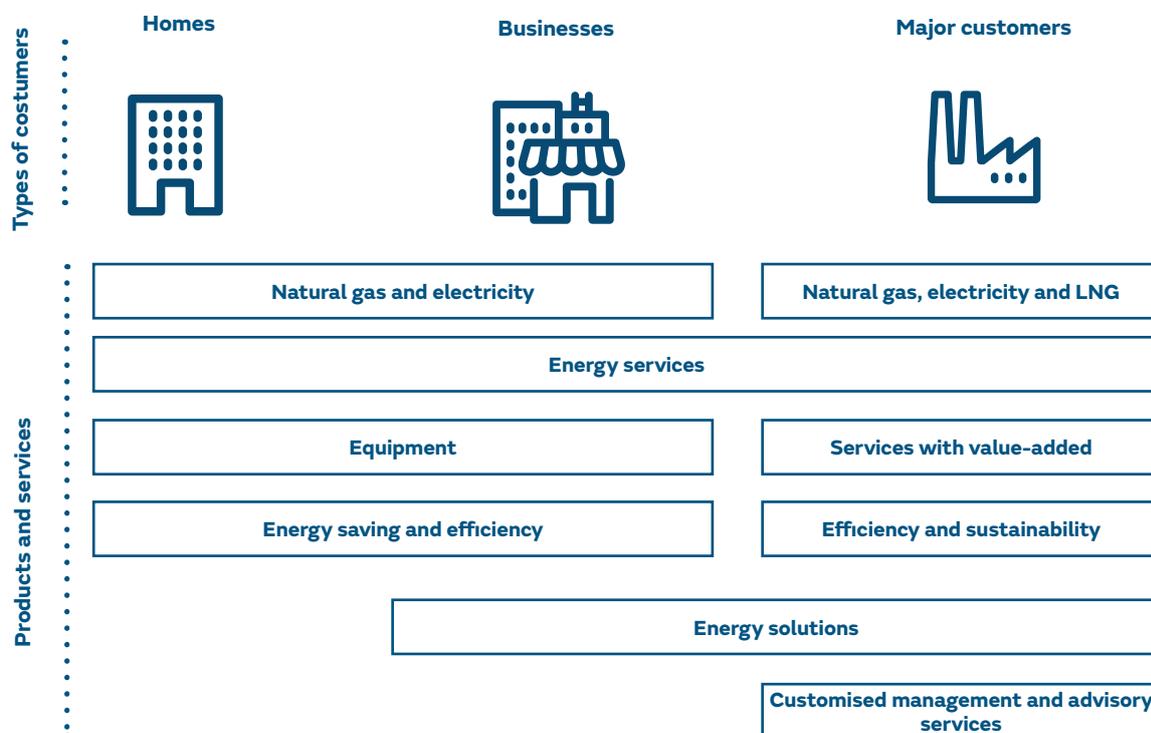
The preventive and corrective maintenance procedures are frequently subject to reviews by the technical quality, safety, and internal auditing, compliance and control divisions.

The maintenance actions performed by the company are reflected in the evolution of the main quality/service indicators, which have revealed a notable improvement in recent years. These indicators measure, *inter alia*, response times to a notification of a malfunction or anomalous situation affecting the grid, the stoppage time per customer or installed power, the kilometres of the grid and facilities inspected, and the number of incidents per kilometre of grid.

To ensure that supply meets demand, Naturgy regularly reviews the operating conditions of its networks, to make sure these are correctly sized or, if appropriate, to determine the potential needs of repowering or enlarging these. Furthermore, in electricity distribution, Naturgy partakes in several R&D&I projects for storage of energy in batteries, the development of smart grids, the application of drones to the maintenance installations and the introduction of predictive maintenance techniques for the main grid equipment.

Products and services adapted to customers' requirements and priorities

Naturgy's commercial offer is targeted at homes, businesses and major customers. The products offered are not restricted solely to the supply of gas and electricity, but encompass other aspects.



The development of new products is based on the needs detected through the mechanisms enabled by the company. The commercial supply seeks efficacy and efficiency above other factors. Efficacy, to satisfy customers' demand; and efficiency, to achieve the maximum competitiveness.

In 2018 we have renewed the commercial catalogue with new tariffs and new services to offer the customer a broader range of choices and to find more appropriate solutions for their needs, whilst simultaneously seeking to simplify the portfolio to provide customers with a simpler and more comprehensive experience. In the domestic area, we have also redesigned promotions by applying benefits according to customers' characteristics and habits.

Customer service

Naturgy has introduced an innovative Customer Service Model that is fully adapted to customers' characteristics and needs, offering close at hand and accessible solutions that allow for greater comfort and flexibility to our customers' requests. This model is included in the quality management system certified in accordance with ISO 9001 by AENOR.

The customer service channels that Naturgy makes available to customers aim to offer customised service that satisfies their expectations, and with a particular focus on digital channels in line with society's evolution, to achieve a swift and flexible resolution with self-management, simplicity and in an environmentally friendly way.

Customer service model

Our model comprises three focal points:

- Operational and training model: the aim is to anticipate customers' needs through predictive and data analysis models
- Technological model: committed to a technological revolution that encourages greater self-management by customers
- Procurement and financial model: building a partnership model with suppliers and an alignment of the win-to-win objectives

Provision of customer service at Naturgy:

- Digital channel
- Telephone channel
- Guarantee office
- Face-to-face channel - Centres
- Face-to-face channel - Personal manager

The company manages claims from three different areas: retail commercialisation, wholesale commercialisation and distribution of gas and electricity.

In the retail sphere, in Spain over 650 thousand customer claims were processed, approximately half of them dealing with billing issues. The process with the next highest number of claims was that of entering into contracts and, finally, claims related to payment collection. These three kinds of claims account for approximately 90% of all those received, whilst there are other processes, such as registration for new supplies, management of payment defaults and problems with readings, which make up the difference. The average claim response time was approximately one week.

In the wholesale sphere, around eight thousand claims were processed, down approximately 20% year-on-year. Most claims concerned billing and measuring processes, and none of them were of a relevant nature. Around 80% of these claims were resolved within the deadlines established.

In the area of gas and electricity distribution, any claim or complaint received from customers via the different channels available -whether through their gas or electricity marketer in issues for which the distributor is responsible (meter reading, supply quality, new registrations, etc.), directly with the electricity or gas distributor of the Naturgy Group through the customer service channels of the distributors, via the website contacts, by postal mail or through any competent organisation- is received and processed centrally in our integrated claims management system at the Shared Services Department.

The organisation handles not only customers of the electricity or gas system in its operational area, but also any individual or legal entity that may have a claim or complaint through the action or non-action of our distribution assets (works in progress, technical elements on public thoroughfares, etc.) is dealt with as if they were a customer.

With regard to transparency in communication of claims or complaints submitted, both business of Electricity Distribution in Spain (UFD) and Gas Distribution in Spain (Nedgia) comply with the obligations set out in circular 2 of 2016 issued by the National Securities Market Commission (CNMC), reporting every quarter with regard to the details on the situation of claims processed in accordance with the formats and deadlines established by the regulator.

Customer's satisfaction and experience

Naturgy listens to its customers' opinions and incorporates them into the decision-taking in order to develop innovative products and services that meet their needs and expectations.

The company has a model to measure customers' experience, through which it constantly monitors the satisfaction of its customers and the level of recommendation.

The model is based on three levers:

- **Measurement:** Naturgy collect the opinion of its customers through surveys that are classified into two supplementary blocks: general surveys and interaction with the company surveys.
- **Analysis:** the results are added to the daily management reports, which allows us to include the customer's voice in decision taking.
- **Close the loop:** process that enables immediate corrective action through the management of alerts that activate whenever the minimum satisfaction and recommendation thresholds required to maintain the level of quality that the company imposes with its customer relations are not reached.

Customer Experience programme (CeX)

The Customer Experience programme, based on cultural transformation, was born in 2015 at group level with the purpose of making the company a benchmark at international level in customer satisfaction in the energy sector, measured in terms of recommendation.

With Customer Experience the company introduces a new methodology through which the customer is at the centre the decision-making process, changing the way we do things in order to meet their needs and expectations, but above all, being sensitive to how they perceive the company and their experience within the company.

To this end we introduced a working model based on five pillars:

- Unique company identity (brand and culture).
- Organizational drive (sponsorship and commitment).
- Employees as ambassadors programme.
- Improvement of customer journey and contact points (the journey being the time necessary to cover the customer's needs, from start to finish).
- Continuous real-time measurement of the customer's voice.

As a response to our commitment towards the customer, we have formalised the Customer Experience as a cross-cutting group process and we have developed the Customer eXperience Global Policy for the group.

The Policy sets out the Naturgy action framework to ensure that the Customer Experience is integrated into the company's operations and decision taking.

As a result of this Policy, this year we have introduced the Clear Communication Project in the Customer Service billing area, in retail customers and markets and in infrastructures in Spain, providing the knowledge and tools so that people can develop a clearer and simpler communication for the customer.

Privacy and security of the customer's data

Naturgy, as part of its commitment to the privacy and security of data of employees and customers, has updated the Information Security Policy and the regulatory corpus of information security that ensures proper processing of this data throughout their life cycle collection and processing through to removal or safeguarding this data once the relationship has terminated.

The Policy and the regulatory corpus are communicated to employees, suppliers and customers, and is implemented in line with the legal requirements that govern the processing of information, the internationally accepted best practices and standards.

This regulatory corpus includes a specific technical standard, which is for the purpose of guaranteeing the protection of personal data at Naturgy and applies to all organisational units and companies of the group that capture or process personal data, as well as partners and suppliers that collaborate in such processing. This standard complies with the provisions set out in the EU General Data Protection Regulation (GDPR).

Security forms an essential part of the design, development and exploitation of all processes and systems, in particular those that process information. All of Naturgy's systems include procedures for authentication and administration of authorisations and access and are designed to guarantee that the use of these does not affect the security of the data handled.

7.4. Responsible management of the environment

What does it mean for Naturgy? Risks and management approach

Naturgy is aware of the environmental impacts that its activities have on the surrounding area, and the company therefore pays special attention to environmental protection and the efficient use of natural resources to satisfy the energy demand.

Naturgy goes beyond legal requirements and even the requirements we adopted voluntarily in our care for the environment. We involve our suppliers and we encourage and work with our stakeholders to use energy responsibly.

Inadequate management of climate change and its associated risks can lead to substantial losses for the company, caused by the increase in exposure to natural disasters, the decarbonisation trend of the sector and the loss of affinity on the part of stakeholders.

Improper environmental management can cause environmental impacts and the deterioration of natural conditions and biodiversity in the areas where the company operates. This, in addition to the direct impact on the environment, can cause the company reputational harm. The risk is greater if the company has infrastructures and/or carries out operations in protected areas.

What is our commitment?

- Contributing to sustainable development through eco-efficiency, the rational use of natural and energy resources, minimising environmental impact, encouraging innovation and using the best available technologies and processes.
- Contributing to the mitigation and adaptation of climate change through low-carbon and renewable sources of energy, encouraging savings and energy efficiency and the application of new technologies.
- Integrating environmental criteria in business processes, in new projects, activities, products and services, and in selecting and assessing suppliers.

- Minimising adverse effects on ecosystems and fostering the conservation of biodiversity.
- Encouraging the efficient and responsible use of energy and natural resources, introducing activities aimed at improving the management of these within the framework of the circular economy.
- Guaranteeing the prevention of pollution through ongoing improvement, the use of best available techniques and the analysis, control and minimisation of environmental risks.

How do we measure our performance?

	Unit	2018	2017
Direct greenhouse gas emissions	MtCO ₂ e	18.3	20.5
Emission factor for electricity generation ¹	tCO ₂ /GWh	342	388
Installed capacity free of emissions ¹	%	27.5	26.4
Net production free of emissions ¹	%	24.9	19.6
Activity with environmental certification ²	%	88.7	87.7
Water consumption	Hm ³	26.5	28.0
Consumption of raw materials	Kt	6,729	7,580
Natural gas	Kt	4,736	4,638
Coal	Kt	1,630	2,480
Petroleum derivatives	Kt	352	452
Uranium	Kt	11	11
Direct energy consumption ³	GWh	60,614	64,728
Indirect energy consumption (final use of natural gas distributed/commercialized)	GWh	577,647	613,181
Resources targeted at the prevention of environmental risks ⁴	Million euros	494	96

1. Includes hydroelectric, wind, nuclear and solar generation.

2. Percentage of Ebitda certified with regard to that which is certifiable. The ebitda used in the ratio is the November closing ebitda.

3. It includes consumption of renewable, non-renewable and electricity resources and separates the electricity and the heat sold.

4. The 2018 figure includes the investment in renewable energies.

It does not include the information of Moldova, Kenya and South Africa. The figures for Moldova are: GHG emissions: 0.002 MtCO₂e, Consumption of raw materials: 0.5 kt (0.0001 kt natural gas, 0.5 kt petroleum derivatives), Direct energy consumption: 254 GWh.

Provisions and guarantees for environmental risks

The company makes financial provisions to cover the materialisation of potential environmental risks, including:

In addition, Naturgy has guarantees to cover the occurrence of environmental risks in the insurance policies it has taken out. The insurance policies that the company has contracted and in which there is environmental coverage are:

- Environmental liability insurance: limit contracted for a value of Euros 150 million per loss event and in the annual aggregate.
- Liability coverage for sudden and accidental pollution in the general public liability policy: limit of Euros 700 million per loss event.
- Protection and compensation insurance: maximum limit of USD 500 million per loss event, in accordance with the Rules of the UK P&I CLUB 2018 (Charterers), to cover the liabilities for pollution arising from chartering vessels.

What are our main milestones in 2018?

- Growth of renewable power with low or zero emission.
- Development of renewable gas projects.
- Promotion of sustainable mobility.
- Extension of the biodiversity actions and plans.
- Progress in the certification of new environmental management systems pursuant to the ISO 14001.

What are our goals for 2019?

- Growth of renewable energies, in line with the goal of the 2018-2022 strategic plan (tripling installed capacity) to contribute to the mitigation of climate change and the energy transition.
- Promote innovation and the development of renewable gas projects as an energy and storage vector that facilitates the transition to a circular and decarbonised energy model.
- Offer sustainable mobility solutions for cities and land and maritime transport that improve air quality.
- Protect biodiversity in operations, applying a preventive approach, implementing best practices and encouraging the creation of natural capital.

Analysis of the 2018 results

Environmental management

Responsible management of the environment is a strategic pillar for Naturgy, which reflects its commitment to the Corporate Responsibility Policy approved and supervised by the Board of Directors. The policy includes the company's action principles, with an emphasis on promoting the sustainable development of society through the supply of competitive, safe energy and with the utmost respect for the environment.

Environmental management is structured around three strategic pillars:

- Climate and air: contributing to the mitigation of climate change, the energy transition and the improvement of air quality.
- Circular economy: promoting eco-efficiency in the use of resources to reduce negative environmental impacts.
- Natural capital and biodiversity: encouraging the preservation of natural and cultural heritage within the areas of operation.

The most significant current and foreseeable effects of the company's activities on the environment are the following:

- Contribution to climate change
- Pollution of air, water and land
- Biodiversity loss
- Consumption of non-renewable raw materials

To minimise these effects, Naturgy employs a preventive approach throughout the entire value chain of its business:

- Certified and externally-audited environmental management system aimed at preventing pollution and reducing environmental impacts along the entire value chain, involving employees, suppliers and other stakeholders. During the design phase of new facilities and during dismantling, the environmental conditions of the surrounding area are studied, and the projects are adapted, including the necessary preventive, corrective and compensatory measures. During the operational phase, strict monitoring is performed to ensure compliance with legislation and to maintain impacts within the limits set.
- Integration of the environment in the management of risks and opportunities and in the decision-taking processes, paying special attention to climate change and the energy transition.

To ensure consistency and uniformity in the company's key environmental management processes, there are global methodologies and tools for environmental management that are used in different businesses and geographies, including the following:

- Themis, for the identification, registration, monitoring and management of compliance with legal requirements.
- Prosafety, for recording and management of the findings, nonconformities, observations and opportunities to improve environmental management.
- Enablon, for recording and centralized management of environmental indicators related to atmospheric emissions, consumption of raw materials, water and other resources, discharges, waste, etc. The system is also used to monitor environmental targets and action plans.
- Geographical information system of biodiversity, showing the protected natural areas, the group's facilities and the initiatives carried out to protect and improve natural capital.
- Carbon footprint, to determine greenhouse gas emissions throughout the entire value chain, including indirect emissions produced by third parties upstream and downstream of group activities.
- Environmental footprint, to measure the company's environmental performance, distinguishing between the components of atmosphere, waste, climate change, water, biodiversity and resources.
- DAMAS, to identify and assess the direct and indirect environmental aspects of the company, allowing us to establish the most relevant aspects to take into account both in the environmental management of these as well as the environmental targets defined each year.
- Environmental planning, through which action lines are defined, introduced and supervised to reduce environmental impact and for continuous improvement.
- Environmental audits, both external and internal, conducted within the scope of the integrated management system.

Integrated Management System

For years, Naturgy has had an integrated quality, environment, health and safety management system (IMS), certified according to the requirements of the ISO 9001:2015 and ISO 14001:2015 standards. This system is audited externally every year.

The processes certified through this system are:

- Extraction and injection of natural gas
- Transport and operation of the Maghreb-Europe gas pipeline
- Electricity generation (thermal, hydraulic, wind and solar origin)
- Distribution of natural gas and electricity
- Wholesale and retail commercialisation of natural gas and electricity
- Development and execution of engineering projects
- Energy management in organised Iberian electricity markets
- Corporate activities involving customer service, billing and payment, training and management of office buildings

Environmental risk management

Naturgy identifies, records and analyses all the environmental risks and events that have occurred in order to define, apply and disseminate preventive measures to reduce potential damage to the environment. To do this, facilities with environmental risk are assessed using recognised standards as a reference. The first element for management is self-protection plans and their associated procedures, in which the most appropriate risks and responses are identified in light of potential accidents and emergency situations that can cause environmental damage.

In addition, there are global and uniform procedures and systems in the different businesses and geographies for reporting, classifying, monitoring and managing environmental events (Prosafety).

This methodology allows not only an adequate and uniform monitoring of environmental events, but also the identification, analysis, development, application and exchange of preventive measures and best practices in risk management at a global level.

For management of the climate change risk, Naturgy has a specific tool, developed in Ms Excel and @Risk, which allows us to estimate the Group's exposure to risks at an aggregate level and broken down by business and geography. This tool analyses the impact of climate change on different businesses and technologies, over time periods (short, medium and long term) and geographies. This allows us to estimate the impact of different climate change scenarios (IPCC) through different indicators:

- Physical: impact forecasts on energy (produced, traded, purchased, etc.) water level with regard to the height of the corporation's facilities, availability of hydric resources, etc.
- Environmental: emissions of CO₂.
- Business: market shares and penetration levels.
- Economic: impact forecasts on level of revenue, Ebitda, cash flow and present value of the business, as well as estimates of the value at risk for different confidence levels.

In addition, it means we can simulate new scenarios based on new products and services, etc. and the implementation of R&D&I actions, generating different scenarios to assess the impact.

1. Climate and air quality

Naturgy believes that climate change is a global environmental challenge and is committed to offering its customers eco-efficient and less CO₂-intensive energy products and services to help mitigate climate change and the energy transition.

The main strategic lines of action in terms of climate are:

- Favouring the mitigation of climate change and the improvement of air quality, displacing carbon-intensive fuels and encouraging the promotion of energy savings and efficiency both in our own facilities and at our customers.
- Contributing to the decarbonisation of the system, increasing the use of gas and renewable electricity and encouraging their integration through the development of smart grids.
- Supporting international climate change negotiations and mechanisms that foster technological neutrality and industrial competitiveness, promoting the development of the most appropriate technologies at each stage of the energy transition.

Naturgy has a voluntary goal for GHG reduction. This target is aligned with science to avoid an increase in temperature above 2°C (Science Based Targets Initiative. Tool V8): Average reduction of 26% of total direct emissions for the 2013-2025 period, taking 2012 as the base year.

The main lines of action carried out to reduce GHG emissions:

- Displacement of carbon intensive fuels.
- Fostering renewable electricity.
- Promoting renewable gas.
- Encouraging the gas-renewable binomial in generation.
- Reducing fugitive emissions.
- Increasing energy efficiency in our facilities.
- Promoting energy efficiency at our customers.
- Exploring and developing technologies to reduce emissions.

For management of climate change, the following means are available:

- Measurement and control tools for GHG emissions and operational plans implemented to reduce them, including the annual calculation of the group's carbon footprint.
- Transparency and dissemination of information, publishing the carbon footprint report and participating in the international benchmark indexes on climate change, such as the CDP.
- Participation in the following initiatives related to climate action:
 - Carbon Pricing Leadership Coalition (CPLC).
 - Caring for Climate.

- Statement on fiduciary duty and climate change disclosure.
- Corporate commitment with the Science Based Targets climate policy initiative.

2. Circular economy

Naturgy is committed to promoting the circular economy through the efficient use of resources to reduce environmental impacts. To do this, different lines of action are developed, focused fundamentally on:

- Improving eco-efficiency in the use of resources, energy, water and raw materials, reducing pollution, waste and its impact on the environment.
- Innovating for the promotion of renewable gas (biomethane and hydrogen) as an energy and storage vector that facilitates the transition to a circular and decarbonised economy model.
- Offering sustainable mobility solutions for cities and land and maritime transport that reduce atmospheric contamination and improve air quality.

Within the framework of the integrated management system, Naturgy develops management and control procedures aimed at minimising the waste that is disposed of in landfills, through prevention, reuse, recycling and/or energy recovery.

Most water consumption at the facilities of Naturgy is due to the operation of thermal power stations. Specifically, the majority is produced through the evaporation of water in the cooling towers; the rest corresponds to consumption in other processes, in the water-steam cycle and in other auxiliary services. Most of the water collected is returned to the environment. Depending on its origin, the main source of supply is the sea, with fresh water accounting for a much smaller contribution. It is important to note that Naturgy, aware of the scarcity of water in the environments of some of its power plants, introduced systems for the reuse of wastewater in these facilities.

Regarding effluent discharges, at power stations we monitor and analyse not only the effluents but also of the waters of the environment receiving the effluent discharges. The treatment equipment and systems worked as planned in 2018, complying with environmental permits. In addition, studies of the receiving environment reveal that no significant impacts were generated in the aquatic ecosystems where the effluent discharges are made.

Furthermore, Naturgy also promotes energy efficiency, both in its own facilities and at its customers, helping to reduce environmental impacts due to unconsumed energy. Moreover, numerous innovation initiatives are under development in the field of renewable gas, in order to promote this new energy vector, which allows the recovery of organic waste and reduces GHG emissions.

3. Natural capital

Naturgy is committed to the preservation of natural capital, biodiversity and cultural heritage in the areas around its facilities, with special attention paid to protected areas and species. To this end, it is based on the precautionary principle, conducting prior environmental studies during the design phase that minimise the negative impacts of the complete life cycle of the facilities.

Introducing additional voluntary measures contributes to the knowledge and mitigation of the impacts arising from the development of new projects and the operation of the facilities once they have been introduced. The company also takes into consideration the opinion of stakeholders in places where activities and projects are developed.

In addition, in the areas surrounding the facilities, especially in those that are close to protected areas or of high value for biodiversity, studies are carried out to improve the knowledge of the natural spaces and to reduce impacts.

The development of Naturgy's activities requires the occupation of land. When the facilities are being designed, environmental impact studies are carried out, in which the protected areas that have a high ecological value are analysed, adapting the project to avoid or minimise the impacts on biodiversity. In those cases in which it is not possible to completely avoid the impact, the required compensatory measures are introduced.

Once the facilities are operational, they are integrated into a Geographical Information System, where they are cross-checked with the protected natural spaces to identify, quantify and monitor the impacts on biodiversity.

To minimise these effects, the company applies operational control procedures and, at those facilities where there can be greater potential risk, we carry out environmental assessment studies and define environmental emergency plans to prevent the incident before it occurs, or to minimise any damage. We also regularly perform environmental emergency drills to test the procedures that have been defined.

The key impacts on biodiversity that may arise from the company's operation in the area of the sites and in the areas adjacent to them, are the following:

- Temporary condition affecting the fauna present in the environment, as a consequence of the construction of transportation and distribution infrastructure of gas and electricity.
- Permanent condition affecting bird life and arboreal vegetation, as a result of the operation of transport networks and the distribution of electricity.
- Impact on the abiotic and biotic environment of the environments around the facilities, as a consequence of emissions arising from combustion.
- Condition affecting the populations of species present in the environment, as a consequence of changes in land use and the permanent presence of the facilities in the natural environment.
- Effect on the aquatic environment, as a result of effluent discharges.
- Relevant effect on biodiversity (positive and negative), as a consequence of the creation of reservoirs associated with hydraulic power stations.

7.5. Interest in people

What does it mean for Naturgy? Risks and management approach

For Naturgy it is essential to foster a quality working environment, based on respect, diversity and personal and professional development. Naturgy also has a Code of Ethics that establishes the guidelines governing the ethical behaviour of all employees in their daily work and, specifically, with regard to the group's relations and interactions with its stakeholders.

Persons that suffer any kind of discrimination or do not feel themselves to be fairly rewarded tend to reduce their pride of belonging and lower their productivity. Furthermore, research reveals that the increase of pay inequality is associated with lower profits, productivity and business competitiveness.

The major transformation of the energy sector and digitalisation require new expertise and skills which, if they are not covered in a flexible way, would place the company at a disadvantage with its competitors, with the resulting consequences this could have on the business.

What is our commitment?

- Applying best practices in identifying, attracting and retaining the talent necessary for the development of the businesses, ensuring the principles of fairness and non-discrimination on any grounds whatsoever (disability, age, gender, work history, etc.).
- Encouraging the professional development of persons as part of the talent management model, ensuring that all professionals have the means, programmes and tools necessary to foster their skills and expertise.
- Promoting a motivational work setting that guarantees internal recognition of the culture of effort, the autonomy required to be able to create, develop and innovate, and an overall framework of compensation that is commensurate with this.
- Ensuring the effective introduction of flexibility mechanisms that facilitate the balance between professional and personal life, and which favour the human and social development of persons.
- Promoting diversity and equal opportunities in an environment of respect, understanding and ongoing dialogue, with a special focus on the inclusion of disabled persons and extending this commitment to suppliers and collaborating companies.
- Fostering constant liaison between the company and workers' representatives that enables feedback in order to take decisions.

How do we measure our performance?¹

Distribution of employees by age group, country, gender, and employee category

	2018											
	N° employees	18-35 (%)	36-50 (%)	>50 (%)	Management team		Middle managers		Technicians		Operators	
					Men (%)	Women (%)	Men (%)	Women (%)	Men (%)	Women (%)	Men (%)	Women (%)
Germany	7	14.3	57.1	28.6	-	-	-	-	71.4	28.6	-	-
Argentina	767	21.3	37.4	41.3	3.7	0.8	13.7	3.5	15.1	4.8	45.0	13.4
Australia	8	50.0	37.5	12.5	-	-	-	-	25.0	-	62.5	12.5
Belgium	3	66.7	33.3	-	33.3	-	-	33.3	-	33.3	-	-
Brazil	478	25.7	61.5	12.8	5.2	2.9	12.8	7.1	15.5	11.5	29.3	15.7
Chile	3,046	27.2	49.1	23.7	2.2	0.8	12.6	3.2	26.5	11.0	33.7	10.0
Colombia	84	36.9	48.8	14.3	10.7	13.1	6.0	9.5	17.9	22.6	8.3	11.9
Costa Rica	20	20.0	65.0	15.0	5.0	-	5.0	-	10.0	-	75.0	5.0
Spain	6,532	11.1	59.9	29.0	11.0	4.4	15.2	4.6	19.9	15.0	19.2	10.6
France	66	57.6	40.9	1.5	10.6	3.0	6.1	7.6	28.8	31.8	3.0	9.1
Holland	7	28.6	71.4	-	14.3	-	14.3	-	28.6	28.6	14.3	-
Ireland	40	50.0	45.0	5.0	12.5	2.5	12.5	5.0	32.5	27.5	7.5	-
Israel	15	73.3	26.7	-	-	-	13.3	6.7	53.3	26.7	-	-
Morocco	93	7.5	43.0	49.5	3.2	1.1	39.8	2.2	11.8	2.2	29.0	10.8
Mexico	989	37.1	54.5	8.4	5.8	1.3	16.5	4.0	23.7	10.5	27.2	11.0
Panama	362	37.0	36.2	26.8	5.0	2.5	21.3	9.9	12.7	11.6	25.4	11.6
Peru	21	52.4	42.9	4.8	-	4.8	14.3	4.8	33.3	14.3	9.5	19.0
Portugal	18	38.9	61.1	-	-	11.1	-	-	16.7	44.4	5.6	22.2
Puerto Rico	5	20.0	20.0	60.0	40.0	-	40.0	-	-	-	-	20.0
Dominican Rep.	84	19.0	66.7	14.3	1.2	2.4	23.8	9.5	3.6	7.1	50.0	2.4
Singapur	4	75.0	25.0	-	25.0	-	-	-	75.0	-	-	-
Uganda	51	66.7	29.4	3.9	2.0	-	39.2	5.9	-	2.0	43.1	7.8
TOTAL	12,700	20.1	54.3	25.6	7.4	2.9	14.8	4.5	21.0	12.8	25.8	10.8

1. The indicators that represent the evolution over the year include information from companies held for sale (Moldova, Kenya) or sold prior to the year-end (South Africa) provided that the opposite is not specified, while the indicators that represent information at the year-end do not include information about these companies.

Annual average of indefinite and temporary contracts by age, gender and professional category

percentage of workforce by type of contract			2018	Average annual workforce temporary contract by professional category		Average annual workforce temporary contract by age		
				2018		2018		
				Men	Women	Men	Women	
Permanent contract	Men	67.7	Executives	2	-	18-35	136	92
	Women	30.1	Technicians	102	70	36-50	68	38
Temporary contracts	Men	1.2	Administrative staff	-	-	>50	9	2
	Women	1.0	Operatives	109	62	Total	213	132
Total		100.0	Total	213	132			

Rotation and voluntary rotation index

(%)	2018	2017
Rotation	17.4	6.4
Voluntary Rotation	2.5	2.9

Number of dismissals by age group, gender, and professional category

Dismissals by professional category and gender	2018		Dismissals by age group and gender	2018	
	Men	Women		Men	Women
Executives	9	2	18-35	60	23
Technicians	111	32	36-50	72	44
Administrative staff	-	-	>50	58	22
Operatives	70	55	Total	190	89
Total	190	89			

Salary gap¹

Below is a detail of the salary gap measure according to which a % above zero represents the % that women earn less than men:

	2018			
	Executives	Technicians	Administrative staff	Operative
Argentina	21.4%	12.8%	11.6%	17.8%
Brazil	22.7%	14.7%	-	24.1%
Chile	38.1%	6.1%	18.0%	17.8%
Colombia	10.2%	28.0%	(2.4%)	-
Spain	13.1%	4.5%	6.2%	13.3%
France	23.7%	18.1%	8.2%	-
Ireland	38.9%	19.6%	-	-
Morocco	4.5%	6.7%	7.1%	-
Mexico	4.5%	(2.1%)	(26.6%)	(30.1%)
Moldova	2.3%	2.5%	(17.9%)	(2.1%)
Panama	(20.4%)	(16.1%)	15.9%	-
Dominicana Rep.	-	(10.0%)	22.7%	-

1. Data is provided about the most relevant countries for Naturgy. The difference in salary shown by the results is in line with the context of the sector and generated mainly by the company's past gender make-up, which means greater average seniority of men in comparison with women. The reason why boxes are left blank is because there are no employees of one gender or another in said professional category.

Average remuneration by age group, gender, and employee category¹

	2018							
	Executives		Technicians		Administrative Staff		Operative	
	Men	Women	Men	Women	Men	Women	Men	Women
Argentina	59,279	46,587	22,995	20,060	17,868	15,799	20,135	16,555
Brazil	51,148	39,534	21,571	18,399	-	18,494	14,887	11,306
Chile	156,804	96,992	46,327	43,515	28,184	23,125	17,951	14,456
Colombia	83,685	75,116	15,804	11,377	6,156	6,305	-	-
Spain	102,177	88,797	45,203	43,135	33,346	31,269	31,691	27,498
France	100,743	76,888	52,909	43,353	35,231	32,339	-	-
Ireland	99,000	60,500	56,000	45,000	-	-	-	-
Morocco	93,061	88,902	34,577	32,248	13,090	12,155	17,532	-
Mexico	33,186	31,693	14,442	14,747	6,828	8,646	6,567	8,544
Panama	38,576	46,463	17,256	20,036	18,896	15,899	14,128	-
Dominicana Rep.	-	73,110	23,216	25,545	12,210	9,439	11,946	-

¹It includes only the fixed remuneration.

	2017							
	Executives		Technicians		Administrative Staff		Operative	
	Men	Women	Men	Women	Men	Women	Men	Women
Argentina	78,404	63,187	31,615	28,602	24,812	22,116	26,555	25,626
Brazil	75,051	65,270	26,068	23,699	-	20,518	15,449	15,034
Chile	128,109	87,065	41,803	38,023	25,064	20,438	15,191	13,140
Colombia	63,952	54,794	13,550	12,569	6,564	6,455	6,227	6,615
Spain	99,531	84,576	50,329	45,813	42,004	35,990	38,876	29,529
France	97,143	82,911	52,146	42,623	34,596	31,617	-	-
Ireland	312,231	67,600	46,680	41,656	-	-	-	-
Morocco	85,786	81,598	33,235	29,675	9,499	12,013	16,277	-
Mexico	31,796	29,357	12,741	12,849	6,478	8,188	5,617	5,585
Panama	41,041	43,775	16,393	18,152	16,216	15,082	13,098	-
Dominicana Rep.	46,643	73,699	20,009	24,309	11,915	9,045	11,683	-

¹It includes only the fixed remuneration.

Average remuneration by age (Spain)	Amount
18-35	34,446
36-50	48,737
> 50	56,196

Average remuneration of directors and executives

The remuneration of the executives of Naturgy is detailed in an individual basis in Note 26 of the annual accounts.

The average remuneration of directors of Naturgy (without taking into account indemnities detail in the section of the Corporate governance) amounted 808 thousand of euros in the exercise 2018.

Disabled persons integration rate

	2018	2017
Employees with disabilities (%) in Spain	2.40	2.50

Percentage of employees covered by collective bargaining agreements

	2018		2017	
	Not covered by collective bargaining agreement	Covered by collective bargaining agreement	Not covered by collective bargaining agreement	Covered by collective bargaining agreement
Germany	-	100.0	-	100.0
Argentina	19.3	80.7	23.0	77.0
Australia	-	100.0	-	100.0
Belgium	33.3	66.7	18.2	81.8
Brazil	25.5	74.5	24.6	75.4
Chile	4.6	95.4	4.8	95.2
Colombia	47.6	52.4	45.5	54.5
Costa Rica	-	100.0	-	100.0
Spain	32.0	68.0	29.8	70.2
France	72.7	27.3	71.3	28.7
Holland	-	100.0	-	100.0
Ireland	100.0	-	95.1	4.9
Israel	-	100.0	-	-
Morocco	34.4	65.6	33.0	67.0
Mexico	19.0	81.0	18.3	81.7
Panama	61.9	38.1	59.9	40.1
Peru	-	100.0	-	100.0
Portugal	-	100.0	-	100.0
Puerto Rico	-	100.0	44.4	55.6
Dominicana Rep.	3.6	96.4	3.9	96.1
Singapur	100.0	-	100.0	-
Uganda	-	100.0	-	100.0
Total	24.1	75.9	22.8	77.2

Training¹

	2018	2017
Workforce trained (%)	91.0	93.7
Total course hours	645,311	613,623

	2018				
	Management team	Middle managers	Technicians	Operators	Total
Total course hours	113,262	137,823	204,617	189,609	645,311

1. They do not include Kenya or South Africa. They do not include figures for companies and/or countries that do not have access to the Success factor platform (Energía de San Juan, S.A., Ireland and Israel).

What are our main milestones in 2018?

New organisational model of the group

- Scaling up the use of people analytics in the preparation of diagnostics and in taking decisions that concern persons.
- Implementation of new ways of working and new methods of collaboration that accompany the evolution of the businesses.

What are our goals for 2019?

- Application of the new People Model
- New ways of working project: TEAM
- Launch of the Transformational Leadership Academy
- Naturgy in-house Communication Plan focused on: corporate priorities, the executive role in communication, and fostering participation

Analysis of the 2018 results

People management model

During 2018 the people management strategy at Naturgy has revolved around the transformation and creation of value, as set out in the company's roadmap. The empowerment of people is one of the levers that drives the transformation the company is introducing, and, in this regard, management of people has focused on defining its management model, bridging the new strategic targets with people and simplifying processes to accompany the creation of value.

The people management model is designed as a dynamic ecosystem that enables people to be part of the company's evolution, and is one of the key levers, together with customers and shareholders, in the creation of value. The Naturgy people model applies at corporate level and incorporates three major areas, where a series of focal points and their associated processes come together to ensure consistency and solidity of the model:

- Commitment and loyalty, which works on attracting, retaining and the segmentation of talent.
- Total compensation, which links the professional category, remuneration and the working environment.
- Training, as an element of evolution and development of the company's professionals.

Measures to foster employment

Naturgy has a pool of young professionals with sound technical and management training, through the annual programmes of work experience and the agreements for Dual VT. A pool that enables us to respond to the company's needs and to attract the best talent in those spheres of knowledge in which Naturgy is the leader:

- Professional practices programme: Naturgy has partnerships with the main universities and higher education centres in those countries where it operates, through which it selects young people for work experience each year.

The Dual VT offers Naturgy the opportunity to participate in the vocational training of young people, developing academic content adapted to the needs of the company, ensuring rapid adaptation to the working environment.

Diversity and equality

For Naturgy it is essential to promote diversity and equal opportunities in an environment of respect, understanding and ongoing dialogue, with a special focus on gender diversity targets, on the inclusion of individuals with various disabilities and extending this commitment to suppliers and collaborating companies.

In 2013, Naturgy established an Equality Plan at corporate level together with the union representations that was published in the Official State Gazette under Registration Number 90100073112013. It is based on 14 strengths to be maintained and 14 weaknesses to be corrected identified by outsourced experts, giving rise to 32 actions in issues of *communication* and raising awareness, culture and leadership, development and promotion, remuneration, flexible employment and work-life balance, selection, prevention of harassment, measurement and monitoring.

The creation and activation of a specific protocol against harassment; the best practices protocol in the selection processes, or the communication guide for business professionals that need to intervene for some reason in the selection process, are just some of the measures introduced and which, together with the Integrated Diversity Plan, approved at the end of 2015, have propitiated major advances in diversity and equal opportunities.

The protocol against sexual harassment lays out some preventive actions to avoid situations of harassment that include informing all employees about the protocol; training the entire workforce in the issue, and in particular employees with personnel under their charge; the obligatory nature and responsibility of each employee to establish their relationships with respect and dignity and for each employee to report any case of harassment to their superior.

The action procedure in the event of detecting any situation of harassment sets out two channels:

- Informal procedure: through which the affected party informs the alleged aggressor that this behaviour is not welcome, that it is offensive and interferes with their work. And if the situation is not resolved, then the formal procedure will be instigated.
- Formal procedure: through which the harassment situation is reported, following these steps:
 - Notification to the Code of Ethics Committee or reporting to their superior or to the Human Resources Department, who will decide whether to accept it for processing.
 - Investigation, gathering the information and conducting interviews with the affected parties and witnesses, if there are any.
 - Possibility of introducing precautionary measures.
 - Report on conclusions and resolution of the procedure, which will include the corrective measures and the introduction of the following solutions: filling of the report or commencement of the disciplinary file depending on the seriousness of the offence.

The protocol offers a series of guarantees, inter alia the complete anonymity of the informant; the process will be completed as expeditiously as possible; the intervention of the workers' representatives may be requested and an impartial hearing guaranteed, along with fair treatment for all of the affected parties. No reprisals will be allowed, and the identity of the informers will be protected.

In 2018, the company's commitment to diversity remained strong, consolidating the Integrated Diversity Plan which brings together specific initiatives, in all geographies and territories, for people management, classified into three areas: gender, disabilities and age.

As regards integration and accessibility of people with different capabilities, the Management of Naturgy acts as an impetus for a range of actions targeted at standardising management of functional diversity:

- Family Plan: this provides relatives of employees with advice from professionals and experts in disability and employment integration, so that from the earliest ages they can develop the skills and abilities that enable persons with disabilities to increase their autonomy and employability.
- Capacitas Plan: this aims to promote the employment of people at risk of social exclusion on grounds of disability.
- Aflora Plan: this encourages those employees of Naturgy with some degree of disability to contact the company for information on new measures specifically designed to achieve the full integration of everybody in a unique environment of diversity.
- Bequal Plus certificate: Naturgy renewed this certificate in 2018, substantiating our commitment in corporate social responsibility and disability.

The Equality Plan has encompassed the development of best practices protocol to avoid discrimination in the selection processes, and which includes the following measures:

- Open up the spectrum of recruitment sources to associations and foundations to guarantee equal job opportunities at the company.
- In the publication of job offers:
 - No discriminatory terminology is used.
 - Put the feminine gender first followed by the masculine.
 - Gender separation will always be carried out with slashes.
 - Do not use any notation as a requisite that does not offer equal conditions to the different candidates on the grounds of gender, appearance, disability, age, religion or personal beliefs of any kind.
 - Only specify the need for a driving licence when the job requires this.
 - Do not use possession of own vehicle as a requirement.
 - Do not use the need to reside near the place of work as a requirement.
- In the selection process:
 - In the case of disabled candidates, make sure we have the accessibility required so that they can attend the interview with us.
 - Avoid prejudices and stereotypes associated to gender, appearance, disability, age, religion, religious beliefs of any kind.
 - Transmit the corporate image.
 - Avoid personal questions and, if necessary, justify them.
 - Avoid preferential treatment.

- In the finalisation of the process:
 - Explain the result of the process.
 - Explain the next steps if they have passed the process.
- On joining the company:
 - Inform them about the equal opportunity policies.
 - Transmit values.
 - Non-discriminatory social benefits.
 - Career plans based on merits and capabilities.

Training and development

Training is one of the key areas of the Naturgy People Model. The Naturgy training and development model is instrumented through the Naturgy Corporate University, as this is a strategic lever of transformation that serves the business to build the future, create value and achieve the goals set out in the Strategic Plan.

The Corporate University's mission is to help develop professionals that make Naturgy's vision a reality and its aim is to ensure adequacy between the job position and the person, the acquisition of expertise linked to new needs of the organisation and the development of skills and abilities related to the Naturgy leadership and culture model.

Its advisory board guarantees a steadfast connection between the company's strategy and the activity of the Corporate University. The board comprises representatives from the company's senior management as well as external advisers from prestigious academic institutions.

The Corporate University has a quality management system pursuant to the ISO 9001:2015 standard, renewed in 2017 and with CLIP (Corporate Learning Improvement Process) accreditation from the European Foundation for Management Development (EFMD) since 2003 and last renewed in 2018 for a five-year period. This certificate recognises the quality of learning and development processes of people of corporate education organisations.

2018 has seen consolidation of the introduction of Evolution as an on-line training platform of the Corporate University and the evolution of the company's new training model based on three levers: employee experience, personalisation of the training available and centralised global operations.

The Corporate University's management model responds to the training needs through its two academies:

- The Tech Academy guarantees the transfer of specific technical knowledge in each business, thus permitting its efficient development and ensuring quality and uniformity in all countries.
- The Transformational Leadership Academy, focused on transformation through the development of leadership of the executive, director and management team of Naturgy.

Flexibility

Naturgy is committed to promote an appropriate work-life balance through a significant number of flexible employment measures, services and benefits adapted to employees' needs.

Global FRC certification

Naturgy is a benchmark of the new socio-labour and business culture. This is recognised in the Global Family Responsible Company (FRC) certification, obtained in 2013, renewed in 2016 for another three years and reviewed in 2017 and 2018, respectively. We were the first and only company to obtain this qualification issued by the Más familia Foundation. This certification is audited by AENOR, and is supported by the Ministry of Health, Consumer Affairs and Social Welfare.

This certification is an endorsement of the country-specific local measures on conciliation and development, but it also identifies 20 measures that are common to all of them and which are promoted at corporate level. Among these 20 measures, we can highlight those expressly related to the principles set out in the Global FRC Standard 1000/23 on time flexibility (flexible working day and paid leave); support to the personal environment (support to the family environment and spaces of integration between employees and relatives), personal development (with non-work integration activities), and job quality (use of technological tools to avoid travel, along with health, safety and well-being measures).

Time Bank

Naturgy provides its employees with a space, both physical and virtual, where they can delegate the performance of daily tasks in order to increase the free time they can spend on the most enriching aspects of their personal life. The range of services available to them is extensive and structured into three blocks:

- Administrative tasks: advisory and assistance services for frequent administrative tasks.
- Advantages club: an exclusive virtual space with more than 500 offers.
- Easylife space: outreach services and acquisition of products.

The Time Bank also offers services available on a quotation basis, such as technical services, courier services, returning clothes to stores and currency exchange, or special services provided during Christmas or back-to-school campaigns, among others.

In addition, in April 2018 we introduced the Easybox service which makes all of these tasks even easier and more flexible, through an interactive drop-point service and a website where users can request more than 20 different services, with the benefit of being able to deliver and collect at the most convenient time.

Access to these services is built into the My Benefits platform, on the corporate Intranet. Leadership and talent programmes have helped promote professional development and training, strengthening the human potential of the company.

Compensation and remuneration

Naturgy's remuneration policy is governed by equity on an internal scale and competitiveness from the market point of view. There are two models:

- The remuneration level of employees included in the collective bargaining agreement depends on the professional group and subgroup to which they belong.
- For those employees not included in the collective bargaining agreement, it is established on an individual basis according to the remuneration policy approved by the Board of Directors' Appointments and Remuneration Committee.

The remuneration package of Naturgy employees is supplemented with a social benefits system, which includes a pension plan, the main vehicle of funding post-employment commitments.

In the case of Spain, the Joint Pension Plan for Employees of the Naturgy group is a defined contribution plan for retirement and defined benefits in the event of death or incapacity whilst actively working.

The plan currently has assets totalling more than Euros 500 million, distributed among more than 6,300 active employees, and close to 2,000 beneficiaries.

On the international stage, the group's retirement policy at all companies revolves around retirement savings instruments and coverage for death or incapacity while an active worker. These provide employees with benefits that complement the public systems of social security and are always introduced in accordance with the particular nature and needs of the social welfare issues of each country.

By the same token, the company provides a series of social benefits that supplement employee remuneration packages, irrespective of their type of workday.

Internal communication with employees

The purpose of Naturgy's internal communication is to assist compliance with the company's strategic goals, aligning the entire organisation and strengthening corporate culture and values.

Naturgy has a range of channels to disseminate these messages, such as the corporate Intranet, Naturalnet, and the magazine Natural, which is distributed internationally and the social network Yammer. In February this year the company set up a new channel, Naturalnews, which operates as the digital newspaper of Naturgy and provides information on the company's latest news.

Labour relations

Respect for the freedom to join a union; fundamental rights; collective bargaining, and the agreement culture represent the key principles of what we do. Furthermore, we respect workers' representatives freely elected in all countries where the company operates, and we have also introduced communication channels with these representatives as a major part of our corporate action principles.

The collective bargaining agreements include several communications channels with representatives, under the form of committees to deal with the many and varied aspects of general interest.

One of the mechanisms for consultation and employee participation are the regular health and safety meetings held in all areas of the company. This means that all employees have a channel of direct participation available to them through the joint meetings between management and employees, and 100% of the workforce is represented at meetings.

It should be noted that the holding of these meetings is to not replace the various health and safety committees required under labour legislation and which correspond to each country. The main issues, formerly dealt with during 2018 of these kinds of meetings with the workers' representatives, were:

- Health and safety commitment.
- Analysis of the accident rate.
- Launch of new regulations.
- Comprehensive health.
- Quarterly monitoring of measures.

7.6. Health and safety

What is our commitment?

- Guarantee that health and safety are non-delegable individual duties, and that they are taken on by senior management through a visible collective commitment, proactively accepted and implemented by the entire organisation, and by our suppliers and collaborating companies.
- Establish health and safety as an individual responsibility and as a condition of employment at Naturgy and of the activity of its collaborating companies.
- Ensure that any potential risk situations that may affect employees, suppliers, customers, the general public and the safety of facilities are brought to attention, assessed and managed in the appropriate manner.
- Work to maintain a risk-free working environment by integrating prevention of occupational risks and the protection and promotion of health and well-being.
- Establish learning as the driver of a safety culture, by means of ongoing training, accident and incident analysis, the dissemination of lessons learnt, education and the promotion of health.
- Incorporate health and safety criteria into business processes, new projects, activities, facilities, products and services, and in the selection and assessment of suppliers and collaborating companies, non-compliance with which will condition the commencement or continuity of their activity.
- Invest in new strategies of health education and health promotion, which allow the workplace to become the vector of transmission of healthy conduct for workers and their environment.
- Implement measures targeted at improving the quality of life, well-being and health of people within the communities where the company operates.
- Provide the resources and necessary means to enable compliance with established safety standards at all times.

How do we measure our performance?

Accident indicators

	2018		
	Total	Men	Women
Accidents requiring sick leave (Nº of employees)	28	25	3
Days lost	1,524	1,497	27
Mortalities	-	-	-
Frequency rate	1.00	1.30	0.35
Severity rate	0.055	0.078	0.003
Incidence rate	1.99	2.58	0.69

It does not include the information of Moldova, Kenya and South Africa. The accident rates including Moldova and South Africa are: No. of accidents with sick leave: 34, Days lost: 1,745, Mortalities: 1, Frequency rate: 1.138, Severity rate: 0.058, Frequency rate: 2.204.

Occupational illness

There have been no occupational illnesses registered in 2018.

Absenteeism

	Lost Hours ¹
Spain	382,147
Chile	250,980
Argentina	33,912
Brazil	15,749
Colombia	3,160
Costa Rica	813
France	3,836
Kenya	1,072
Morocco	2,899
Mexico	9,840
Moldova	33,415
Panama	8,790
Peru	152
Dominican Republic	3,184
South Africa	54,720
Uganda	313
Total	804,981

1. We have considered the hours of absenteeism for occupational illness and non-occupational illness, and the total number of hours worked in 2018 was 30,010,519.

What are our main milestones in 2018?

- Launch of the predictive health and safety analysis tool DaVis (Data Visualization).
- Introduction of the “Meeting Point” two-way information exchange channel with suppliers and collaborating companies.
- Launch of the security of consumers and communities management programme “Spear”. The implementation of the new management model of health and safety training in the global scope of the company.
- Plan to assist employees while they are on sick leave.
- Consolidation of the healthy business model in countries already certified.

What are our goals for 2019?

- Horus: multi-factor analytical preventive analysis.
- Integra: exchange of best practices and learning through collaboration with collaborating companies.
- Kepler: ongoing innovation applied to prevention.
- Optimise the approach to cases of colon cancer.
- Optimise the approach to osteomuscular injuries.

Analysis of the 2018 results

Health and Safety Strategy

Safety as strategy guides the way in which Naturgy operates. Health and safety are key parts of the company's business strategy, which is referred to as the "Health and Safety Commitment", one of the major undertakings established in the Corporate Responsibility Policy. A common culture has been achieved in which all levels of the company, spearheaded by the Board of Directors, have acquired a firm commitment to continuous improvement in this area.

The preventive culture of health and safety at Naturgy has consolidated itself thanks to the evolution in 2018 of the "Health and Safety Commitment" throughout the company. The actions at all levels of the organisation are based on the motto "nothing is more important than health and safety".

Since 2017, the health and safety strategy has revolved around four pillars, leading to the development of different strategic objectives and goals to be achieved. The four pillars are:

- Consolidating health and safety as a strategic lever to align and to capture efficiencies.
- Maintaining Naturgy as a worldwide benchmark in health and safety issues.
- Drastically reducing the accident rate at collaborating companies.
- Implementing the commitment in all countries where the company will have a presence.

The Health and Safety Commitment Plan, implemented between 2012 and 2016, involved overcoming the implementation stage until we were able to reach the "Health and Safety Commitment".

First of all, we analysed the initial situation, which allowed us to characterise the integration and management of the company's commitment. Next, we established responsibilities for each one of the defined work areas and strengthened the management and dissemination tools. All this involved a major impulse for the new health and safety culture.

The definitive consolidation of the plan came about in 2016, with the "Health and Safety Commitment". Achieving the commitment has involved integration of health and safety as an ongoing and stable value, taken into consideration by everybody that makes up the organisation.

This new approach has closed a cycle whose driving force has been the ongoing improvement into the daily life of the company, the increased efforts to achieve the desired objectives and the proposal for innovative initiatives.

These new steps of the strategy maintain the four lines of action of the "Health and Safety Commitment": leadership, employees, collaborating companies, and facilities and processes, each one of which has its own "network" charged with spearheading development. Furthermore, the transversal networks continue working in the quest to provide support in areas such as communication, systems, training and corporate aspects.

The cultural change has served to transfer the company's principles of health and safety to daily activity, and it reaches our collaborating companies and any new businesses that join Naturgy.

Health and safety leadership

Leadership is considered the driver of cultural change in the company. This means efforts have to be made at all organisational levels, and promoted by the management, with a visible, solid and firm commitment in taking all decisions, with health and safety paramount at all times. Naturgy's commitment to the target of zero accidents is strengthened through the involvement of senior management in the management of safety in all activities.

Senior management and the various committees have the tools necessary and the power to control and apply the appropriate measures in the event of any sign or anomaly concerning safety issues in all activities and geographies.

Risk prevention

To ensure safety in the activities of Naturgy, measures aimed at preventing accidents and incidents have been introduced. Risk prevention is a key factor that governs business leadership and is supported on these principles:



This is the commitment of Naturgy and also the one that must be shared and applied by its collaborating companies.

Furthermore, we have also developed mechanisms to learn from events that occur and to avoid them in the future. These actions revolve around the main cultural axes of the company's health and safety, the cornerstone of its commitment.

Risk assessment and management mechanisms

The process of occupational risk assessment aims to estimate the magnitude of those risks that could not be avoided. In these cases, the company obtains information for the adoption of effective preventive measures.

Naturgy uses a general procedure that applies to the entire group and which establishes the guidelines and principles to be followed for the identification, assessment and control of occupational risks. The following review periods are established:

- Risk assessments every three years.
- Yearly checks of the health and safety conditions.
- Monitoring of preventive measures to be introduced as a result of the risk assessment and regular checks every quarter.

Prevention of risks at collaborating companies: suppliers, contractors and subcontractors

Naturgy acquires the undertaking to provide a safe working environment not only for its employees but for all those who make the activity of the company possible.

For this reason, the growth of involvement of the collaborating companies within the health and safety culture has been essential.

Safety is an indispensable condition of procurement for all collaborating companies and is taken into consideration in the assessment and award of tenders and bids. Furthermore, the criterion of red lines that cannot be crossed is applied, and if this rule is broken the contract can be terminated or the supplier's approval withdrawn.

Naturgy develops other mechanisms designed to ensure that the safety level of collaborating companies is the same as for its own staff. In recent years an impact plan has been introduced for all collaborating companies of Naturgy. Among other things, this plan encompasses site inspections, the introduction of training itineraries, the application of Preventive Safety Observations, the creation of check-lists prior to commencement of works and the planning of coordination meetings.

Training and awareness

The training of each employee in the prevention of occupational risks and industrial security associated with their job is the basic tool for achieving the target of reducing the number of occupational accidents. To provide adequate training, the company receives support in management from the Occupational Risk Prevention Classroom, a tool that the Corporate University has in order to comply with the goals established.

Certifications

As included in the strategic lines of the commitment, the certification according to health and safety standards enables consistency and standardisation of working conditions at Naturgy.

The company has a Global Certification Plan for the Occupational Health and Safety System; its aim consists of achieving global certification according to the OHSAS 18001 international standard. For its fulfilment, multi-discipline working parties were created as advised by the Prevention Service.

Safety audits and process diagnostics

To verify compliance with the country's prevailing rules and regulations, Naturgy has conducted safety audits of the company's different technical processes, of the technical procedures introduced by the group and the own internal regulations of the business unit.

To contribute value to the business lines and to assist in the ongoing improvement of processes, there is monitoring and control of the operational risks concerning technology, accidents and malfunctions and impacts on the environment, and of the relevant management parameters.

As regards diagnostics, these are conducted on technical processes and on request by the different business units. The aim is to show the degree of control of the business, the monitoring mechanisms and, if anomalies are found, the appropriate actions for correction can be carried out.

Safety among customers and society

Naturgy conducts accident prevention campaigns for customers of the company, through giving advice that is communicated through the global communication channels.

Additionally, the company uses the bills as a direct communication channel with customers. The company uses the bill as a way of introducing, inter alia: campaigns to raise awareness and information on specific actions concerning situations of risk, and campaigns that explain good use of devices and the maintenance of these.

Health

Naturgy is firmly committed to offering its employees a healthy working environment and well-being. The Comprehensive Medical and Health Assistance Unit is based on excellence and ongoing innovation to make available to employees, their relatives, collaborating companies, customers and the social environment in which the company operates, a global, health and welfare strategy that encompasses everything necessary for their benefit, both with regard to prevention, promotion and health care, in a customised way, as well as training and information with regard to healthy habits, taking into account both individual needs as well as the particular circumstances of each country.

Master Health Plan

This plan defines the strategic guidelines and establishes the general framework for action of Naturgy in the field of healthcare, ergonomics and psychosociology. The responsibilities under the plan correspond to each and every one of the business areas and countries within the group. In addition, comprehensive medical and health assistance services act as advisers for the development, monitoring and control of the plan in each of the areas.

Master Health Plan targets	
Standardised actions	Ensuring the health of workers, developing standardised actions respecting differences inherent in each country.
Compliance with regulations	Monitoring compliance with the relevant regulations to each area in health.
Development of activities by external collaborators	Coordinating the development of activities by external collaborators and establish monitoring and control measurements.
Definition of indicators	Defining the indicators necessary to assess the implementation and development of the Master Health Plan, as well as all of the involved activities.
Continuous training	Ensuring continuous training of professionals in the activity, information about the latest technological developments and promoting creativity for innovation.

7.7. Supply chain

What does it mean for Naturgy? Risks and management approach

Suppliers and collaborating companies are key players in the optimum performance of the value chain of Naturgy, and the company therefore promotes relations based on trust, that are stable, sound and of mutual benefit, under the principles of transparency and risk management.

Naturgy establishes objective and impartial mechanisms of assessment and selection of suppliers, ensuring that the supply chain complies with the principles set out in the Supplier Code of Ethics, to which all suppliers have to adhere and the content of which comes from the Code of Ethics of Naturgy, from the Human Rights Policy, from the Health and Safety Policy, from the Anti-Corruption Policy, as well as the internationally acknowledged good governance principles.

The risks to the company extend beyond its activity, as it can be severely impacted by the inadequate performance of its suppliers and contractors in terms of the environment, health and safety, human rights, labour practices or corruption.

What is our commitment?

- Extending the culture of Naturgy to the supply chain, passing on the target of excellence in service, efficient use of resources and the company's principles of acting responsibly, and encouraging the incorporation of sustainability criteria in their daily management.
- Fostering compliance with the codes and policies of Naturgy in the supply chain, in particular in the area of human rights, ethics, health and safety and the environment.
- Encouraging the hiring of suppliers from the country or region where the company performs its activities against similar competitiveness in other locations, supporting the generation of a positive social impact.
- Fostering practices that encourage traceability and fair trade of raw materials at source.

How do we measure our performance?

	2018	2017
Total number of suppliers	8,670	9,877
Total purchase volume awarded (euros millions)	3,147	3,428
Number of ESG assessed suppliers	6,906	4,758
Number of critical suppliers	2,584	2,457
Official-approval suspended suppliers	1	7

Environmental, Social and Governance (ESG): The suppliers ESG assessment is conducted at the main subsidiaries of the group where the Achilles tool is implemented, and through which the business classification of suppliers is carried out.

NB: Two thirds of the overall amount awarded corresponds to service suppliers that fundamentally take part in the following business areas:

- Development and maintenance of grids, both natural gas and electricity.
- Operators and maintenance workers of energy plants.
- Commercial management services.

The remaining third corresponds to suppliers that provide materials required for the construction and maintenance of grids and plants, as well as those support services that complement the general activity.

The development of this activity essentially takes place in the following geographical areas: Argentina, Australia, Brazil, Chile, Costa Rica, Spain, Kenya, Morocco, Mexico, Moldova, Panama, Peru, Dominican Republic and South Africa.

The evolution of data with regard to 2017 reveals a decrease in the purchase volume, number of suppliers and number of suppliers assessed. The decrease of the purchase volume is fundamentally due to the divestment in Italy, in some companies in Colombia (those that represented the highest volume) and to a lower business volume in Mexico (Euros 135 million) and Australia (Euros 85 million). In general, there has been a decrease in the remaining countries except Chile, which in 2018 contributed a higher amount (Euros 160 million more) through business growth.

As regards the number of total suppliers and suppliers assessed, the change is due to the removal of Italy and the companies in Colombia, and the increase of critical suppliers is due to the entry of new suppliers in Chile through business growth generally associated to critical activities.

What are our main milestones in 2018?

- Conducting audits at suppliers of any country of the group with the highest purchase volume in activities with a high ESG risk.
- ESG audits conducted with tier-2 suppliers.
- Review of the ESG risks matrix.

What are our goals for 2019?

- Quarterly monitoring of successful suppliers based on reputational, economic-financial and CSR ratings of external data sources.
- Introduction of the updated risk matrix throughout the group.

Analysis of the 2018 results

The supply chain of Naturgy

Suppliers, contractors and outsourced partners are key players in the optimal functioning and sustainable management of the value chain, demonstrating Naturgy's commitment as an efficient, responsible and innovative company, in a process of continuous improvement that guarantees safety, reliability and competitiveness of the supply chain.

In 2018, Naturgy set up trade relations with a total of 8,670 suppliers which accounted for a total expenditure of Euros 3,147 million.

Naturgy performs the procurement of works, goods and services, as well as the assessment, monitoring and development of suppliers in accordance with the general principles established in the company's policies, rules and procedures, as well as internationally recognised principles of good governance, ensuring a uniform, efficient and sustainable model.

The main goals of Naturgy in terms of sustainability with respect to the supply chain are:

- Extend the corporate culture to the supply chain in a sustained way, passing on the objective of excellence in service.
- Guarantee sustainable management of the supply chain in an ongoing way, safeguarding the group's reputation.
- Promote continuous improvement and drive the development of suppliers by identifying opportunities for collaboration and innovation.

The values transmitted:

- Transparency: guaranteeing fairness, independence and free competition.
- Integrity: we commit to acting with honesty, fairness, dignity and morality.
- Sustainability: the strategic horizon for our activities goes beyond immediate economic interests, contributing to economic, environmental and social development.
- Commitment to results: we develop plans, fix objectives and make decisions that comply with the objectives of our Vision, assuring compliance with the commitments made.

Management of the supply chain

Purchasing model

The Purchasing and Supplier Management Model introduces a management process with unified and overarching criteria for Naturgy's entire scope of operations. The corporate unit is responsible for defining the policy, general principles and the model of application and for ensuring compliance. The business units develop, implement and ensure traceability of the processes of contracting and management of suppliers, applying the established principles.

We encourage the aggregation of demand in purchases in which there is a single supplier market that covers most of the group's business needs and countries. In the remaining cases, the contracting of suppliers from the country or region where the company performs its activities is encouraged, supporting the generation of a positive social impact through the creation of wealth and investment in the local community, generating economic inclusion in the company's spheres of influence.

Transparency in purchasing

In terms of procurement, Naturgy is committed to ensure free competition, objectivity, impartiality, transparency and traceability throughout the procurement process.

The use of secure electronic means, the Jaggaer Advantage platform, for management of all bids brings greater transparency to the procurement process and ensures information traceability. In addition, communication channels have been established with the supplier that facilitate access to all the information necessary for their participation in the procurement processes.

Naturgy actively participates at associations, national and international fairs on supply chain management. In this regard, the company is member of the Association Representing Purchasing and Materials Management Professionals in Spain (Aerce) and RePro in Argentina, Brazil, Chile, and Spain.

Furthermore, the company subscribes to the worldwide Procurement Leaders network and in 2018 took an active part in the CPOnet Congress.

Human rights at suppliers

Naturgy has a Human Rights Policy that extends to the supplier's Code of Ethics, thus transferring to the supply chain the commitment to protect Human Rights within their sphere of influence, especially since international growth has led us to operate in some environments where their protection takes on special relevance

Supplier Code of Ethics

Naturgy is keen to extend the corporate culture to the supply chain, ensuring that collaborating companies comply with the principles set out in the Supplier Code of Ethics, which all group suppliers have to adhere since 2016.

Reporting Channel

All suppliers, contractors and outsourced collaborating companies of Naturgy that wish to report a violation of the Code of Ethics that they may have observed in the exercise of their functions may contact the Code of Ethics Committee through the email address published in the Naturgy Supplier's Code of Ethics.

Supply chain management process

In order to promote responsible management in the supply chain, Naturgy has a comprehensive purchase process, with application of unified and universal contractual conditions for the company’s entire sphere of operation and which is publicly available on the Naturgy website “The group’s general procurement conditions” and where supplier management is of vital importance.



Risk management of the supply chain

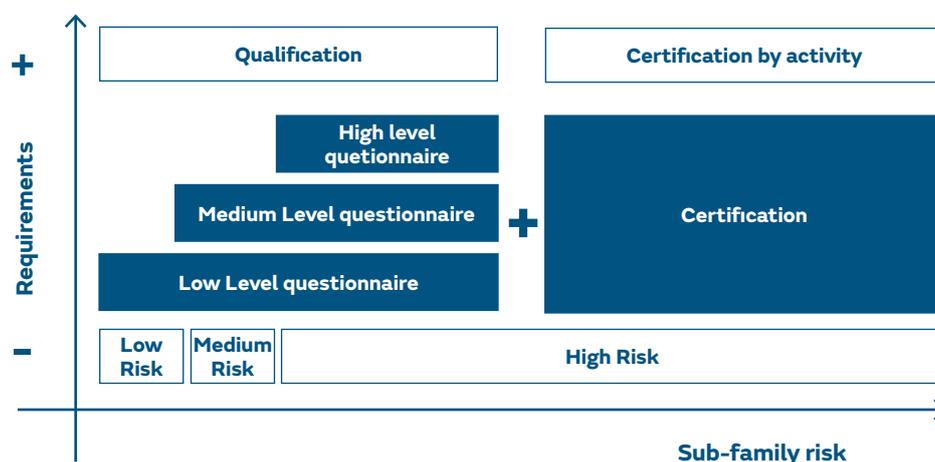
The risk factors of the supply chain are elements, conditioning factors or situations inherent to the same and which are considered significant in achieving our goals.

Risk factors assessed:

- Health and safety: this measures the potential risk of an incorrect action, service and/or product fault with regard to the life or physical integrity of persons.
- Quality: the impact that breach by the supplier with regard to the expected or agreed quality levels would have at Naturgy.
- Environmental, social and corporate governance (ESG): this measures the existing risk of purchasing products or contracting services that are not environmentally friendly, which are manufactured or generated under socially unfair conditions, or using labour practices that are ethically incorrect. Naturgy performs “responsible purchasing” through a management process that encourages the acquisition of products and services that are environmentally friendly, and which are manufactured under socially fair conditions.
- Operational risk: the potential impact on operations incurred by Naturgy as a consequence of a lack of continuity in the supply of a good or service by suppliers that have been awarded contracts.
- Legal risk: possibility of infringements and breaches by providers of laws, rules and practices that apply to them.

Assessment of suppliers

Assessment of suppliers is introduced in the processes of Business Classification of suppliers and Approval of suppliers and products.



With the risk evaluation of the purchase categories that are managed worldwide and assessing the risks of the countries where the company usually contracts, we obtain the risk of each purchase category in accordance with its activity and the country where the activity is conducted.

This combination allows us to assign a high, medium or low risk to each purchase category, which is integrated into the map, thus obtaining the risk of each purchase category by country.

Suppliers with a high level of risk in any of the assessed risk factors associated with the purchase categories they supply will be considered by the company as critical suppliers.

Naturgy also identifies the “suppliers with high risk in sustainability”, considering those that reveal a high-risk level in the Health and Safety and ESG factors.

Supplier classification

This process is based on the assessment of compliance at business level of what is required by Naturgy in the different risk factors, in order to participate in the procurement process of goods and services. All suppliers must pass this process before maintaining commercial relations with Naturgy.

The classification is conducted using self-assessment questionnaires that take into consideration legal, economic-financial, criminal, solvency, experience, business organisation, quality, safety, human rights, environmental, social and employment practices criteria.

Official approval and management of supplier quality

Naturgy has introduced the goal whereby all suppliers that perform critical activities through being defined with a high risk in any of the ESG, quality and health and safety risk factors must be approved.

The approval process is based on audits conducted at the supplier's facilities or by distance depending on the critical nature, to check compliance with the specific requirements defined for the service or material. Any non-compliances detected during the audits lead to corrective actions that the supplier must introduce within the deadlines agreed between Naturgy and the supplier, and this deadline is always less than one year.

Naturgy also approves the Non-Tier 1 suppliers corresponding to categories of purchase of critical products, over which audits are conducted based fundamentally on quality-related aspects.

Products corresponding to critical categories may be subjected to inspections, technical acceptances or FAT at the production centres before the material is shipped.

Every year approval plans are drawn up to audit suppliers in-situ. These approvals are for an open-ended period depending on the critical nature of the service or product and the purchase volume.

The approval process may unveil anomalies that lead to a plan of corrective actions, or the non-approval of the supplier, which would prevent such supplier from performing this activity for Naturgy.

The corrective action plan identifies the development actions and corrective actions to be introduced to achieve compliance with the requirements and standards established by the company.

During 2018 one supplier was suspended and disqualified from holding a contractual relationship with Naturgy for significant breaches related to security, quality and other aspects.

Monitoring, follow-up and development of suppliers

The Supplier Code of Ethics sets out that suppliers must take the utmost care to preserve the image and reputation of Naturgy in their professional actions and to monitor the respect and proper use of Naturgy's image and corporate reputation by its employees and that of its subcontracted companies.

In addition, other analyses based on reputational risk and corporate social responsibility are carried out with suppliers assessed as suitable at the high-risk level.

In 2018 no supplier was disqualified on the grounds of fraud or unethical practices.

Performance follow-up is carried out on the most relevant suppliers with a contractual relationship with the company and this involves carrying out surveys with the Naturgy units to measure their level of satisfaction with the suppliers.

Regarding the development of suppliers, one of the most important aspects is to extend Naturgy's culture to the supply chain, performing actions that allow the company's values to be transferred.

During 2018, Naturgy continued to form part of Bettercoal, an initiative launched by the main European utility companies for the purchase of coal from suppliers that comply with a series of social, environmental and corporate governance criteria, and was represented on its Board of Directors. Over the year, 94% of coal purchased by Naturgy was from mines that had agreed to follow an evaluation process with regard to these criteria.

7.8. Commitment to society

What does it mean for Naturgy? Risks and management approach.

Naturgy is committed to the economic and social development of those regions where it performs its activities, providing expertise, management capacity, as well as spending part of its profits on social investment. Fluid and ongoing dialogue with society enables to be aware of the expectations and interests of those communities where it operates and thus be able to involve itself in their development.

Inadequate management in access to energy can cause significant costs through non-payments and theft of electricity. By the same token, depriving vulnerable groups from receiving energy could have an impact on the company's reputation.

The lack of involvement and participation with local communities and their needs in those territories where the company operates could result in rejection and unease in the community, which could lead to lobbying for the company to cease its operation in these territories.

What is our commitment?

- Guarantee fluid and two-way dialogue and to encourage involvement in local communities, respecting the culture, rules and the environment, so that their concerns are responded to appropriately and expeditiously.
- Assess the social impact that the company's activity could cause, to avoid or mitigate the adverse effects these could generate and to foster positive effects.
- Develop initiatives to create shared value and to have a positive social impact in energy projects.
- Promotion of education, cultural wealth, health, research and the inclusion of the more underprivileged collectives through social investment.
- Transfer knowledge and values to society through partnership agreements with the academic community and the supply chain.

How do we measure our performance?

Sponsorship and social action investment

	Million euros
Sponsorship and social action investment	11

What are our main milestones in 2018?

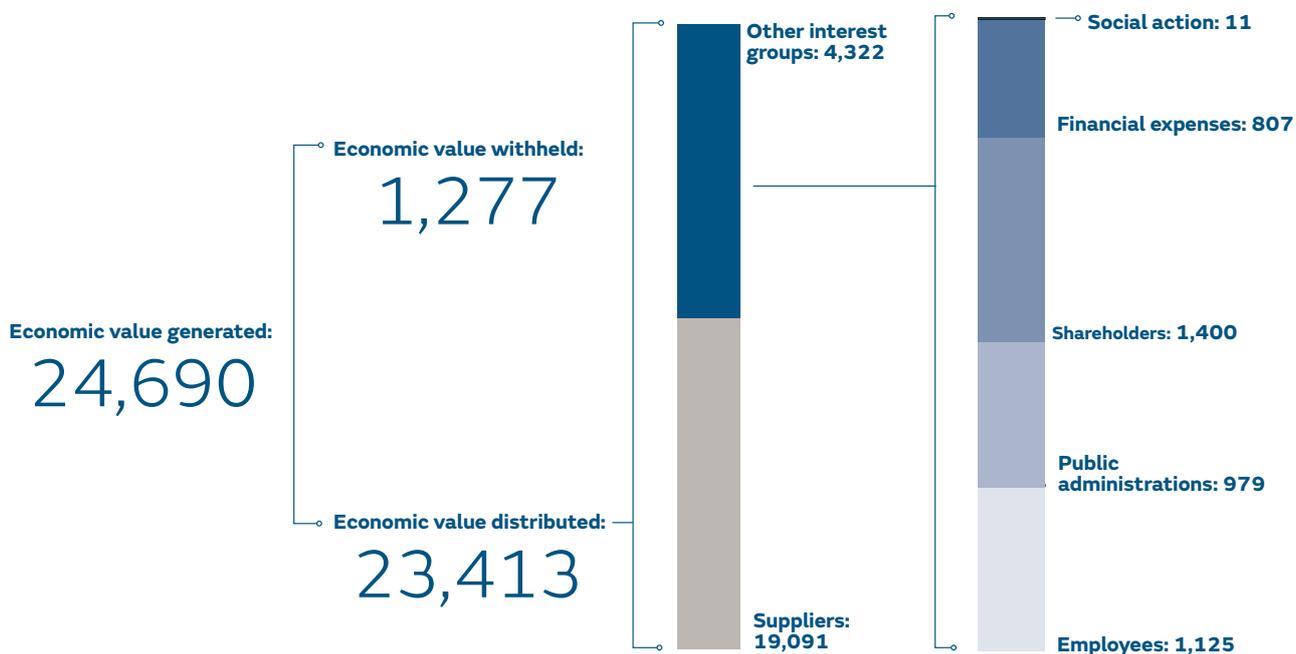
- Launch of the Energy Vulnerability Social Fund.
- Review and update of the General Regulations on Sponsorship and Donations.
- Launch of actions to support dissemination of the Vulnerability Plan and the promotion of energy efficiency.

What are our goals for 2019?

- To continue promoting the Energy Vulnerability Plan
- Approval of the General Procedure of Sponsorship and Donations and its introduction in all countries and societies.
- Smart energy and mobility to improve air quality

Analysis of the 2018 results

Economic Value Distributed. Detail by group of interest (euros million)



Sponsorship and social action investment

Economic contributions to social investment and sponsorship programmes are another important part of the Naturgy commitment. In 2018, they totalled Euros 11 million.

The aim of the company is to generate a higher corporate commitment to society of which it forms a part. The programmes to which these resources are therefore allocated form part of the business development strategy.

Creation of wealth and well-being where the company operates

Naturgy develops its commitment to society through four main lines of action that are aligned with the company's core activities:

1. Energy vulnerability

Naturgy performs its activity in areas where the energy supply does not reach the entire population. The company considers it a priority to reach the people that live in these areas. This is why it actively works in developing its distribution networks to offer these populations a service under safe conditions.

The company has extensive experience in this regard. Accordingly, the project carried out at Cuartel V in Argentina or the CGE group agreement in Chile made it possible to provide access to clean and reliable energies to tens of thousands of people.

Energy Vulnerability Plan in Spain

During 2018, Naturgy, together with the Foundation, continued the development of the Energy Vulnerability Plan throughout Spain to protect vulnerable customers. The plan has become a new core focus; the actions to mitigate energy poverty are now a priority for the Foundation.

The objectives of the plan are:

- Improve management and customer relations in cases of energy vulnerability.
- Streamlining the exchange of information with town and city councils for better identification of situations of vulnerability.
- Implementing activities with associations that work to alleviate energy poverty cases and to detect vulnerabilities.

During this year there have been three new initiatives:

- Creation of the Energy Rehabilitation Solidarity Fund, to finance improvements at vulnerable homes through donations from individuals and a contribution from the Foundation.
- Job Circle project: commencement of a training course to refurbish 15 homes, performed by long-term unemployed persons with an undertaking from the companies to recruit 25% of course participants.
- Social entrepreneurs: we have strengthened the corporate volunteer programme with this initiative, the purpose of which is to enable Naturgy employees to encourage initiatives promoted by not-for-profit organisations and which are related to energy (energy poverty, energy efficiency) and the environment.

2. Relationship with communities

Naturgy, under its Human Rights Policy, makes a firm commitment to the respect of local communities. To achieve this commitment, the social impact that the company activities may have on affected communities and contributing to improving the living conditions of these communities are key aspects.

Naturgy has a method based on the Measuring Impact methodology of the World Business Council for Sustainable Development (WBCSD) and the aim is to define initiatives and programmes for the effective management of social impacts associated with the company's business.

The company bases its relationship with communities on the following principles:

- Identifying communities affected by the company's activity and finding out their needs and aspirations.
- Analysing the potential environmental and social impacts that its activity could cause in the communities, using the social impact assessment methodology designed for this purpose.
- Reporting to, and inviting participation from, the community at the different stages of the project through a consultation procedure that enables us to listen to their concerns and questions as well as benefit from their contribution.
- Incorporating the opportunities identified through dialogue with the communities and which encourage sustainable development of the community into the impact assessment studies.
- Introducing a system of communication and relations with communities that ensures that these communities receive project information in a clear, updated and efficient way.

The company currently prioritises the performance of social impact assessments in those locations where the company is looking to carry out new investment projects. These assessments serve to measure numerous impacts (positive and negative) that the company may produce as a consequence of its activity, both in local communities as well as in the territory. These include:

- Impact on human rights.
- Displacement or relocation of local communities.
- Modification to the traditional ways of life.
- Changes in the traditional uses of territory.
- Attracting new technologies.
- Creation of skilled and unskilled jobs.
- Temporary occupation of the communication routes.
- Impact on landscapes.
- Noise.

The most prominent projects in this sphere are:

- Bujagali hydroelectric power station (Uganda): with local procurement programmes, development of suppliers, health and prevention, training and the fight against energy poverty.
- Bif Hioxo wind farm (Mexico): with actions to support fishermen, improve highways and delivery of material, support to the fire brigade, health campaigns, improved education infrastructures, support to culture and technology and guided tours of the wind farm.
- Nairobi thermal power station (Kenya): with education support programmes, health campaigns, environmental protection and promotion of art and local culture.
- Torito hydroelectric power station (Costa Rica): with support to local schools with the supply of academic material. As well as improvements along the local roads surrounding the power station.

- La Joya hydroelectric power station (Costa Rica): with support to local schools with the supply of academic material.
- CGE (Chile): development of a plan to encourage relations with social organisations to foster their links with neighbourhood councils, through participatory meetings.

During 2018 we started implementation of the Quilombola Basic Environmental Project (QBEP), associated to the Sobral I photovoltaic plant in the municipality of São João do Piauí (Piauí, Brazil) as a measure to mitigate and offset the impacts this facility could cause in the local communities of the territories of Riacho dos Negros and Saco/Curtume. To carry out this project, we mobilised a social manager responsible for channelling ongoing communication between the company and the local community, supporting the introduction of the measures developed in the QBEP.

The project involves 4 action lines and 12 activities, of which the following have been implemented this year:

- Mobilisation of the social technical team required to undertake ongoing communication with the community, and introduction of the QBEP measures.
- Meetings and workshops to disseminate and gather information.
- Collection of information about wells in the region that could be improved with the set-up of a solar pump kit.
- Collection of information on the needs and expectations of technical and higher training for young people in the region.

3. Social action

In 2011, when the Latin America Operational Centre was created, pillars were established, and social investment programmes designed for unified development in all countries where the company has a presence.

Types of COIL projects	
Inclusive business	<p>Projects that promote the inclusion of the most disadvantaged social sectors through inclusive programmes. For this project type, we continued with the programme called Energy of Flavour, launched in 2016, which aims to promote social inclusion of disadvantaged groups through training linked to gastronomy.</p> <p>Through the Training Classrooms programme we offer a training workshop on the ceramics technique which since last year has integrated persons with mild intellectual disability.</p>
Responsible consumption	<p>Encompasses projects targeted at providing knowledge about energy in general, safety and efficient use, of both gas and electricity. They also promote environmental stewardship among customers and society. As part of this pillar, the following traditional programmes were carried out:</p> <ul style="list-style-type: none"> • Responsible Consumption of Gas, in versions for children and adults. • Responsible Consumption of Electricity, in versions for children and adults. <p>In 2018 we created the Sowing the Future programme through which we created a vegetable garden at a school in Buenos Aires together with the students. To achieve this, the students were trained and instructed in the acquisition of expertise and the development of theoretical and practical skills to be able to set up the vegetable garden and maintain it over time.</p>
Talent promotion	<p>This pillar promotes projects that foster the studies and access to employment for the children and relatives of collaborators:</p> <ul style="list-style-type: none"> • The “Planning your Future” programme provides a financial grant for those who are starting college. • “Natural Vocation” seeks to contribute to the vocational and professional decision process that relatives of collaborators go through. • “Summer Internship”, offers the possibility of work experience in the company in the summer months.

4. Sponsorship, patronage and donations

The resources assigned to cultural, social and environmental programmes pays special attention to those community projects that generate greater value for society, while also strengthening the company's commitment to positive integration in each community and country where the group operates.

Through the General Regulations on Sponsorship and Donations of the company, the general management principles are established for sponsorships and donations by the company and to define the processes that regulate and control its development. Similarly, activities related to sponsorship and donations are subject to a process of 100% transparency. The regulations also provide priorities, which can be summarised in social action, culture and energy, and the environment.

- Educational initiatives: Naturgy carries out educational activities for young people on the correct use of energy and sustainable development. By the same token, the company implemented a wide range of collaboration, participation and sponsorship initiatives with different educational entities in Spain and Latin America.
- Social action focused on underprivileged groups: the company drives, and support projects targeted at integrating the most vulnerable social groups and to mitigate problems stemming from social exclusion. It therefore collaborates financially with foundations and associations whose corporate purpose is to help mitigate or minimise these problems in some of the countries where it performs its activity.
- Promotion of health and research: among the different programmes in which Naturgy participates to promote research and health, we can highlight research targeted at improving the life quality of the infirm and their relatives, or research into cardiovascular diseases, which are the leading cause of mortality worldwide, through the Procnic Foundation, as well as with other international entities.
- Promotion of music, theatre and films: Naturgy maintains its undertaking to contribute towards the development of culture that goes beyond its business activity and which involves extensive sponsorship work in initiatives that generate high value for society. We sponsor musical cycles and artistic seasons of different institutions throughout the territory.
- The company's support to the Gran Teatre del Liceu and the Teatro Real have been strengthened with twin celebrations declared to be "events of exceptional public interest".

Corporate volunteers and employee participation

Through corporate volunteering, Naturgy aims to promote social cohesion, values and a spirit of solidarity.

To achieve this, Naturgy has defined the programme objectives in three areas simultaneously -corporate, employees and the environment-, and an integrated structure of committees that includes both the areas of people as well as communication and the environment of all countries that form part of the programme.

During 2018, the company has promoted environmental, social and energy volunteer actions, in which employees contributed their time and their personal and professional skills.

Naturgy Foundation

The Naturgy Foundation, founded in 1992 by Naturgy, and with a presence in those countries where the company is active, is tasked with the dissemination, training, information and raising society's awareness in issues of energy and the environment, as well as the development of business and academic programmes. It also develops social action programmes in the national and international arenas, with a particular focus on actions targeted at relieving energy vulnerability.

During 2018, the foundation continued to provide seminars on energy and the environment in Spain, as well as presentations of the book Air quality in cities. A worldwide challenge; taking advantage of the presentations to give temporary exhibitions about air quality in Barcelona and Guadalajara. There was also an exhibition about "Smart Ports" in Málaga. One new item this year has been the commencement of two new action lines as part of the "energy and technology" and "smart energy and mobility" sphere.

In 2018, to once again drive its educational activity and provide access to its teaching programme throughout the territory, the Foundation turned the Gas Museum into a travelling one. This allowed us to multiply the Foundation's participation throughout the year in a great many anniversaries related to education of technology in the energy sphere, through innovative and flexible agendas adapted to all kinds of audiences.

The international activities of the Foundation were developed in seven countries: Algeria, Argentina, Brazil, Chile, Morocco, Mexico y Panama.

7.9. Integrity and transparency

What does it mean for Naturgy? Risks and management approach.

Naturgy considers that the trust of its stakeholders is based on integrity, which is understood to be action which is ethical, honest, responsible and in good faith of each one of the people who work in and for the group.

To respond to the risks related to integrity and transparency, Naturgy has developed a series of mechanisms that introduce the guidelines that are to cover ethical and transparent behaviour of the directors and employees of the company and their daily performance, as set out in the Code of Ethics, the Anti-Corruption Policy, the Human Rights Policy and the Fiscal Policy of Naturgy.

Corruption, fraud and bribery can have a major impact for the company, leading to sanctions imposed by the administrations, loss of contracts, legal consequences, loss of customers and loss of reputation that could also see investors disappear or the non-purchase of shares by investors that consider these aspects in their investment decisions.

What is our commitment?

- Reject corruption, fraud and bribery in business dealings and establishing measures to prevent and combat them, developing internal channels allowing communication of irregularities while preserving anonymity.
- Comply with national and international laws and standards in force in which the company operates, in particular, abiding by the principles expressed in the United Nations Universal Declaration of Human Rights, in the Declaration of the International Labour Organisation (ILO), in the United Nations Global Compact, in the United Nations Guiding Principles on Business & Human Rights, and the OECD Principles of Corporate Governance.
- Act with responsibility in management and complying with fiscal obligations in all jurisdictions in which the company operates, undertaking to act transparently and collaborate with tax authorities.
- Compete fairly on the market and prevent misleading, fraudulent or malicious conduct through which the company could obtain an unfair advantage.
- Promote transparency in information and responsible, truthful, efficient, complete and timely reporting, with regular publication of financial and non-financial information to measure the company's activities.
- Maintain, at all times, permanent dialogue with stakeholders through adequate and accessible channels.

How do we measure our performance?

Queries and notifications to the Code of Ethics

	2018	2017
Queries	76	37
Notifications	123	104
Total	199	141
No. of messages received per 200 employees	3.18	1.67

What are our main milestones in 2018?

- Analysis, content design and drafting of the Conflict of Interest Policy.
- Launching of the Compliance Communication Plan (Campaign “Compliance Café”).

What are our goals for 2019?

- Approval and dissemination of the Conflict of Interest Policy.
- Update of the Corporate Responsibility Policy.
- Audit the implementation of the Human Rights Policy.
- Approval of update of the Human Rights Policy text to concepts and terminology of the United Nations Guiding Principles on Business & Human Rights.

Analysis of the 2018 results

Code of Ethics Management Model

The Code of Ethics of Naturgy, formulated and approved by the Board of Directors, is the document that establishes guidelines that must govern the ethical behaviour of managers and employees of Naturgy, in their daily work, with regard to relationships and interactions with all its stakeholders. The principles for the company's employees are related to corruption and bribery, respect for people, professional development, equal opportunities, relation with collaborating companies, occupational health and safety, and caring for the environment, among others.

Since 2005, when it was adopted, the code has been regularly renewed to adapt it to the new situations that affect the company. The code sets out the undertakings entered into by Naturgy in the fields of good governance, corporate responsibility and questions of ethics and regulatory compliance.

In addition, Naturgy has an Anti-Corruption Policy, which establishes the principles which must be used to guide the conduct of all employees and administrators of the companies of the group with regard to the prevention, detection, investigation and correction of any corrupt practice within the organisation.

The company also has a Code of Ethics and an Anti-Corruption Policy Management Model, headed by the Compliance Unit, whose targets are to ensure the knowledge, application and fulfilment of the code.

This model also provides that the Audit Committee of the Board of Directors must receive regular reports from the Ethics and Compliance Committee on the most relevant issues related to the dissemination of and compliance with the Code of Ethics and the Anti-Corruption Policy. The Ethics and Compliance Committee, which in 2018 has fully assumed the functions that were previously performed by the Code of Ethics Committee, is responsible for supervising the dissemination and compliance with the Code of Ethics and the Anti-Corruption Policy through supervision and control of the safeguard systems:

- Whistleblowing channel (the “Code of Ethics Channel”), through which all the employees and suppliers can send the Ethics and Compliance Committee queries or notify breaches of the code, in good faith, in a confidential manner and without fear of reprisal.
- Annual declaration procedure: through which all the employees repeatedly declare that they have read, understood and comply with the code.
- Online courses: on the issues included in the Code of Ethics and the Anti-Corruption Policy, mandatory for all employees. Certain groups of employees also receive classroom training sessions on a range of issues in the sphere of regulatory compliance, which include the content of the Code of Ethics.

In 2018, 24% of the notifications received were related to alleged fraud, none of which had any significant impact.

No notifications were reported related to labour or child exploitation or in relation to the rights of the corresponding local communities and human rights.

A total of 24% of the notifications were related to the people management, and they were all solved appropriately.

In 2018, it was not necessary to repair damages relating to impacts caused by human rights cases.

In 2018, the work plan of the Ethics and Compliance Committee included:

- Project to improve the Code of Ethics Channel.
- Training and informative actions on the Code of Ethics, Anti-Corruption Policy and Corporate Hospitality Policy, targeted at the company's employees.
- Collaboration with the Supply Unit to introduce improvements in communications and supplier evaluation related to compliance with the Code of Ethics.
- Updating of the Code of Ethics.

The company has introduced local committees in countries where the company has the greatest activity. The main mission of these is to make everyone aware of the Code of Ethics and the Anti-Corruption Policy and to reproduce the functions the committee carries out in Spain in each country to cover the company's entire sphere of operation.

Code of Ethics chapter to which notifications refers

	Queries	Notifications	Total
Respect for the law, human rights and ethical values	3	3	6
Respect for the individual	1	35	36
Professional development and equal opportunities	2	13	15
Cooperation and dedication	-	2	2
Occupational health and safety	-	2	2
Corruption and bribery	17	23	40
Use and protection of assets	-	3	3
Irregular payments and money laundering	-	-	-
Corporate image and reputation	2	1	3
Loyalty to the company and conflict of interest	30	13	43
Processing of information and knowledge	3	1	4
Customer relations	13	14	27
Shareholders relations	-	1	1
Relations with collaborating companies and suppliers	5	10	15
Respect for the environment	-	2	2
Total	76	123	199

Crime Prevention Model

The company has a Crime Prevention Model which is updated annually. Thus in 2018, the model was subject to a process of adaptation to the new organisational structure in force at Naturgy.

The model incorporates the already established Naturgy internal control structure. Its purpose is to effectively prevent the occurrence of offences under the Organic Law 5/2010 governing the Amendment of the Penal Code. This modification

introduces in Spain the criminal responsibility of artificial persons in cases in which they do not exercise due control over the systems of individuals subject to their authority.

The model contains 18 crimes that have been identified, together with definitions of their impact and probability of occurrence, mechanisms for their control and minimisation, and responsibilities with regard to their fulfilment.

Worldwide, the group has deployed crime prevention models in countries with laws governing the civil liability of legal persons.

During 2018, we have continued with the online training course mandatory for all employees on the Crime Prevention Model, the Code of Ethics and the Anti-Corruption Policy in order to emphasise the importance of compliance, ensure implementation of preventive and control activities and to inform all employees of the current status in these matters.

Anti-fraud and anti-corruption policies and plans

Although fraud and corruption are covered in the crime prevention system, the company worked to improve and update its internal regulations and define specific protocols and mechanisms in this area.

The Naturgy Anti-Corruption Policy complies with national and international legislation on corruption and bribery.

This policy has the object of establishing the principles which must be used to guide the conduct of all employees and administrators of the companies of Naturgy with regard to the prevention, detection, investigation and correction of any corrupt practice within the organisation. It covers all the actions in this area and avoid conduct that may give rise to fraud or corruption and lead to situations that are damaging for the company, its administrators and employees from a legal point of view or in relation to its reputation.

The policy establishes 14 principles of action, including aspects such as promoting integrity and transparency in the processing of information, money laundering, conflicts of interest and relationships with third parties.

The focus of the Naturgy Anti-Corruption programme covers three key areas:

- Establishment of an anti-fraud and anti-corruption culture through training and awareness.
- Implementation of proactive measures to assess the risk of fraud and corruption, monitoring and controls.
- Development of measures and response plans in the event of situations that constitute fraud and corruption. These plans and measures include the investigation of the episodes, the definition of solutions and the establishment of disciplinary measures.

Naturgy organises regular training initiatives based on the programme with the aim of raising awareness of the importance of fighting against corruption and ensuring that administrators, employees and suppliers are given enough and appropriate information to act accordingly.

Some of these regular initiatives include the following:

- Update of the NaturalNet space which concerns the Code of Ethics and the Anti-Corruption Policy.
- Publication of information about the Ethics and Compliance Committee activities (notifications received, activities carried out, etc.).
- Training course on Crime Prevention Model, Code of Ethics and Anti-Corruption Policy.
- Specific training in relation to the Crime Prevention Model and Anti-Corruption Policy for new employees and administrators.

- Presentations in Boards of Directors and Management Committees of the Crime Prevention Model.
- Regular declaration of compliance with the Code of Ethics and Anti-Corruption Policy.

Likewise, Naturgy has introduced a Corporate Hospitality Policy, within the framework of the Code of Ethics and the Anti-Corruption Policy. The purpose of this policy is to regulate the conditions in which the directors and employees of Naturgy can accept/offer business courtesies from or to their business counterparts within the framework of performing their professional duties, to ensure effective compliance with the principles set out in the Code of Ethics and in the Anti-Corruption Policy of Naturgy.

The directors and employees of the group cannot accept or offer, whether directly or indirectly, business courtesies for the purpose of improperly influencing their commercial, professional or administrative relations, whether with public or private entities.

In 2018 there was a specific dissemination campaign concerning the Corporate Hospitality Policy, targeted at all employees and, in addition, one of the modules of the “Compliance Café” campaign carried out in the same year was exclusively dedicated to this Policy.

In addition, in all operations involving risk, the company conducts due diligence processes systematically, both for high-risk suppliers, and company relationships with third parties (partners, joint ventures, etc.).

The counterparty due diligence procedure aims to ensure that, across the board, reputational risk and corruption are analysed and assessed efficiently and in a standard way when third parties intervene in business relationships of the companies forming the group.

Naturgy has the mechanisms, procedures and policies that seek to prevent and, where appropriate, detect and react to those possible breaches in the area of prevention of money laundering that are detected in the performance of its activity.

We can divide these measures into three control levels that seek to prevent, detect and, if appropriate, react to money laundering:

- Prevention: both the Naturgy Code of Ethics as well as its Anti-Corruption Policy have specific sections that expressly establish the prevention of money laundering as one of the principles that presides over the operations of the company and all of its employees. All Naturgy employees receive training on the content of the Code of Ethics, the Anti-Corruption Policy and the conduct guidelines that they must heed.

In addition, Naturgy has other more specific policies and procedures that establish a full series of controls in its day-to-day work and in the operations it performs, which encompass the prevention of money laundering. Key among these are the counterparty due diligence procedure; the general external procurement standard; the procedure on granting the signing level, or the internal control procedure for the processing of payments and cash movements, among others.

- Detection: some of the foregoing policies and procedures also allow the risk of money laundering to be detected.

Every year, those in charge of controls at Naturgy are subject to a self-assessment in the Crime Prevention Model on compliance with the same, including those where there is a risk of potential money laundering. In addition, to ensure efficiency of this model, it is reviewed regularly and audited every year by an independent expert.

Internal Auditing periodically reviews the different processes of Naturgy to detect possible breaches that may have occurred in the different operational risks. These reviews include checks of revenue and payments that may be subject to the risk of money laundering.

Naturgy also has an Internal Control System on Financial Reporting that is audited every year by an independent expert.

In addition, Naturgy provides both its employees as well as stakeholders with channels so they can report to the Ethics and Compliance Committee concerning any breach or irregular or suspicious conduct in this area. They can perform these communications through the website channel of the Naturgy Code of Ethics or through ordinary or internal mail. In addition, in accordance with what is permitted under new data protection legislation, these communications may be carried out anonymously.

- Reaction and response: Naturgy has an investigation and response protocol as well as a disciplinary system so that, if it becomes aware of any denouncement or irregularity it can introduce all measures within its reach to rectify this and, if appropriate, adopt the measures required to prevent future repetition. Furthermore, Naturgy collaborates with the competent authorities of each country in the fight against money laundering and the financing of terrorism, furnishing all the information they request in accordance with prevailing regulations. The company also reports any suspicious transactions.

Fiscal policies

Tax strategy and tax risks control and management policy

At a meeting on 9 January 2018, the Board of Directors approved the Tax Strategy and Tax Risks Control and Management Policy, which sets out the basic principles governing Naturgy's tax function and the main lines of action to mitigate and guide proper control of tax risks.

The basic principles governing Naturgy's tax strategy are as follows:

- Responsible compliance with tax obligations.
- A low tax risk profile.
- Adoption of tax treatments based on economic reasons.
- Transparency of tax information.
- Cooperation with the tax authorities.

The main lines of the Tax Risks Control and Management Policy are as follows:

- Tax governance clearly defined.
- Procedures for controlling the tax risk arising from compliance.
- Procedures for assessing and controlling tax approaches where there is uncertainty.
- Oversight of the performance of the Tax Control Framework.
- Regular reporting of the tax situation to the Board of Directors.

All of Naturgy's tax policies are aligned with:

- The Naturgy Corporate Social Responsibility Policy, in which one of the commitments and principles of action is to "adopt responsible business management practices and comply with all tax obligations in all jurisdictions in which the company operates, accepting the commitment to accountability and collaboration with the corresponding tax agencies."
- Naturgy's Code of Ethics, which establishes that "All employees of the group must comply with the laws in force in the countries where they conduct their activities, thereby heeding the spirit and objectives of the laws and behaving ethically in all their actions".

- The Code of Best Tax Practices (CBTP), approved on 20 July 2010 by the Plenary session of the Large Business Forum, a body established by the Spanish National Tax Agency with Spain's largest companies, including Gas Natural SDG, S.A. The CBTP contains recommendations by the tax authorities, which Naturgy has adopted voluntarily, that are aimed at improving the application of the tax system by enhancing legal certainty, reducing litigation, fostering mutual cooperation based on good faith and legitimate trust, and the application of responsible tax policies.

To align Naturgy's tax policies with these principles, the group has a General Regulation governing the Tax Control Framework, designed in accordance with the guidelines of the Organisation for Economic Co-operation and Development (OECD) for multinational enterprises, and for the design and implementation of a Tax Control Framework.

Naturgy also has a Risk Map that specifically identifies the tax risks and issues regarding the interpretation or application of tax law. The main matters with a tax impact are detailed in Note 21 "Tax situation" in the notes to the consolidated financial statements.

Tax havens

The incorporation or acquisition of undertakings domiciled in countries or territories designated as tax havens must be reported to the Board of Directors via the Audit Committee.

At 2018 year-end, the Naturgy Group did not have any company in a territory designated as a tax haven under the related Spanish regulations (Royal Decree 1080/1991, of 5 July, and Royal Decree 116/2003, of 31 January).

Buenergía Gas & Power, Ltd. (the company that indirectly owns a single industrial holding that engages in power generation using a combined cycle gas turbine in Puerto Rico (Ecoeléctrica, L.P.)), which was domiciled in the Cayman Islands and in which Naturgy holds a 95% stake, changed its domicile to Puerto Rico on 2 February 2018.

Gasoducto del Pacífico (Cayman), Ltd. (a dormant company acquired by the group as part of the CGE acquisition), which was domiciled in the Cayman Islands and in which Naturgy held a 52.2% stake, was liquidated on 12 January 2018 and dissolved and deregistered on 12 April 2018.

Tax contribution

Naturgy gives priority to fulfilling its obligation to pay the taxes that are due in each territory in accordance with the applicable regulations.

Naturgy's total tax contribution amounted to Euros 3,268 million in 2018 (3,272 million in 2017). The following table shows the breakdown of the taxes actually paid by Gas Natural Fenosa in each country, segmented into those that represent an actual expense for the group ("own taxes") and those that the company withholds from or charges to other taxpayers (third-party taxes):

Country	Own taxes						Third-party taxes						Total			
	Income tax ¹		Others ²		Total		VAT		Tax on hydrocarbons		Others ³				Total	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Spain	62	112	621	537	683	649	1,056	845	409	342	270	228	1,735	1,415	2,418	2,064
Argentina	10	15	17	67	27	82	9	19	-	-	39	34	48	53	75	135
Brazil	52	51	46	67	98	118	73	74	-	-	13	7	86	81	184	199
Colombia	-	60	-	57	-	117	-	-	-	-	-	11	-	11	-	128
Chile	31	101	13	11	44	112	60	81	-	-	47	22	107	103	151	215
Mexico	71	66	2	4	73	70	39	57	-	-	13	19	52	76	125	146
Panama	6	10	7	9	13	19	-	-	-	-	4	4	4	4	17	23
Rest of LatAm	7	8	2	1	9	9	5	4	-	-	8	4	13	8	22	17
Total LatAm	177	311	87	216	264	527	186	235	-	-	124	101	310	336	574	863
Europe	24	15	8	35	32	50	161	170	80	111	3	14	244	295	276	345
Total	263	438	716	788	979	1,226	1,403	1,250	489	453	397	343	2,289	2,046	3,268	3,272

1. Income tax actually paid in the year that figures in the Cash Flow Statement in the Consolidated Annual Accounts. Does not include accrued amounts. The reconciliation between reported "income tax" and that which would result from applying the nominal tax rate in force in the parent company's home country (Spain) to "Profit before taxes" is detailed in Note 21 ("Tax situation") to the consolidated financial statements.

2. Includes energy taxes in Spain amounting to 306 million in 2018 (Euros 260 million in 2017), local taxes, employer social security contributions and other specific taxes in each country.

3. Includes basically employee withholdings and employee social security contributions.

Income by country

2018	Million Euros
Spain	(3,297)
Argentina	41
Brazil	37
Chile	106
Mexico	104
Panama	13
Rest of LatAm	(63)
Total LatAm	238
Europe	237
Total	(2,822)

Received Grants

The movements of the received capital grants are breakdown in the Note 15 of Annual consolidated accounts. The received amount is Euros 1 Million in 2018 (Euros 4 million in 2017). The amount of the received operating grants is detailed in the Note 24 of the Annual consolidated accounts and amounted Euros 1 million in 2018 (Euros 1 million in 2017).

Human Rights Policy

The company's commitment to respect for and protection of human rights is expressed in both the Corporate Responsibility Policy and the Code the Ethics. The Human Rights Policy, approved in 2011 by the Management Committee, defines and precisely establishes how the company believes it has to include these principles in its business management.

The Human Rights Policy acquires its full meaning in those locations where local legislation does not afford a suitable level of protection of human rights, and its compliance is horizontally integrated within the company and is the responsibility of each business area.

The policy establishes ten commitments, which were determined on the basis of the main risks that affect human rights in the company, and accepts the United Nations Guiding Principles on Business and Human Rights. It is also focused on the most important principles which have the greatest impact on the company's business.

Human Rights Policy Principles

1. Avoiding any practices which are discriminatory, or which might compromise people's dignity
 2. Eradicating the use of child labour
 3. Helping to ensure freedom of association and collective negotiation
 4. Protecting people's health
 5. Offering dignified employment
 6. Commitment towards people linked to suppliers, contractors and collaborating companies
 7. Supporting and publicly promoting respect for human rights
 8. Respecting for indigenous communities and traditional ways of life
 9. Protecting facilities and people on the basis of respect for human rights
 10. Helping to fight corruption
-

The company encourages the policy to be known and to be complied with using a communication and training plan, which includes a compulsory online course for all employees, seminars based around explaining principles of the policy and conflicts which could arise, and guidance sessions about the policy and its role in business activity.

Naturgy undertakes to engage the resources necessary to guarantee the effective implementation of this Human Rights Policy. In this regard, the company regularly analyses the human rights issues that are applicable to its activity and will introduce mechanisms that enable it to assess the risk of breach of these in the environments in which it operates.

During the initial stages of investment projects, and in the analyses of the social and environmental impact, the company will consider their impact on the protection and promotion of human rights and will define indicators in this regard. Similarly, the company will introduce specific measures for management of potential impacts and risks to human rights from the projects and investments and will ensure that sufficient resources are targeted at the implementation of the corrective measures identified.

In the due diligence processes prior to formalisation of collaboration agreements, also with governmental agencies, the company undertakes to assess the human rights policies and practices of its counterparts and to act in accordance with the principles laid out in the policy.

Any breaches, whether of the policy or any other aspect related to the respect of human rights will be studied in accordance with the internal procedures, legal regulations and the prevailing agreements, and could give rise to disciplinary or employment measures as determined in the internal regulations and legislation.

Employees of Naturgy are obliged to report any breach of the undertakings set out in this policy to the company, confidentially and without fear of reprisals. Those people who, without being company employees, witness potential malpractice in this area may also report this.

7.10 Table of contents required by Law 11/2018, of December 28, 2018 amending the Commercial Code, the revised Capital Companies Law approved by Legislative Royal Decree 1/2010, of July 2, 2010 and Audit Law 22/2015, of July 20, 2015, as regards non-financial information and diversity.

Content	Page	Reporting Criteria
Business model		
– Description of the business model	229	GRI 102-2
– Geographical presence	230	GRI 102-3 GRI 102-4 GRI 102-6 GRI 102-7
– Objectives and strategies	235	GRI 102-14
– Main factors and trends that affect future evolution	235	GRI 102-15
Reporting framework used	228	GRI 102-54
Materiality analysis	298	GRI 102-46 GRI 102-47
Social and personnel issues		
– Management approach	250	
– Employment		
▪ Number and distribution of employees by country, gender, age group and employee category	251	GRI 102-8
▪ Distribution of employment contract types and the annual average by gender, age group and employee category	251	GRI 102-8
▪ Number of dismissals by gender, age group and employee category	252	GRI 401-1
▪ Average remuneration by gender, employee category and age group	253	GRI 405-2
▪ Salary gap	252	GRI 405-2
▪ Average remuneration of directors and executives	253	GRI 102-38
▪ Payments to the savings and pension schemes	259	GRI 102-38 GRI 201-3
▪ Introduction of policies on disconnecting from work	259	GRI 401-2 GRI 401-3
▪ Percentage of employees with disabilities	254	GRI 405-1
– Work organisation		
▪ Organisation of work time	258	GRI 401-2 GRI 401-3
▪ Absenteeism	262	GRI 403-2
▪ Measures to facilitate work-life balance	259	GRI 401-2 GRI 401-3
– Health and safety		
▪ Health and safety conditions in the workplace	261	GRI 403-2 GRI 403-3 GRI 403-4
▪ Indicators of work injury	262	GRI 403-2
▪ Occupational illness	262	GRI 403-2
– Social relations		
▪ Organisation of social dialogue	260	GRI 402-1 GRI 403-1 GRI 403-4
▪ Percentage of total employees covered by collective bargaining agreements	254	GRI 102-41
▪ Balance of the agreements in the field of health and safety	254	GRI 403-4
– Training		
▪ Policies introduced in the field of training	258	GRI 404-2
▪ Training indicators	254	GRI 404-1
– Universal accessibility of people with disabilities	254	GRI 405-1
– Equality	256	GRI 405-1 GRI 405-2
Environmental issues		
– Management approach	242	

Content	Page	Reporting Criteria
– Environmental management	244	GRI 102-11 GRI 307-1
– Measures to prevent pollution	244	GRI 305-1 GRI 305-2 GRI 305-3 GRI 305-6 GRI 305-7
– Circular economy and waste prevention	248	GRI 306-2
▪ Consumption of raw materials	243	GRI 301-1
▪ Direct and indirect energy consumption	243	GRI 302-1
▪ Consumption of water	243	GRI 303-1
▪ Measures to improve energy efficiency	243	GRI 302-4 GRI 302-5
▪ Renewable energy used	247	GRI 302-1
– Climate change		
▪ Greenhouse gas emissions	243	GRI 305-1 GRI 305-2 GRI 305-3
▪ Measures to adapt to climate change	247	GRI 201-2
▪ Goals to reduce greenhouse gases	247	GRI 305-5
– Biodiversity		
▪ Measures to preserve or restore biodiversity	248	GRI 304-3
▪ Impacts caused by the activity	248	GRI 304-2
Information on respect for human rights		
– Management approach	279	
– Application of due diligence procedures	287	GRI 102-16 GRI 102-17 GRI 412-2
– Prevention and management measures of possible abuses	287	GRI 102-16 GRI 102-17 GRI 412-2
– Complaints on violations of human rights	281	GRI 102-17
– Promotion and compliance with the ILO provisions	280	GRI 102-16 GRI 407-1 GRI 408-1 GRI 409-1
Information on the fight against corruption and bribery		
– Management approach	279	
– Measures to prevent corruption and bribery	283	GRI 102-16 GRI 102-17
– Anti-money laundering measures	284	GRI 102-16 GRI 102-17
– Contributions to foundations and not-for-profit associations	273	GRI 201-1 GRI 413-1
Social commitment		
– Management approach	273	
– The commitment of companies to sustainable development	273	GRI 102-43 GRI 413-1 GRI 413-2
– Responsible supply chain management	267	GRI 308-1 GRI 414-1
– Management of customers relations	236	GRI 416-1 GRI 417-1
– Tax information and transparency	285	GRI 201-1 GRI 201-4

Annex I. Additional information

1. Treasury shares

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

Movements during 2018 and 2017 involving the treasury shares of Naturgy Energy Group, S.A. are as follows:

	Number of shares	Amount (million euro)	% Capital
At 1 January 2017	750,545	13	0.1
Acquisitions	7,623,586	147	0.8
Delivered to employees	(336,625)	(7)	-
Disposals	(8,037,506)	(153)	(0.8)
At 31 December 2017	-	-	-
Acquisitions	10,782,040	227	1.0
Acquisitions LTI coverage	8,639,595	200	0.9
Delivered to employees	(354,422)	(7)	-
Disposals	(5,029,881)	(99)	(0.5)
At 31 December 2018	14,037,332	321	1.4

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

In accordance with the resolutions adopted by the shareholders of Naturgy Energy Group, S.A. at the general meeting held on 20 April 2017, within the Share Acquisition Plan 2017-2018-2019, those relating to 2017 and 2018 addressed to Naturgy employees in Spain who decide voluntarily to take part in the Plan were set in motion. The Plan enables participants to receive part of their remuneration in the form of shares in Naturgy Energy Group, S.A., subject to an annual limit of Euros 12,000. During 2018, 354,422 of the Company's own shares were acquired for Euros 7 million to be handed over to the employees taking part in the Plan (336,625 own shares amounting to Euros 7 million in 2017).

In 2018 the proceeds on transactions involving Naturgy treasury shares of amounted to a loss of Euros 0.4 million, recognised under "Other reserves" (Euros 0.5 million profit in 2017).

During 2018 Naturgy acquired 8,639,595 treasury shares at an average price of 23.15 euro/share for a total of Euros 200 million, the objective of which is to cover the potential delivery of shares derived from the increase in the value of the shares involved in the long-term variable incentive plan (Note 3.4.11 of the Consolidated Financial Statements).

Note 14 of the Notes to the Consolidated Financial Statements contains all the information on treasury shares.

2. Disclosure of deferrals of payment to suppliers Additional Provision 3 “Duty of disclosure” of Law 15/2010/5 July

The total amount of payments made during the year, with details of periods of payments, according to the maximum legal limit under Law 15/2010 of 5 July, which laid down measures against slow payers in Spain, is as follows:

	2018	2017
Total payments (Euro million)	13,457	12,256
Total payments outstanding (Euro million)	450	403
Average supplier payment period (days) ⁽¹⁾	22	25
Transactions paid ratio (days) ⁽²⁾	22	24
Transactions pending payment ratio (days) ⁽³⁾	23	34

1. Calculated on the basis of amounts paid and pending payment.

2. Average payment period in transactions paid during the year.

3. Average age, suppliers pending payment balance.

3. Subsequent events

Events subsequent to the end of the period are described in Note 38 of the Notes to the Consolidated Financial Statements.

Annex II. Alternative performance metrics

Naturgy's financial disclosures contain magnitudes and metrics drafted in accordance with International Financial Reporting Standards (IFRS) and others that are based on the Group's disclosure model, referred to as Alternative Performance Metrics (APM), which are viewed as adjusted figures with respect to those presented in accordance with IFRS.

The chosen APMs are useful for persons consulting the financial information as they allow an analysis of the financial performance, cash flows and financial situation of Naturgy, and a comparison with other companies.

Below is a glossary of terms with the definition of the APMs. Generally, the APM terms are directly traceable to the relevant items of the consolidated balance sheet, consolidated income statement, consolidated statement of cash flows or Notes to the Financial Statements of Naturgy. To enhance the traceability, a reconciliation is presented of the calculated values.

Alternative performance metrics	Definition and terms	Reconciliation of values at 31.12.2018	Reconciliation of values at 31.12.2017	Relevance
Ebitda	Operating gross profit = Net sales ² – Procurement ² + Other operating income ⁴ – Personnel costs ⁴ – Operating expenses ⁴ + Own work capitalised ⁴	Euros 4,019 million	Euros 3,903 million	Measure of earnings before interest, taxes, depreciation and amortisation and provisions
Ordinary Ebitda	Ebitda - Non-ordinary items ¹	4,413 = Euros 4,019 million + 394	3,948 = Euros 3,903 million + 45	Ebitda corrected of impacts like restructuring costs and other non-ordinary items considered relevant for a better understanding of the underlying results of the Group.
OPEX	Personnel expenses ² + Own work capitalised ⁴ + Operating expenses (without Taxes) ⁴ – Concession construction or improvements services (IFRIC 12) that are also registered as an income ⁴	Euros 2,436 million = 1,010 + 115 + 1,816 – 437 – 68	Euros 2,534 million = 1,009 + 122 + 1,969 – 450 – 116	Amount registered in the income statement regarding to operating expenses, without considering the ones matched with income of the same amount and Taxes.
Ordinary Net income	Attributable net income of the period ² – Non-ordinary items ⁷	Euros 1,245 million = -2,822 + 4,067	Euros 793 million = 1,360 - 567	Attributable Net Income corrected of impacts like assets write-down, discontinued operations, restructuring costs and other non-ordinary items considered relevant for a better understanding of the underlying results of the Group.
Investments (CAPEX)	Investments in intangible assets ⁴ + Investments in property, plant & equipment ⁴	Euros 2,321 million = 281 + 2,040	Euros 1,782 million = 389 + 1,393	Realised investments in property, plant & equipment and intangible assets.

Alternative performance metrics	Definition and terms	Reconciliation of values at 31.12.2018	Reconciliation of values at 31.12.2017	Relevance
Net Investments	CAPEX ⁵ + Financial investments ⁶ – Proceeds from divestitures of PPE and intangible assets ⁶ – Other proceeds/(payments) of investments activities ⁶ .	Euros -284 million = 2,321 + 35 – 57 – 2,583	Euros 1,597 million = 1,782 + 44 – 229	Total investments net of the cash received from divestments and other investing receipts.
Gross financial debt	“Non-current financial liabilities” ¹ + “Current financial liabilities” ¹	Euros 15,431 million = 13,352 + 2,079	Euros 18,459 million = 15,916 + 2,543	Current and non-current financial debt.
Net financial debt	Gross financial debt ⁵ – “Cash and cash equivalents” ¹ – “Derivative financial assets” ⁴ (Note 18)	Euros 13,667 million = 15,431 – 1,716 – 48	Euros 15,154 million = 18,459 – 3,225 – 80	Current and non-current financial debt less cash and cash equivalents and derivative financial assets.
Leverage (%)	Net financial debt ⁵ / (Net financial debt ⁵ + “Net equity” ¹)	48.4% = 13,667 / (13,667 + 14,595)	45.3% = 15,154 / (15,154 + 18,305)	The ratio of external funds over total funds The ratio of external funds over total funds.
Cost of net financial debt	“Cost of financial debt” ⁴ (Note 29) – “Interest revenue” ⁴ (Note 29)	Euros 538 million = 557 – 19	Euros 611 million = 630 – 19	Amount of expense relative to the cost of financial debt less interest revenue.
Ebitda/Cost of net financial debt	Ebitda ⁵ / Cost of net financial debt ⁵	7.5x = 4,019 / 538	6.4x = 3,903 / 611	Ratio between Ebitda and net financial debt.
Net financial debt/ Ebitda	Net financial debt ⁵ / Ebitda ⁵	3.4x = 13,667 / 4,019	3.9x = 15,154 / 3,903	Ratio between net financial debt and ebitda.
Net financial debt/ Ebitda (IFRS 16)	Net financial debt(IFRS 16) / Ebitda ⁵	3.8x = 15,310 / 4,019	4.2x = 16,387 / 3,903	Ratio between net financial debt under IFRS 16 and ebitda
Market capitalisation	No. of shares ('000) outstanding at end of period ⁶ * Market price at end of period ⁶	Euros 22,275 million = 1,000,689 * Euros 22,26	Euros 19,263 million = 1,000,689 * Euros 19,25	Measure of the company's total value based on its share price
Free Cash Flow after minorities	Free Cash Flow ⁵ + Dividends and other ⁴ + Acquisitions of treasury shares ⁴ + Inorganic investments payments ⁴	Euros 3,054 million = 1,318 + 1,400 + 309 + 27	Euros 746 million = - 241 + 1,001 – 14 + 0	Cash flow generated by the Company available to pay to the shareholders (dividends or treasury shares), the payment of inorganic investments and debt payments.
Free Cash Flow	Cash flow generated from operating activities ³ + Cash flows from investing activities ³ + Cash flow generated from financing activities ³ – Receipts and payments on financial liability instruments ³	Euros 1,318 million = 2,881 – 617 – 3,759 + 2,813	Euros -241 million = 2,768 – 1,606 + 232 – 1,635	Cash flow generated by the Company available to pay the debt.

1. Consolidated balance sheet line item.

2. Consolidated income statement line item.

3. Consolidated statement of cash flows line item.

4. Figure detailed in the Notes to the consolidated financial statements.

5. Figure detailed in the APMs.

6. Figure detailed in the Director's Report.

7. The non-ordinary items are summarized below:

Euros million	Ebitda		Net income	
	2018	2017	2018	2017
Gas transport & procurement retroactivity	(50)	20	(38)	15
Chile non-ordinary expenses	(44)	-	(28)	-
Restructuring costs	(180)	(126)	(137)	(99)
Asset write-down	-	-	(3,824)	-
Discontinued operations and minority interests 1	-	-	49	494
Chile mergers tax effect	-	-	42	116
Others	(120)	61	(131)	41
Total	(394)	(45)	(4,067)	567

Annex III. Glossary of non-financial indicators

Indicator	Definition
Investment in innovation	Amount in euros earmarked for innovation activities
Overall satisfaction with service quality	Customers level of satisfaction with global service quality in a range of 1 to 10 (in Chile 1 to 7), broken down by country or geographical region.
Direct GHG emissions	Greenhouse gas (GHG) emissions from sources owned or controlled by the company.
Emission generation factor (t CO ₂ /GWh)	Rate of emissions as a result of electricity generation, obtained as the ratio between the amounts of pollutant emitted (tonnes of carbon dioxide) and the power produced (GWh).
Emissions-free installed capacity (%)	Installed capacity in hydroelectric, mini-hydro, wind, nuclear and solar technologies as a percentage of total installed capacity.
Emissions-free net production (%)	Net production using hydroelectric, mini-hydro, wind, nuclear and solar technologies as a percentage of total net production.
Activity with ISO 14001 environmental certification (%)	<p>Ebitda percentage corresponding to certified companies (*) through the environmental management model included in ISO 14001, with respect to the total of ebitda generated by activities that produce environmental impact.</p> <p>(*) As certified companies, companies that can be assimilated to certified companies have been included according to the following definition:</p> <ul style="list-style-type: none"> - Those dominant companies whose dependent companies, of which they hold more than 50% ownership, are almost all certified - Those companies that concentrate corporate services only of certified companies. - Those companies whose dominant
Water consumption	Volume of water consumption for the activities of the company.
Consumption of raw materials	Thousands of tons of raw materials use on the main proceeds of the company.
Direct energy consumption	Represents the difference between the consumption of non-renewable fuels, electricity purchased for consumption and renewable electricity generated, minus electricity and steam sold.
Indirect energy consumption	It represents the consumption for the final use of the natural gas distributed / commercialized.
Resources targeted at the prevention of environmental risks	Amounted devoted to environmental investments and environmental expenses.
Distribution of employees by age group, country, gender, and employee category	Distribution of employees by age group, country, gender, and employee category at year-end.
Annual average of indefinite and temporary contracts by age, gender and professional category	Percentage of employees contracted indefinite and temporary contracts at year-end and annual average of employees by age, gender and professional category
Rotation Index	Resignation/average workforce
Voluntary Index	Voluntary Resignations/average workforce
Number of dismissals by age group, gender, and professional category	Number of people dismissed, with character originating or not, classified by age, sex and professional classification.

Salary gap	Difference between the salary of men and women, calculated by the difference between the salary of men and women, divided by the salary of men. The result above zero represents the percentage of salary that women received lower than men. The result less than zero represents the percentage of salary that women perceived above men.
Average remuneration by age group, gender, and employee category	Amount of the average remuneration of the staff classified by country, age, gender and professional classification.
Average remuneration of directors and executives	Amount of the remuneration of directors (without considering indemnities) and directors weighted by the number of directors and executives.
Percentage of employees covered by collective bargaining agreements	Percentage of employees by country whose contract is attached to a collective agreement.
Trained workforce (%)	Percentage of workforce that has received training
Total training hours	Total training hours received by employees in the workforce
Disabled persons integration rate	Percentage of disabled employees on the payroll
No. of accidents leading to days lost	Number of workplace accidents leading to days of work lost.
Days lost	Number of days lost due to workplace accidents. Counted in calendar days from the first day after receiving medical leave.
Fatalities	Number of employees killed as a result of workplace accidents.
Frequency	Number of accidents at the workplace leading to days lost per million hours worked.
Severity accident index	Number of days lost as a result of workplace accidents per 1,000 hours worked.
Incidence	Number of workplace accidents per 1,000 employees
Occupational illness	Illness caused as a result of work activity.
Absenteeism	Hours of absenteeism for occupational illness and non-occupational illness.
Total number of suppliers	Number of suppliers from whom a product or service has been contracted in the year.
Total volume of purchases allocated	Total monetary amount used to cover the company's purchases.
Supplier ESG assessment ¹	Suppliers responding to the assessment survey which examines environmental, social and governance (labour practices) criteria
Number of critical suppliers	Suppliers classified as high-risk based on any of the risk factors assessed (health and safety, quality, ESG, operating and legal)
Disqualified suppliers	Suppliers that have failed to pass the supplier approval process.
Investment in social action	Financial contribution to social action and social investing programmes, sponsorship and patronage
No. of notifications received related to the Code of Ethics (queries and complaints)	Number of notifications received by the Ethics Committee from employees and suppliers in relation to the Code of Ethics and Anti-Corruption Policy.
Tax contribution	Amount of taxes actually paid by country and divided between those that suppose an effective cost for the group and those that are retained or are passed on to the final taxpayer.

1 Environmental, Social and Governance

Annex IV. About this report

This report has been prepared in accordance with the information reporting (IR) framework published by the International Integrated Reporting Council (IIRC). Furthermore, in relation to non-financial aspects, Global Reporting Initiative (GRI) Standards were taken into account.

As established in the Law 11/2018, of 28 de December, by which are modified the Commercial Code, Consolidated text of the law on capital companies approved by the Royal Legislative Decree 1/2010, of 2 July, and the Law 22/2015, of 20 de July, of Audit Accounts, in terms of non-financial information and diversity, the consolidated state of non-financial situation is incorporated, in what refers to environmental, social matters, as well as the ones referred to personnel, about respect to human rights and the fight against corruption and bribery contained in the section 7 of this director's report.

Likewise, for the preparation of the report recommendations in the "Guide for the elaboration of the management report of the listed companies" that the "Comisión Nacional del Mercado de Valores" (CNMV) published in 2013 have been taken into account.

Every year, Naturgy conducts a materiality analysis that identifies the most relevant and key issues for the company in environmental, social and governance matters (ESG).

This analysis allows us to identify the issues that:

- Are of greatest relevance from the standpoint of corporate responsibility and reporting.
- Could provoke a more significant change.
- Are considered of greatest relevance for the company's stakeholders.

The purpose of the materiality analysis is to:

- Identify which issues are material and must be reported.
- Serve as the basis to respond to sustainability indices and rating agencies.
- Discover the internal and external relevance of the issues identified.
- Show the correlation of the issues identified.
- Explain the meaning that each of the issues identified has for Naturgy.
- Find out the impact that each of the material issues has on the business and on which stakeholders.
- Identify the key risks and opportunities for Naturgy with regard to each material issue.
- Associate the material issues with the Global Reporting Initiative (GRI) Standards.
- Bring together the management status of Naturgy with regard to each material issue.
- Serve as the basis of a dashboard that enables us to monitor and improve management of the material issues for Naturgy.
- Link material issues with the Sustainable Development Goals (SDG) and reveal their degree of progress in those countries where Naturgy operates.
- Discover the main events that have taken place in the last 12 months related to Naturgy and linked to each of the issues identified.

During 2018 the materiality analysis has been updated, in line with the commitments and strategy of the company.

Materiality of the main aspects identified has been assessed and prioritised the most relevant contents for inclusion in the Directors' Report, as detailed below:

Identification of significant aspects	<p>Based on internal and external analyses, a list was drawn up of aspects that may substantially affect Naturgy's capacity to create value in the short, medium and long term. The following were taken into account:</p> <ul style="list-style-type: none"> Stakeholders' expectations: the main aspects defined by GRI Standards and sector-specific GRI supplements "Electric Utilities" and "Oil&Gas", on the basis of the materiality study conducted by Naturgy. It was taken the basis of the 33 GRI Standards. Investors' expectations: feedback from investors and ESG1 analysts received during the various roadshows held in 2018. Taking into account the external and internal opinions: it has been made more than 39 interviews with different areas of the company and 10 interviews with external interest groups. Other external prescriber's sources.
Assessment of the materiality of the aspects identified	<p>Classification of the various aspects identified in line with their significance for Naturgy according to their potential impact (positive or negative) on its capacity to generate value.</p> <p>According to the degree of significance, those aspects to be considered as part of the contents of the Directors' Report are obtained.</p>
Prioritising contents	<p>Once determined, the contents of the report are prioritised based on their materiality so as to focus the report on the most significant aspects.</p>

Naturgy has identified eleven most relevant ESG issues for the company, in order of priority. Also, it has identified the rest of the interest items:

	Material issues identified	Nature of the matter
Matters of maximum significance	1 Emissions and climate change.	Environmental
	2 Occupational health and safety.	Social
	3 Access to energy.	Social
	4 Development of the communities and social action.	Social
	5 Innovation and sustainable technology.	Economic and social
	6 Customer care and satisfaction.	Social
	7 Biodiversity.	Environmental
	8 Talent retention and attraction.	Social
	9 Energy efficiency and consumption.	Environmental
	10 Assessment of the supply chain.	Social and environmental
	11 Diversity and equal opportunities.	Social

For each of the material issues identified, the company has collected, identified and analysed the following information in its materiality study:

- Definition and description of the issue.
- Sub-issues into which the issue is divided.
- Principle of the corporate responsibility policy associated with the issue.
- Relevance of the issue for the company and its business.
- How the issue impacts on the business (cost, revenue or risk).
- On which stage of the value chain does the issue impact.
- Which stakeholders are impacted by the issue.

- Risks and opportunities related to the issue.
- Management of the issue by Naturgy:
- Sustainable Development Goals (SDG) directly associated to the issue.
- Relevant events related to Naturgy and associated to the issue.

Scope

The financial and non-financial information on Naturgy presented in this report is consolidated and refers to all the activities undertaken in 2018 as a global gas and electricity operator, although there are certain specific aspects:

As a result of the divestments of the South African mining business described in Note 9 “Non-current assets and disposal groups of assets held for sale and discontinued operations” of the Consolidated Annual Accounts, the consolidated income statement for 2017 and the operational magnitudes have been restated for purposes of comparison in compliance with IFRS 5.

With the object of clarify the scope used in the non-financial indicators and to provide the greatest possible transparency, in every part of the non-financial information state would be specified with a footnote every indicator that it was not able to collect the data of any of this countries.

The indicators that represent the evolution over the year include information from companies held for sale provided that the opposite is not specified, while the indicators that represent information at the year-end do not include information about these companies.

In the sphere of human resources, the information reported corresponds to the countries in which Naturgy is present and has companies incorporated with their own staff and in which the company manages its human resources policies centrally, except on the number of employees and the average men/women that takes into account all the employees of the group according to consolidation perimeter.

With regard to the environment, the disclosures refer solely to those companies or activities that are at least 50% owned or controlled by the company, which have the capacity to influence environmental management or have the capacity to make a significant impact, based on global data.

Appendix I of the Consolidated Annual Financial Statements, titled “Naturgy Companies”, contains a complete list of companies belonging to the Naturgy group at 31 December 2018.

Moreover, any changes in the consolidation scope are described in Annex II of the Consolidated Financial Statements.

Verification

The non-financial information in the Directors' Report was subject to an independent external revision process. The independent assurance report, where objectives and scope of the process as well as the procedures applied and conclusions are included, is attached as an annex hereto.

Annex V. Independent verification report



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Translation of a report originally issued in Spanish. In the event of discrepancy,
the Spanish-language version prevails

INDEPENDENT LIMITED ASSURANCE REPORT OF THE NON-FINANCIAL STATEMENT

To the Shareholders of Naturgy Energy Group, S.A.:

Pursuant to article 49 of the Code of Commerce we have performed a verification, with a limited assurance scope, of the accompanying Consolidated Non-Financial Statement (hereinafter NFS) for the year ended December 31, 2018, of NATURGY ENERGY GROUP, S.A. and subsidiaries (hereinafter, the Group), which is part of the Director's Report of the Group.

The content of the NFS includes additional information to that required by prevailing mercantile regulations in relation to non-financial information that has not been subject to our verification. In this regard, our review has been exclusively limited to the verification of the information shown in section 7.10 of the accompanying NFS.

Responsibility of the Board of Directors and Management

The Board of Directors of the Group is responsible for the approval and content of the NFS included in the Director's Report of Naturgy Energy Group, S.A. The NFS has been prepared in accordance with the content established in prevailing mercantile regulations and the criteria of the selected GRI standards, as well as other criteria described in accordance with that indicated for each subject in section 7.10 of the NFS.

The directors are also responsible for the design, implementation and maintenance of such internal control as they determine is necessary to enable the preparation of a NFS that is free from material misstatement, whether due to fraud or error.

They are further responsible for defining, implementing, adapting and maintaining the management systems from which the information necessary for the preparation of the NFS is obtained.

Our independence and quality control procedures

We have complied with the independence and other Code of Ethics requirements for accounting professionals issued by the International Ethics Standards Board for Accountants (IESBA), which is based on the fundamental principles of integrity, objectivity, professional competence, diligence, confidentiality and professionalism.

Our Firm complies with the International Standard on Quality Control No. 1 and thus maintains a global quality control system that includes documented policies and procedures related to compliance with ethical requirements, professional standards, as well as applicable legal provisions and regulations.



The engagement team consisted of experts in the review of Non-Financial Information and, specifically, in information about economic, social and environmental performance.

Our responsibility

Our responsibility is to express our conclusions in an independent limited assurance report based on the work performed, that refers exclusively to 2018. Information on prior years was not subject to the verification required by prevailing mercantile regulations. Our review has been performed in accordance with the requirements established in prevailing International Standard on Assurance Engagements 3000 "Assurance Engagements Other than Audits or Reviews of Historical Financial Information" (ISAE 3000) issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC).

The procedures carried out in a limited assurance engagement vary in nature and timing and are smaller in scope than reasonable assurance engagements, and therefore, the level of assurance provided is likewise lower.

Our work consisted in requesting information from Management and the various Group units participating in the preparation of the NFS, reviewing the process for gathering and validating the information included in the NFS, and applying certain analytical procedures and sampling review tests as described below:

- Meeting with Group personnel to know the business model, policies and management approaches applied, the main risks related to these matters and obtain the necessary information for our external review.
- Analyzing the scope, relevance and integrity of the content included in the NFS based on the materiality analysis made by the Group and described in Annex IV of the Director's Report, considering the content required by prevailing mercantile regulations.
- Analyzing the processes for gathering and validating the data included in the 2018 Non-Financial Statement.
- Reviewing the information on the risks, policies and management approaches applied in relation to the material aspects included in the NFS.
- Checking, through tests, based on a selection of a sample, the information related to the content of the 2018 NFS and its correct compilation from the data provided.
- Obtaining a representation letter from the Directors and Management.



Conclusion

Based on the procedures performed in our verification and the evidence obtained, no matter came to our attention that would lead us to believe that the 2018 NFS of Naturgy Energy Group, S.A. has not been prepared, in all material respects, in accordance with the content established in prevailing mercantile regulations and the criteria of the selected GRI standards, as well as other criteria described in accordance with that indicated for each subject in section 7.10 of the NFS.

Use and distribution

This report has been prepared as required by prevailing mercantile regulations in Spain and may not be suitable for any other purpose or jurisdiction.

ERNST & YOUNG, S.L.

(Signature on the original in Spanish)

Antonio Capella Elizalde

January 31, 2019

Annex VI. Annual Corporate governance report

A. Ownership structure

A.1 Complete the following table on the company's share capital:

Date of last change	Share capital (€)	Number of shares	Number of voting rights
22/06/12	1,000,689,341	1,000,689,341	1,000,689,341

Please indicate if there are different types of shares with different rights associated:

YES NO

Class	Number of shares	Face value	Number of voting rights	Different r ights
-------	------------------	------------	-------------------------	-------------------

A.2 List the direct and indirect holders of significant ownership interests in your company at year-end, excluding directors¹:

Name or company name of shareholder	% voting rights attributed to the shares		% voting rights through financial instruments		% of total voting rights
	Direct	Indirect	Direct	Indirect	
Global Infrastructure Management LLP		20.000%			20.000%
Société Nationale pour la Recherche, la Production, le Transport, la Transformation et la Commercialisation des Hydrocarbures	3.850%				3.850%
Criteria Caixa S.A.U.	20.422%	5.23%			25.652%
CVC Capital Partners SICAV-FIS S.A.		20.072%			20.072%

Detail of the indirect holding:

Name or company name of the indirect holder	Name or company name of the direct holder	% voting rights attributed to the shares	% voting rights through financial instruments	% of total voting rights
Global Infrastructure Partners III	GIP III Canary 1, S	20.000%		20.000%
Criteria Caixa S.A.U.		20.422%		20.422%
Criteria Caixa S.A.U.	Energía Boreal S.A.	5.0%		5.0%
Criteria Caixa S.A.U.	G3T S.L	0.10%		0.10%
Criteria Caixa S.A.U.	BCN Godia S.L.U	0.13%		0.13%
CVC Capital Partners SICAV-FIS S.A.	Rioja Bidco Shareholdings, S.L.U	20,072%		20.072%

1. According to information on significant shareholdings reported to the CNMV by the reporting parties.

Indicate the most significant changes in the shareholder structure occurred during the year:

Name or company name of shareholder	Date of the transaction	Description of the transaction
Repsol, S.A.	18-05-2018	Sale of all of its holding to Rioja Bidco Shareholdings, S.à.r.l
Criteria Caixa S.A.U.	3-10-2018	It transfers 5% of the share capital to Energía Boreal 2018, S.A.

A.3 Complete the following tables regarding the members of the company's Board of Directors who hold voting rights over the company shares:

Name or company name of director	% voting rights attributed to the shares		% voting rights through financial instruments		% of total voting rights	% voting rights that can be transferred through financial instruments	
	Direct	Indirect	Direct	Indirect		Direct	Indirect
Mr Francisco Reynés Massanet		0.008			0.008		
Rioja Bidco Shareholdings	20.072				20.072		
Theatre Directorship Services	0				0		
Mr William Alan Woodburn	0				0		
Mr Pedro Sainz de Baranda Riva	0				0		
Mr Ramón Adell Ramón	0.001				0.001		
Mr Enrique Alcántara-García Irazoqui	0.003				0.003		
Mr Claudio Santiago Ponsa	0				0		
Mr Marcelino Armenter Vidal	0.001				0.001		
Mr Francisco Belil Creixell	0.001				0.001		
Ms Helena Herrero Starkie	0				0		
Mr Rajaram Rao	0				0		
% total voting rights held by the Board of Directors						20,086%	

Detail of the indirect holding

Name or company name of director	Name or company name of the direct holder	% voting rights attributed to the shares	% voting rights through financial instruments	% of total voting rights	% voting rights that can be transferred through financial instruments
Mr Francisco Reynés Massanet	Frinvycó, SL	0.008			

Observations:

A.4 Indicate, where applicable, the family, commercial, contractual or corporate relations which could exist between the owners of significant stakes, provided they are known by the company, unless they are irrelevant or arise from normal trading activities, excluding those enquired about in section A.6:

Name or company name of related parties	Relationship type	Brief outline

Observations:

See section A. 7

A.5 Indicate, where applicable, the commercial, contractual or corporate relations which could exist between the holders of significant shares and the company and/or its group, unless they are irrelevant or arise from normal trading activities:

Name or company name of related parties	Relationship type	Brief outline
Criteria Caixa S.A.U.	Commercial	The existing relationships derive from ordinary commercial traffic and are referred to in section D.2 and in the annual accounts.
Repsol, S.A.	Commercial	The existing relationships derive from ordinary commercial traffic and are referred to in section D.2 and in the annual accounts.
CVC Capital Partners SICAV-FIS S.A.	Commercial	The existing relationships derive from ordinary commercial traffic and are referred to in section D.2 and in the annual accounts.
GIP III Canary 1, S.à r.l.	Commercial	The existing relationships derive from ordinary commercial traffic and are referred to in section D.2 and in the annual accounts.

A.6 Describe the relationships, unless they are scarcely relevant to the two parties, that exist between the significant shareholders or those represented on the board and the directors, or their representatives, in the case of legal entity administrators.

Explain, where appropriate, how significant shareholders are represented. Specifically, give details of those directors who have been appointed on behalf of significant shareholders, those whose appointment would have been promoted by significant shareholders, or who are linked to significant shareholders and/or entities of their group, with a specification of the nature of such relationships. In particular, mention shall be made, where appropriate, of the existence, identity and position of board members, or representatives of directors, of the listed company, who are, in turn, members of the administrative body, or their representatives, in companies that hold significant holdings in the listed company or in entities of the group of said significant shareholders.

Name or company name of related director or representative	Name or company name of significant related shareholder	Company name of the significant shareholder group	Description of the relationship/position
Mr Marcelino Armenter Vidal	Criteria Caixa S.A.U.	Criteria Caixa S.A.U.	Proprietary/Managing Director Criteria Caixa
		Caixa Capital Risc, S.G.E.I.C. S.A.	Deputy Chairman– CEO
		Inmo Criteria Caixa, S.A.U.	Director
		Mediterránea Beach & Golf S.A.U.	Chairman
		Saba Infraestructuras, S.A.	Director
		Caixa Invierte Industria, S.C.R., S.A.	Chairman
		Caixa Capital Biomed, S.C.R. S.A.	Physical person representing the Sole Administrator of Caixa Capital Risc, S.G.E.I.C, S.A.
		Caixa Capital Fondos, S.C.R. S.A.	Physical person representing the Sole Administrator of Caixa Capital Risc, S.G.E.I.C, S.A.
		Caixa Capital Micro, S.C.R. S.A.	Physical person representing the Sole Administrator of Caixa Capital Risc, S.G.E.I.C, S.A.
		Caixa Capital Tic, S.C.R. S.A.	Physical person representing the Sole Administrator of Caixa Capital Risc, S.G.E.I.C, S.A.
		Criteria Venture Capital, S.I.C.C. S.A.	Physical person representing the Sole Administrator of Caixa Capital Risc, S.G.E.I.C, S.A.
Mr Enrique Alcántara García-Irazoqui	Criteria Caixa S.A.U.		Proprietary
Mr William Alan Woodburn	Global Infrastructure Management LLP		Proprietary
Mr Rajaram Rao	Global Infrastructure Management LLP		Proprietary/Shareholder
Mr Javier De Jaime Guijarro	CVC Capital Partners SICAV-FIS S.A.		Proprietary
Mr José Antonio Torre de Silva López de Letona	CVC Capital Partners SICAV-FIS S.A.		Proprietary/Employee

A.7 Indicate whether or not the company has been notified of parallel shareholders agreements that affect it as per Articles 530 and 531 of the Corporate Enterprises Act. Where applicable, give a brief description and list the shareholders associated with the agreement:

YES NO

Parties to parallel shareholders agreements	% of share capital affected	Brief outline of agreement	Expiration date of the agreement, if there is one
Criteria Caixa, S.A.U GIP III Canary 1, S.à r.l.	45.65%	The agreement reported in Relevant Fact No. 242612 of 12/09/2016. specifies that the intervening parties assume certain undertakings concerning corporate governance of the Company and which are for the purpose of respecting the rights to proportional representation both on the Board as well as on Committees.	
Alba Europe S.à r.l. and Rioja Investment S.à r.l.	20.072%	The agreement reported in Relevant Fact No. 265818 of 18 May 2018 affects 1. The proposal for designation of directors in representation of Rioja Bidco Shareholdings, 2. The adoption of decisions on the Board and at the Meeting, and 3. The system for transfer of shares.	
Criteria Caixa, S.A.U and G3T, S.L. Criteria Caixa, S.A.U and BCN Godia, S.L.U.	5.123%	The agreement reported in Relevant Fact No. 270130 of 3 October 2018 deals with regulating the exercise of the voting rights of the indirect holding of G3T and BCN Godia S.L.U (through Energía Boreal 2018, S.A.) in Naturgy, indicating that it will do what Criteria specifies.	

Indicate whether or not the company is aware of the existence of concerted actions among its shareholders. Give a brief description as applicable:

YES NO

Parties to concerted action	% of share capital affected	Brief description of the concerted action	Expiry date of the concerted action, if there is one

If any modification or cancellation of said agreements or concerted actions has taken place during the year, please make express mention of this:

When Repsol sold its entire stake in the Company, it ceased to be part of the paracorporate agreement that it maintained with Criteria Caixa, S.A.U. and GIP III Canary 1, S.à.r.l.

A.8 Indicate whether any individual or legal entity currently exercise control or could exercise control over the company in accordance with article 5 of the Securities Market Act. If so, identify:

YES NO

Name or company name
Observations

A.9 Complete the following tables on the company's treasury share:

At year-end:

Number of direct shares	Number of indirect shares (*)	% of total share capital
5,397,737	8,639,595	14,037,332

Observations:

Explain the significant changes over the year:

Details of significant changes

As reported in the relevant facts dated 3 August, 1 October and 6 December, Naturgy has acquired 8,639,595 shares that will be kept in a separate corporate vehicle to generate a yield that will finance the long-term incentive of certain executives if the established conditions are met -see section B.7 of the Annual Remuneration Report.

On the other hand, at 31 December 2018, a further 5,397,737 shares were held for the purpose of repurchasing shares for possible redemption, providing for the acquisition of shares for up to Euros 400 million in the period ending on 30 June 2019.

A.10 Give details of the terms and conditions corresponding to the General Meeting of Shareholders' current mandate to the Board of Directors for issuing, repurchasing or assigning own shares.

The General Meeting of Shareholders held on 14 May 2015, in item 14 of the Agenda, authorised the Board of Directors to agree the acquisition of the Company shares in exchange for valuable consideration and to do so within a deadline of five years, under the following conditions:

Fourteenth.- Authorisation to the Board of Directors for the derivative acquisition of own shares, either directly or through group companies of Naturgy Energy Group S.A., in the terms agreed by the General Meeting and with the legally established restrictions, thus cancelling the authorisation agreed by the Ordinary General Meeting of 20 April 2010.

Fourteen 1.- To cancel, in the unused part, the authorisation granted to the Board of Directors by the General Meeting held on 20 April 2010 to acquire company shares by onerous title.

Fourteenth 2.- To authorise the Board of Directors to acquire in a term of no longer than five years fully paid-up company shares to a maximum of 10% of share capital by onerous title, on one or more occasions, or the maximum applicable figure in accordance with the legislation in force at the time of acquisition, provided that the aforesaid percentage between the shares acquired by the company directly or indirectly and those already held by the company and its subsidiaries should never exceed 10% of share capital or any other legally prescribed percentage of capital. The minimum and maximum acquisition price shall be the share price on the Continuous Market of the Spanish Stock Exchange, with an upward or downward variation of 5%.

If the shares are not listed, the maximum and minimum acquisition price shall be established at between one and a half times and twice the book value of the shares, as per the latest audited consolidated balance sheet. The Board of Directors is authorised to delegate this authorisation to the Executive Committee or to the person or persons it deems pertinent. This authorisation is understood to apply to the acquisition of the company's shares by owned companies.

Likewise, the General Meeting of Shareholders held on 20 April 2017, in item 14 of the Agenda, authorised the Board of Directors to agree the increase in share capital, and to do so within a deadline of five years, under the following conditions:

Fourteenth.- Authorisation for the Board of Directors, with substitution powers on the Executive Committee, in accordance with the provisions laid down in Article 297.1 b) of the Corporate Enterprises Act, so that, within the maximum term of five (5) years, if it considers it appropriate, it can increase the share capital, to the maximum quantity corresponding to 50% of the share capital of the company, with the possibility of incomplete subscription, on the date of the authorisation, issuing shares with or without the right to vote, with or without a premium, up to half the share capital, in one or more times and on the occasions and to the amount it considers appropriate, up to the limit of 20% of the share capital at the time of this authorisation, rewriting the articles of the Articles of Association and cancelling the authorisation agreed by the Ordinary General Meeting held on 20 April 2012.

Fourteenth.

- 1) Taking into consideration the current share capital figure, to authorise the Board of Directors, with the power to delegate this to the Executive Committee, to increase the share capital by FIVE HUNDRED MILLION THREE HUNDRED AND FORTY FOUR THOUSAND AND SIX HUNDRED AND SEVENTY EUROS (Euros 500,344,670), within five (5) years from this date (20/4/2017), through a cash contribution, in one or more payments and as appropriate for the amount decided, duly issuing ordinary, privileged and redeemable shares, with or without the right to vote, with or without a premium, without the need for fresh authorisation from the General Meeting, as well as to amend the Articles of Association required for the share capital increase(s) carried out by virtue of the foregoing authorisation, not fully subscribed. All the foregoing is in accordance with the provisions laid down in Article 297.1.b) of the Corporate Enterprises Act, rendering null and void the authorisation agreed by the Ordinary General Meeting of 20 April 2012.
- 2) The Board of Directors is expressly empowered, with the power to delegate this to the Executive Committee, to fully or partially exclude the preferential subscription right with regard to all or any of the issuances agreed in accordance with the provisions of this authorisation. This power is limited to the fact that the exclusions of the pre-emptive subscription right do not exceed, as a whole, 20% of the Company's current share capital.
- 3) As a consequence of the foregoing agreement, to amend the Transitory Article of the Articles of Association, which will henceforth be drafted as follows:

"Transitory article - delegation to the board of directors.

The company's Board of Directors, with the powers of replacing this delegation with the Executive Committee, has been authorised to increase the share capital by FIVE HUNDRED MILLION THREE HUNDRED AND FORTY FOUR THOUSAND AND SIX HUNDRED AND SEVENTY EUROS (Euros 500,344,670), within five (5) years from this date (20/04/2017), through a cash contribution, in one or more payments and as appropriate for the amount decided, duly issuing ordinary, privileged and redeemable shares, with or without the right to vote, with or without a premium, without the need for new authorisation from the General Meeting, up to the limit of 20% of the share capital at the time of this authorisation, as well as to amend the Articles of Association required for the share capital increase carried out by virtue of the foregoing authorisation, not fully subscribed. All the foregoing is in accordance with the provisions laid down in Article 297.1.b) of the Corporate Enterprises Act".

A.11 Estimated floating capital:

	%
Estimated floating capital	30.426

A.12 Indicate whether there is any restriction (statutory, legislative or of any other nature) on the transferability of securities and/or any restrictions on the voting rights. In particular, the existence of any type of restrictions that may make it difficult to take control of the company through the acquisition of its shares in the market, as well as those authorisation or prior notification systems that apply to acquisitions or transfers of financial instruments of the company through sectoral regulations, will be reported.

YES NO

Description of the restrictions

As a company that incorporates certain regulated and quasi-regulated assets and activities into its Group, the acquisition of Naturgy Energy Group S.A. shares may be subject to the provisions laid down in Additional Provision 9 of Law 3/2013, of 4 June, governing the National Commission on Markets and Competition.

Given its nature as a major operator in the gas and electricity markets, the holding of its shares is subject to the restrictions laid down in article 34 of Decree-Law 6/2000, governing Urgent Measures to intensify competition in the goods and services markets.

A.13 Indicate whether the General Meeting has agreed to take up measures of neutralisation against a takeover bid by virtue of the provisions laid down in Law 6/2007.

YES NO

If appropriate, explain the measures approved and the terms under which the restrictions would not be enforceable:

A.14 Indicate whether the company has issued securities not traded in a regulated market of the European Union.

YES NO

If appropriate, indicate the different types of shares and, for each type of share, the rights and obligations conferred.

B. General Meeting

B.1 Indicate and, where applicable, give details of whether the quorum required for constitution of the General Shareholders' Meeting differs from the system of minimum quorums established in the Corporate Enterprises Act.

YES NO

	% quorum different to that laid down in Article 193 LSC for general cases	% quorum different to that laid down in Article 194 LSC for special cases
Quorum required for the first call to meeting		
Quorum required for the second call to meeting		
Description of the differences		

B.2 Indicate and, as applicable, describe any differences between the company's system of adopting corporate agreements and the framework established in the Corporate Enterprises Act (LSC):

YES NO

Describe how the system differs from that of the LSC.

Reinforced majority other than that laid down by Article 201.2 LSC for the cases of 194.1 LSC	Other cases of reinforced majorities
% laid down by the institution for the adoption of agreements	
Describe the differences	

B.3 Indicate the rules governing amendments to the company's Articles of Association. In particular, indicate the majorities required to amend the Articles of Association and, if applicable, the rules for protecting shareholders' rights when changing the Articles of Association.

The amendment of the Articles of Association is regulated in article 6.2 of the Articles of Association and in article 12 of the Regulations on the General Meeting, which is supplemented with the corresponding provisions of the Corporate Enterprises Act.

The shareholders constituted in a duly convened General Meeting, shall generally decide by simple majority vote on the matters which fall to the terms of reference of the meeting. In such case an agreement shall be deemed adopted when it obtains more votes in favour than against of the share capital either present or represented.

All shareholders, including dissidents and those that have not taken part in the meeting, are subject to the resolutions of the General Meeting.

In order for the ordinary or extraordinary General Meeting to validly agree the issue of bonds, the increase or reduction of share capital, the removal or limitation of the preferential subscription right for new shares or convertible bonds, as well as the transformation, merger, spin-off or global assignment of assets and liabilities, the transfer of the company's registered office abroad and, in general, any modification to the Articles of Association, will require, at the first call to meeting, the attendance of shareholders, either present or represented, that hold at least fifty percent (50%) of the subscribed share capital with voting rights. In the second call to meeting, it will be sufficient for twenty-five percent (25%) of the share capital to be present.

The modification of the Articles of Association must be agreed by the General Meeting and requires the concurrence of the following requisites:

- 1) The Board of Directors or, where appropriate, the shareholders that make the proposal, must compile a written report with justification for the amendment.
- 2) The call to meeting must clearly express the proposed points of change, as well as the right all shareholders have to examine, at the registered office, the full text of the proposed modification and a report on this. They also have the right to ask for handover or free-of-charge sending of said documents.
- 3) The agreement must be adopted by the General Meeting in accordance with the provisions set out in these Articles of Association.
- 4) Under all circumstances, the agreement must be set out in a public deed, which will be registered with the Mercantile Registry and published in the Official Bulletin of the Mercantile Registry.

B.4 Indicate the attendance data of the General Meetings held during the financial year to which this report refers:

Date of General Meeting	Attendance data				Total
	% physical presence	% represented	% remote voting Electronic vote	Other	
04/05/2016	68.67%	8.77%	0	0	77.44%
Of the floating capital 2016	0.13%	8.77%	0	0	8.9%
20/04/2017	68.66%	13.34%	0%	0%	82%
Of the floating capital 2017	0.1%	13.3%	0%	0%	13.4%
27/06/2018	68.69%	15.13%	0%	0%	83.82%
Of the floating capital 2018	0.2%	15.1%	0%	0%	15.3%

B.5 Indicate whether at the General Meetings held during the year there has been any item on the agenda that, for whatever reason, has not been approved by the shareholders.YES NO

Agenda items that have not been approved	% of votes against ^(*)

* If the non-approval of the item is for a reason other than a vote against, this will be explained in the part of the text and "n/a" will be placed in the "% of votes against" column.

B.6 Indicate whether or not there is a statutory restriction to the minimum number of shares required to attend the General Meeting.YES NO

Number of shares required to attend the General Meeting
Number of shares required to vote remotely

Observations

B.7 Indicate whether it has been established that certain decisions, other than those established by Law, which involve the acquisition, disposal, the contribution to another company of essential assets or other similar corporate operations must be submitted to approval of the general meeting of shareholders.YES NO

Explanation of the decisions that must be submitted to the board other than those established by law
--

B.8 Indicate the URL of the company and the means of access to corporate governance content and other information concerning the general meetings and which must be made available to shareholders through the company's website.

With regard to the Corporate Governance section, the route is as follows: https://www.naturgy.com/accionistas_e_inversores/gobierno_corporativo/normas_de_gobierno

With the following itinerary www.naturgy.com → Shareholders and Investors → Corporate Governance.

Indicate the removals from office due to resignation, dismissal or for any other reason, that have occurred on the Board of Directors during the reporting period:

Name or company name of director	Category of director at time of vacancy	Date of last appointment	Date of vacancy	Specialist committees of which he or she was a member	Indicate whether the removal from office occurred before the end of the mandate
Isidro Fainé Casas	Proprietary	18/05/2015	6/02/2018	EXC	Yes
Rafael Villaseca Marco	Executive	14/05/2015	6/02/2018	EXC	Yes
Josu Jon Imaz Sanmiguel	Proprietary	20/4/2017	22/02/2018	EXC	Yes
Luis Suarez de Lezo Mantilla	Proprietary	20/4/2017	17/05/2018	EXC, AUC	Yes
Miguel Martinez Sanmartín	Proprietary	14/05/2015	6/3/2018	EXC, ARC	Yes
Iñigo Alonso de Noriega Satrústegui	Proprietary	6/3/2018	17/05/2018	ARC	
Guillermo Llopis García	Proprietary	6/3/2018	18/05/2018	AUC	Yes
Cristina Garmendia Mendizábal	Independent	14/05/2015	27/06/2018	ARC, AUC	Yes
Benita Ferrero-Waldner	Independent	14/05/2015	27/06/2018	EXC	No
Xavier Añoveros Trias de Bes	Independent	14/05/2015	27/06/2018	AUC	No
Alejandro García- Bragado Dalmau	Proprietary	21/09/2016	21/05/2018	EXC, ARC	No
Mario Armero	Proprietary	20/04/2017	27/06/2018	--	Yes
Theatre Directorship Services Delta, S.À.R.L. (Represented by Mr Juan Arbide Estensoro)	Proprietary	17/05/2018	27/06/2018	--	Yes
					No

Reason for the resignation and other observations

The exit of Repsol's share capital and the simplification and reduction of the size of the Board and its Committees has led to a reduction in the number of proprietary directors, which is why several of them tendered their resignation. The Proprietary Director Mr García-Bragado resigned, alleging differences of opinion in the selection of new directors, which were not shared by the other members of the board.

With regard to the independent directors, the reason for their removal from office was the expiration of their mandates.

C.1.3 Complete the following tables on board members and their respective categories:

Executive directors

Name or company name of director	Position in the company's management structure	Profile
Mr Francisco Reynés Massanet	Executive Chairman	Engineering and international business profile: Industrial Engineer, specialising in mechanics, with a degree from the Polytechnic University of Barcelona, and an MBA from IESE; he has also completed Senior Management programmes in the United States and Germany.
Total number of executive directors		1
% of the entire board		8.33%
Observations		

External proprietary directors

Name or company name of director	Name or title of significant shareholder represented by the director or that has proposed the director's appointment	Profile
Mr Enrique Alcántara-García Irazoqui	Criteria Caixa S.A.U.	Legal profile: Former Public prosecutor. He is Secretary of the Board of Directors and of the Trusts of multiple Societies and Foundations.
Mr Marcelino Armenter Vidal	Criteria Caixa S.A.U.	Economics and business profile: Degree in Business Administration and Management and a Master's degree in Business Administration and Management from ESADE.
Mr Rajaram Rao	Global Infrastructure Partners III	IT, economics and international business profile: Qualified Electronic and Telecommunications Engineer. He also holds an MBA from the University of Delhi and a Master's degree in Finance from the London Business School.
Mr William Alan Woodburn	Global Infrastructure Partners III	International technical engineer profile: MS and BS degrees in Engineering from Northwestern University and the US Merchant Marine Academy.
Rioja Bidco Shareholdings, S.L.U. (Mr Javier de Jaime Guijarro)	CVC Capital Partners SICAV-FIS S.A.	
Theatre Directorship Services Beta, S.à.r.l. (Mr José Antonio Torre de Silva López de Letona)	CVC Capital Partners SICAV-FIS S.A.	Economics and Business profile. Degree in industrial Engineering from the Higher Technical School of the Comillas Pontifical University (ICAI) and an MBA from the University of Navarre (IESE).
Total number of proprietary directors		6
% of the entire Board		50.00%
Observations		

External independent directors

Name or company name of Director	Profile
Mr Ramón Adell Ramón	Expert financial and accounting profile: Doctorate in Economics and Business Administration. Graduate in Law. Professor of Financial Economics and Accounting at the University of Barcelona. An academic from the Royal Academy of Economic and Financial Sciences of Spain and Honorary Member of the European Doctorate Degree Holders and Dr H.C. (Consedoc).
Mr Claudi Santiago Ponsa	IT and international business profile; energy sector: Degree in Computer Engineering from the Autonomous University of Barcelona (UAB) and International executive programme (INSEAD) through the Executive International Business at Georgetown University.
Mr Francisco Belil Creixell	Engineering and international business profile: Senior Engineer. He has been CEO of the Southwest Europe region at Siemens and Chairman of the German Chamber of Commerce for Spain and the Federation of the Spanish Chemical Industry.
Mr Pedro Sainz de Baranda Riva	Engineering and international business profile; capitals market: Mining Engineer from the University of Oviedo, PhD in Engineering, Rutgers University of New Jersey and an MBA from the Sloan School of Management of Massachusetts, Institute of Technology (MIT).
Ms Helena Herrero Starkie	IT and R&D&i and international business profile: Degree in Chemical Sciences. She is the Chairperson and CEO of Hewlett Packard (HP) for Spain and Portugal.
Total number of independent directors	5
% total of the board	41.66%
Observations	

Indicate whether or not any director qualified as independent receives from the company, or from its group, any amount or benefit for an item other than remuneration as director, or holds or has held, over the last year, a business relationship with the company or any other group company, whether in their own name or as a significant shareholder, Director or senior executive of an entity that maintains or has maintained any such relationship.

Where appropriate, include a reasoned statement from the board on the grounds why it believes this director may perform his duties as an independent director.

Name or company name of director	Description of the relationship	Reasoned statement
Ms Cristina Garmendia Mendizábal	Director of Science & Innovation Link, Office (SILO), an entity that has rendered services to a company of the Naturgy Group.	The business relationship maintained with Science & Innovation Link Office is not significant given its intangible amount.

Other external directors

Identify all other external directors and explain why these cannot be considered proprietary or independent directors and detail their relationships with the company, its executives or shareholders:

Name or company name of director	Reasons	Company, executive or shareholder with whom the relationship is maintained	Profile
Ms Cristina Garmendia Mendizábal	She was considered external from 17-05-18 to 27-06-18.	Indirect link with the significant shareholder CVC Capital Partners SICAV-FIS S.A., being a Director of Corporación Financiera Alba, a company that has concluded a paracorporate agreement with CVC	Business management and innovation

Total number of other external directors

% total of the board

Observations

List any changes in the category of each director which have occurred during the year.

Name or company name of director	Date of change	Former category	Current category
Ms Cristina Garmendia Mendizábal	17-05-2018	Independent	Other external director until 27/06/18

Observations

C.1.4 Complete the following table with information regarding the number of female directors at the close of the last four financial years, and their category:

	Number of female directors				% of total directors of each type			
	Financial year t	Financial year t-1	Financial year t-2	Financial year t-3	Financial year t	Financial year t-1	Financial year	Ejercicio t-3
Executive	0	0	0	0	0	0	0	0
Proprietary	0	0	0	0	0	0	0	0
Independent	1	3	3	2	8.33%	17.65%	17.65 %	11.76%
Other external	0	0	0	0	0	0	0	0
Total:	1	3	2	2	8.33%	17.65%	17.65%	11.76%

Observations

In the preceding table, the number of female directors at the end of each year has been recorded.

C.1.5 Indicate whether the company has diversity policies in relation to the Board of Directors of the company with regard to issues such as age, gender, disability, or professional training and experience. Small and medium-sized enterprises, in accordance with the definition contained in the Accounts Auditing Law, will at least have to report the policy they have established in relation to gender diversity.

YES NO Partial policies

If yes, describe these diversity policies, their objectives, the measures and the way in which they have been applied and their results over the year. Also indicate the specific measures adopted by the Board of Directors and the Appointments and Remuneration Committee to achieve a balanced and diverse presence of directors.

If the company does not apply a diversity policy, explain the reasons why

Description of the policies, objectives, measures and manner in which they have been applied, as well as the results obtained

Naturgy's director selection policy includes guidelines aimed at selecting candidates whose appointment fosters professional expertise and gender diversity on the Board of Directors. In any case, it should be noted that said policy is applied with full respect to the right of proportional representation legally recognized to shareholders

The Appointments and Remuneration Committee ensures that the screening procedures do not include any implicit bias that could involve any discrimination whatsoever.

Throughout 2018 there has been a significant renewal process of the Board of Directors, which has affected both proprietary directors and independent directors.

With respect to proprietary directors, the process of renewal of directors has been linked to two circumstances:

1. Changes in the shareholding structure of the Company, which have caused the exit of the proprietary directors representing Repsol and the entry of the directors representing CVC.
2. The reduction in the number of board members, which has led to a reduction in the number of proprietary directors representing each shareholder, from three to two.

Within the framework of this process of renewal of proprietary directors, the Company has first all been respectful of the right to proportional representation that lawfully corresponds to shareholders. The detail of the assessment made by the Appointments and Remuneration Committee of the different candidates proposed by the shareholders is included in the corresponding report of the Committee that was published with the call to Meeting. With regard to independent directors, the expiration of the term of a significant number of them, as well as the decision to reduce the number of directors, led to the appointment of four independent directors to the General Meeting of Shareholders, until there were a total of five directors in accordance with the new configuration of the board.

At the time of formulating the proposal for appointing independent directors, the Appointments and Remuneration Committee was well aware of the conclusions of the self-assessment process of the board's performance in 2017, which was carried out with the assistance of an outsourced consultant. This self-assessment process helped the board, assisted by said consultant, to identify those profiles that were deemed necessary to strengthen with regard to the appointment of independent directors. In particular, the need to take into account in the appointment and renewal processes of independent directors the following profiles: industrial, regulatory in the matter of energy and technology, as well as, in general, more international profiles. It was considered desirable for the new candidates to have knowledge of the energy sector acquired outside of Naturgy and also have specialized profiles in the capital market.

The proposal for the appointment of directors that the board submitted to the General Meeting of Shareholders was consistent with that analysis. The detail of the relevant professional elements of the proposed directors was given in the corresponding report of the Appointments and Remuneration Committee that was published together with the other documentation of the Meeting.

C.1.6 Explain the measures which, where appropriate, have been agreed by the Appointments Committee so that the selection procedures are unaffected by any implicit bias that hampers the selection of female directors, and which show that the company purposefully seeks and includes women that satisfy the professional profile sought among the potential candidates:

Explanation of the measures

The Appointments and Remuneration Committee is tasked with reviewing the necessary skills of candidates required for each vacancy, compliance with the requirements needed for each category of director and the incorporation process of new members, forwarding the opportune reports or proposals to the Board as necessary. For covering new vacancies, selection processes shall be guaranteed that are not subject to implicit bias that prevents the selection of female directors, with special value place on, under the same conditions and among potential candidates, women who meet the professional profile being sought.

When, despite the measures adopted, the number of female directors is zero or few, explain the reasons for this:

Explanation of the reasons

The Company's Appointments and Remuneration Committee fully respects the legally recognised right to proportional representation of its significant shareholders.

C.1.7 Explain the Appointments Committee's conclusions on the checks carried out to ensure that the director selection policy is being complied with. Particularly whether the policy pursues the goal of having at least 30% of total board places occupied by female directors before the year 2020.

The Appointments and Remuneration Committee has verified that the Policy for the Selection of Directors has been complied with as regards the provision of existing vacancies on the board, all within the framework of the Company's shareholding structure, which imposes respect of certain legal requirements of proportional representation of the shareholders. The recommendations of good corporate governance must conform to this condition. The Committee has verified that in the selection processes for directors, the balance of criteria such as: i) expertise, ii) skills, iii) diversity and iv) experience has been taken into account.

The percentage of female profiles among independent directors represents 20% of the total, although it is lower than in previous years, it is expected to increase again when it is appropriate to make new proposals.

C.1.8 Where applicable, explain why proprietary directors have been appointed at the request of shareholders whose shareholding in the capital is less than 3%:

Name or company name of shareholder	Explanation
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Indicate whether or not formal requests have been accepted for presence on the board from shareholders whose holding is equal to or higher than that of others for whom proprietary directors have been appointed. If so, explain why these requests have not been answered:

YES NO

Name or company name of shareholder	Explanation
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C.1.9 Indicate, in the event that they exist, the powers and faculties delegated by the Board of Directors to directors or to board committees:

Name or company name of the director or committee	Brief outline
Mr Francisco Reynés Massanet	He has delegated extensive powers of representation and administration in accordance with the nature and requirements of the position of Executive Chairman.

C.1.10 List the Directors, if any, who hold office as directors or representatives of directors in other companies belonging to the listed company's group:

Name or company name of director	Company name of group entity	Position	Do they have executive duties?

Observations:

C.1.11 Identify, where applicable, the directors or representatives of legal persons of your company, who are members of the Board of Directors or director representatives, legal persons of other companies listed on official stock exchanges in Spain other than those of your group, that have been reported to the company:

Name or company name of director	Corporate name of the listed company	Position
Mr Ramón Adell Ramón	Oryzon Genomics, S.A.	Independent Director/Audit Committee's Chairman
Mr Marcelino Armenter Vidal	Grupo Financiero Inbursa	Representative of the director Criteria Caixa S.A.U.
Mr William Alan Woodburn	Hess Midstream Partners	Director
Mr Pedro Sainz de Baranda Riva	Zardoya Otis S.A.	Physical representative of the Director
Mr Pedro Sainz de Baranda Riva	Gestamp Automoción, S.A.	Director
Mr José Antonio Torre de Silva López de Letona	Cortefiel, S.A.	Representative of the Director Theatre Directorship Service Beta, S.À.R.L.

C.1.12 Indicate and, where appropriate, explain whether the company has established rules about the maximum number of company boards on which its directors may sit, identifying how this is regulated where appropriate:

YES NO

Explanation of the rules and identification of the document where it is regulated

C.1.13 Indicate the amounts of the following items relating to the overall remuneration of the board of directors:

Overall remuneration earned by the Board of Directors during the year (thousands of euros)	22,724
Cumulative amount of rights of current directors in pension scheme (thousands of euros)	360
Cumulative amount of rights of former directors in pension scheme (thousands of euros)	3,680

Observations

C.1.14 Identify members of senior management who are not also executive directors, and indicate the total remuneration they earned during the year:

Name or company name	Position/s
Mr Carlos Javier Álvarez Fernández	Chief Financial Officer
Mr Antonio Gallart Gabás	Director of Business Infrastructures Latin America South Zone
Mr José García Sanleandro	Director of Business Infrastructures Latin America North Zone
Mr Antonio Basolas Tena	Manager Corporate Strategy & Development
Mr José María Egea Krauel	Pipe Project Manager
Mr Manuel Fernández Álvarez	Business Director Gas & Electricity
Mr Manuel García Cobaleda	General and Board Secretary
Mr Jordi García Tabernero	Communication & Institutional Relations Managing Director
Mr Daniel López Jordà	Director of the Digitalization Project
Mr Antoni Peris Mingot	Corporate Resources Manager
Ms Rosa María Sanz García	España & Empl – Medgaz Infrastructure Business Managing Director
Mr Sergio Aranda Moreno	Colombia Project Manager
Mr Miguel Angel Aller Blanco	Lean Project Manager
Mr Steven Fernández Fernández	Capitals Market Director
Mr Jon Ganuza Fernandez de Arroyabe	Controlling
Mr Carlos Ayuso Salinas	Director of Internal Audit
Total remuneration of senior management (in thousands of euros)	17,940

Observations

Mr Daniel López Jordà and Mr Sergi Aranda Moreno stopped working for the company in December 2018. Mr Steven Fernández Fernández joined the company in June 2018.

C.1.15 Indicate whether or not there has been any modification to the regulations of the board during the year:

YES NO

Description of modifications

At the meeting of 21 May 2018, the Board Regulations were substantially modified in order to simplify their content. After the Shareholders' Meeting was held, on 27 June 2018 the Regulations were amended once again as regards the number of members of the Appointments and Remuneration Committee to comply with recommendation 47 of the CNMV Good Governance Code.

C.1.16 Indicate the procedures for appointing, re-electing, evaluating and removing directors. Provide details of the competent bodies, the procedures to be followed and the criteria applicable in each procedure.

The procedures for the appointment, re-election, evaluation and removal of directors are regulated in article 7 of the Articles of Association and in articles 9 and 10 of the Regulations for the Organisation and Functioning of the Board of Directors and its Committees, supplemented by the provisions of Article 529 decies of the Corporate Enterprises Act.

1. Appointment:

The General Meeting is competent for appointing directors and establishing the number thereof, subject to the limits stipulated in Article 7 of the Articles of Association.

If vacancies were to arise during the term for which the directors were appointed, the board shall be entitled to designate, using the co-option system, the persons to occupy these vacancies until the first General Meeting of Shareholders is held.

The status of shareholder is not required to be appointed director.

Anyone who is in any of the situations that, pursuant to prevailing legislation, prevents such characterisation, cannot be proposed, appointed or qualified as independent directors.

It will be necessary to appoint persons who not only satisfy legal provisions and those laid down in the Articles of Association for the position, but who have a prestigious position and are equipped with the professional skills and expertise required to perform their duties.

Directors are appointed and re-elected in accordance with a formal and transparent procedure, following a previous report/proposal from the Appointments and Remuneration Committee.

In particular, the proposals for the appointment of directors which the Board of Directors submits to the General Shareholders' Meeting, as well as appointments adopted by the Board by virtue of its powers of co-option, must be made subject to a proposal from the Appointments and Remuneration Committee in the case of independent directors, or a report for the remaining directors. When the Board does not follow the recommendations of said committee, it will have to explain the reasons and record the said reasons in the minutes.

2. Re-election:

Directors elected as of 27 June 2018, will hold office for a maximum term of four years, and may be re-elected (those elected up to that date have a term of three years). The directors appointed by co-option will exercise their position under the terms established in prevailing legislation.

The Appointments and Remuneration Committee is also entrusted with evaluating the quality of the work and the dedication of the directors proposed during the preceding mandate. It will make suggestions regarding independent directors and report on the remaining directors, on a compulsory basis, on the proposals for the re-election of directors which the Board of Directors chooses to submit to the General Meeting.

The independent directors shall not remain in their post for a period of more than 12 years.

3. Replacement or removal:

Directors shall be replaced in their position for the length of the term for which they were appointed, unless they are re-elected, and when so determined by the General Meeting by virtue of the powers granted thereto. Likewise, directors shall be replaced in all other circumstances where applicable pursuant to the Law, the Articles of Association and Regulations of the Board of Directors.

Directors shall be compelled to tender their resignation to the Board of Directors and proceed with the pertinent resignation, if the latter deemed it appropriate, in the following cases:

- a) When executive directors step down from their executive positions.
- b) When they are subject to any of the conditions of professional prohibition or incompatibility pursuant to applicable laws, the Articles of Association or these regulations.
- c) When they commit a serious breach of their obligations as directors, jeopardising the interests of the Company.
- d) When the reason why they were appointed as independent, executive or proprietary directors is no longer applicable.

In any case, the Board of Directors pays special attention to issues of diversity and not only gender diversity, within the framework of full respect for the right of shareholders as recognised by the Law on Proportional Representation. As explained in previous sections, and in accordance with the analysis carried out within the framework of the self-assessment process with an outsourced consultant, profiles have been identified whose reinforcement was considered relevant in order to strengthen the diversity of the Board. This has meant that current members of the Board of Directors respond to professional profiles and different career paths that complement each other: it is made up of directors who respond to financial, industrial, business management, and legal profiles related to the world of innovation and new technologies, or finally with experience in the capital market and accounting. During 2018, the Board made a special effort to increase the international profile of its members. The Board of Directors considers this circumstance particularly relevant because it helps to promote a more complete and integrating vision when analysing the different issues submitted to the board.

C.1.17 Explain, if applicable, to what extent this annual evaluation has prompted significant changes in its internal organisation and the procedures applicable to its activities:

Description of modifications

The evaluation of the Board of Directors for 2017 included the participation of an independent expert as consultant. Notwithstanding the fact that the outsourced consultant reported the highly satisfactory functioning of the Board and its Committees, the Board verified the possibility of progressing in certain areas of improvement to simplify its operation, which led to an Action Plan on the subject of corporate governance that was agreed on 6 March 2018, with measures aimed at this simplification and which have been implemented throughout 2018.

The framework of this process must include the modification proposed by the Board to the General Meeting of Shareholders with regard to the Company's new Articles of Association, a reduction of the number of directors, the removal of the Executive Committee, the attribution to the Appointments and Remuneration Committee of new powers in matters of corporate governance.

In addition, as explained in the previous sections, the 2017 annual evaluation report of the Board allowed us to identify the professional profiles whose incorporation was important to achieve in order to advance in the diversity of its composition. In particular, the need to take into account the following profiles in the appointment and renewal processes of independent directors: industrial, regulatory in the matter of energy and technology, as well as, in general, more international profiles, and also specialized profiles in the capital market.. This analysis was taken into account in relation to the proposals for the appointment of independent directors submitted to the General Meeting of Shareholders in 2018.

Describe the evaluation process and the areas evaluated by the Board of Directors, assisted by an outsourced consultant, regarding the operation and composition of its committees, and any other area or aspect that has been subject to evaluation.

Description of the evaluation process and areas evaluated

The Board was advised by an external consultant for the self-assessment of its operation during 2017, which allowed it to have a base with which to address the process of simplification and the broad renewal of the Board in June 2018. For this reason, the Board has not resorted to such external consultation in 2018, on the understanding that it is appropriate to let a certain period of time pass in order to adequately analyse the effectiveness of the agreed measures, since they have been implemented throughout 2018

C.1.18 Explain, for any of the years in which the evaluation has been assisted by an external advisor, the business relationship the adviser or any group company maintains with the company or any group company.

NOT APPLICABLE

C.1.19 Indicate the cases in which directors must resign.

Directors shall be replaced in their position for the length of the term for which they were appointed, unless they are re-elected, and when so determined by the General Meeting by virtue of the powers granted thereto. Likewise, Directors shall be replaced in all other circumstances where applicable pursuant to the Law, the Articles of Association and Regulations of the Board of Directors.

Directors shall be compelled to tender their resignation to the Board of Directors and proceed with the pertinent resignation, if the latter deemed it appropriate, in the following cases:

- a) When executive directors step down from their executive positions.
 - b) When they are subject to any of the conditions of professional prohibition or incompatibility pursuant to applicable laws, the Articles of Association or these regulations.
 - c) When they commit a serious breach of their obligations as directors, jeopardising the interests of the Company.
 - d) When the reason why they were appointed as independent, executive or proprietary directors is no longer applicable.
-

C.1.20 Are qualified majorities other than those prescribed by law required for any type of decision?

YES NO

Where appropriate, describe the differences.

Description of the differences

Article 7.4 of the Regulations of the Board of Directors states the following:

“4.- The resolutions must be adopted with the vote of the absolute majority of the directors who attend, whether present or represented, unless the Law, the Articles of Association or these Regulations establish an enhanced majority.

In particular, the favourable vote of more than two thirds of the directors, whether present or represented, will be required for the valid adoption of resolutions on the following matters reserved for the plenary session of the Board and, therefore, non-delegable:

- a) The acquisition or disposal of assets belonging to the Company (regardless of the legal means used for this purpose and, in particular, even if they are carried out through merger, spin-off or other operations of subsidiaries) in excess of Euros 500,000,000, unless its approval corresponds to the General Meeting or is carried out in execution of the budget or strategic or business plan of the Company.
- b) The approval of the budget and the strategic or business plan of the Company.
- c) The modification of the dividend distribution policy and the approval of a new one.
- d) The subscription, modification, renewal, non-renewal or termination by the Company of financing or refinancing agreements for an amount exceeding Euros 500,000,000.
- e) The subscription, modification, renewal, non-renewal or termination by the Company of any material contract, other than those provided for in section d) above, whose amount exceeds Euros 500,000,000 in the case of gas supply contracts and of Euros 200,000,000 in the case of other contracts.

- f) The material changes in the accounting and tax criteria and policies of the Company, unless they are due to modifications of applicable legislation or compliance with the guidelines and criteria set by the competent authorities in the matter.
- g) The reformulation of the Company's annual accounts, unless such reformulation is due to a modification of applicable legislation or compliance with the guidelines and criteria set by the competent authorities in the matter.
- h) Capital investments (capex) not provided for in the Company's annual budget for an amount exceeding Euros 200,000,000.
- i) The modification of the matters of paragraphs a) to i) or modification of the enhanced majority of the vote required for any of them."

C.1.21 Indicate if there are specific requirements other than those relating to directors in order to be appointed as Chairman of the Board of Directors.

YES NO

Description of requirements

C.1.22 Indicate whether the Articles of Association or the Board Regulations establish any age limit for directors:

YES NO

Age limit

Chairman

Chief Executive Officer

Director

Observations:

C.1.23 Indicate whether the Articles of Association or the Board regulations set a limited term, or other requirements stricter than those legally determined, of office for independent directors different to the one established in the regulations:

YES NO

Additional requirements and/or maximum number of years of in office

C.1.24 Indicate whether the Articles of Association or Board Regulations stipulate specific rules on appointing a proxy to the board, the procedures thereof and, in particular, the maximum number of proxy appointments a director may hold. Also indicate whether there are any restrictions as to what categories may be appointed as a proxy other than those stipulated by law. Where appropriate, give a brief description of these rules.

As established in Article 7.5 of the Articles of Association "Directors who cannot attend may delegate their representation to another director, with or without instructions to vote, and must notify the Chairman or the Secretary."

In addition, Article 7.3 of the Regulations of the Board states: "Each director shall be entitled to confer his/her representation to another director, there being no limit on the number of representations held by each member for attending the Board meeting. Absent directors' representations can be conferred by means of any written document, or any electronic means, addressed to the Chairman's Office or the Board Secretary before the beginning of the session".

C.1.25 Indicate the number of board meetings held during the year. Also indicate, where applicable, how many times the board has met without the chairman being present. When calculating the number, representations made with specific instructions shall be considered as attendance.

Number of board meetings	12
Number of board meetings without the chairman attending	0

Observations

Additionally, there have been two meetings held in writing and without a meeting, up to a total of 14 meetings.

Indicate the number of meetings held by the Coordinating Director with the rest of the directors, without the attendance or representation of any executive director.

Number of meetings	0
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Observations

Since the Coordinating Director is also the Chairman of the Appointments and Remuneration Committee and had held this position on the Audit Committee, of which he is still a member, he has usually had contacts with the non-executive directors and especially with the independent directors, both as regards remuneration issues as well as corporate governance in general, which have made it unnecessary to convene formal meetings.

Indicate the number of meetings held by the different board committees over the year:

Number of meetings of the Executive Committee	2
Number of meetings of the Audit Committee	7
Number of meetings of the Appointments and Remuneration Committee	10
Number of meetings of the Appointments Committee	
Number of meetings of the Remuneration Committee	
Number of meetings of the _____ Committee	

Observations

C.1.26 Indicate the number of board meetings held during the year with all members in attendance:

Number of meetings attended in person by at least 80% of the directors	12
% of attendance over the total number of votes during the year	93%
Number of meetings with attendance in person, or representations made with specific instructions of all the directors	3
% votes cast with attendance in person and representations made with specific instructions, on total votes during the year	More than 90%

Observations

C.1.27 Indicate whether the consolidated and individual annual accounts submitted for authorisation for issue by the board are certified previously.

YES NO

Identify, where applicable, the person(s) who has/have certified the company's individual and consolidated annual accounts in order to be drawn up by the board:

Name	Position
Mr Carlos Javier Álvarez Fernández	Chief Financial Officer

C.1.28 Explain the mechanisms, if any, established by the Board of Directors to prevent the individual and consolidated annual accounts it prepares from being laid before the General Meeting with a qualified audit report.

By virtue of those established in article 529.4 of the Corporate Enterprises Act and in the Articles of Association, the Audit Committee is responsible for, among others, the functions of informing the General Meeting of Shareholders about the issues that arise in relation to those matters that fall within the remit of the Committee and, in particular, on the result of the audit, explaining how this has contributed to the integrity of the financial reporting and the role that the committee has played in that process, as well as supervising the process of preparation and presentation of mandatory financial reporting and submitting recommendations or proposals to the administrative body, aimed at safeguarding its integrity.

To this end, the Audit Committee has supervised the process of preparing financial information and has engaged in fluid dialogue with the external auditor, with the utmost respect for its independence, where it has been informed of the Audit Plan, of the preliminary and final results of the auditor's analyses, and where its independence has been specifically ensured. In any case, it is noteworthy that no accounting qualifications have been made.

C.1.29 Is the secretary of the board also a director?

YES NO

Complete if the secretary is not also a director:

Name or corporate name of the secretary	Representative
Mr Manuel García Cobaleda	-
Observations	

C.1.30 Indicate the specific mechanisms introduced by the company to preserve the independence of the external auditors, as well as, if any, mechanisms to preserve the independence of financial analysts, investment banks and rating agencies, including how the legal provisions have been implemented in practice.

Among the legal functions that correspond to the Audit Committee are to establish the appropriate relations with the external auditor to receive information on those issues that may pose a threat to its independence, for examination by the committee, and any others related to the process for conducting the accounts audit and, where appropriate, the authorisation of services other than those prohibited, under the terms set out in articles 5, paragraph 4, and 6.2.b) of Regulation (EU) No. 537/2014, of 16 April, and as set out in section 3 of chapter IV of title I of Law 22/2015, of 20 July, on Accounts Auditing, on the independence regime, as well as those other communications provided for in the audit legislation of accounts and in the auditing standards. In all cases, on an annual basis, the Audit Committee shall receive from the auditors written confirmation of their independence vis-à-vis the company or entities related to it directly or indirectly, in addition to detailed and individual information on additional services of any kind rendered to these entities by the aforementioned auditors or persons or entities related to them in conformity with the provisions of auditing legislation.

Issuing annually, prior to the issuance of the audit report, a report expressing an opinion on whether the independence of the auditors or audit companies is compromised. This report shall in all cases include a reason assessment of each of the additional services provided, as referred to in the previous section, considered separately and in their totality, that consists of services other than statutory audits and how they relate to the requirement of independence or to the regulatory legislation of the activity on auditing of accounts.

Likewise, the Board of Directors has entrusted the Audit Committee with, inter alia, the following functions: to ensure that the remuneration of the external auditor for its work does not compromise its quality or independence and ensure that the company and the external auditor respect the standards in force on the provision of services other than auditing, the limits on the concentration of the auditor's business and, in general, the other rules governing the independence of auditors.

The company's relations with financial analysts and investment banks are based on the principles of transparency, simultaneity and non-discrimination, as well as the existence of specific and different agents for each collective. In order to increase transparency, this area has been enhanced by differentiating it from the Financial Department.

In addition, the company shall take special care not to compromise or interfere with the independence of the financial analysts in respect of the services offered by investment banks, in accordance with the internal codes of conduct established by them and designed to separate their analysis and assessment services.

C.1.31 Indicate whether the company has changed its external audit firm during the year. If appropriate, identify the incoming and outgoing auditors:

YES NO

Outgoing auditor	Incoming auditor
PWC	E&Y
Observations	

In the case of disagreements with the outgoing auditor, explain the content of the said disagreements:

YES NO

Explanation of the disagreements

C.1.32 Indicate if the audit company performs other tasks for the company and/or its group other than auditing activities, and if so, state the amount of the fees received for said activities and the percentage of the fees billed to the company and/or its group:

YES NO

	Company	Group	Total
Amount of tasks other than auditing activities (in thousands of euros)	181	540	721
Amount of tasks other than auditing/ Amount billed by the audit company (%)	20.00%	12.60%	13.90%
Observations			

C.1.33 Indicate if the auditor's report on the annual accounts corresponding to the previous year involves reservations or exceptions. Where applicable, indicate the reasons given by the Chairman of the Audit Committee to explain the content and scope of the said reservations or exceptions.

YES NO

Explanation of the reasons

C.1.34 Indicate the number of consecutive years during which the current audit firm has been auditing the annual accounts of the company. Also indicate the percentage of the number of years audited by the current audit company over the total number of years that the annual accounts have been audited:

	Individual	Consolidated
Number of years without interruption	1	1

	Individual	Consolidated
Number of years audited by the current audit company / Number of years the company has been audited (in %)	3.57%	3.57%

Observations

C.1.35 Indicate, and give details if any, whether there are procedures for directors to receive the information they need in sufficient time to prepare for meetings of the governing bodies:

YES NO

Details of the procedure

Articles 6.2 and 6.3 of the Regulations of the Board of Directors state: "2-Notices convening sessions shall be issued by the Chairman or the Secretary, or by the Deputy Chairman on order of the Chairman, and may be effected by any of the channels set out in the Articles of Association. The notification shall include the place and the agenda of said meeting and shall be issued, at least 5 days before the meeting is to be held, specifying the agenda of the meeting. In the event of an emergency duly justified by the Chairman and thus appreciated by the Board at the start of the meeting, a call to meeting will be made by telephone, fax, email or any other telematic means, with sufficient notice to allow the directors to participate in the meeting. Prior to each meeting, the directors shall be furnished with the information and documentation considered to be pertinent or relevant regarding the subjects to be addressed in the board meeting. Directors shall also be furnished with the minutes of the previous meeting, regardless of whether said minutes have been approved or not. The Chairman shall be authorised to establish the order of the day, except in the event of the compulsory convening, in which case the agenda of the convened meeting will include the issues indicated by the Directors who request it. 3.- The board meeting shall have a quorum, without being previously convoked, if all the directors are present or represented and unanimously accept that the board meeting be held".

The procedure followed involves sending, usually a week in advance, the call to meeting, the agenda and any information that is available and may be useful for more accurate knowledge of the matters to be discussed in the Board session.

To this end, the Board's documentation is made available to the directors through a computer platform, which allows them permanent access to it. The directors have access to the documentation of all bodies of the Board, irrespective of whether or not they are members of a Committee. In addition, directors are provided with other information relevant to the exercise of their functions (relevant events, new regulations, access to press reviews, etc.) through the platform.

Furthermore, during the meeting, those directors whose issues are being dealt with at the meeting are available to be called -and they frequently are called -so that the directors in attendance can ask them directly for any clarifications, details or opinions in relation to the items discussed in the session and can directly appreciate their suitability for the position.

Finally, the directors may request additional information they deem necessary for the exercise of their duties through the Board Secretary.

C.1.36 Indicate and, where applicable, give details of whether or not the company has laid down rules that oblige the directors to report and, if necessary, resign in cases that damage the company's credit and reputation:

YES NO

Explain the rules

In accordance with article 11.3 of the Board Regulations, the director is subject to the duty of loyalty under the terms established in prevailing legislation and, in particular, section e) of said article 11.3, establishes that

the director shall inform the company of any kind of legal or administrative claim or any claim of any nature in which he/she is involved which, due to its significance, could have a serious bearing on the reputation of the company. The Board shall examine the matter and adopt the appropriate measures in the company's interest and with the required urgency.

Also, directors shall be compelled to tender their resignation to the Board of Directors and proceed with the pertinent resignation, if the latter deemed it appropriate, in the following cases:

- a) When executive directors step down from their executive positions.
- b) When they are subject to any of the conditions of professional prohibition or incompatibility pursuant to applicable laws, the Articles of Association or these regulations.
- c) When they commit a serious breach of their obligations as directors, jeopardising the interests of the Company.
- d) When the reason why they were appointed as independent, executive or proprietary directors is no longer applicable.

C.1.37 Indicate whether or not any member of the Board of Directors has informed the company that he/she has been prosecuted or hearings against him/her have been opened for any of the offences laid down in Article 213 of the Corporate Enterprises Act:

YES NO

Director's name	Criminal case	Observations
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Indicate whether or not the Board of Directors has analysed the case. If the answer is affirmative, give a reasoned explanation of the decision taken as to whether or not the director remains in his/her post or, where appropriate, list the actions taken by the Board of Directors up to the date of this report or those scheduled to be taken.

YES NO

Decision taken/action taken	Reasoned explanation
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C.1.38 Detail the major agreements entered into by the company and which remain in force, are modified or conclude in the event of a change of control of the company based on the takeover, and the effects of these agreements.

An important part of the Naturgy investee companies with shareholders outside the group contain change of control clauses whereby the other shareholder is entitled to choose to acquire the shareholdings in the event of change of control of the holding company of the Naturgy Group.

On the other hand, most of the outstanding financial debt includes a clause related to the change of control, either by acquiring more than 50% of the voting shares or by obtaining the right to appoint the majority of members of the Board of Naturgy Energy Group, S.A. These clauses are subject to additional conditions, whereby their activation depends on the simultaneity of some of the following events: the significant reduction of the credit rating caused by the change of control, or the loss of the investment grade by the rating agencies; the inability to meet the financial obligations of the contract; material damage to the creditor, or a material adverse change in solvency. These clauses entail the repayment of the debt, although they usually have a longer period than that granted in the event of early termination.

More specifically, the bonds issued, with an approximate value of Euros 9.7 billion (standard practice in the Euromarket), would be susceptible to early maturity providing that the change of control causes a fall of two or more full notches in at least two of the three ratings it had or all of the ratings fall below investment grade, and providing the Rating Agency explains that the reduction of the credit rating is caused by the change of control.

There are also loans for an amount of approximately Euros 2 billion, linked to long-term infrastructure financing with funds from the European Investment Bank, which could be subject to early repayment in the event of a change of control. To activate these clauses, in addition to the change of control event a reduction of the rating is required, and they have special repayment terms for the debt that are longer than those of early termination cases.

C.1.39 Identify, individually, when referring to directors and in aggregate form in all other cases, and provide detailed information on agreements between the company and its officers, executives and employees that provide indemnities for the event of resignation, unfair dismissal or termination as a result of a takeover bid or other type of operations.

Number of beneficiaries	23
Beneficiary type	Description of the agreement
Former Chief Executive Officer	<p>The contract of the CEO, who served the Company until February 2018, established compensation for three years of the total remuneration on the date of the contractual amendment for certain cases of termination of the contractual relationship: through a decision by the company, except for very serious and culpable breach of his professional obligations that causes serious harm to the interests of Naturgy, through a decision of the CEO or through termination of the contract. As a post-contractual non-competition agreement compensation was also established amounting to a full year of total remuneration.</p> <p>On 6 February 2018, the Board of Directors agreed to terminate the contract, pay the compensation envisaged for the amount of three years of the total compensation for the amount of Euros 10,685,763 and compensation for a non-competition agreement for one year's total remuneration, that is, Euros 3,561,921, as well as settling the outstanding amounts of the different remuneration items accrued in 2018 -fixed, annual variable and ongoing PREMP programmes.</p>
Current Executive Chairman	<p>The Chairman's contract establishes compensation for the cessation or non-renewal of the position of director for the overall amount of two years of: (i) fixed total annual cash remuneration, (ii) the annual variable remuneration and (iii) according to the concept of multi-year variable remuneration, a lump sum equivalent to 1.25 of the fixed total annual cash remuneration. This concept will only be multiplied by a full year if, at the time of accrual, the minimum profitability target of the LTI plan has not been reached; the second full year can be recovered if the minimum target was finally reached at the end of the plan.</p> <p>The compensation will not be payable in the event of serious and culpable breach of their professional obligations that causes significant damage to the interests of Naturgy. As a post-contractual non-competition agreement compensation was also established amounting to a full year of total remuneration.</p> <p>The contract of the Executive Chairman sets out the termination of the contract and the payment of compensation if he forfeits his executive functions and will continue as non-executive Chairman. In this case, the compensation provided is identical to that of the previous section, but reduced by half, that is, one full year.</p>
Executives	<p>The contracts signed with 16 executives contain a clause that establishes a minimum compensation of one full year of fixed remuneration in some cases and two full years of compensation in others in certain cases of termination of the relationship, which include certain cases of change of control, unfair dismissal or the cases set out in Arts. 40, 41 and 50 of the Workers' Statute. These contracts also contain a clause which sets out compensation equivalent to one year's fixed remuneration for post-contractual non-competition for a period of two years.</p> <p>In addition, 2 executives have compensation agreements whose amounts entitle them to receive a minimum compensation of one fixed full year of remuneration in some cases and two full years of compensation in others in certain cases of termination of the relationship, which include unfair dismissal or the cases set out in Arts. 40, 41 and 50 of the Workers' Statute.</p> <p>Moreover, there are compensation agreements with four other executives, equivalent to one year's fixed remuneration for post-contractual non-competition for a period of two years.</p>

Indicate whether the composition of the Delegated or Executive Committee reflects the participation in the board by the various directors depending on their category:

YES NO

If the answer is negative, explain the composition of your Delegated or Executive Committee

Not applicable.

Audit committee

Name	Position	Category
Mr Francisco Belil Creixell	Chairman	Independent
Mr Ramón Adell Ramón	Board Member	Independent
Mr Enrique Alcántara-García Irazoqui	Board Member	Proprietary
Mr Pedro Sainz de Baranda Riva	Board Member	Independent
Ms Helena Herrero Starkie	Board Member	Independent
Mr Rajaram Rao	Board Member	Proprietary
Theatre Directorship Services Beta, S.à.r.l., represented by Mr Jose Antonio Torre de Silva Lopez de Letona	Board Member	Proprietary
% of proprietary directors		42.86%
% of independent directors		57.14%
% of other external directors		-

Observations

Explain the functions, including, if applicable, those additional to those legally envisaged, which have been attributed to this committee, describe the procedures and rules for the organisation and functioning of the same. For each of these functions, indicate its most important actions during the year and how it has exercised in practice each of the functions attributed to it either in the law or in the articles of association or other corporate resolutions.

a) Functions of the Audit Committee:

The Committee has the powers set out in Law and those entrusted to it by the Board of Directors in a general or specific manner.

In response to different resolutions of the Board of Directors of 27 November 2015, 29 January 2016 and 6 March 2018, it exercises the following functions:

- Prepare the report on auditor independence.
- Prepare the report on the performance of the Audit Committee.
- Prepare the report on related-party transactions.
- Strive to ensure that the Board of Directors can present the company's accounts to the General Meeting without limitations or qualifications in the auditor's report. In the exceptional case that qualifications exist, both the Chairman of the Committee and the Auditors should give a clear account to shareholders of their scope and content of said limitations.
- With respect to control and reporting systems:
 - (a) Supervising the preparation and completeness of the financial information concerning the company and, if appropriate, the group, checking due compliance with the governing regulations, the proper delimitation of the consolidation criteria and the correct application of accounting criteria.
 - (b) Ensuring the independence of the unit handling the internal audit function; approve its priorities and work programmes, ensuring that it focuses primarily on the main risks the company is exposed to; receive regular reports on its activities; and verify that senior management is acting on the findings and recommendations of its reports. Propose to the Chairman of the Board of Directors the selection, appointment, re-election and removal of the person responsible for the internal audit service, as well as proposing the budget for that service, with the final decision corresponding to the Chairman of the Board of Directors.
 - (c) Setting up and supervising a mechanism whereby staff can report, confidentially and, if appropriate and feasible, anonymously, any significant irregularities that they detect in the course of their duties, in particular financial or accounting irregularities.

- With regard to the external auditor:
 - (a) In the event of resignation of any external auditor, the Committee should investigate the issues giving rise to the resignation.
 - (b) Ensuring that the remuneration of the external auditor does not compromise its quality or independence.
 - (c) Supervising that the company notifies any change of external auditor to the National Securities Market Commission as a relevant event, accompanied by a statement of any disagreements arising with the outgoing auditor and the reasons for the same.
 - (d) Ensuring that the external auditor has a yearly meeting with the board in full to inform them of the work undertaken and developments in the company's risk and accounting positions.
 - (e) Ensuring that the company and the external auditor adhere to current regulations on the provision of non-audit services, limits on the concentration of the auditor's business and other requirements concerning auditor independence.
- Call any of the Company's employees or managers, and also have them appear without the presence of any other executive.
- Analyse and report to the Board of Directors on the economic conditions and the accounting impact and, especially, where applicable, on the exchange ratio, in relation to the operations of structural and corporate modifications that, due to their nature or amount, are of special relevance. Transactions whose net value exceeds the value of 25% of the assets that appear on the last approved balance sheet of the Company will be deemed relevant.
- In addition:
 - (a) Supervision of compliance with the internal codes of conduct.
 - (b) Overseeing the communication and relations strategy with shareholders and investors, including small and medium-sized shareholders.
 - (c) The regular evaluation of the adequacy of the company's corporate governance system
 - (d) Monitoring and assessing the processes of liaising with different stakeholders.
 - (e) The evaluation of the company's non-financial risks

**b) Procedures, and organisational and operational rules
in accordance with Article 26 of the Regulations of the board**

The Audit Committee shall comprise a minimum of three and a maximum of seven directors appointed by the Board of Directors from among the non-executive directors, and one of them will be appointed taking into account their knowledge and experience in issues of accountancy, audit or both. Its members shall leave their post when they do so in their capacity as directors or as agreed by the Board of Directors.

The Board of Directors shall elect the Chairman from amongst the members of the Committee, the majority of whom will have the status of independent director; the Chairman shall not have the casting vote. The post of Secretary of the Committee will be held by the person who is the Secretary of the Board of Directors, if there is one.

The committee shall hold meetings whenever necessary in order to issue its reports or proposals, and will be convened by its Chairman on his own initiative or upon prior request of two of its members. At least four meetings per year must be held. The committee may invite to its meetings any executive or employee it deems appropriate.

c) Main actions taken during the year 2018

In the exercise of its powers during the financial year it has reported and/or adopted proposals, among others, on the following matters:

- Quality and efficiency of its operation.
- External audit of the individual and consolidated annual accounts.
- Supervision of the process of preparation of financial reporting.
- Tax situation
- Independence of the auditor.
- Related-party transactions
- Verification of the crime prevention system.
- Supervision of risk control systems and specific risk analysis
- Supervision of internal control and internal audit systems

Identify the directors who are members of the Audit Committee who have been appointed Chairman on the basis of knowledge and experience of accounting or auditing, or both, and state the date that said director was appointed Chairman.

Name of directors with experience	Mr Ramón Adell Ramón
Date of appointment as Chairman	27/06/2018

Observations:

Appointments and remuneration committee

Name	Position	Category
Mr Ramón Adell Ramón	Chairman	Independent
Mr Francisco Belil Creixell	Board Member	Independent
Mr Pedro Sainz de Baranda Riva	Board Member	Independent
Mr Claudi Santiago Ponsa	Board Member	Independent
Mr Marcelino Armenter Vidal	Board Member	Proprietary
Mr William Alan Woodburn	Board Member	Proprietary
Rioja Bidco Shareholdings SLU Mr Javier De Jaime Guijarro	Board Member	Proprietary
% of proprietary directors		42.86%
% of independent directors		57.14%
% of other external directors		-
Observations		

Explain the committee's duties, describe the procedure, and organisational and operational rules. For each of these functions, indicate its most important actions during the year and how it has exercised in practice each of the functions attributed to it either in the law or in the articles of association or other corporate resolutions.

a) Duties of the Appointments and Remuneration Committee:

The Committee has the powers set out in Law and those entrusted to it by the Board of Directors in a general or specific manner.

The Board of Directors has entrusted it with the following functions:

- Prepare the report on performance of the Appointments and Remuneration Committee.
- Verify the selection policy for directors and report on this in the Annual Corporate Governance Report.
- Through delegation that must be granted by the Chairman of the Board, to organise and coordinate the regular assessment of the Board and that of the chief executive of the Company.
- Prepare the report on the operation of the Board of Directors.
- Propose to the Board of Directors the standard conditions for senior executives contracts.
- Monitor compliance with the remuneration policy set by the company.
- Regularly review the remuneration policy for directors and senior executives.
- Ensure that conflicts of interest do not undermine the independence of any external advice the committee engages.
- Verify information on remuneration of directors and senior executives contained in the various corporate documents.
- Through a resolution of the Board of Directors on 29 January 2016, it was entrusted with the exercise of all the corporate social responsibility powers that hitherto had been exercised by the Audit Committee.
- Through a resolution of the Board of Directors on 6 March 2018, it was agreed to entrust the Appointments and Remuneration Committee with the following tasks previously entrusted to the Audit Committee:
 - i) Monitor the most relevant incidents in terms of health, safety and the environment.
 - ii) Raise proposals and report on initiatives in corporate governance.

b) Procedures, and organisational and operational rules

in accordance with Article 25 of the Regulations of the board

The Appointments and Remuneration Committee shall comprise a minimum of three and a maximum of seven directors appointed by the Board of Directors from among the non-executive directors, and one of them will be appointed taking into account their knowledge and experience in issues of accountancy, audit or both. Its members shall leave their post when they do so in their capacity as directors or as agreed by the Board of Directors.

The majority of members of the Committee will hold the status of independent director, from among which the Board of Directors will elect the Chairman of the same, who will not have a casting vote. The post of Secretary of the Committee will be held by the person who is the Secretary of the Board of Directors, if there is one.

D. Related-party transactions and intra-group transactions

D.1 Explain, if applicable, the procedures for approving related party or intra-group transactions.

Procedures for approving related party transactions

In accordance with art. 3.II h) of the Board Regulations, among the powers that cannot be delegated by the Board but that may be adopted by the Executive Committee or by the CEO(s) for reasons of urgency duly justified and which must be ratified in the first Board Meeting to be held after the adoption of the decision is the approval, following a report from the Audit Committee, of the operations that the Company or its group companies carry out with directors, under the terms established in prevailing legislation, or with main shareholders, individually or in concert with others, of a significant stake, including shareholders represented on the Board of Directors of the Company or other companies that are part of the same group or with persons related to them.

In some circumstances and to a limited extent, the Board has granted generic authorisations for transactions related to one of its shareholders, always in matters of a minor nature linked to the ordinary trade of the Company, and with the requirement that they be carried out under arm's length conditions and with the obligation to report the use of such authorisation to the Audit Committee every year.

As regards operations with Caixabank, this entity was controlled and formed a group with Criteria until 2017 when the conditions established by the ECB for deconsolidation were met.

D.2 List any relevant transactions, by virtue of their amount or importance, between the company or its group of companies and the company's significant shareholders:

Name or company name of significant shareholder	Name or company name of the company or entity of the group	Nature of the relationship	Type of operation	Amount (thousands of euros)
Criteria Caixa S.A.U.	Naturgy Energy Group, S.A.	Commercial	Reception of services	12
Criteria Caixa S.A.U.	Naturgy Energy Group, S.A.	Commercial	Provision of services	36
Criteria Caixa S.A.U.	Naturgy Energy Group, S.A.	Commercial	Sales of manufactured goods or not	3,095
Criteria Caixa S.A.U.	Naturgy Energy Group, S.A.	Commercial	Dividends and other distributed earnings	346,808
Repsol, S.A.	Naturgy Energy Group, S.A.	Commercial	Reception of services	3,944
Repsol, S.A.	Naturgy Energy Group, S.A.	Commercial	Procurement of manufactured goods or not	160,003
Repsol, S.A.	Naturgy Energy Group, S.A.	Commercial	Provision of services	20,545
Repsol, S.A.	Naturgy Energy Group, S.A.	Commercial	Sales of manufactured goods or not	367,115
Repsol, S.A.	Naturgy Energy Group, S.A.	Commercial	Purchase of tangible fixed assets	295
CVC Capital Partners Sicav-Fis S.A.	Naturgy Energy Group, S.A.	Commercial	Dividends and other distributed earnings	281,202
Gip III Canary 1, S.À R.L.	Naturgy Energy Group, S.A.	Commercial	Dividends and other distributed earnings	280,193

Observations

D.3 Detail those transactions that are significant because of their amount or which are materially relevant, performed between the company or entities within its group and the company's administrators or executives:

Name or company name of the administrators or executives	Name or company name of the related party	Relationship	Nature of the operation	Amount (thousands of euros)
Observations				

D.4 Report on the significant transactions carried out by the company with other companies belonging to the same group, provided that they are not eliminated in the process of drafting the consolidated financial statements and are not part of the company's usual trading in terms of its purpose and conditions.

En todo caso, se informará de cualquier operación intragrupo realizada con entidades establecidas en países o territorios que tengan la consideración de paraíso fiscal:

Company name of the entity of the group	Brief description of the operation	Amount (thousands of euros)
Observations		

D.5 Indicate the amount from related party transactions.

0 (in thousands of euros).

D.6 List the mechanisms established to detect, determine and resolve any possible conflicts of interest between the company and/or its group, and its directors, management or significant shareholders.

1. Directors:

In accordance with the Regulations of the Board:

- The Director is subject to the duty of loyalty under the terms established in prevailing legislation and, in particular:
- The director must refrain from participating in deliberating and voting on resolutions or decisions in which they or a related person have a direct or indirect conflict of interests. Resolutions or decisions that affect them in their capacity as director, such as their appointment to or removal from posts on the governing body or others of a similar nature, will be excluded from the preceding obligation.
- Also, the director shall adopt the measures required to avoid becoming involved in situations in which their interests, either for their own personal reasons or those of another party, may conflict with the company's interest or with their duties with the company.
- In his/her capacity as loyal representative of the Company, the director must inform the company of shares in the company he/she holds, directly or through companies in which he/she has a majority holding, following the procedure and other processes that are established for investment in Naturgy Energy Group S.A. and investee companies.
- The director must notify the Company of significant changes to their professional circumstances and changes which affect the nature or capacity by which he/she was categorised.
- The director shall inform the company of any kind of legal or administrative claim or any claim of any nature in which they are involved which, due to its significance, could have a serious bearing on the reputation of the company. The board shall examine the matter and adopt the appropriate measures in the company's interest and with the required urgency.
- The Board of Directors shall endeavour, at all times, to prevent proprietary directors from using their position to obtain asset benefits without adequate compensation, to the advantage of the shareholder that put them forward for the position.

The Director must abstain from conducting activities for themselves or for another party which, actually or potentially, entail effective competition with the Company or which, in any other manner, place them in permanent conflict with the Company's interests. Particularly, the director, may not hold, himself or by means of a representative, posts of whatsoever kind in companies or enterprises that compete with Naturgy Energy Group S.A. or any company in its group, or provide the same services of representation or consultancy in favour thereof. A company shall be considered as a competitor of Naturgy Energy Group S.A., when, directly or indirectly, or through companies in its group, it is devoted to any of the activities included in the corporate purpose of Naturgy Energy Group S.A.

2. Directors and executives:

On the other hand, pursuant to Art. 5 of the Internal Code of Conduct in Matters Relating to the Securities Markets (ICC), persons with management responsibilities and insiders, during certain periods of time will refrain from carrying out transactions on their own or for the account of a third party, directly or indirectly on the Affected Securities ((i) The transferable securities issued by the Company and/or by the companies of the Naturgy Group that are traded on a secondary market or other regulated markets, in multilateral trading systems or on other organised secondary markets, or in respect of which an application for admission to trading in one of such markets or systems has been filed; (ii) Financial instruments and contracts of any kind that grant the right to acquire the securities indicated in (i); (iii) Financial instruments and contracts whose underlying assets are the securities indicated in (i), and (iv) For the sole purpose of the rules of conduct in relation to the privileged information contained in Title III of the Regulations, the securities and financial instruments issued by other companies or entities other than the Company, for which Inside Information is available.)

Internal Audit, upon written request to the Board Secretary by the stakeholder, may authorise Persons with Management Responsibilities to perform personal transactions on Affected securities in the periods in which there is a general prohibition when certain circumstances are given and justified in the ICC itself. Internal Audit will inform the Audit Committee at least once a year about the authorisations that have been requested.

For their part, pursuant to section 4.10 of the Code of Ethics, employees must inform the company in the event that they or their close relatives participate or will participate on the governing bodies of other companies that may clash with the interests of Naturgy. In the performance of their professional responsibilities, employees must act with loyalty and defend the interests of the group. Furthermore, they must avoid situations that may give rise to a conflict between personal interests and the interests of the company. Accordingly, Naturgy employees must refrain from representing the company and participating in and influencing decisions in any situation in which they directly or indirectly have a personal interest.

3. Significant shareholders:

It will be the responsibility of the Board of Directors, pursuant to a report from the Audit Committee, to approve transactions carried out by the company or the companies in its Group with directors under the terms set forth in the current applicable legislation or with shareholders who, individually or in conjunction with others, hold a significant stake, including shareholders represented on the company's Board of Directors or the boards of other companies belonging to the same group or with persons associated with them.

D.7 Is more than one group company listed in Spain?

YES NO

Identify the subsidiary companies that are listed in Spain:

Listed subsidiary companies

Indicate whether or not their respective activity areas and possible business relations between them have been publicly defined, as well as those of the listed subsidiary with the other companies in the group:

YES NO

Define the possible business relationships between the parent company and the listed subsidiary company and between the listed subsidiary and the other companies in the group

Indicate the mechanisms laid down to solve possible conflicts of interests between the listed subsidiary and the other companies in the group:

Mechanisms for solving possible conflicts of interests

E. Control systems and risk management

E.1 Describe the risk management system in place at the company, including fiscal risks.

The Risk Management System works in a comprehensive and continuous way, and integrates the corporate visions of Corporate Governance, Risks and Compliance of the Company, enabling a full overview of the Group's processes, the existing controls over these and the associated risk.

The system ensures the independence of the control and risk management functions attributed to each of the responsible bodies and units, and is responsible for determining thresholds for the main risk categories in order to define the overall risk profile of the Company, guaranteeing the predictability of its performance in all relevant aspects for its stakeholders.

The main objective of global risk management is to ensure that the most relevant risks are correctly identified, assessed and managed, to ensure that the level of risk exposure assumed by Naturgy in the performance of its activities is consistent with the global profile of defined objective risk and with the achievement of the annual and strategic objectives..

E.2 Identify the bodies responsible for preparing and implementing the risk management system, including fiscal risks.

Risk Committee

It regularly evaluates and determines the overall risk profile of Naturgy, based on the information requested from the different responsible Units and proposes the global risk limits for consideration and approval by the Chairman, thus determining the global profile of objective risk.

Financial area

Through its Risk and Insurance Unit, it is responsible for providing support to the Risk Committee in the determination and monitoring of the global risk profile and the determination of the objective risk profile, by introducing policies and metrics in coordination with the business units affected. In particular, it is responsible for coordinating with the relevant units and issuing the recurring risk reports to be forwarded to the Board of Directors, including the Corporate Risk Map.

Internal auditing

It is responsible for ensuring effective supervision of the internal control system that ensures efficiency and effectiveness in operations, transparency and reliability of financial and management reporting, the safeguarding of group assets and compliance with applicable internal and external regulations, as well as making independent and objective contributions to add value and improve the operations of the organisation and contribute to the interests of shareholders. By the same token, through appropriate audits, it is responsible for examining the level of compliance with this Risk Control and Management Policy and the implementing procedures.

Audit Committee

It is an advisory body that provides specialized advice on everything related to external auditing, risk management systems and internal control.

The Business, Service and Project Units

They are responsible for risk management in their areas of responsibility, observing, reporting, managing and mitigating the different risks that have been identified.

E.3 Indicate the main risks, including fiscal, which may prevent the company from achieving its business targets.

	Description	Management
Market risk		
Gas price	Volatility in international markets which determine gas prices.	Physical and financial hedges. Portfolio management.
Electricity price	Volatility in electricity markets in Spain and Portugal.	Physical and financial hedges. Optimisation of generation park.
Gas volume	Gap between gas supply and demand.	Optimisation of contracts and assets. Trading.
Electricity volume	Reduction in available thermal gap. Uncertainty in the volume of hydraulic production	Optimisation of commercialisation-generation gap.
Regulation	Exposure to revision of criteria and levels of return recognised for regulated activities.	Heightened intensity of communication with regulatory bodies. Adjusting efficiencies and investments to recognised rates.
Exchange rates	Volatility in international currency markets.	Geographical diversification. Hedges through financing in local currency and derivatives. Monitoring of the net position.
Interest rates and credit spread	Volatility in financing rates.	Financial hedges. Diversification in financing sources.

	Description	Management
Fiscal	Ambiguity or subjectiveness in the interpretation of the prevailing fiscal regulations, or through a relevant change to the same.	Consultations with independent expert organisations. Recruitment of leading consultancy firms. Adhesion to the Code of Good Tax Practices. Allocation of provisions with criteria of prudence.
Credit risk		
Credit.	Uncertainty over the evolution of ratios of payment default conditioned by the economic cycle.	Análisis de solvencia de clientes para definir condiciones contractuales específicas. Proceso de recobro.
Operational risk		
Operational: image and reputation	Deterioration in perception of Naturgy by different stakeholders.	Identification and tracking of potential reputation events. Transparency in communication.
Operational: insurable.	Accidents, damages or non-availabilities in assets of Naturgy.	Ongoing improvement plans. Optimisation of total cost of risk and hedging.
Operational: environment	Damages to the natural and/or social environment. Evolution of environmental regulation.	Emergency plans in installations with risk of environmental accidents. Specific insurance policies. Complete environmental management.
Operational: climate change	Evolution of environmental factors as a consequence of climate change. Regulation geared towards fighting it.	Corporate positioning with regard to climate change. Active participation on influence forums.
Operational: cybersecurity	Attacks on computer systems.	Implementation of security measures Analysis of events and application of remedies Training.

E.4 Identify if the company has a risk tolerance level, including tax risks.

The company has levels of risk tolerance established at corporate level for the main kinds of risks.

The risk assessment process lies in identifying the risks, generally by those businesses that are subject to risk exposure. This identification takes place at the time the risk exposure originates. However, an in-depth review is carried out every year by the Risk Units to ensure proper identification of all risk exposures, whether current or future.

It is the Risk Units's responsibility to assess the risks identified, based on:

- Risk position: definition and characteristics.
- Impact variables.
- Qualitative and quantitative severity of the risk occurring.
- Probability of risk occurring.
- Defined mitigation controls and mechanisms, and their effectiveness.

Lastly, it will propose a tolerance level for the types identified, which will be approved by the Risk Committee.

E.5 Identify any risks, including tax risks, which have occurred during the year.

The risks that have materialised during the financial year have been inherent to the activity carried out, such as: exposure to regulatory risks, volatility of fuels and of the pool in Spain, the exchange, interest, credit or counterparty rates.

The risk control mechanisms have enabled the company to keep their impact within the established tolerance range, defined by means of the current risk limits.

Faced with uncertainty in the domestic and worldwide economic outlook, the company will seek to position itself in countries that promote legal security, economic developments in stable macroeconomic environments that ensure steady growth that contributes to the generation of value and profitability of business and enterprise, balancing the weight of its businesses in its mix of activities, and it will place greater focus on increasing the contribution of regulated activities and a more electric profile.

Subsequent to the approval of the new Strategic Plan 2018-2022, asset impairment or write-offs of Euros 4,851 million have been recorded, caused by the reassessment of future cash flow estimates based on the aforementioned plan, as well as other factors that have occurred during the period.

E.6 Explain the response and monitoring plans for the main risks the company is exposed to, including tax risks.

The risks regarding the performance of Naturgy are set out in the company's Corporate Risk Map, containing:

- Definition and characteristics of the main risk factors.
- Evolutionary aspects of the Risks Map.
- Impact variables.
- Main measurement methodologies used for each kind of risk.
- Qualitative, quantitative and probable severity of the risk materialising.
- Defined controls and their effectiveness.

The Risk Control Units and other specific areas (Regulation, Environment, Generation) perform periodic measurements of the evolution of main risks, duly giving the opportune instructions in the event of observing levels of exposure or trends in risk evolution that could exceed the established

F. Internal systems of control and risk management with regard to the internal control systems over financial reporting (ICFR)

Describe the mechanisms that make up your entity's internal control system and management of risks with regard to the financial information reporting process (ICFR).

F.1 The company's control environment

Report on, duly detailing their main characteristics, at least:

F.1.1. Which bodies and/or functions are in charge of: (i) the existence and upkeep of an appropriate and effective ICFR; (ii) its implementation; and (iii) its supervision.

Naturgy has defined its Internal Control System over Financial Reporting (hereinafter "ICFR") in the "Internal Control System over Financial Reporting (ICFR) General Standard of Naturgy".

As part of the ICFR, Naturgy has defined, in the foregoing General Standard, the responsibilities model of the same. This model revolves around the following five areas of responsibility:

- Board of Directors: The board is responsible for the existence of an appropriate and efficient ICFR, the supervision of which is delegated upon the Audit Committee.

The Board Regulations of Naturgy Energy Group, S.A. and its Committees, in article 3 section II, establish that the determination of the risk control and management policy, including tax risk, and supervision of the internal information and control systems are, among others, a matter that cannot ordinarily be delegated by the Board of Directors.

- Audit Committee: Among other tasks, this committee is responsible for supervision of the ICFR. Article 26 section 2 of the Board Regulations states that the Committee has the powers set out in Law and those entrusted to it by the Board of Directors in a general or specific manner. Thus, article 529.14 of the Corporate Enterprises Act sets out in section 4.b) that the Audit Committee will have the function of supervising the effectiveness of the company's internal control, internal audit and risk management systems, as well as discussing with the accounts auditor the significant weaknesses of the internal control system detected in performance of the audit. In particular and in relation to the reporting and control systems, the Audit Committee is responsible for, inter alia, the supervision of the preparation process and integrity of the financial information related to the company and, where applicable, the group, reviewing compliance with the standard requirements, the appropriate definition of the consolidation perimeter and the correct application of accounting criteria. For the performance of some of these duties, the Audit Committee is supported by the Internal Auditing Unit.
- Financial Department: This department is responsible for the design, implementation and operation of the ICFR. For the performance of this duty, it is supported by the Accounting Unit.

- Internal Auditing Unit: In general, it is responsible for assisting the Audit Committee in the ongoing review and assessment of the effectiveness of the Internal Control System in all areas of Naturgy, providing a systematic and rigorous approach for the monitoring and improvement of processes and for the assessment of operational risks and controls associated to these, including those corresponding to the ICFR and to the Crime Prevention Model.
- Compliance Unit.
- Business units, services and projects units involved in the financial reporting process. These are responsible for carrying out the processes and maintaining daily operations to ensure that the control activities introduced are performed.

F.1.2. Whether or not the following elements exist, particularly with regard to the procedure for financial reporting:

- ▣ **Departments and/or mechanisms responsible for: (i) the design and review of the organisational structure; (ii) the clear definition of the lines of responsibility and authority, with an appropriate distribution of tasks and duties; and (iii) that there are sufficient procedures for proper dissemination at the entity.**

The design and review of the organisational structure of top tier management, as well as definition of the lines of responsibility, are carried out by the Board of Directors, through the CEO and the Appointments and Remuneration Committee.

To ensure proper management of the group's economic-financial reporting, the Financial Department has developed, as part of the ICFR, a technical instruction comprising an interrelationships map (information flows) for the financial reporting process. This map documents communications between the Financial Department, the different parties in charge of the processes and those in charge that are either the source or destination of the financial reporting. The map is called "Interrelationships Map of Financial Reporting of Naturgy".

In this regard, there are six main areas that Naturgy has taken into consideration in compiling the interrelationships map showing the financial reporting processes:

- (i) the information required to prepare the financial reporting;
- (ii) the parties in charge that are either the source or destination of the financial reporting and
- (iii) the distribution of tasks among the different organizational units
- (iv) the scope of this distribution to all group companies
- (v) the frequency of information transfer.
- (vi) the information systems that are involved in the drafting process and for the issue of the financial reporting;

Thus, using the interrelationships map of Naturgy, the processes that have an impact on the preparation of financial reporting are clearly defined, both the operational processes that have a relevant impact on financial reporting, as well as those processes associated to the administrative and accounting area, and those managers involved in the same.

- ▣ **Code of Conduct, approval body, level of dissemination and instruction, principles and values included (indicating whether or not there are specific mentions to the register of operations and the preparation of financial reporting), the body in charge of analysing breaches and proposing corrective actions and fines.**

The undertakings of senior management of Naturgy include focusing their efforts on ensuring that operations are carried out within an environment of professional and ethical practices, not only through the introduction of mechanisms targeted at preventing and detecting fraud committed by employees, or inappropriate practices that

could lead to sanctions, fines or which could damage the image of Naturgy, but also reinforcing the importance of ethical values and integrity among its professionals.

In this regard, Naturgy has a Code of Conduct (hereinafter "Code of Ethics"), which was approved by the Board of Directors on 31 March 2005. This code is mandatory for all employees of Naturgy Energy Group, S.A and for all investee companies in which Naturgy holds management control. The updates and modifications to the Code of Ethics are carried out by the Board of Directors of Naturgy Energy Group, S.A.

Since it was approved, it has been amended four times, on the last occasion in 27 June 2014, with the object of updating it and including new commitments acquired by Naturgy in relation to the coming into force of the reform of the Penal Code (Organic Law 5/2010), the implementation of a Crime Prevention Model in the group, the issue of the Anti-Corruption Policy of Naturgy and in order to adapt it to the best Corporate Responsibility practices.

The Code of Ethics sets out the general ethical principles for Naturgy as a whole, setting out the values to be pursued in practice throughout the organisation, and which includes: (i) purpose (ii) scope of application (involving all members of Naturgy); (iii) governing criteria of conduct at Naturgy (declaration of the group's style of governance); (iv) conduct guidelines (declaration of key values of Naturgy); (v) acceptance and compliance of the code; (vi) Code of Ethics Committee and (vii) enforceability.

The Code of Ethics considers integrity and responsibility in the exercise of professional activities to constitute a fundamental general criteria for conduct at Naturgy. More specifically, it sets out a series of action guidelines to a greater or lesser extent related to the reliability of the financial reporting and to compliance with applicable regulations, and in particular:

- Respect for the law, human rights and ethical values (Section 4.1)

“Naturgy undertakes the commitment of acting at all times in accordance with applicable laws, with the internal regulatory system established with internationally accepted ethical practices, with total respect towards human rights and public liberties (...)”

- Processing of information and knowledge (Section 4.11):

“All employees that enter any kind of information into the group's IT systems must ensure that this information is rigorous and reliable.

In particular, all of the group's economic transactions should be clearly and precisely set out in the corresponding registries, via the pertinent accounts, and in all transactions performed, including all income and incurred expenses.

Employees of Naturgy shall refrain from any practice that contravenes the undertaking to clearly and accurately reflect all financial transactions in the group's accounts”.

Naturgy has also established an Anti-Corruption Policy, which was approved by the Management Committee in a meeting held on 3 March 2014, amended in the meeting held on 24 November 2015, and which is compulsory for all employees of all the companies which make up the Naturgy group with majority shareholding and those in which it has responsibility in its operation and/or management. The policy is understood to be an extension of Chapter 4.7. “Corruption and Bribery” of the Code of Ethics of the group, which has the object of establishing the principles which must be used to guide the conduct of all employees and administrators of the companies of Naturgy with regard to the prevention, detection, investigation and remedy of any corrupt practice within the organisation.

In July 2005, Naturgy set up the Code of Ethics Committee with the principal mission of promoting its dissemination and application throughout the group, and to provide a channel of communication to all employees in order to receive inquiries and notifications regarding breaches of the Code of Ethics and the Anti-Corruption Policy. On 30 October 2018, the functions of this Committee were assumed by the Ethics and Compliance Committee.

The Committee is chaired by the Compliance Unit and is formed by representatives of different units involved in the monitoring of compliance of the Code of Ethics and the Anti-Corruption Policy.

The Committee regularly reports to senior management and to the Audit Committee. The nature of the committee is to provide reports and recommendations, proposing corrective actions to those units in charge of providing solutions to problems through practical application of the Code of Ethics and the Anti-Corruption Policy, and simultaneously acting as a bridge between these units and employees.

The sanctionary regime, where necessary, is established by the Human Resources Unit.

To favour not only the exercise of said responsibility but also knowledge and dissemination of the Code of Ethics, this code is available in nine languages:

- Externally: Naturgy corporate website.
- Internally, on the group's Naturalnet platform.

In addition, online training courses through the Corporate University of Naturgy have been developed, which are mandatory for all employees of Naturgy.

Through the Code of Ethics Committee, Naturgy periodically carries out campaigns for the Code of Ethics Compliance Declaration and Anti-Corruption Policy, to disclose the guidelines governing the conduct expected from all employees, to circulate the mechanisms that exist to make inquiries and notifications, and to periodically formalise the commitment of all of the employees of the group in accordance with the ethical guidelines and principles of integrity.

Naturgy, to encourage the knowledge of the Code of Ethics among its suppliers and collaborating companies sets out a clause in the General Terms and Conditions of Contracting in which it promotes practices which are in keeping with the guidelines for conduct included in the Code of Ethics of Naturgy, and informs them of where they can find the Code of Ethics of the group, along with information in the queries channel and notifications on aspects related to the Code of Ethics. Furthermore, in 2016 the Code of Ethics for Suppliers was approved and published, the purpose of which is to establish the guidelines that must govern the ethical behaviour of suppliers, contractors and external collaborators of Naturgy. This Code sets out the commitments provided for under the United Nations Global Compact as well as under the Code of Ethics, the Human Rights Policy, the Corporate Responsibility Policy and the Anti-Corruption Policy of Naturgy.

- ▣ **Whistleblowing channel, which enables communication to be sent to the Audit Committee concerning any irregularities of a financial and accounting nature, along with any possible breaches of the Code of Conduct and irregular activity within the organisation, and state whether said channel is confidential.**

Professional ethics at Naturgy focuses on professional responsibility and integrity, with integrity understood as ethical and honest action performed in good faith; and professional responsibility as proactive and efficient action targeted at excellence, quality and willingness to serve.

As provided for under Article 26.2 of the Regulations of the Board and its Committees, “the Audit Committee shall have the powers that are provided for by the Law and the powers that are generally or specifically conferred by the Board of Directors”. The powers of the Audit Committee include the power to “establish and supervise a mechanism that enables employees to communicate, confidentially and, if possible and if considered appropriate, anonymously, any potentially significant irregularities, in particular of a financial and accounting nature within the company”.

In harmony with the foregoing, the Board of Directors, at its meeting held on 31 March 2006, established that the notifications received through the notification procedure for breaches of the Code of Ethics of Naturgy, related to fraudulent practices, audits or deficiencies in the accounting and internal control thereof, shall be directly notified to the Audit Committee.

As a mechanism for obtaining a higher degree of internal control regarding compliance with the principles included in the Code of Ethics, in July 2005 the Code of Ethics Committee of Naturgy (currently, Ethics and Compliance Committee) was established, whereby one of the main functions thereof is to provide and supervise a communication channel for all employees in order to receive queries and notifications of breaches of the Code, and to facilitate the resolution of disputes related to the application of the Code of Ethics and of the Anti-Corruption Policy and to draft reports for the governing bodies of Naturgy in relation to the dissemination and compliance of the Code of Ethics and of the Anti-Corruption Policy, and the activities of the committee itself.

The aforementioned communication channel constitutes an open channel (e-mail, fax, postal mail and internal mail) for all employees of Naturgy in order to notify aspects related to the code. This channel enables all group employees, suppliers and collaborating companies to obtain or provide information on any issue concerning the Code of Ethics and the Anti-Corruption Policy. Conduct contrary to the code can also be reported in good faith and confidentially. All of this is outside of the hierarchy governing habitual operations performed by employees.

All of the communications are absolutely confidential, and adhere to the limitations established under the Data Protection Act. Accordingly, the chairman of the committee (Compliance Director) is the only member thereof, in first instance, that is authorised to access all of the information regarding all of the queries and notifications received from the group through the query and notification procedure. Furthermore, the notifications related to fraudulent practices, audits or deficiencies in accounting or internal control processes are directly notified to the Audit Committee.

In the 2018 Naturgy Corporate Responsibility Report, further information is provided regarding the Code of Ethics, the Anti-Corruption Policy, the activities of the Code of Ethics Committee (Ethics and Compliance Committee since November 2018) and the use of the communication channel.

- ▣ **raining programmes and periodic retraining for personnel involved in the preparation and review of financial reporting, as well as the assessment of the ICFR, which at least cover the accounting, audit, internal control and risk management standards.**

The need to have a sufficient and, above all, updated qualification of those professionals involved in the preparation and review of financial reporting, as well as in the assessment of the ICFR, make it essential to implement an appropriate training plan, by which those persons in charge of each area have the knowledge required to perform the different functions included in the process of preparing and reviewing financial reporting.

To this end, Naturgy has the Corporate University, which is responsible for managing the knowledge and development of persons in all areas of the company. It integrates the model, the channels, the programmes and the training and learning actions of the group, introducing methodologies and training experiences with criteria of quality, impact, efficiency and cost optimisation.

The Corporate University has a quality management system pursuant to the ISO 9001:2015 standard, renewed in 2017 and with CLIP (Corporate Learning Improvement Process) accreditation from the European Foundation for Management Development (EFMD) since 2003 and last renewed in 2018 for a five-year period. This certificate recognises the quality of learning and development processes of people of corporate education organisations.

The aims of the Corporate University are, among others: to guarantee the adequacy of the position/person, the acquisition of knowledge linked to new needs of the organisation and the development of skills and abilities related to the Naturgy leadership and culture model; based on placing an updated and quality training offer at the disposal of employees.

With the implementation of the Evolution - Success Factors platform as a training management tool, to improve and adapt training to the demands of employees and businesses, since 2017 employees and their managers have been involved in defining the training required; in addition, all employees have direct access to all the online training of the company's catalogue, with a model of institutes and knowledge areas and a set of channels for disseminating specific content.

The relevant programmes performed in 2018 included the fourth edition of the Savia programme, with a focus on cybersecurity and innovation. In 2014 the Savia programme was established, which is a training program the purpose of which is to strengthen the current role of managers, that must be the change agents in relation to the global implementation of the new processes associated with the strategic challenges. In 2015 the second phase of the programme was commenced, Savia 2.0, which was focused upon the experience of customers and on change management. This programme continued in 2016, placing the focus, on this occasion, on cooperation and empowerment, completing the delivery of the course in October 2017.

Another of the relevant programmes carried out is the development of the online Cybersecurity course for all employees, with a focus on technical knowledge and on the duties and obligations in this area.

The specific knowledge for the economic-financial area covers several objectives, including, making uniform the economic-financial processes developed in any area of the organisation; updating the criteria governing accounting, tax, finance, risk management, management control, international regulations and technical knowledge of the tax area; as well as providing sufficient knowledge on the assessment of companies, financial derivatives and analysis of financial statements.

In total, in 2018 more than 150 professionals from the economic-financial area devoted nearly 1,400 hours to training in specific content, highlighting, among other matters, risk management, taxation, financial management, accounting and budgeting.

F.2 Assessment of financial reporting risks

Provide information, at least, on the following:

F.2.1. What are the main characteristics in the risk identification process, including risks of error or fraudulent practices, with regard to:

▣ **If the process exists and it is documented.**

The approach used by Naturgy to carry out the financial reporting risk identification and analysis process is set out in three interrelated matrices:

- A matrix for defining the scope of the financial reporting.
- A matrix of risks associated with the financial reporting.
- A matrix of financial reporting control activities.

The matrix for defining the scope of the financial reporting has the object of identifying the accounts and breakdowns which have an associated significant risk, whose potential impact on financial reporting is material and therefore requires special attention. In this regard, a series of quantitative variables (account balance and variation) and qualitative variables (complexity of transactions; changes and complexity in standards; need to use estimates or forecasts; application of judgement and qualitative importance of the information) have been taken into account in the process of identifying accounts and significant breakdowns. The methodology for preparing the scope matrix has been outlined in a technical instruction entitled "Matrix for defining scope of financial reporting of Naturgy".

For each one of the accounts/significant breakdowns identified in the scope matrix, the critical processes and sub processes associated have been defined, and the risks which might give rise to errors in financial reporting have been identified, covering the objectives for the control of existence and occurrence; integrity; valuation; presentation, breakdown and comparability; and rights and obligations, in the "Risks matrix of financial reporting of Naturgy"

Within the risk identification process defined by Naturgy in its ICFR, problems relating to fraud have been considered to be a very important element. In this regard, the fraud risk control policy of Naturgy is supported by three basic pillars:

- Fraud prevention.
- Fraud detection.
- Investigation and management of fraud situations.

Preventive anti-fraud controls, from the perspective of financial reporting, have been defined, and are classified into two categories. Those called active controls, which are considered to be barriers for restricting or preventing access to valuable assets by persons who might attempt to commit fraud. On the other hand, passive controls aim to prevent fraud by way of dissuasive measures.

Lastly, both the general control activities as well as the process control activities, which consist of the policies and procedures included in all stages of the financial reporting process and which can assure its reliability, are set out in the “Matrix of activities of control for financial reporting in Naturgy”.

The ICFR of Naturgy is a dynamic system, so its periodic updating is a fundamental process to comply at all times with the goal of the same, viz., to ensure that the group's financial reporting is reliable. In particular, the definition matrix of the scope thereof is updated yearly.

- ▣ **If the process covers all the financial reporting objectives (existence and occurrence; integrity; assessment; presentation, breakdown and comparability; and rights and obligations), if it is updated and how frequently.**

Naturgy, being aware of the importance of having a tool to ensure adequate control of ICFR management, implemented, in 2013, the SAP GRC Process Control, for the comprehensive management of documentation, assessment and oversight of internal control in Naturgy processes. This implementation, which was performed within the framework of the programme for improving the efficiency of Naturgy, was initially carried out in all Spanish companies with majority shareholdings in which the company is held responsible for its operation and/or management. In 2014 the implementation of the SAP GRC Process Control tool was carried out in Colombia and in the Shared Economic and Financial Services Centre of Latin America; in 2015 the implementation was extended to other countries of the group, such as Mexico and France; in 2016 the tool was implemented in Holland, in 2017 in Panama and Brazil. For the implementation of SAP GRC Process Control, both within national and international level, users responsible for the key controls of the ICFR and of the Internal Auditing Unit have provided support.

It is noteworthy to mention that, during the year 2015, the scope of the corporate ICFR model was extended to the countries which have recently been included within the group, such as Chile, as a result of the acquisition in November 2014 of the Chilean group Compañía General de Electricidad, S.A. (CGE). Additionally, during 2018, this was extended to companies in Ireland that have a relevant presence in terms of the international commercialisation of LNG. These additions strengthen and reinforce internal control in Naturgy.

The ICFR model of Naturgy is integrated in SAP GRC Process Control, except for the scope definition matrix. This application identifies the General Environment Controls and the General Computer Controls, the critical processes, their associated risks and the control activities used to mitigate them, set out in the aforementioned risks matrices and controls. The units responsible for carrying out the control activities are also identified and integrated in the processes structure.

The benefits provided by the implementation of SAP GRC Process Control include the following:

- It centralises all the ICFR documentation and management of Naturgy in a uniform way.

- It integrates the internal control over financial reporting in business and corporate processes, allowing each responsible organisational unit to regularly assess its controls, providing the necessary evidence and, every year, execute the ICFR internal certification process.
- It uses work flows and forms for managing control activities, the documentation of evidence of the execution thereof and for the action plans.
- It allows documentary access to evidence of controls in respect of processes and viewing of the result of the assessment in a user-friendly and immediate way.
- It is a support tool for the ICFR supervision process by Internal Auditing.
- It allows both external and internal information required for reporting on the ICFR to be obtained and support.

After SAP GRC Process Control was started up in April 2013, the control evaluation requests have been performed in the following years according to the established schedules, whereby the units involved in ICFR were asked to provide evidence of the controls performed, in accordance with the frequency stipulated in each case. If applicable, this assessment allows weaknesses, and the actions plans necessary, to be identified and completed.

- **The existence of a process for the identification of the consolidation perimeter, taking into account, among other aspects, the possible existence of complex corporate structures, instrumental or special purpose entities.**

Part of the critical processes identified includes the process for identifying the consolidation perimeter of Naturgy and it has been described in a technical instruction called “Consolidated closing cycle of Naturgy”. Said document sets out the process for the monthly update of the perimeter, in accordance with the corporate operations of the period, and the units involved therein are defined. This process of identification and update of the perimeter is of fundamental importance for the drafting of the consolidated financial reporting of Naturgy.

- **If the process takes other types of risks into account (operating, technological, financial, legal, reputational, environmental, etc.) insofar as they affect the financial statements.**

The risks matrix has taken into account the risks associated with reaching the objectives of financial reporting, considering, in that identification, the effects of other kinds of risks (for example: operating, technological, financial, reputational, etc.) which form part of the Corporate Risk Map of Naturgy.

- **Which governing body of the company supervises the process.**

The Audit Committee is responsible for supervising the efficacy of the ICFR. In order to carry out this function, the Audit Committee uses the Internal Audit Unit (see section F.5).

F.3 Control activities

State, duly detailing their main characteristics, whether, at least, the following aspects exist:

F.3.1. Procedures for the review and authorisation of financial reporting, and the description of ICFR, to be published on the securities markets, indicating their supervisors, and the documentation which describes the flow of activities and controls (including those relating to risk of fraud) of the different types of transactions which can have a material impact on the financial statements, including the closing of accounts procedure and the specific review of relevant judgements, estimates, valuations and projection.

Naturgy conducts regular reviews of the financial information prepared and of the description in the ICFR according to the different levels of responsibility, guaranteeing the quality of this description.

As a first level of review, the persons responsible for the closing of accounts of each company of Naturgy review the financial reporting drawn up to ensure it is reliable.

Furthermore, the financial reporting of Naturgy is regularly reviewed by the head of the Financial Department, identifying possible deviations.

Ultimately, the Chief Financial Officer certifies the reasonability of the individual and consolidated annual accounts of Naturgy Energy Group, S.A. presented to the Board of Directors for approval.

Furthermore, as indicated in the “Internal Control System over Financial Reporting (ICFR) General Standard” of Naturgy, control activities defined by the group in its ICFR comply with the basic objective of ensuring that the financial reporting of Naturgy represents the true and fair image of the group.

The control activities defined in the ICFR include both general controls and controls in critical points.

While they do not allow a sufficient degree of control to be achieved over the group's processes, general controls are mechanisms that enable a series of key targets to be obtained for the achievement of an effective ICFR; in other words, they describe the policies and guidelines designed to protect Naturgy's ICFR in its entirety.

In addition, all the critical processes identified have been documented by means of the control activities matrix and by the pertinent descriptive technical descriptions of the processes. These critical processes, their associated risks and the control activities which mitigate them, as well as the descriptive documentation of the aforesaid processes, are identified in the ICFR management tool, SAP GRC Process Control. In this regard, Naturgy has identified all the processes necessary to draw up the financial information, using relevant judgements, estimates, valuations and forecasts, all of them being considered to be critical. The Audit Committee is regularly informed of the main hypotheses used to estimate the financial reporting which depends on relevant judgements, valuations and projections.

The following information has been included in the documentation included in SAP GRC Process Control of the critical processes and control activities:

- Process description.
- Process information flow chart.
- Map of systems which interact in the process.
- Description of financial reporting risks associated with the different processes and control objectives.
- Definition of control activities to mitigate risks identified and their attributes.
- Descriptions of persons responsible for processes and control activities.

The following classifications of control activities have also been identified in the definition of control activities, in accordance with the five following criteria:

- Scope: depending on the scope of the control activities, they can be divided into:
 - General control activities.
 - Processes control activities.

- Level of automation: depending on the level of automation of the control activities, they can be divided into automatic and manual.
- Nature of the activity: depending on the nature of the control activities, they can be divided into preventive or detection activities.
- Frequency: depending on the recurrence which the activity has over the course of time, for example: annual, weekly, monthly, daily, etc.

Lastly, the ICFR of Naturgy includes the definition of the annual internal certification model of the controls identified in the critical processes which have to be performed by the business and corporate units involved in the process of drawing up financial information. The Accounting Unit is responsible for launching and monitoring this certification process. In order to carry out this internal certification process, the units taking part use the functionalities integrated in the SAP GRC Process Control application for managing the ICFR of Naturgy (see section F.2.1).

The Internal Audit Unit is responsible for reviewing and assessing the conclusions regarding the compliance and effectiveness of the annual internal certifications process of the units which are responsible for carrying out the controls, to identify the weaknesses and action plans.

F.3.2. Internal control policies and procedures on information systems (inter alia, on access security, control of changes, operation thereof, operating continuity and separation of functions) which support the relevant processes of the company in drawing up and publishing financial information.

For the critical processes associated with the drawing up and publication of the financial reporting of Naturgy which have been defined in the ICFR of the group, the control activities which operate in information systems have been defined, both for those used directly in preparing their financial information and for those which are relevant in the process or control of the transactions included in it.

At general level, within the reporting systems map of Naturgy, a series of policies have been defined and implemented to guarantee the following aspects:

- Security of access to both data and applications.
- Control of changes in applications.
- Correct operation of applications.
- Availability of data and continuity of applications.
- Adequate separation of functions.
- The correct regulatory compliance (GDPR)

a) Secure access:

A series of measures have been defined at different levels to guarantee confidentiality and to prevent unauthorised access to data and/or applications. Most internal users are managed and authenticated in a centralised way in the OIM (Oracle Identity Manager) Directories, which ensure they remain confidential.

The company has two main data processing centres in Madrid, to facilitate availability of information systems in the event of any contingency. Only authorised staff is able to access those facilities, all accesses are registered, and they are subsequently inspected to check for any possible anomalies.

Communications with these systems include systems such as Firewall, IPS (Intrusion Prevention System) and antivirus to internally reinforce control against threats.

Moreover, the Company is currently working on the creation and updating of the BRS (Business Recovery Systems) of the main information systems, for the recovery of interrupted critical functions.

Lastly, at application, operating system and database level, the user-password combination is used as preventive control. At a data level, profiles have been defined that limit access thereto. Naturgy is developing a project for the definition and implementation of a users/roles/profiles matrix for the enhancement of the segregation of functions that ensures the procedures for access to systems and data.

b) Change control:

A change management methodology has been developed and implemented based on best practices, setting out the precautions and validations which are necessary to limit risk in that process.

Some of the main aspects it includes are as follows:

- Approval by the Technical Committee, Changes Committees and Business.
- Carrying out tests in the different environments before passing to production.
- Specific environments for the development and tests tasks.
- Roll-back procedures.
- Separation of functions in most of the environments between development and production teams.
- Monitoring and control in any phase of development.
- User manuals and training courses.
- Regular maintenance of changes documentation.

c) Operation:

To guarantee that operations are carried out correctly, monitoring is conducted at four levels:

- All interfaces between systems are monitored to ensure they are correctly executed.
- At perimeter level, there are different availability indicators to prevent interruptions in communications.
- Automatic validations on the data entered so that they are in line with expectations based on their nature, rank, etc.
- Of the infrastructures which support applications.

There is also an internal Help Desk service which final users can contact, and they also have a management tools at their disposal to report any kind of discrepancy.

d) Availability and continuity:

The majority of the systems have a high degree of local availability, and the servers thereof are situated in the same DPC, and in certain cases, in the support DPC for critical aspects. The high availability of information systems allows them to remain available should any incidents arise.

A backup copy of data is made regularly, and temporarily kept in a temporary secure location based on the legal requirements established for each system. The data are copied and stored in different locations, so preventing any loss of information. In order to restore these data there is a specific procedure, although tests are not carried out regularly.

e) Segregations of functions:

Access to the Information Systems is defined based on roles and profiles which define the functionalities to which a user must have access. These profiles are used to limit user access to Reporting Systems.

f) Regulatory compliance: GDPR

Naturgy complies with the provisions of Regulation (EU) 2016/679 of the European Parliament and the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and the free movement of such data, and with the provisions of Organic Law 3/2018, of 5 December, on the Protection of Personal Data and the guarantee of digital rights, as well as with the other provisions on data protection, to guarantee the protection of data of a personal nature of its directors, employees, customers, suppliers, shareholders, investors and other stakeholders.

Naturgy, when it is the data controller, performs as many actions as necessary to comply with the legislation on data protection, which include the following, for merely illustrative purposes:

- It processes personal data in a lawful, sincere and transparent manner.
- It collects data for specific, explicit and legitimate purposes.
- It minimises the data subject to processing.
- It updates the data, providing data subjects with simple systems for this update.
- It limits the data storage periods.
- It applies appropriate technical and organisational measures to guarantee the security, integrity and confidentiality of the data.
- It obtained the consent of the data subject for processing whenever necessary.
- It introduces simple and adequate mechanisms so that the data subject, directly or through their legal or voluntary representation, can exercise their rights pursuant to prevailing legislation.
- It chooses data processors that offer sufficient guarantees to apply appropriate technical and organisational measures so that data processing is carried out in compliance with the requirements of relevant legislation. In addition it signs agreement with these data processes through which the data processor will only process data in accordance with the instructions given by the data controller, and will not apply the data or use them for any purpose other than the one set out in this agreement, and will not disclose them, even for safeguarding purposes, to third parties.
- It keeps a record of data-processing activity.
- It carries out the impact assessments it deems appropriate.
- It has a collegiate body that acts as Data Protection Officer.

- It makes the appropriate queries with the Spanish Data Protection Agency (AEPD) in issues of international transfers of personal data.
- It performs audits to guarantee compliance with data protection regulations.

F.3.3. Internal control policies and procedures for supervising the management of activities subcontracted to third parties, and those assessment, calculation or valuation questions entrusted to independent experts, which could have a material impact on the financial statements.

Naturgy has developed a series of policies and procedures used to supervise the management of activities subcontracted to third parties, all of which are approved by the levels established in the group, which include a “General External Procurement Standard”, a “General Supplier Quality Standard” and the procedures which implement them, and the “Counterparty Due Diligence Procedure (corruption and reputational risks)”.

In this context, in the “General External Procurement Standard”, Naturgy sets out the general principles which have to be applied to all awarding or procurement of works, goods and services carried out by the group, guaranteeing a uniform, efficient and quality model for managing the procurement process in Naturgy.

This standard also establish, generally speaking, the responsibilities of the different units in the contracting process, which include the procurement department as the area responsible for promoting the creation of long-term relationships of trust and confidence with suppliers by establishing objective and impartial mechanisms of assessment and selection and ensuring that the supply chain complies with the principles provided for in the Supplier Code of Ethics, that the suppliers, as from 2016, must ratify and the terms of which are sourced from the Code of Ethics of Naturgy, from the Human Rights Policy, from the Health and Safety Policy, from the Anti-Corruption Policy, as well as from internationally recognised principles of good governance. The aforementioned standards create the obligation for the initial evaluation of all potential suppliers prior to the participation thereof within a procurement process, by which the Company evaluates, inter alia, legal, financial, quality, safety, environmental and corporate responsibility aspects, and also carries out the periodic evaluation thereof. In certain critical processes an additional level of control is required, that is referred to as “certification”, which is supported by documentary evidence and/or audits in order to secure the quality of the goods and services that are acquired.

For said purposes, Naturgy has developed, in the “General Supplier Quality Standard” and in the relevant procedures thereof, the basic principles that govern the evaluation and certification process of the suppliers of the group, which include the establishment of procedures and controls that guarantee the compliance of requirements set out in the specifications by potential suppliers and awarded contractors and furthermore also requires the certification of the suppliers of certain services or materials identified as of high risk (operating risk, legal risk, health and safety risk, quality risk, and environmental-social-governance risk). The approval process may unveil anomalies that lead to a plan of corrective actions, or the non-approval of the supplier, which would prevent such supplier from performing this activity for Naturgy.

Furthermore, the measurement of performance is carried out by means of satisfaction surveys of the service provided by suppliers that carry out high risk activities, with special attention on the health and safety aspects. The necessary corrective measures or action plans are established, as the case may be.

The main areas which affect the critical processes of the financial information which Naturgy has subcontracted to third parties are as follows:

- Certain processes of the Systems area.
- Reading and measuring processes.
- Certain customer service processes.
- Logistics operator.
- Payroll and staff management process.

- Works management and maintenance of the distribution business.
- Certain services to customers of the retail business.

Also, the Business Units carry out the supervision and quality control of its suppliers to determine if they offer the levels of quality required to the works. If not, they send the proposals for the withdrawal of certification/authorisation to suppliers/products/persons as a result of deficiencies in the performance of services or products.

Naturgy uses experts in works which are used for support to valuations, judgements or accounting calculations, only when they are registered in the corresponding Professional Colleges, or have an equivalent certification, show their independence and are companies which the market considers to be prestigious.

Naturgy has also defined the “Counterparty Due Diligence Procedure” which, in general terms, is designed to cover the main legal and reputational risks involved in business relations with third parties, and, in particular, covering misconduct associated with the risk of corruption.

The Internal Auditing Unit of Naturgy audits the processes and correct application of procurement and supplier quality standards and counterparty due diligence, and if breaches are detected then the pertinent corrective actions are taken.

F.4 Information and communication

State, duly detailing their main characteristics, whether, at least, the following aspects exist:

F.4.1. A specific function responsible for defining accounting policies (area or department of accounting policies), keeping them up to date, and resolving doubts or conflicts arising from their interpretation, keeping fluid communications with the persons responsible for operations in the organisation, as well as a manual of accounting policies which is up to date and communicated with the units through which the entity operates.

One of the responsibilities, inter alia, of the Financial Department, via the Accounting Planning Unit, is to keep the accounting policies applicable to the group up to date. In this regard, it is responsible for updating the “Naturgy Accounting Plan”, which includes the group's accounting criteria and accounts plan, and an analysis of the accounting changes which might have an impact on the financial reporting of Naturgy.

The “Naturgy Accounting Plan” is updated every year. Both the accounting criteria on the basis of changes in the IFRS-EU standards applicable and the group's accounting structure are reviewed in the updates, ensuring the traceability between the Individual Account Plans of the group's subsidiaries and the Accounting Plan of Naturgy, that constitutes the basis for the drafting of the different financial reporting to be provided to external bodies as well as the Management Control information.

Once the Accounting Plan is updated, it is disseminated to all the personnel of the organisation via the Naturgy Intranet. Furthermore, after the updated accounting plan is published on the Intranet, an on-line alert is sent to users who access the Intranet, thus informing all the staff of the update.

On the other hand, the Accounting Planning Unit is responsible for analysing the EU-IFRS regulations that might have a significant impact on financial statements and for reporting to the Naturgy management affected by any such regulatory changes. It is also entrusted with the task of resolving questions regarding the account entry of specific transactions that may be considered by those responsible for Naturgy financial reporting.

F.4.2. Mechanisms for the capture and preparation of financial information with uniform formats, applied and used by all units of the company or the group, used to support the main financial statements and the notes, as well as the information set out in detail on the ICFR.

The complete economic-financial management model of Naturgy guarantees that the administrative and accounting processes are uniform by means of centralising the administrative transactional and accounting processes and in Economic-Financial Shared Services Centres (CSCs) and the accounting in the Corporate

Accounting of Businesses the use of SAP as a support system in the majority of the companies which form part of the group. The other companies which do not use SAP are obliged to follow the criteria established by the group to ensure that such processes are uniform.

The most important features of the aforesaid model are as follows:

- It is unique for all countries and businesses;
- It includes the legal, fiscal, mercantile and regulatory requirements of the countries;
- It includes internal control requirements;
- It is used as a base for obtaining information furnished to senior management and to official bodies;
- It is supported by a certain organisational model and unique economic and financial reporting processes and systems for all countries and businesses.

The IFRS-EU financial statements of each country are obtained directly through the local account-group account assignment and the registration of IFRS-EU adjustments in the SAP application.

As part of the group ICFR, the interrelationships map of the process of drawing up financial information of Naturgy has been defined. The aforesaid map defines a number of things, including the reporting systems which take part in the process of drawing up and issue of financial information both from the standpoint of individual closing of accounts and the closing of the consolidated accounts.

Accordingly, in the processes of drawing up the financial reporting and its breakdowns of Naturgy, the SAP BPC application is used, which is a SAP application for managing the consolidation process.

The information is uploaded in the two systems automatically and directly, once the month is closed.

These two applications help in managing the consolidation process in tasks such as:

- Standardisation of the information.
- Validation of the information.

The preparation of the financial reporting is done centrally in Consolidation, which ensures the integration, uniformity, coherence and streamlining of Naturgy's financial statements.

Naturgy also has local accounts plans to comply with accounting, fiscal, mercantile and regulatory requirements established by the different laws of the countries in which it operates. Those local accounting plans are conflated into a group accounting plan, which is unified and homogeneous for the purposes of consolidation and reporting of financial information.

F.5 Supervision of the functioning of the system

Report on, duly detailing their main characteristics, at least

F.5.1. The supervision activities of the ICFR carried out by the Audit Committee and whether the company has an internal audit function which includes the responsibility of supporting the committee in its task of supervising the internal control system, including the ICFR. Information will also be provided on the scope of the assessment of ICFR carried out during the year and on the procedure through which the party responsible for carrying out the assessment notifies its results, if the company has an action plan with details of the possible corrective measures, and if its impact on financial information has been taken into account.

The Audit Committee has the powers that are provided for at Law, as well as the specific or general powers that are delegated upon it by the Board of Directors. The powers thereof include the following:

- Supervising the preparation process and integrity of the financial information related to the company and, where applicable, the group, reviewing compliance with the standard requirements, the appropriate definition of the consolidation perimeter and the correct application of the accounting criteria.
- Overseeing the effectiveness of the internal control of the Company, internal audit, and risk management systems, including tax risks, and discuss with the auditors the significant weaknesses of the internal control system detected during the carrying out of the audit.
- Notifying the General Shareholders' Meeting regarding the questions that are raised thereby in relation to the aspects for which the committee is responsible.
- Submitting to the Board of Directors proposals for the selection, appointment, re-election and replacement of the external auditor, as well as the conditions of their contracting and regularly collecting information on the audit plan and its execution, in addition to preserving its independence in the exercise of its functions.
- Establishing the appropriate relations with the accounts auditor to receive information on any issues which could jeopardise their independence, to be examined by the committee, and any other matters relating to the progress of the audit, as well as any communications required pursuant to legislation governing accounts auditing and auditing standards. In any event, the committee must receive, annually, from the external auditors the declaration of their independence in relation to any directly or indirectly related parties, as well as the information regarding the additional services of any type whatsoever provided thereby and the corresponding professional fees received from said entities by the external auditor or by the persons or related parties thereof, in accordance with the provisions of accounts audit legislation.
- Annually issue, prior to the issue of the audit report, a report giving an opinion on the independence of the auditors. This report shall in all cases include a valuation of the additional services provided, as referred to in the previous section, considered separately and in their entirety, consisting of services other than statutory audits and how they relate to the requirement of independence or to the regulatory legislation on auditing.
- Ensuring the independence of the unit handling the internal audit function; approve its priorities and work programmes, ensuring that it focuses primarily on the main risks the company is exposed to; receive regular reports on its activities; and verify that senior management is acting on the findings and recommendations of its reports. Propose to the Chairman of the Board of Directors the selection, appointment, re-election and removal of the person responsible for the internal audit service, as well as proposing the budget for that service, with the final decision corresponding to the Chairman of the Board of Directors

In order to be able to comply with its responsibilities, the Audit Committee has the information and documentation provided by the Internal Audit and the Financial Department.

The internal audit function is established in Naturgy as a means of independent and objective assessment and for this reason the Internal Audit Area, reports to the Audit Committee of Naturgy Energy Group S.A.

It has the task of guaranteeing the continuous review and improvement of the group's internal control system, as well as safeguarding compliance with external and internal norms and the Control Models established in order to safeguard the efficacy and efficiency of operations, and to mitigate the main risks in each one of the fields in which the group operates, in particular the operational, corruption, fraud and legal risks. Likewise, it is responsible for the report of the internal audit activity to the Audit Committee.

In the performance of its activity, Internal Auditing methodically reviews the internal control system of the group's processes in all areas, and also assesses the operational risks and controls associated to these processes, (including

those established in the ICFR and in the Crime Prevention Model), through definition and execution of the Annual Internal Audit Plan, to improve efficacy and efficiency of these. It also provides support to the divisions in achieving their objectives.

The overall aim is to safeguard the efficacy and efficiency of operations and mitigate the main risks in each sphere of Naturgy, in particular the operational, corruption, fraud and legal risks.

The Strategic Audit Plan (with a time frame of five years) and the Annual Internal Audit Plans are drawn up principally on the basis of the Corporate Strategic Plan, the risk areas included in the Corporate Risk Map, the Internal Control System over Financial Reporting (ICFR) scope matrix, the operational risk maps, the results of previous years' audits and the proposals from the Audit Committee and from top-tier management.

In accordance with the Strategic Audit Plan, the ICFR of Naturgy is fully supervised by the Internal Auditing the period of five years.

The methodology for the assessment of operational risks is in accordance with best corporate governance practices, based on the conceptual framework of the COSO Report (Committee of Sponsoring Organisations of the Treadway Commission) and on the basis of the types of risks defined in the company's Corporate Risk Map.

The operational risks associated with the processes are prioritised by assessing their incidence, relative importance and degree of control. Depending on the findings, the company designs an action plan with corrective measures that enable mitigation of residual risks identified with a potential impact above the tolerable or accepted risk established.

Internal Auditing is supported by the implementation of a SAP environment corporate application which it uses to manage and document internal audit projects in accordance with the defined methodology.

More specifically and with regard to the Internal Control System on Financial Reporting (ICFR), Internal Auditing is in charge of:

- Validating the proper design of the ICFR, based on the basic principles of the model approved by the Audit Committee.
- Supervising the efficacy and adaptation of control policies and procedures put in place (in full over five years).
- Revising and assessing of conclusions on compliance and effectiveness of the ICFR resulting from the internal certifications of the business and corporate units in charge of the controls (in full over five years).
- Assessing and communicating the results obtained in the process of supervising the Internal Control System on Financial Reporting (ICFR) and the controls of the ICFR processes.

With regard to the Crime Prevention Model, the Internal Audit Area is in charge of its annual supervision to make reasonably sure that the model is efficient and effective at preventing, identifying or mitigating the occurrence of crimes provided for under applicable legislation.

The main processes revised by the Internal Audit in 2018 were as follows:

- Gas networks: construction of networks, household operations, regular inspection, emergency care and contracting access to the network.

- Electricity grids: development of high voltage grid, irregularities and fraud management, high voltage grid maintenance, claims management and logistics.
- Generation: operation and management of generation assets, warehouse management, development and commissioning of new projects.
- Commercialisation (gas, electricity and services): collection and contracting of energy facilities, construction and commissioning of energy facilities, collection and contracting of industrial customers
- LNG: Vayu processes review.
- Exploration and production: exploration and production.
- Energy management: management and optimisation of gas logistics, demand estimation and gas purchase.
- Customer service: collection, debt management, customer service.
- Physical resources management: supplier monitoring and certification.
- Management of internal control: follow-up of corrective actions, ICFR, general data protection regulation.
- Management of information systems: information security, cloud systems management.
- Human resources management: administration and human resources services, DPO.
- Communication management and external relationships: foundations, corporate responsibility, sponsorships.
- Management of financial and physical resources: treasury stock, economic-administrative management of operations.
- Legal advice and support: powers of attorney.
- Technology and engineering management engineering.
- Review of the group's regulatory system.
- Code of Ethics.
- Crime Prevention Model.

36% of the reviewed processes correspond to Spain and the remaining 64% to the international sphere.

Controls on the above processes relating to the Financial Information, were reviewed in accordance with the work methodology described above.

F.5.2. If the company has a discussion procedure through which the accounts auditor (as established in the TAS), the internal audit function and other experts can inform the company senior management and the Audit Committee or administrators of significant weaknesses in internal control identified during the annual accounts review processes or others which might have been entrusted to them. The company shall also state whether it has an action plan to try to correct or mitigate the weaknesses observed.

As established in Article 6 of the Regulation of the Board:

The Board shall meet six times a year and, on the Chairman's initiative, as many times as he/she considers it appropriate for the smooth running of the company or requests at least one third of Directors.

The members of the Board of Directors, in order to obtain the information necessary for them to carry out their duties, shall be aided by the Audit Committee, whose duties include the knowledge and supervision of the process for drawing up regulated financial information, and the efficacy of the internal control system.

In accordance with the Articles of Association and Regulations of the Board of Directors and of its Committees, the Audit Committee shall comprise a minimum of three and a maximum of seven directors appointed by the Board of Directors from among the non-executive directors, and at least one of them will be assigned with taking into account their knowledge and experience in issues of accountancy, audit and risk management. Its members shall leave their post when they do so in their capacity as Directors or as agreed by the Board of Directors. The majority of the committee members will be an independent director. At 31 December 2018, the committee was made up of seven Directors, three proprietary and four independent; and one of the latter, in turn, was the Chairman.

The Board of Directors shall elect the Chairman from among the members of the Committee; the Chairman shall not have the casting vote. The Secretary of the Committee shall be the same as the Secretary of the Board of Directors.

The committee shall hold meetings whenever necessary in order to issue its reports, and will be convened by its Chairman on his own initiative or upon request of two of its members. At least four meetings per year must be held. The committee may invite to its meetings any executive or employee it deems appropriate.

The sphere of activity of the Audit Committee extends to:

- Naturgy Energy Group S.A.
- Companies that are majority-owned by Naturgy Energy Group S.A.
- Other entities and companies for which Naturgy Energy Group S.A. has in some form the effective control or responsibility for management or operation.

The Internal Audit Unit regularly reports to the Audit Committee on the actions taken to ensure that Naturgy complies with all the policies, standards and controls of the processes established by the top-tier Management of the group.

They also present:

- The Annual Internal Audit Plan for the committee's approval.
- The degree of execution of the Internal Audit Plan and the main conclusions and recommendations included in the Internal Audit Reports.
- The assessment of the efficacy of the Control System and assessment of operational and Internal Control risks of Naturgy (including those referring to ICFR and to the Crime Prevention Model), including the corresponding Action Plans to improve the level of internal control.
- The level of implementation by the audited units of the corrective measures appearing in the Auditor's Reports, in particular those proposed by the Audit Committee.

The external auditor informs the Audit Committee of the weaknesses in internal control detected during the audit. The external auditors also report on the main conclusions they have reached in the review of internal control, regarding the risks assessment and action plans.

Finally, the external auditor, in addition to meeting periodically with the Audit Committee, also meets with the Board of Directors in plenary session before the latter formulates the Annual Accounts.

F.6 Other relevant information.

As indicated in section F.3.1. above, as part of the model for the assessment of the Internal Control System over Financial Reporting of Naturgy, it has been decided to carry out an annual internal certification process whereby, through SAP GRC Process Control, the Business and Corporate Units which are involved in the process of drawing up financial reporting guarantee that the identified controls are applied within their processes and that they are valid and sufficient. They also inform the Financial Control Accounting Unit of weaknesses and/or shortcomings detected and of changes arising in their processes so as to assess if they need to develop new controls or modify existing ones.

During the 2018 year, Naturgy carried out the annual internal certification process, whereby changes were identified in a limited number of processes. Importantly, those changes did not necessitate a modification of the control activities previously identified, so that the risks associated with the preparation and reporting of financial reporting were considered to be covered in the critical processes affected. The main items of this process were as follows:

	Spain	International	Total
Business and corporate units	132	167	299
Processes identified	54	154	208
Controls certified	837	1,29	2,136

Action plans were also identified due to weaknesses in evidence of controls, which amounted to 35, 4 of which were in Spain. During 2018, 56% of the action plans identified in 2017 were resolved, and new plans arose during 2018. In any event, the subprocesses affected by the aforesaid action plans do not have a significant impact on the quality of financial reporting.

F.7 Report of the external auditor**State:**

F.7.1. If the ICFR information submitted to the markets has been reviewed by the external auditor, in which case the company will have to include the corresponding report as an annex. Otherwise, it will have to explain why.

Naturgy has deemed it pertinent to ask the external auditor to issue a report referring to the information on the Internal Control System over Financial Reporting (ICFR).

G. Degree of compliance with the corporate governance recommendations

State the degree of compliance of the company in respect of the recommendations regarding the Good Governance Code of Listed Companies.

If any recommendations are not followed or are followed partially, it will be necessary to include a detailed explanation of the reasons why so that the shareholders, investors and the market in general, have sufficient information to be able to assess the company's actions. General explanations are not acceptable.

1. The Articles of Association of listed companies should not limit the maximum number of votes that can be issued by the same shareholder or contain other restrictions that prevent the company from being taken over through the purchase of its shares on the market.

Compliant Explain

2. When the parent company and the subsidiary are listed, they must both publicly define the following in detail:
 - a) The respective areas of activity and possible business relationships between them, as well as those of the listed subsidiary with the remaining group companies;

b) The mechanisms in place to solve possible conflicts of interest that may occur.

Compliant Partially compliant Explain Not applicable

3. During the annual general meeting the Chairman of the Board should verbally inform shareholders in sufficient detail of the most relevant aspects of the company's corporate governance, supplementing the written information circulated in the annual corporate governance report. In particular:

a) Changes taking place since the previous annual general meeting.

b) The specific reasons for the company not following a given Good Governance Code recommendation, and any alternative procedures followed in its stead.

Compliant Partially compliant Explain

4. The company should draw up and implement a policy of communication and contacts with shareholders, institutional investors and proxy advisers that complies in full with market abuse regulations and accords equitable treatment to shareholders in the same position.

This policy should be disclosed on the company's website, complete with details of how it has been put into practice and the identities of the relevant interlocutors or those charged with its implementation.

Compliant Partially compliant Explain

5. The Board of Directors should not make a proposal to the general meeting for the delegation of powers to issue shares or convertible securities without pre-emptive subscription rights for an amount exceeding 20% of capital at the time of such delegation.

When the Board approves the issuance of shares or convertible securities without pre-emptive subscription rights, the company should immediately post a report on its website explaining the exclusion as envisaged in company legislation.

Compliant Partially compliant Explain

6. Listed companies drawing up the following reports on a voluntary or compulsory basis should publish them on their website well in advance of the ordinary general meeting, even if their distribution is not obligatory:

a) Report on auditor independence.

b) Reports of the operation of the Audit Committee and the Appointments and Remuneration Committee.

c) Audit Committee report on related party transactions.

d) Report on corporate social responsibility policy.

Compliant Partially compliant Explain

7. The company should broadcast its general meetings on the corporate website.

Compliant Explain

8. The Audit Committee should strive to ensure that the Board of Directors can present the company's accounts to the General Shareholders' Meeting without limitations or qualifications in the auditor's report. In the exceptional case that qualifications exist, both the Chairman of the Audit Committee and the auditors should give a clear account to shareholders of their scope and content.

Compliant Partially compliant Explain

9. The company should disclose its conditions and procedures for admitting share ownership, the right to attend General Shareholders' Meetings and the exercise or delegation of voting rights, and display them permanently on its website

Such conditions and procedures should encourage shareholders to attend and exercise their rights and be applied in a non-discriminatory manner.

Compliant Partially compliant Explain

10. When an accredited shareholder exercises the right to supplement the agenda or submit new proposals prior to the General Shareholders' Meeting, the company should:

- a) Immediately circulate the supplementary items and new proposals.
- b) Disclose the model of attendance card or proxy appointment or remote voting form duly modified so that new agenda items and alternative proposals can be voted on in the same terms as those submitted by the Board of Directors.
- c) Put all these items or alternative proposals to the vote applying the same voting rules as for those submitted by the Board of Directors, with particular regard to presumptions or deductions about the direction of votes.
- d) After the general meeting, disclose the breakdown of votes on such supplementary items or alternative proposals.

Compliant Partially compliant Explain Not applicable

11. In the event that the company plans to pay for attendance at the General Shareholders' Meeting, it should establish a general, long-term policy in this respect.

Compliant Partially compliant Explain Not applicable

12. The Board of Directors should perform its duties with unity of purpose and independent judgement, affording the same treatment to all shareholders in the same position. It should be guided at all times by the company's best interests, understood as the creation of a profitable business that promotes its sustainable success over time, while maximising its economic value.

In pursuing the corporate interest, it should not only abide by laws and regulations and conduct itself according to principles of good faith, ethics and respect for commonly accepted customs and good practices, but also strive to reconcile its own interests with the legitimate interests of its employees, suppliers, clients and other stakeholders, as well as with the impact of its activities on the broader community and the natural environment.

Compliant Partially compliant Explain

13. **The Board of Directors should be of an optimal size to promote its efficient functioning and maximise participation. The recommended range is accordingly between five and fifteen members.**

Compliant Explain

14. **The Board of Directors should approve a director selection policy that:**

- a) **Is concrete and verifiable.**
- b) **Ensures that appointment or re-election proposals are based on a prior analysis of the Board's needs.**
- c) **Favours a diversity of knowledge, experience and gender.**

The results of the prior analysis of Board needs should be written up in the Appointments Committee's explanatory report, to be published when the General Shareholders' Meeting is convened that will ratify the appointment and re-election of each director.

The director selection policy should pursue the goal of having at least 30% of total Board places occupied by female directors before the year 2020.

The Appointments Committee should run an annual check on compliance with the director selection policy and set out its findings in the annual corporate governance report.

Compliant Partially compliant Explain

The policy for the selection of directors ensures that the selection procedures do not suffer from implicit biases that may imply any discrimination, within the framework of full respect for the right of proportional representation of the shareholders recognised in Law. The policy for the selection of directors is aimed at ensuring adequate diversity in the composition of the Board of Directors, which has led to Board members responding to professional profiles and different and complementary career paths among themselves, based on the conviction that said diversity results in better performance of the Board. Within this framework, the Board pays attention to issues of gender diversity. Although the goal of having females represent one third of the board by 2020 has not been made explicit, the Board is firmly committed to the principle of diversity in its composition in all its manifestations, and has made proposals for the incorporation of new directors following the recommendations of profiles resulting from the self-assessment exercise assisted by the independent external consultant.

Although the Company shares the willingness to increase the presence of females on the Board up to at least 30%, it has been considered that the non-critical follow-up of the recommendation -and without taking into account the other legal considerations- could result in an undue restriction in the exercise of the functions of the Appointments and Remuneration Committee. This is because it could be counterproductive, in order to obtain the designation of the best possible candidate, to not even consider male profiles for the appointment as independent directors (irrespective of whether or not they are finally chosen).

15. **Proprietary and independent directors should constitute an ample majority on the Board of Directors, while the number of executive directors should be the minimum practical bearing in mind the complexity of the corporate group and the ownership interests they control.**

Compliant Partially compliant Explain

16. The percentage of proprietary directors out of all non-executive directors should not be greater than the proportion between the ownership stake of the shareholders they represent and the remainder of the company's capital.

This criterion can be relaxed:

- a) In large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings.
- b) In companies with a plurality of shareholders represented on the board but not otherwise related.

Compliant Explain

17. Independent directors should be at least half of all Board members.

However, when the company does not have a large market capitalisation, or when a large cap company has shareholders individually or concertedly controlling over 30% of capital, Independent directors should occupy, at least, a third of Board places.

Compliant Explain

As of 31 December 2018, more than one third of the directors hold the status of independent, although the Company cannot be qualified as low capitalisation and nor does it have shareholders who jointly and control more than 30% of the capital. Here, it must be taken into account that the Company has three shareholders who do not act in concert and who have a shareholding equal to or greater share than 20%, and that their representation on the Board of Directors is in line with the principle of proportional representation. On the other hand, it should be noted that the establishment of enhanced majorities for certain matters has allowed blocking capacity for all independent directors as a whole.

Respect for prevailing legislation and the special shareholder configuration of the Company mean that, for legal reasons, this recommendation cannot be complied with if shareholders with more than 8.33% of the share capital wish to exercise their right to proportional representation, which is the case. Current legislation establishes the principle of proportional representation, for which reason the Company is obliged to guarantee respect for the legitimate exercise of that right by its shareholders.

At present, the number of independent directors is 5 out of a total of 12 directors, in other words, they represent 41.6% of the directors. As a whole, the significant shareholders of the Company hold 65.62% of the capital and have proposed 50% of the directors (in total 6 out of 12). While this is maintained, out of respect for the legal mandate of proportionality, the number of independent directors cannot be equal to half of the total number of directors. In any case, the figure of five, apart from quantitatively being the one according to the law, has qualitative relevance: a modification of the Board Regulations has established that, for matters of greater relevance, an enhanced majority of more than two thirds is required, which amounts to a possibility of blocking the set of independent directors.

18. The companies should publish the following information about their directors on their website and keep the said information up-to-date:

- a) Background and professional experience.
- b) Directorships held in other companies, listed or otherwise, and other paid activities they engage in, of whatever nature.
- c) Statement of the director class to which they belong; in the case of proprietary directors indicating the shareholder they represent or have links with.

d) Dates of their first appointment as a Board member and subsequent re-elections.

e) Shares held in the company, and any options on the same

Compliant Partially compliant Explain

19. The annual corporate governance report, with prior verification by the Appointments Committee is to provide an explanation for the reasons proprietary directors were appointed at the behest of shareholders whose stake in the company is less than 3% of share capital, and reasons given for the rejections of formal requests for board representation from shareholders whose equity interest is equal to or greater than that of other shareholders who have successfully requested the appointment of proprietary directors.

Compliant Partially compliant Explain Not applicable

20. Proprietary directors are to submit their resignation when the shareholder whom they represent fully disposes of their stake. They should also present their resignation, in the corresponding number, when the said shareholder lowers his/her shares in the company to a level that requires a reduction in the number of his/her proprietary directors.

Compliant Partially compliant Explain Not applicable

21. The Board of Directors should not propose the removal of independent directors before the expiry of their tenure as mandated by the Articles of Association, except where just cause is found by the board, based on a report from the Appointments Committee. In particular, it shall be understood that there is just cause when the director takes on new offices or assumes new obligations that prevent them from devoting the time necessary to perform the duties of the office of director, breaches the duties inherent to their position or is affected by one of the circumstances that cause them to lose their independent status in accordance with the provisions of applicable law.

The removal of independent directors may also be proposed as a consequence of offers for the takeover, merger or similar corporate actions affecting the company that may involve a change in the company's capital structure, whenever such changes in the Board of Directors arise under application of the proportionality criterion pointed out in Recommendation 16.

Compliant Explain

22. Companies are to stipulate rules obliging directors to inform of and, as the case may be, resign in situations that may harm the credit and reputation of the company. In particular, they are to inform the Board of Directors of any criminal cases for which they are under indictment, and of their subsequent legal proceedings.

The moment a director is indicted or tried for any of the offences stated in company legislation, the Board of Directors should open an investigation and, in light of the particular circumstances, decide whether or not he or she should be called on to resign. The Board of Directors should give a reasoned account of all such determinations in the annual corporate governance report.

Compliant Partially compliant Explain

23. All directors are to clearly express their opposition when they consider that any proposal subject to the decision of the Board of Directors may be detrimental to corporate interests. The independent directors and other directors who are not affected by the potential conflict of interest are to voice their opposition in a special manner whenever such decisions may be of detriment to shareholders not represented on the Board of Directors.

When the Board makes material or reiterated decisions about which a director has expressed serious reservations, then he or she must draw the pertinent conclusions. Directors resigning for such causes should set out their reasons in the letter referred to in the next recommendation.

The terms of this recommendation also apply to the secretary of the board, even if he or she is not a director.

Compliant Partially compliant Explain Not applicable

- 24. Directors who give up their place before their tenure expires, through resignation or otherwise, should state their reasons in a letter to be sent to all members of the Board. Whether or not such resignation is disclosed as a material event, the motivating factors should be explained in the annual corporate governance report.**

Compliant Partially compliant Explain Not applicable

- 25. The Appointments Committee should ensure that non-executive directors have sufficient time available to discharge their responsibilities effectively.**

The Board of Directors regulations should lay down the maximum number of company boards on which directors can serve.

Compliant Partially compliant Explain

Owing to the high level of participation and attendance at the sessions of the governing bodies by the members of the Board, to date the company has not established any rules on the number of Boards on which the said directors can sit without prejudice to the fact that the proper functioning of the Board of Directors has been confirmed, both in terms of the number of meetings, which have exceeded those recommended, and in qualitative terms.

- 26. The Board should meet with the necessary frequency to properly perform its functions, eight times a year at least, in accordance with a calendar and agendas set at the start of the year, to which each director may propose the addition of initially unscheduled items.**

Compliant Partially compliant Explain

In accordance with article 17 of the Board Regulations, the Chairman of the Board of Directors is responsible for promoting and directing the Company's activities. In the exercise of these powers, the Company understands that it corresponds essentially to the Chairman of the Board, or whoever acts as such, to establish the items on the agenda of its meetings. Likewise, one third of the directors may propose other items on the agenda that were initially not provided for.

The reason why this number of directors is established for the inclusion of items on the agenda has to do with the need to reconcile the breadth of management functions held by the Board of Directors within the realm of the Company with the need to streamline and facilitate its operation, with a view to ensuring diligent management of the Company. Thus, the Executive Committee has been removed in such a way that the Board has assumed a very significant number of functions, which fully affects the workload of the Board. That is why it is considered appropriate that, given this abundant workload, the Board focuses on the analysis of those issues in addition to the exhaustive ordinary list around which there is a minimum degree of consensus, which would be that of four directors. This number is relevant, since it allows independent directors to make proposals through this channel or through the coordinating director, whilst limiting the power of individual proposal of the set of proprietary directors representing a significant shareholder, so that the proprietary directors corresponding to a significant shareholder cannot impose an item on the agenda on their own.

27. Director absences should be kept to a strict minimum and quantified in the annual corporate governance report. In the event of absence, directors should delegate their powers of representation with the appropriate instructions.

Compliant Partially complian Explain

Regarding the issue of voting instructions, the Company considers that 100% compliance with this recommendation is not necessarily optimal since there may be justification for the represented party not to grant specific instructions to the representative, as it deems it more appropriate to vote during the debate on the Board of Directors.

28. When directors or the secretary express concerns about some proposal or, in the case of directors, about the company's performance, and such concerns are not resolved at the meeting, they should be recorded in the minute book if the person expressing them so requests.

Compliant Partially complian Explain Not applicable

29. The company should provide suitable channels for directors to obtain the advice they need to carry out their duties, extending if necessary to external assistance at the company's expense.

Compliant Partially complian Explain

30. Regardless of the knowledge directors must possess to carry out their duties, they should also be offered refresher programmes when circumstances so advise.

Compliant Explain Not applicable

31. The agendas of Board meetings should clearly indicate on which points directors must arrive at a decision, so they can study the matter beforehand or gather together the material they need.

For reasons of urgency, the Chairman may wish to present decisions or resolutions for Board approval that were not on the meeting agenda. In such exceptional circumstances, their inclusion will require the express prior consent, duly reported/recorded in the minutes, of the majority of directors present.

Compliant Partially complian Explain

32. Directors should be regularly informed of movements in share ownership and of the views of major shareholders, investors and rating agencies on the company and its group.

Compliant Partially complian Explain

33. The Chairman, as the person charged with the efficient functioning of the Board of Directors, in addition to the functions assigned by law and the company's Articles of Association, should prepare and submit to the Board a schedule of meeting dates and agendas; organise and coordinate regular evaluations of the Board and, where appropriate, the company's Chief Executive Officer; exercise leadership of the Board and be accountable for its proper functioning; ensure that sufficient time is given to the discussion of strategic issues, and approve and review refresher courses for each director, when circumstances so advise.

Compliant Partially complian Explain

34. When a lead independent director has been appointed, the Articles of Association or Board of Directors regulations should grant him or her the following powers over and above those conferred by law: chair the Board of Directors in the absence of the Chairman or Deputy Chairmen, give voice to the concerns of non-executive directors; maintain contacts with investors and shareholders to hear their views and develop a balanced understanding of their concerns, especially those that have to do with the company's corporate governance; and coordinate the chairman's succession plan.

Compliant Partially compliant Explain Not applicable

The coordinating director has all the recommended functions attributed, except for the relationship with investors.

35. The Board secretary should strive to ensure that the Board's actions and decisions are informed by the governance recommendations of the Good Governance Code of relevance to the company.

Compliant Explain

36. The Board in full should conduct an annual evaluation, adopting, where necessary, an action plan to correct weakness detected in:

- a) The quality and efficiency of the Board's operation.
- b) The performance and membership of its committees.
- c) The diversity of Board membership and competences.
- e) The performance of the Chairman of the Board of Directors and the company's chief executive.
- f) The performance and contribution of each director, with particular attention to the Chairmen of Board Committees.

The evaluation of Board Committees should start from the reports they send to the Board of Directors, while that of the Board itself should start from the report of the Appointments Committee.

Every three years, the Board of Directors should engage an external facilitator to aid in the evaluation process. This facilitator's independence should be verified by the Appointments Committee.

Any business dealings that the facilitator or members of its corporate group maintain with the company or members of its corporate group should be detailed in the annual corporate governance report.

The process followed and areas evaluated should be detailed in the annual corporate governance report.

Compliant Partially compliant Explain Not applicable

37. When an executive committee exists, its membership mix by director class should resemble that of the Board. The secretary of the Board should also act as secretary to the executive committee.

Compliant Partially compliant Explain Not applicable

38. The Board should be kept fully informed of the business transacted and decisions made by the executive committee. To this end, all Board members should receive a copy of the committee's minutes.

Compliant Partially compliant Explain Not applicable

39. All members of the Audit Committee, particularly its Chairman, should be appointed with regard to their knowledge and experience in accounting, auditing and risk management matters. A majority of committee places should be held by independent directors.

Compliant Partially compliant Explain

40. Listed companies should have a unit in charge of the internal audit function, under the supervision of the Audit Committee, to monitor the effectiveness of reporting and control systems. This unit should report functionally to the Board's non-executive chairman or the Chairman of the Audit Committee.

Compliant Partially compliant Explain

The Internal Audit Department supervises, among others, the proper functioning and internal control on behalf of the Executive Chairman, through the Financial Department. Supervision of the performance of the Internal Audit Department corresponds to the Audit Committee, so that it reports its activities to said Committee, which also authorises its annual budget and proposes the remuneration targets of the Internal Audit Director. Likewise, the Audit Committee, together with the Appointments and Remuneration Committee, is responsible for assessing the annual performance of the Audit Director, for the purpose of remuneration.

41. The head of the unit handling the internal audit function should present an annual work programme to the Audit Committee, inform it directly of any incidents arising during its implementation and submit an activities report at the end of each year.

Compliant Partially compliant Explain Not applicable

42. The Audit Committee should have the following functions over and above those legally assigned:

1. With respect to internal control and reporting systems:

- a) Supervising the preparation process and integrity of the financial information related to the company and, where applicable, the group, reviewing compliance with the standard requirements, the appropriate definition of the consolidation perimeter and the correct application of the accounting criteria.
- b) Monitor the independence of the unit handling the internal audit function; propose the selection, appointment, re-election and removal of the head of the internal audit service; propose the service's budget; approve its priorities and work programmes, ensuring that it focuses primarily on the main risks the company is exposed to; receive regular report-backs on its activities; and verify that senior management is acting on the findings and recommendations of its reports.
- c) Establish and supervise a mechanism whereby staff can report, confidentially and, if appropriate and feasible, anonymously, any significant irregularities that they detect in the course of their duties, in particular financial or accounting irregularities.

2. With regard to the external auditor:

- a) In the event of resignation of any external auditor, the Committee should investigate the issues giving rise to the resignation.
- b) Ensure that the remuneration of the external auditor does not compromise its quality or independence.
- c) Ensure that the company notifies any change of external auditor to the CNMV as a material event, accompanied by a statement of any disagreements arising with the outgoing auditor and the reasons for the same.

- d) Ensure that the external auditor has a yearly meeting with the Board in full to inform them of the work undertaken and developments in the company's risk and accounting positions.
- e) Ensure that the company and the external auditor adhere to current regulations on the provision of non-audit services, limits on the concentration of the auditor's business and other requirements concerning auditor independence.

Compliant Partially compliant Explain

43. The Audit Committee should be empowered to meet with any company employee or manager, even ordering their appearance without the presence of another senior officer.

Compliant Partially compliant Explain

44. The Audit Committee should be informed of any fundamental changes or corporate transactions the company is planning, so the committee can analyse the operation and report to the Board beforehand on its economic conditions and accounting impact and, when applicable, the exchange ratio proposed.

Compliant Partially compliant Explain Not applicable

45. The risk control and management policies should identify at least:

- a) The different types of financial and non-financial risk the company is exposed to (including operational, technological, financial, legal, social, environmental, political and reputational risks), with the inclusion under financial or economic risks of contingent liabilities and other off-balance-sheet risks.
- b) The level of risk considered acceptable by the company.
- c) The measures laid down to reduce the impact of the risks that are identified should they occur.
- d) Internal control and information systems which shall be used to control and manage the foregoing risks, including the contingent liabilities or off-balance sheet risks.

Compliant Partially compliant Explain

The Company has a risk control and management system supervised by the Audit Committee, which results in a risk map that pools together the main risk factors and defines both the overall risk profile and those responsible for determining the risk limits. At its meeting on 6 February 2018, the Board of Directors consolidated the essential aspects of the risk control and management system.

46. That under the direct supervision of the Audit Committee or, as the case may be, of a specialized committee of the Board of Directors, there is an internal function of control and risk management exercised by a unit or internal department of the company that has been assigned expressly the following functions:

- a) Ensure the proper functioning of the risk management and control systems and, in particular, that all important risks affecting the company are identified, managed and quantified adequately.
- b) Participate actively in the preparation of risk strategies and in key decisions about their management.

- c) **Ensure that risk control and management systems mitigate risks adequately within the framework of the policy defined by the Board of Directors.**

Compliant Partially compliant Explain

47. **Members of the Appointments and Remuneration Committee - or of the Appointments Committee and Remuneration Committee, if separately constituted - should have the right mix of knowledge, skills and experience for the functions they are called on to discharge. The majority of their members should be independent directors.**

Compliant Partially compliant Explain

48. **Large cap companies should operate separately constituted Appointments Committees and Remuneration Committees.**

Compliant Explain Not applicable

The Company believes that, at least in its case, it is neither necessary nor effective to separate the powers of the Appointments and Remuneration Committee into two Committees, one of Appointments and the other of Remuneration. The existence of a single Committee does not harm or limit the exercise of the powers granted by law to the Appointments and Remuneration Committee, which also allows the Company to optimize costs insofar as this avoids the accrual of additional remuneration to the directors called to be part of the two split committees. Furthermore, the Company considers that such splitting could be counterproductive, given that for the Company the presence of a significant number of independent directors on the Board Committees is relevant. Given the restrictions on the number of independent directors imposed under prevailing legislation in application of the principle of proportional representation, the number of independent directors on the Board of Directors is currently five. In order for there to be a significant number of independent directors on the two separate Committees, in addition to the Audit Committee (where they must be the majority by legal provision), an overload of work derived from a new Committee would be imposed on said directors.

49. **The Appointments Committee should consult with the Chairman of the Boards of Directors and Chief Executive Officer, especially on matters relating to executive directors.**

When there are vacancies on the Board, any director may approach the Appointments Committee to propose candidates that it might consider suitable.

Compliant Partially compliant Explain

50. **The Remuneration Committee should operate independently and have the following functions in addition to those assigned by law:**

- a) **Propose to the Board the standard conditions for senior executives contracts.**
- b) **Monitor compliance with the remuneration policy set by the company.**
- c) **Periodically review the remuneration policy for directors and senior executives, including share-based remuneration systems and their application, and ensure that their individual compensation is proportionate to the amounts paid to other directors and senior executives in the company.**
- d) **Ensure that conflicts of interest do not undermine the independence of any external advice the committee engages.**

- e) Verify the information on remuneration of directors and senior executives contained in the various corporate documents, including the Annual Report on Directors' Remuneration.

Compliant Partially compliant Explain

51. The Remuneration Committee should consult the company's Chairman and chief executive, especially with regard to business concerning the executive directors and senior executives.

Compliant Partially compliant Explain

52. The terms of reference of supervision and control committees should be set out in the Board of Directors regulations and aligned with those governing legally mandatory Board Committees as specified in the preceding sets of recommendations. They should include at least the following terms:

- a) Committees should be formed exclusively by non-executive directors, with a majority of independents.
- b) Committees should be chaired by an Independent director.
- c) The Board should appoint the members of such committees with regard to the knowledge, skills and experience of its directors and each committee's terms of reference; discuss their proposals and reports; and provide report backs on their activities and work at the first board plenary following each committee meeting.
- d) They may engage external advice, when they feel it necessary for the discharge of their functions.
- e) Meeting proceedings should be recorded/notified in the minutes and a copy made available to all Board members.

Compliant Partially compliant Explain Not applicable

53. The task of supervising compliance with corporate governance rules, internal codes of conduct and corporate social responsibility policy should be assigned to one board committee or split between several, which could be the Audit Committee, the Appointments Committee, the Corporate Social Responsibility committee, where one exists, or a dedicated committee established ad hoc by the Board under its powers of self-organisation, with at the least the following functions:

- a) Monitor compliance with the company's internal codes of conduct and corporate governance rules.
- b) Oversee the communication and relations strategy with shareholders and investors, including small and medium-sized shareholders.
- c) Periodically evaluate the effectiveness of the company's corporate governance system, to confirm that it is fulfilling its mission to promote the corporate interest and catering, as appropriate, to the legitimate interests of remaining stakeholders.
- d) Review the company's corporate social responsibility policy, ensuring that it is geared to value creation
- e) Monitor the corporate social responsibility strategy and practices and assess their degree of compliance.
- f) Monitor and assess the processes of liaising with different stakeholders.

- g) Evaluate all aspects of the non-financial risks the company is exposed to, including operational, technological, legal, social, environmental, political and reputational risks.
- h) Coordinate non-financial and diversity reporting processes in accordance with applicable legislation and international benchmarks.

Compliant Partially compliant Explain

54. The corporate social responsibility policy should state the principles or commitments the company will voluntarily adhere to in its dealings with stakeholder groups, specifying at least:

- a) The goals of its corporate social responsibility policy and the support instruments to be deployed.
- b) The corporate strategy with regard to sustainability, the environment and social issues.
- c) Concrete practices in matters relative to shareholders, employees, clients, suppliers, social welfare issues, the environment, diversity, fiscal responsibility, respect for human rights and the prevention of illegal conducts.
- d) The methods or systems for monitoring the results of the practices referred to above, and identifying and managing related risks.
- e) The mechanisms for supervising non-financial risk, ethics and business conduct.
- f) Channels for stakeholder communication, participation and dialogue.
- g) Responsible communication practices that prevent the manipulation of information and protect the company's honour and integrity.

Compliant Partially compliant Explain

55. The company should report on corporate social responsibility developments in its directors' report or in a separate document, using an internationally accepted methodology.

Compliant Cumple parcialmente Explain

56. Directors' remuneration should be sufficient to attract individuals with the desired profile and compensate the commitment, abilities and responsibility that the post demands, but not so high as to compromise the independent judgement of non-executive directors.

Compliant Explique

57. Variable remuneration linked to the company and the director's performance, the award of shares, options or any other right to acquire shares or to be remunerated on the basis of share price movements, and membership of long-term savings schemes such as pension plans should be confined to executive directors.

The company may consider the share-based remuneration of non-executive directors provided they retain such shares until the end of their mandate. The above condition will not apply to any shares that the director must dispose of to defray costs related to their acquisition.

Compliant Cumple parcialmente Explique

- 58. In the case of variable awards, remuneration policies should include limits and technical safeguards to ensure they reflect the professional performance of the beneficiaries and not simply the general progress of the markets or the company's sector, or circumstances of that kind.**

In particular, variable remuneration items should meet the following conditions:

- a) Be subject to predetermined and measurable performance criteria that factor the risk assumed to obtain a given outcome.
- b) Promote the long-term sustainability of the company and include non-financial criteria that are relevant for the company's long-term value, such as compliance with its internal rules and procedures and its risk control and management policies.
- c) Be focused on achieving a balance between the delivery of short, medium and long-term objectives, such that performance-related pay rewards ongoing achievement, maintained over sufficient time to appreciate its contribution to long-term value creation. This will ensure that performance measurement is not based solely on one-off, occasional or extraordinary events.

Compliant Partially compliant Explain Not applicable

In setting the variable remuneration, the Board has considered it appropriate to combine variable remunerations with different time horizons and metrics: on the one hand, annual variable remuneration whose metrics, linked to operational objectives, respond to a classic incentive model, which fits with the limits and precaution set out in this recommendation. On the other hand, remuneration with a long-term horizon has been introduced (it expires in July 2023), which has now been aligned with the return the shareholder would receive, and therefore does not tally exactly with the more traditional models of remuneration. The Board considers that, in the long term, the best and simplest metric of the performance of the Executive Chairman is the one referring to dividends distributed and changes to the share price.

- 59. A major part of variable remuneration components should be deferred for a long enough period to ensure that predetermined performance criteria have effectively been met.**

Compliant Partially compliant Explain Not applicable

- 60. Remuneration linked to company earnings should bear in mind any qualifications stated in the external auditor's report that reduce their amount.**

Compliant Partially compliant Explain Not applicable

The variable remuneration of the Executive Chairman does not explicitly take into account the qualifications that may appear in the external auditor's report and which reduce the profits, nor is it a situation that has previously arisen at the Company. However, the Appointments and Remuneration Committee only sets the degree to which targets are met for the variable remuneration once the company's accounts have been audited, so it is in a position to take into account the aforementioned qualifications, if any, when determining the degree to which targets have been achieved.

Accordingly, the degree of compliance with the targets established by the Board of Directors, mainly associated with the audited annual accounts, is reviewed and validated by the Internal Audit Department prior to approval of its favourable report by the Appointments and Remuneration Committee of the Company and is made at the time the annual accounts are formulated.

61. A major part of executive directors' variable remuneration should be linked to the award of shares or financial instruments whose value is linked to the share price.

Compliant Partially compliant Explain Not applicable

62. Following the award of shares, share options or other rights on shares derived from the remuneration system, directors should not be allowed to transfer a number of shares equivalent to twice their annual fixed remuneration, or to exercise the share options or other rights on shares for at least three years after their award.

The above condition will not apply to any shares that the director must dispose of to defray costs related to their acquisition.

Compliant Partially compliant Explain Not applicable

The long-term incentive applicable to the Executive Chairman and other relevant executives of the Company brings into line the interests of the executives with those of the shareholders through a mechanism that contemplates a deferral in the payment of the incentive more than five years after its approval. Accordingly, it is unnecessary to introduce an additional period of limitation to the transfer of shares when the plan expires and the shares are handed over.

63. Contractual arrangements should include provisions that permit the company to reclaim variable components of remuneration when payment was out of step with the director's actual performance or based on data subsequently found to be misstated.

Compliant Partially compliant Explain Not applicable

64. Termination payments should not exceed a fixed amount equivalent to two years of the director's total annual remuneration and should not be paid until the company confirms that said director has met the predetermined performance criteria.

Compliant Partially compliant Explain Not applicable

H. Other information of interest

1. If there is any relevant aspect in corporate governance in the company or in the group companies which has not been included in the rest of the sections of this report, but which it was necessary to include to show more complete and reasoned information on the governance structure and practices in the company or its group, briefly indicate them here.
2. In this section, you may include any information or clarification with regard to the previous sections of this report to the extent that they are relevant and non-repetitive.

More specifically, indicate whether your company is subject to any corporate governance legislation other than Spanish law, and if so, include any information that is mandatory and different from that requested herein.

3. The company will also be able to indicate if it has voluntarily subscribed to other codes of ethical principles or good practices, at international or sector level, or in any other field. In that case, indicate the code in question and the date it was subscribed to. In particular, mention whether there has been adherence to the Code of Good Tax Practices of 20 July 2010.

At its meeting on 17 September 2010, the Board of Directors agreed that Naturgy would adhere to the Code of Good Tax Practices. In accordance with the provisions laid down in the Code of Good Tax Practices, it is expressly placed on record that Naturgy has effectively complied with the content of this code and, more specifically, at the meeting held on 29 January 2019, the Board was notified, through the Audit Committee about the tax policies adhered to by the group in 2018.

Furthermore, at its session on 9 January 2018, and with the favourable report from the Audit Committee, the Board of Directors approved the Fiscal Strategy and the Fiscal Risks Control and Management Policy, which regulates the basic principles that must guide the fiscal function of Naturgy, as well as the key action lines to mitigate and guide proper control of fiscal risks.

This annual corporate governance report has been adopted by the Board of Directors of the Company in its session held on 29 January 2019.

Indicate whether or not there have been directors who voted against or abstained from voting on the adoption of this report.

YES NO

Name or company name of the director not voting in favour of the adoption of this report	Reasons (against, abstention, not present)	Explain the reasons

Annex VII. Report on independent review of ICFR

Translation of a report originally issued in Spanish. In the event of discrepancy, the Spanish-language version prevails

AUDITOR'S REPORT ON INFORMATION RELATING TO THE INTERNAL CONTROL OVER FINANCIAL REPORTING (ICFR)

To the Directors of Naturgy Energy Group S.A.

At the request of the Board of Directors of Naturgy Energy Group, S.A. (hereinafter, the Entity) and in accordance with our proposal dated December 17, 2018, we have applied certain procedures to the accompanying "ICFR-related information" of the Entity for 2018, which summarizes the Entity's internal control procedures regarding annual financial reporting.

The Board of Directors is responsible for adopting the appropriate measures in order to reasonably guarantee the implementation, maintenance and supervision of an adequate internal control system as well as developing improvements to that system, and preparing and establishing the content of the accompanying ICFR-related information.

It should be noted that irrespective of the quality of the design and effectiveness of the internal control system adopted by the Entity in relation to its annual financial reporting, it can only provide reasonable, rather than absolute assurance with respect to the objectives pursued, due to the inherent limitations to any internal control system.

Throughout the course of our audit work on the financial statements, and in conformity with Technical Auditing Standards, the sole purpose of our assessment of the Entity's internal control system was to establish the scope, nature, and timing of the audit procedures to be applied to the Entity's financial statements. Therefore, our internal control assessment performed for the audit of the aforementioned financial statements was not sufficiently extensive to enable us to express a specific opinion on the effectiveness of the internal control over regulated annual financial reporting.

For the purpose of issuing this report, we exclusively applied the specific procedures described below and indicated in the Guidelines on the Auditors' report relating to information on the Internal Control over Financial Reporting on Listed Companies, published by the Spanish National Securities Market Commission (CNMV) on its website, which establishes the work to be performed, the minimum scope thereof and the content of this report. Given that the scope of the abovementioned procedures performed was limited and substantially less than that of an audit or a review of the internal control system, we do not express an opinion on the effectiveness thereof, or its design or operating effectiveness, in relation to the Entity's annual financial reporting for 2018 described in the accompanying ICFR-related information. Consequently, had we applied additional procedures to those established by the Guidelines mentioned above or had we carried out an audit or a review of the internal control over regulated annual financial reporting, other matters might have been detected which would have been reported to you.

Additionally, since this special engagement neither constitutes an audit of the financial statements nor is it subject to prevailing audit regulations in Spain, we do not express an audit opinion in the terms provided for therein.

The procedures performed were as follows:

1. Reading and understanding the information prepared by the Entity regarding ICFR - disclosures included in the management report - and assessing whether this information meets all the minimum reporting requirements needed to fill out section F on the ICFR described in the Annual Corporate Governance Report template established in CNMV Circular 5/2013 of June 12, 2013, subsequently amended by CNMV Circular 7/2015 of June 22, 2015 and CNMV Circular 2/2018 of June 12 (hereinafter the CNMV Circulars).
2. Making inquiries of personnel responsible for preparing the information detailed in point 1 above: (i) to obtain an understanding of the process that goes into preparing the information; (ii) to obtain information that allows us to assess whether the terminology used complies with the framework definitions; and (iii) to obtain information on whether the control procedures described are in place and functioning.
3. Reviewing the explanatory documents supporting the information detailed in point 1 above, which will mainly include documents directly made available to those responsible for describing the ICFR. This documentation includes reports prepared by the Internal Audit Department, senior management, and other internal and external experts in their role supporting the Audit Committee.
4. Comparing the information detailed in point 1 above with our knowledge of the Entity's ICFR obtained through the procedures applied during our audit of the financial statements.
5. Reading the minutes of the meetings of the Board of Directors, the Audit Committee, and other Entity committees in order to evaluate the consistency between matters related to the ICFR and the information detailed in point 1 above.
6. Obtaining a representation letter in connection with the work performed, duly signed by those responsible for preparing and approving the information detailed in point 1 above.

As a result of the procedures applied to the ICFR-related information, no inconsistencies or incidents have come to our attention which might affect it.

This report was prepared exclusively within the framework of the requirements stipulated in article 540 of the consolidated text of the Corporate Enterprises Act and CNMV Circulars on ICFR description in Annual Corporate Governance Reports.

ERNST & YOUNG, S.L.
(Signature on the original in Spanish)

Alfredo Eguiagaray

January 31, 2019

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