Gas Natural Fenosa

Consolidated Directors' Report as of 30 June 2017

1. Company situation

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

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

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

2. Business evolution and results

2.1. Milestones in the six-month period ended 30 June 2017

Net profit amounted to Euros 550 million in the first half of 2017, 14.7% less than in the same period of 2016.

Ebitda amounted to Euros 2,176 million, an 11.4% decrease on the first half of 2016 (6.6% in like-for-like terms, excluding Electricaribe). That reduction was concentrated in the Electricity business in Spain, whose performance was shaped by weather, as Gas Natural Fenosa's hydroelectric output declined by 77.3%.

On 11 January 2017, Euros 1,000 million of 10-year notes with an annual coupon of 1.375% were issued in the euromarket under the EMTN programme.

On 11 April 2017, Euros 1,000 million of 7-year notes with an annual coupon of 1.125% were issued in the euromarket under the EMTN programme; they were paid for in April 2017. In parallel, Gas Natural Fenosa tendered for its notes maturing between 2018 and 2021, with the result that the new bonds were swapped for the redeemed bonds.

On 17 May 2017, Gas Natural Fenosa, through subsidiary Gas Natural Fenosa Renovables, was awarded a total of 667 MW of wind capacity through an auction in Spain. The investment required to develop those projects and the awarded capacity a maximum of Euros 700 million.

On 5 July 2017 Gas Natural Fenosa arranged a Euros 450 million loan agreement with the European Investment Bank (EIB) with a term of 20 years and a vesting period of 4 years which will be used to finance part of the electricity distribution business and the development of renewable energy projects in Spain.

On 17 July 2017 Gas Natural Fenosa arranged a loan with the Official Credit Institute (ICO) for Euros 200 million with a term of 12 years and a vesting period of 2 years.

As of 30 June 2017, the indebtedness ratio was 46.4%, i.e. slightly higher than the ratio in 2016 (45.7%), while the net financial debt/Ebitda ratio was 3.4, in line with 2016 (excluding Electricaribe).

On 20 April 2017, the Shareholders' Meeting approved the distribution of income, consisting of allocating Euros 1,001 million out of 2016 income to dividends, the same amount as in the preceding year, representing a 74.3% payout. That is a dividend of Euros 1 per share, of which Euros 0.330 per share was paid as an interim dividend in cash on 27 September 2016 and the remaining Euros 0.670 per share was paid, also in cash, on 27 June 2017.

The Board of Directors has declared an interim dividend for 2017 of Euros 0.330 per share, to be paid entirely in cash on 27 September 2017.

2.2. Main aggregates

Financial main aggregates

	2017	2016	%
Net sales	12,283	11,409	7.7
Ebitda	2,176	2,457	(11.4)
Operating income	1,269	1,447	(12.3)
Net income attributable to equity holders of the parent company	550	645	(14.7)
Cash flow from operations (CFO)	1,406	1,600	(12.1)
Net investments	740	622	19.0
Net equity (at 30/06)	18,246	18,793	(2.9)
Net equity attributed to the equity holders of the parent company (at 30/06)	14,609	14,575	0.2
Net borrowings (at 30/06)	15,818	15,832	(0.1)

Main financial ratios

	2017	2016
Leverage	46.4%	45.7%
Ebitda / Cost of net financial debt	6.8x	6.6x
Net borrowings / Annualized Ebitda	3.4x	3.1x
Return on assets (ROA)	2.8%	2.9%

Main stock market ratios and shareholder remuneration

	2017	2016
Average number of shares (thousand)	1,000,519	1,000,689
Number of shares at end period (thousand)	1,000,689	1,000,689
Share price at 30/06 (euro)	20.49	17.67
Stock market capitalisation at 30/06 (million euro)	20,504	17,677
Earnings per share (euro)	0.55	0.64
Net equity attributed to the equity holders of the parent company per share (euro)	14.60	14.56
Price-earnings ratio (P/E)	16.4x	12.7x
EV / Annualized Ebitda	7.7x	6.6x

Main physical aggregates

	2017	2016	%
Gas distribution:			
Sales - TPA[1]:	239,030	227,534	5.1
Europe	101,310	96,585	4.9
Latin America	137,720	130,949	5.2
Gas distribution connections points (thousand) (at 30/06):	13,717	13,361	2.7
Europe	5,796	5,760	0.6
Latin America	7,921	7,601	4.2
Electricity distribution:			
Sales - TPA[1]:	28,284	34,685	(18.5)
Europe	17,333	17,250	0.5
Latin America (*)	10,951	17,435	(37.2)
Electricity distribution connections (thousand) (at 30/06):	8,271	10,746	(23.0)
Europe	4,595	4,565	0.7
Latin America (*)	3,676	6,181	(40.5)
ICEIT[2] (minutes)	67	26	157.7
Gas:			
Gas supply (MW):	178,821	160,959	11.1
Spain	90,594	89,686	1.0
Rest of Europe	39,361	37,209	5.8
International LNG	48,866	34,064	43.5
Gas transportation – EMPL (GWh)[3]	49,433	52,299	(5.5)

(*) 1H16 includes Electricaribe's contribution to the consolidated figures.

[1] Third-Party Access (electricity distributed). Includes TPA services in secondary transmission.
[2] Installed capacity equivalent interruption time in Spain.
[3] Europe-Maghreb gas pipeline.

	2017	2016	%
Electricity:			
Electricity generated (GWh):	22,226	21,424	3.7
Spain:	13,161	12,767	3.1
Hydroelectric	737	3,244	(77.3)
Nuclear	2,185	2,104	3.8
Coal	2,832	936	202.6
CCGTs	6,141	4,986	23.2
Renewables and Cogeneration	1,266	1,497	(15.4)
International:	9,065	8,657	4.7
Hydroelectric	234	203	15.3
CCGTs	7,925	7,509	5.5
Oil – gas	600	558	7.5
Wind	306	387	(20.9)
Installed capacity (MW):	15,418	15,416	-
Spain:	12,716	12,714	-
Hydroelectric	1,954	1,954	-
Nuclear	604	604	-
Coal	2,010	2,010	-
CCGTs	7,001	7,001	-
Renewables and Cogeneration	1,147	1,145	0.2
International:	2,702	2,702	-
Hydroelectric	123	123	-
CCGTs	2,035	2,035	-
Oil – gas	310	310	-
Wind	234	234	-
Electricity supply (GWh)	17,284	18,107	(4.5)

2.3. Analysis of consolidated results

Sales

	2017	% of total	2016	% of total	% 2017/2016
Gas distribution	2,944	24.0	2,389	21.0	23.2
Spain	638	5.2	581	5.1	9.8
Italy	43	0.4	43	0.4	-
Latin America	2,263	18.4	1,765	15.5	28.2
Electricity distribution	2,244	18.3	2,840	24.8	(21.0)
Spain	420	3.4	416	3.6	1.0
Moldova	110	0.9	119	1.0	(7.6)
Latin America	1,714	14.0	2,305	20.2	(25.6)
Gas	5,513	44.8	4,527	39.7	21.8
Infrastructures	164	1.3	159	1.4	3.1
Supply	5,349	43.5	4,368	38.3	22.5
Electricity	2,952	24.0	2,926	25.7	0.9
Spain	2,486	20.2	2,573	22.6	(3.4)
International	466	3.8	353	3.1	32.0
Other activities	193	1.6	275	2.4	(29.8)
Consolidation adjustments	(1,563)	(12.7)	(1,548)	(13.6)	1.0
Total	**12,283**	**100.0**	**11,409**	**100.0**	**7.7**

Net sales totalled Euros 12,283 million in the first half of 2017, a 7.7% increase with respect to the same period of 2016, due basically to higher volumes and prices in the gas business compared with the same period of the previous year, and to the currency effect.

EBITDA

	2017	% of total	2016	% of total	% 2017/2016
Gas distribution	882	40.5	830	33.8	6.3
Spain	439	20.2	424	17.3	3.5
Italy	29	1.3	29	1.2	-
Latin America	414	19.0	377	15.3	9.8
Electricity distribution	546	25.1	668	27.1	(18.3)
Spain	302	13.9	303	12.3	(0.3)
Moldova	16	0.7	25	1.0	(36.0)
Latin America	228	10.5	340	13.8	(32.9)
Gas	425	19.5	423	17.2	0.5
Infrastructures	153	7.0	146	5.9	4.8
Supply	272	12.5	277	11.3	(1.8)
Electricity	338	15.5	500	20.4	(32.4)
Spain	190	8.7	376	15.4	(49.5)
International	148	6.8	124	5.0	19.4
Other activities	(15)	(0.6)	36	1.5	(141.7)
Total	**2,176**	**100.0**	**2,457**	**100.0**	**(11.4)**

Consolidated Ebitda in the first half 2017 amounted to Euros 2,176 million, i.e. Euros 281 million (11.4%) less than in the same period of 2016. Nevertheless, the first half of 2017 does not include the figures for Electricaribe; consequently, in like-for-like terms, the reduction would be just 6.6%.

Foreign currency fluctuations in consolidation had a positive impact on Ebitda in the first half of 2017 amounting to Euros 45 million with respect to the same period of 2016, mainly due to appreciation of the Brazilian real and the Chilean peso.

Ebitda from Gas Natural Fenosa's international activities increased by 1.3% to account for 51.4% of the consolidated total, compared with 45.0% in the same period of last year. Ebitda from operations in Spain fell by 21.8% and declined as a share of the consolidated total to 48.6%.

Operating income

	2017	% of total	2016	% of total	% 2017/2016
Gas distribution	617	48.6	582	40.3	6.0
Spain	287	22.6	280	19.4	2.5
Italy	17	1.3	17	1.2	-
Latin America	313	24.7	285	19.7	9.8
Electricity distribution	353	27.8	394	27.2	(10.4)
Spain	189	14.9	193	13.3	(2.1)
Moldova	13	1.0	22	1.5	(40.9)
Latin America	151	11.9	179	12.4	(15.6)
Gas	342	27.0	348	24.0	(1.7)
Infrastructures	128	10.1	122	8.4	4.9
Supply	214	16.9	226	15.6	(5.3)
Electricity	39	3.1	152	10.5	(74.3)
Spain	(45)	(3.5)	93	6.4	(148.4)
International	84	6.6	59	4.1	42.4
Other activities	(82)	(6.5)	(29)	(2.0)	182.8
Total	**1,269**	**100.0**	**1,447**	**100.0**	**(12.3)**

Depreciation and amortisation charges and impairment losses in 1H17 amounted to Euros 843 million, a 2.9% decrease year-on-year, mainly due to extending the useful lives of the combined cycle plants from 25 to 35 years.

Provisions for bad debts amounted to Euros 64 million, compared with Euros 142 million in 2016; this reduction is due basically to deconsolidating Electricaribe.

Operating income in the first half of 2017 declined by Euros 178 million (12.3%) with respect to the same period of 2016, to Euros 1,269 million; in like-for-like terms (i.e. excluding Electricaribe), the reduction was -10.4%.

Net financial income

Net financial expenses amounted to Euros 347 million in the first half of 2017, 16.4% less than in the same period of 2016 (Euros 415 million).

The breakdown of net financial income is as follows:

	2017	2016	%
Cost of net financial debt	(320)	(374)	(14.4)
Other financial expenses/revenues	(34)	(49)	(30.6)
Financial revenues Costa Rica[1]	7	8	(12.5)
Net financial income	**(347)**	**(415)**	**(16.4)**

[1] The Costa Rica generation concessions are accounted for as finance leases in accordance with IFRIC 12.

The cost of net interest-bearing debt in the first half of 2017 was Euros 320 million, i.e. lower than in the same period of 2016 due to deconsolidating Electricaribe and to the lower coupons on new debt issued to refinance maturing debt.

The average cost of gross financial debt is 3.7%, and 80% of the net debt is at fixed rates.

Profit/(loss) of entities recorded by equity method

Equity-accounted affiliates contributed Euros 7 million in earnings in the first half of 2017 (Euros -11 million in the same period of 2016) due to the positive contribution by Ecoeléctrica in Puerto Rico and by other holdings (Chile and renewables), which was partly offset by the negative result contributed by the Union Fenosa Gas subgroup.

Corporate income tax

The effective tax rate as of 30 June 2017, based on the best estimate of the effective tax rate for the full year, was 23.5%, the same as one year earlier.

Non-controlling interests

The main items in this account are the non-controlling interests in EMPL, International Electricity, gas distribution companies in Chile, Brazil, Colombia and Mexico, and electricity distribution companies in Chile and Panama, as well as accrued interest on perpetual subordinated notes.

Income attributed to non-controlling interests amounted to Euros -161 million in 1H17, in line with the 2016 figure of Euros -166 million.

Net income

Net income amounted to Euros 550 million, a reduction of 14.7% with respect to the same period of 2016.

2.4. Analysis of the consolidated balance sheet

Investments

The breakdown of investments by nature is as follows:

	2017	2016	%
Investments in property, plant and equipment and intangible assets (Note 5)	737	629	17.2
Financial investments	27	26	3.8
Total gross investments	**764**	**655**	**16.6**
Disposals and others	(24)	(33)	(27.3)
Total net investments	**740**	**622**	**19.0**

Investments in property, plant and equipment and intangible assets amounted to Euros 737 million in 1H17, a 17.2% increase with respect to 1H16, due basically to greater investment in gas and electricity distribution in Latin America and in the electricity business.

Financial investments in 1H17 correspond to cash flows into investing activities in group companies, associates and business units (Euros 14 million), Compañía General de Electricidad, S.A. treasury shares acquisition (Euros 5 million) and others (Euros 8 million).

Disposals and others in 1H17 correspond to Other proceeds from investing activities (Euros 24 million).

The breakdown of investment in property, plant and equipment and intangible assets, by line of business, is as follows:

	2017	2016	% 2017/2016
Gas distribution	252	257	(1.9)
Spain	82	132	(37.9)
Italy	15	13	15.4
Latin America	155	112	38.4
Electricity distribution	286	252	13.5
Spain	106	106	-
Moldova	3	2	50.0
Latin America	177	144	22.9
Gas	30	14	114.3
Infrastructures	5	2	150.0
Supply	25	12	108.3
Electricity	143	76	88.2
Spain	53	39	35.9
International	90	37	143.2
Other activities	26	30	(13.3)
Total	**737**	**629**	**17.2**

The electricity distribution business accounts for 38.8% of the consolidated total, is the main target of capital expenditure, and expanded by 13.5% with respect to the same period of 2016. The electricity distribution business in Latin America accounts for 24.0% of the consolidated total and expanded by 22.9%, basically as a result of the increase in Chile.

Gas distribution accounts for 34.2% of the consolidated total and declined by 1.9% with respect to the same period of the previous year. Gas distribution in Latin America accounts for 21.0% of the consolidated total and increased by 38.4% with respect to the same period of 2016, as both maintenance and network growth investment increased in all countries.

The electricity business accounts for 19.4% of the consolidated total. Capital expenditure in Spain increased by 35.9% with respect to the same period of 2016, basically due to investment in new wind projects in the Canary Islands. Investment in Electricity International increased by 143.2%, mainly due to the development of photovoltaic projects in Brazil.

Capital expenditure outside Spain increased by 41.7% to account for 60.4% of the total (vs. 49.9% in the same period of 2016).

Investment in Spain declined by 7.3%, and its share declined to 39.6%, compared with 50.1% in 2016.

Equity and shareholder remuneration

The distribution of 2016 income approved by the Shareholders' Meeting on 20 April 2017 entailed allocating Euros 1,001 million to dividends, the same amount as in 2016. That represents a dividend of Euros 1 per share and a pay-out of 74.3%, i.e. a dividend yield of 5.6% based on the share price at 31 December 2016 (Euros 17.91).

An interim dividend amounting to Euros 0.330 per share out of 2016 earnings was paid entirely in cash on 27 September 2016, and the remaining Euros 0.670 per share was paid, also in cash, on 27 June 2017.

The Board of Directors has declared an interim dividend for 2017 of Euros 0.330 per share, to be paid entirely in cash on 27 September 2017.

At 30 June 2017, Gas Natural Fenosa's shareholders' equity totalled Euros 18,246 million. Of that total, Euros 14,609 million is attributable to Gas Natural Fenosa.

Debt and finances

Evolution of net borrowings (million euros)

	30.06.17	30.06.16	%
Net borrowings	15,818	15,832	-0.08

At 30 June 2017, net interest-bearing debt amounted to Euros 15,818 million and leverage was 46.4% (Euros 15,832 million and 45.7% at 30 June 2016).

The net debt/EBITDA ratio was 3.4 and the EBITDA/net financial expenses ratio was 6.8 at 30 June 2017, evidencing that the company maintained its credit fundamentals stable with respect to the preceding year.

The detail of net borrowings is as follows:

	30.06.17	30.06.16
Non-current borrowings	14,485	14,798
Current borrowings	2,857	3,884
Cash and cash equivalents	(1,455)	(2,763)
Derivatives	(69)	(87)
Net borrowings	**15,818**	**15,832**

Net debt maturities (Euros million)

	2017	2018	2019	2020	2021 and thereafter
Net debt maturities	195	1,801	2,463	2,310	9,049

The above table shows Gas Natural Fenosa's net debt maturities at 30 June 2017.

A total of 87.4% of the net interest-bearing debt matures in or after 2019. The average term of the debt is 5.6 years.

Of the net financial debt, 8.5% is short term and the other 91.5% is long term.

The breakdown of the net borrowings by currency at 30 June 2017, in absolute and relative terms, is as follows:

(Euros million)	30.06.2017	%
EUR	12,693	80.2
CLP	1,506	9.5
USD	921	5.8
MXN	316	2.0
BRL	277	1.8
COP	97	0.6
Others	8	0.1
Total net borrowings	**15,818**	**100.0**

Main financial transactions

As part of the ongoing process of optimising interest-bearing debt, on 11 January 2017 Gas Natural Fenosa, through its Euro Medium Term Notes (EMTN) programme, issued notes amounting to Euros 1,000 million, maturing in January 2027, with an annual coupon of 1.375%.

To that same end, Euros 3,624 million in bilateral bank transactions were renegotiated during the period, of which Euros 684 were loans and the remainder were credit lines.

In April 2017 Gas Natural Fenosa issued bonds under its EMTN programme amounting to Euro 1,000 million maturing in seven years and with a coupon of 1.125%. This amount was used to implement the repurchase of debentures for Euros 1,000 million maturing in 2018, 2020 and 2021.

After the closing date some other transactions have been signed, including two long-term transactions with institutional banks: one maturing in 20 years with 4 years of vesting period and amounting to Euro 450 million with European Investment Banks (EIB) and the other maturing in 12 years with 2 years of vesting period amounting to Euro 200 million with the Official Credit Institute (ICO).

Transactions amounting to Euros 657 million were performed in Latin America, including notably a Euros 196 million (MXN 4,000 million) 3- and 5-year debt issue in Mexico, and a Euros 105 million (USD 120 million) 5-year issue in Panama.

For the purposes of managing interest rates, to complement the debt originated at fixed rates, long-term interest rate hedges have been arranged in order to have 80% of the debt at fixed rates.

Credit rating

The credit ratings of Gas Natural Fenosa's short-term and long-term debt are as follows:

Agency	Short term	Long term
Fitch	F2	BBB+
Moody’s	P-2	Baa2
Standard & Poor’s	A-2	BBB

Liquidity and capital funds

At 30 June 2017, cash and cash equivalents together with available bank finance totalled Euros 9,607 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	Available
Committed credit lines	7,656	469	7,187
Uncommitted credit lines	506	43	463
Undrawn loans	502	-	502
Cash and cash equivalents	-	-	1,455
Total	**8,664**	**512**	**9,607**

Additionally, at 30 June 2017, the company had Euros 6,207 million available in the form of shelf registrations for financial instruments, including Euros 3,895 million in the Euro Medium Term Notes (EMTN) programme; Euros 500 million in the Euro Commercial Paper (ECP) programme; and a combined Euros 1,812 million in the stock market certificates programmes on the Mexico Stock Exchange, the commercial paper programme on the Panama Exchange, the straight bonds programme in Colombia and the bond lines in Chile.

2.5. Analysis of results by activity

Gas distribution

2.5.1 Gas distribution Spain

This area includes gas distribution, third-party access (TPA) and secondary transportation, as well as the distribution activities in Spain that are charged for outside the regulated remuneration (meter rentals, customer connections, etc.) and the piped liquefied petroleum gas (LPG) business.

Results

	2017	2016	%
Net sales	638	581	9.8
Procurement	(50)	(9)	-
Net personnel expenses	(39)	(39)	-
Other expenses/revenues	(110)	(109)	0.9
EBITDA	**439**	**424**	**3.5**
Depreciation, amortisation and impairment expenses	(148)	(144)	2.8
Change in operating provisions	(4)	-	-
Operating income	**287**	**280**	**2.5**

Net sales in the gas distribution business totalled Euros 638 million, Euros 57 million more than in the same period last year, due basically to the LPG business, which completed the acquisition of distribution points in the fourth quarter of 2016.

The increase in the LPG business required a larger number of shiploads to meet the higher demand.

These factors, coupled with the positive impact of efficiency measures on operating expenses, resulted in a 3.5% increase in EBITDA.

Main aggregates

The main aggregates in gas distribution in Spain were as follows:

	2017	2016	%
Sales – TPA (GWh)	98,913	94,396	4.8
LPG sales (ton)	85,223	14,064	-
Distribution network (km)	53,042	51,694	2.6
Increase in connection points (thousand)	23	36	(36.1)
Connection points (thousand) (at 30/06)	5,336	5,302	0.6

Regulated gas sales increased by 4.8% (+4,517 GWh).

Residential demand was 1,499 GWh (6%) lower than in the same period of 2016.

Demand growth was concentrated in the industrial market. Demand under 60 bars increased by 8% (+3,715 GWh). Demand for transportation and industrial consumption over 60 bar increased by 10% (+2,301 GWh).

The growth in LPG sales was due to the acquisition of supply connections from Repsol in the fourth quarter of 2016.

In the first half of 2017, the distribution network expanded by 1,086 km.

2.5.2 Gas distribution Italy

The business in Italy includes regulated distribution of gas.

Results

	2017	2016	%
Net sales	43	43	-
Procurement	-	-	-
Net personnel expenses	(6)	(6)	-
Other expenses/revenues	(8)	(8)	-
EBITDA	**29**	**29**	**-**
Depreciation, amortisation and impairment expenses	(12)	(12)	-
Change in operating provisions	-	-	-
Operating income	**17**	**17**	**-**

EBITDA amounted to Euros 29 million, in line with the same period of 2016, since remuneration was stable in 2017 following the update in WACC recognised by the Italian regulator in 2016 as a result of the decline in the risk-free rate.

Main aggregates

	2017	2016	%
Sales – TPA (GWh)	2,397	2,189	9.5
Distribution network (km)	7,291	7,210	1.1
Connection points (thousand) (at 30/06)	460	458	0.4

A total of 2,397 GWh of gas were distributed, i.e. 9.5% more than in 2016, due to favourable weather conditions.

The distribution grid expanded by 26 km in the last six months, to 7,291 km at 30 June 2017.

Gas Natural Fenosa has 460,340 gas distribution connection points in Italy, a slight increase with respect to the previous year.

2.5.3 Gas distribution Latin America

This division involves regulated gas distribution in Argentina, Brazil, Chile, Colombia, Mexico and Peru. In Chile, it also includes the gas procurement and supply business.

Results

	2017	2016	%
Net sales	2,263	1,765	28.2
Procurement	(1,606)	(1,185)	35.5
Net personnel expenses	(68)	(60)	13.3
Other expenses/revenues	(175)	(143)	22.4
EBITDA	**414**	**377**	**9.8**
Depreciation, amortisation and impairment expenses	(88)	(79)	11.4
Change in operating provisions	(13)	(13)	-
Operating income	**314**	**285**	**9.8**

Revenues increased by 28.2% to Euros 2,263 million, affected by appreciation of the main Latin American currencies.

EBITDA amounted to Euros 414 million, an increase of 9.8% with respect to the same period of the previous year, impacted by currency performance in Argentina (-6.7%), Mexico (-4.4%), Colombia (9.2%), Brazil (16.6%) and Chile (7.1%). Excluding the effect of currency fluctuations, EBITDA would have increased by 3.4%.

Brazil contributed 31.4% of total EBITDA. Adjusting for the currency effect, EBITDA increased by 7.8%. Dispatching and TPA for thermal power plants was 2.3% higher than in the second quarter of 2016, while gas sales in the residential-commercial market were down 3.1% year-on-year. In contrast, the change in trend in the industrial sector with respect to 2016 persisted in the second quarter, with 6.8% growth; additionally, sales of automotive natural gas increased by 11.1% year-on-year as it proved more competitive than liquid fuels.

Mexico accounted for 22.2% of total EBITDA in this business. Excluding the exchange rate effect, Mexico's EBITDA increased by 15.4%, and the sales margin increased by 16.7%, with growth in all markets.

EBITDA in Colombia amounted to Euros 72 million, a 22.9% decline year-on-year (excluding the exchange rate effect) as a result of the lower commercialisation margin in the secondary market. This market registered atypically good performance in the first half of 2016 due to the El Niño phenomenon, which produced a sharp decline in hydroelectric output.

Chile contributed Euros 103 million in EBITDA (+12.1% at constant exchange rates), basically due to an increase in the volume of sales in the residential-commercial segment, i.e. 24.9% of total EBITDA from Latin America.

EBITDA in Argentina amounted to Euros 19 million, in line with the same period of 2016, following the entry into force on 1 April 2017 of a new tariff table for all markets, even though the new tariff will be implemented in three stages. Excluding the currency effect, EBITDA would have increased by 10.1%. Overall sales volumes increased by 7.0% in the first half, concentrated particularly in the TPA market, which registered 6.5% growth.

Main aggregates

The main physical aggregates in gas distribution in Latin America were as follows:

	2017	2016	%
Gas activity sales (GWh):	137,720	130,949	5.2
Gas sales at the tariff	77,629	74,903	3.6
TPA	60,091	56,046	7.2
Distribution network (km)	83,689	81,866	2.2
Increase in connection points (thousand)	148	153	(3.3)
Connection points (thousand) (at 30/06)	7,921	7,601	4.2

The main physical aggregates by country as of 30 June 2017 are as follows:

	Argentina	Brazil	Chile	Colombia	Mexico	Total
Gas activity sales (GWh):	34,880	37,197	23,611	13,245	28,787	137,720
Increase v. 1H16 (%)	7.0	4.4	0.8	(5.5)	13.8	5.2
Distribution network (km)	25,749	7,382	7,092	22,081	21,385	83,689
Increase vs. 30/06/2016 (km)	175	73	195	431	949	1,823
Connection points (thousand) (at 30/06)	1,642	1,058	593	2,912	1,716	7,921
Increase vs. 30/06/2016 (thousand)	22	48	24	110	116	320

There were a total of 7.921 million gas distribution connections at 30 June 2017. Customer numbers increased by 320 thousand year-on-year, notably in Colombia and Mexico.

Sales in the gas activity in Latin America, which includes both gas sales and TPA (third-party access) services, totalled 137,720 GWh, i.e. higher than the same period of 2016, particularly due to higher sales in Mexico.

The distribution grid expanded by 1,823 km (+2.2%) in the last 12 months, to 83,689 km at the end of June 2017. This sizeable expansion is attributable most notably to Mexico, which added 949 km, and Colombia, which added 431 km.

Highlights of this area in 2016:

- In Argentina, after a year of intense negotiations, the new tariffs arising from the Integral Tariff Review (RTI) were applied on 1 April 2017. The tariff tables were approved on 31 March 2017 by Resolution 4.354 of ENARGAS, which announced the RTI outcome for Gas Natural BAN.

  The outcome of the Integral Tariff Review process includes a major investment plan that entails a significant change in the scale of this business; the plan is already being implemented.

  The new tariff will be phased in over three stages, and will be adjusted for inflation every six months. The first stage commenced on 1 April 2017; the second will begin on 1 December 2017 and will include the first inflation adjustment; the third stage, which will also include an inflation adjustment, will commence in April 2018.

  Completion of the RTI process and application of the new tariffs will normalise the company in economic and financial terms.

- In Brazil, new residential-commercial customer additions declined by 2.1% year-on-year in the first half due to large number of additions of new buildings in 2016 on the occasion of the Olympic Games. Sales increased by 4.4% due to the higher sales of automotive natural gas, which expanded by 11.1% as this fuel was more competitive than liquid fuels and also because of the increase in vehicle conversions in the period; sales to the industrial market grew by 6.8% against the backdrop of a macroeconomic recovery, while the power generation and TPA market expanded by 2.3% due to the greater utilisation of thermal power plants. In contrast, sales in the residential and commercial market declined by 3.1%, mainly as a result of lower consumption by large retailers.

- In Colombia, gas and TPA sales declined by 5.5% year-on-year, due mainly to an 8.4% decline in the industrial market as a result of the atypical sales volume in the secondary market in the first six months of 2016. Residential-commercial customer numbers increased by 50,057 net in the first half of 2017, which represented a 13.0% decrease year-on-year, basically in the new building segment, as a result of the deceleration in building completion caused by the market contraction.

  In relation to unregulated businesses in Colombia they experienced a 5.8% decrease in margins with respect to the first half of 2016. The energy solutions business shrank by 34.9% due to negative performance by mobility products, partly offset by a 36.7% improvement in the margin in the residential and SME market, basically due to the product Servigas.

- Mexico continued to implement the growth acceleration plan, having increased customer numbers by 8% and made progress in all segments in the first half of the year. Gas sales increased by 13.8%, mainly in the TPA market, while the industrial market expanded by 7.9% due to growth in customer numbers and sales; in contrast, consumption in the residential-commercial market shrank by 2.7%.

  As part of the ongoing energy reform, in December 2016 the company was granted a concession to distribute gas in the Mexico Valley area (Cuautitlán-Texcoco-Hidalgo). This area adjoins Mexico City and will enable gas to be distributed in a market close to the existing grid. Commercialisation commenced this year and customer numbers are expected to reach 125,000 within five years.

- The number of supply connections in Chile increased by 24 thousand, including growth in the residential-commercial (4.1%) and industrial (0.6%) segments with respect to the first half of 2016. As for gas sales and TPA, the strongest growth was observed in the residential-commercial (6.9%) and industrial (3.4%) segments, while TPA sales declined by 0.6% year-on-year.

  The new Gas Law, promulgated in February 2017, filled a legal vacuum by reducing the uncertainties surrounding investment, thereby allowing the distribution business to expand and providing for an increase in natural gas use in Chile, which was one of the main objectives of Chile's Energy Agenda and Energy Policy, both drawn up following work directed by the Ministry of Energy.

  In this context of legal certainty, the aggressive expansion plan has been stepped up since February 2017, with a substantial increase in investment in established territories, where the goal is to increase saturation, and the introduction of gas to new regions throughout the country.

  Work in 2017 will be focused on central and southern areas in order to double new customer additions to approximately 20,000 more new supply connections than in a standard year.

- In Peru, the company continues development work after rescheduling the beginning of commercial operations (originally planned for the third quarter of the year), which depends on completion of construction of the gas terminal.

As a result of the concession awarded in July 2013, Gas Natural Fenosa will supply energy to an area in south-west Peru that is not yet connected to the gas grid and expects to supply natural gas to over 80,000 households.

Electricity distribution

2.5.4 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 Gas Natural Fenosa's distribution network.

Results

	2017	2016	%
Net sales	420	416	1.0
Procurement	-	-	-
Net personnel expenses	(50)	(45)	11.1
Other expenses/revenues	(68)	(68)	-
EBITDA	**302**	**303**	**(0.3)**
Depreciation, amortisation and impairment expenses	(113)	(110)	2.7
Change in operating provisions	-	-	-
Operating income	**189**	**193**	**(2.1)**

The Ministerial Order on electricity tolls for 2017 (ETU/1976/2016) establishes that, until the approval of the remuneration for transmission and distribution for 2017 under the provisions of Royal Decree 1047/2013, of 27 December, and Royal Decree 1048/2013, of 27 December, the remuneration established in Order IET/981/2016 and Order IET/980/2016, which established the remuneration for electricity transmission and distribution companies for 2016, will be paid pro rata.

Net revenues amounted to Euros 420 million, i.e. 1.0% more than in the same period of 2016, due to application of the aforementioned Ministerial Orders and to the accrual of investments that were brought into operation.

EBITDA amounted to Euros 302 million in the first half of 2017, a 0.3% decline with respect to the same period of 2016, due to the 11.1% increase in net personnel expenses caused by the implementation of business efficiency measures that will have a positive impact in subsequent periods.

Main aggregates

	2017	2016	%
Electricity sales (GWh): TPA	15,977	15,934	0.3
Connection points (thousand) (at 30/06)	3,712	3,692	0.5
ICEIT (minutes)	67	26	-

Electricity supplied in the first half of 2017 was in line with the same period of 2016, due to the warm weather. Domestic demand amounted to 123,313 GWh in the first half, a 1.2% increase, according to figures from Red Eléctrica de España (REE).

The number of supply points increased by 10,492 net in the first half of 2017.

The ICEIT outage indicator increased sharply with respect to 2016 due to storms in Galicia in February 2017, where wind speeds reached 178 km/hour, with close to 400,000 customers being affected at times. This effect was mitigated by good ICEIT performance in the second quarter. Galicia accounted for 89% of Gas Natural Fenosa's total outage time.

As of 30 June 2017, smart meters accounted for 92% of the total, and 87% of meter readings are performed on a remote basis. The plan is to achieve 100% smart meters and remote readings in the residential market in 2018.

2.5.5 Electricity distribution in Moldova

The business in Moldova consists of regulated distribution of electricity and the supply of electricity at the bundled tariff in the capital city and the central and southern regions. Gas Natural Fenosa is responsible for 70% of electricity distribution in Moldova.

Results

	2017	2016	%
Net sales	110	119	(7.6)
Procurement	(84)	(86)	(2.3)
Net personnel expenses	(4)	(3)	33.3
Other expenses/revenues	(6)	(5)	20.0
EBITDA	**16**	**25**	**(36.0)**
Depreciation, amortisation and impairment expenses	(3)	(3)	-
Change in operating provisions	-	-	-
Operating income	**13**	**22**	**(40.9)**

Net revenues reflect the pass-through effect of procurement costs together with the capital expenditure and operation and maintenance work performed in accordance with the country's current regulations.

The decline in EBITDA in the first half of 2017 is due to the regulator's adjustment to investments made in 2015 in the tariff approved in March 2017 and to the reform of the distribution tariff methodology applied from May 2017 onwards.

Main aggregates

	2017	2016	%
Electricity sales (GWh) – tariff sales	1,356	1,316	3.0
Connection points (thousand) (at 30/06)	883	873	1.1

In 2017, the company continued to implement its plan to improve operations in Moldova, focusing on processes linked to energy control in the distribution networks, operating processes associated with the entire customer management cycle, and optimisation of facility O&M.

- Electricity supplied increased by 3.0% in 2017 as consumption increased because of the colder winter this year.

- The number of supply connections totalled 883,415, i.e. an increase of 1.1% with respect to the same period of 2016, primarily as a result of growth in the real estate sector.

2.5.6 Electricity distribution Latin America

This division involves regulated electricity distribution in Argentina, Chile and Panama, and electricity transmission in Chile.

In 2016, this area also included electricity distribution in Colombia.

Results

	2017	2016	%
Net sales	1,714	2,305	(25.6)
Procurement	(1,299)	(1,696)	(23.4)
Net personnel expenses	(73)	(100)	(27.0)
Other expenses/revenues	(114)	(169)	(32.5)
EBITDA	**228**	**340**	**(32.9)**
Depreciation, amortisation and impairment expenses	(63)	(76)	(17.1)
Change in operating provisions	(14)	(85)	(83.5)
Operating income	**151**	**179**	**(15.6)**

EBITDA from electricity distribution in Latin America totalled Euros 228 million. Excluding Colombia's contribution to EBITDA in the first half of 2016, EBITDA in this business would have increased by 6.5%, mainly as a result of the appreciation by the Chilean peso.

At constant exchange rates and in like-for-like terms, excluding Electricaribe, EBITDA would have increased by 0.9%.

EBITDA in Panama amounted to Euros 55 million in 2017, a 16.7% decline at constant exchange rates. This variation was mainly due to refunds to customers of revenues corresponding to the tariff for the period 2002-2006, to a greater impact of power losses, and to other effects on the price, notably the higher revenues received in the first half of 2016 as a result of recognition, by the regulator, of extraordinary generation costs corresponding to the year 2015.

EBITDA in Chile and Argentina (CGE) amounted to Euros 173 million, a Euros 13 million increase at constant exchange rates.

Main aggregates

	2017	2016	%
Electricity sales (GWh):	10,951	17,435	(37.2)
Tariff electricity sales	10,130	16,325	(37.9)
TPA	821	1,110	(26.0)
Connection points (thousand) (at 30/06)	3,676	6,181	(40.5)

Electricity sales amounted to 10,951 GWh, a 37.2% decline, basically due to deconsolidating Electricaribe (Colombia). But for that effect, sales would have risen by 1.2%.

Sales in Panama increased slightly (+0.4%) in year-on-year terms. Temperatures in the first half of the year were above the historical average, which attenuated growth in consumption.

The main physical aggregates by country as of 30 June 2017 are as follows:

	Argentina	Chile	Panama	Total
Electricity sales (GWh):	977	7,446	2,528	10,951
Increase vs. 1H16 (%)	(2.0)	2.0	0.4	(37.2)
				-
Connection points (thousand)	224	2,824	628	3,676
Increase vs. 30/06/2016 (thousand)	6	78	25	(2,505)

The increase in sales and in connection points (excluding the impact of deconsolidating Electricaribe) reflects sustained growth in the electricity distribution business in Latin America.

Electricity transmission in Chile

	2017	2016	%
Electricity transmitted (GWh)	7,396	7,531	(1.8)
Transmission network (km)	3,528	3,528	-

Power transmission in Chile decreased by 1.8% year-on-year, mainly due to lower activity in the first half. The transmission grid is 3,528 km long, the same as at 30 June 2016.

Gas

2.5.7 Infrastructure

This area includes operating the Maghreb-Europe gas pipeline as well as gas exploration, production, storage and regasification.

Results

	2017	2016	%
Net sales	164	159	3.1
Procurement	-	(1)	-
Net personnel expenses	(3)	(2)	50.0
Other expenses/revenues	(8)	(10)	(20.0)
EBITDA	**153**	**146**	**4.8**
Depreciation, amortisation and impairment expenses	(25)	(24)	4.2
Change in operating provisions	-	-	-
Operating income	**128**	**122**	**4.9**

Net sales in the infrastructure business totalled Euros 164 million in the first half of 2017, a 3.1% increase with respect to the same period of the previous year.

EBITDA increased by 4.8% year-on-year to Euros 153 million, mainly as a result of the increase in the international shipping tariff on the Maghreb-Europe pipeline and the positive USD exchange rate effect.

Main aggregates

The main aggregates in international gas transportation are as follows:

	2017	2016	%
Gas transport-EMPL (GWh):	49,433	52,299	(5.5)
Portugal-Morocco	20,441	19,988	2.3
Spain (Gas Natural Fenosa)	28,992	32,311	(10.3)

The gas transportation activity conducted in Morocco through companies EMPL and Metragaz represented a total volume of 49,433 GWh, 5.5% less than in the same period last year. Of that figure, 28,992 GWh were shipped for Gas Natural Fenosa through Sagane and 20,441 GWh for Portugal and Morocco.

Gas Natural Fenosa owns 14.9% of Medgaz, the company that owns and operates the Algeria-Europe subsea gas pipeline connecting Beni Saf with the Almería coast (capacity: 8 bcm/year). The corresponding capacity is associated with a new supply contract amounting to 0.8 bcm/year. A total of 3,790 GWh were shipped via the Medgaz pipeline for Gas Natural Fenosa in 1H17.

The company currently has 916 GWh of company-owned gas storage capacity. A number of works (pipeline replacement and initial well drilling) have been completed on one of the projects to increase storage capacity, as part of the exploration, production and storage projects that Gas Natural Fenosa plans for the Guadalquivir Valley in the coming years. The other four projects are at various stages of the permit process.

2.5.8 Supply

This business includes wholesale gas procurement and supply both in the Spanish liberalised market and in other countries, maritime shipping, retail supply of gas and other related products and services in the liberalised market in Spain and Italy, and supply of gas at the last-resort tariff (TUR) in Spain.

Results

	2017	2016	%
Net sales	5,349	4,368	22.5
Procurement	(4,903)	(3,936)	24.6
Net personnel expenses	(41)	(37)	10.8
Other expenses/revenues	(133)	(118)	12.7
EBITDA	**272**	**277**	**(1.8)**
Depreciation, amortisation and impairment expenses	(38)	(28)	35.7
Change in operating provisions	(20)	(23)	(13.0)
Operating income	**214**	**226**	**(5.3)**

Net sales amounted to Euros 5,349 million, a 22.5% increase with respect to the same period of last year. EBITDA amounted to Euros 272 million, in line with the same period of the previous year.

Market context

Spanish gas market demand reached 168,233 GWh in the first half of 2017 (157,936 GWh in the same period of 2016), of which 30,004 GWh relate to the residential market (31,317 GWh in 2016), 111,124 GWh to the industrial market and supplies to third-party (103,989 GWh in 2016) and 27,105 GWh to the electricity market (22,630 GWh in 2016).

Evolution of the main gas market price indices is set out below:

	2017	2016	%
Brent (USD/bbl)	51.8	39.7	30.5
Henry Hub (USD/MBtu)	3.2	2.0	60.0
NBP (USD/MBtu)	5.4	4.5	20.0
TTF (EUR/MWh)	17.4	13.2	31.8

Main aggregates

The main aggregates in the wholesale gas procurement and supply activity are as follows:

	2017	2016	%
Gas supply (MW):	178,821	160,959	11.1
Spain:	90,594	89,686	1.0
Gas Natural Fenosa supply	71,496	71,164	0.5
Residential	15,793	16,850	(6.3)
Industrial	47,457	47,980	(1.1)
Electricity	8,246	6,334	30.2
Supplies to third parties	19,098	18,522	3.1
International:	88,227	71,273	23.8
Europe wholesale	37,275	35,324	5.5
Europe retail	2,086	1,885	10.7
Other foreign	48,866	34,064	43.5
Energy services contracts (thousand) (at 30/06)	2,884	2,816	2.4
Share of supply market in Spain	42.5%	45.0%	(5.8)

Gas supply

Wholesale supply by Gas Natural Fenosa totalled 160,943 GWh, a 13.2% increase, basically due to the international business (+24.1%).

Gas Natural Fenosa supplied 74,802 GWh of gas to end customers in Spain, i.e. 2.7% more than in the same period of the previous year.

International gas supply amounted to 86,141 GWh in the first half of 2017, a 24.1% increase year-on-year, driven particularly by international LNG supply.

In the organised market in gas through MIBGAS, DA (day-ahead) and WD (within day) contracts became more firmly established and there was an increase in liquidity driven by actions proposed by the system operator (GTS) to achieve equilibrium in the gas balance; Gas Natural Comercializadora is one of the few active participants in this market Additionally, the figure of "voluntary market maker" was created in January 2017, giving the market greater liquidity and depth.

In the first quarter of 2017, Gas Natural Fenosa participated in the auction for underground storage capacity for the period from April 2017 to March 2018. Gas Natural Fenosa was awarded 10.3 TWh of capacity, i.e. 46.2% of the total capacity contracted via direct assignment.

Gas Natural Europe has a strong position in natural gas supply in Europe, with a presence in France, Belgium, Ireland, Italy, Luxembourg, Portugal, the Netherlands and Germany. It is also an active trader in these countries' liquid markets, enabling Gas Natural Fenosa to optimise its position and seize opportunities in European markets.

Sales in France in 2017 amounted to 19.5 TWh, to customers in numerous segments such as industry, local government and the public sector. Sales in Belgium, Luxembourg, the Netherlands and Germany amounted to 9.0 TWh in the same period.

Gas Natural Fenosa is also active in the wholesale market in Italy and Ireland, where it sold 4.8 TWh and 0.8 TWh, respectively, in the first half of 2017.

Gas Natural Fenosa is still Portugal's second-largest operator (and its largest foreign operator), with a 15% market share, and it sold 3.1 TWh in the first half of 2017. Its activities are focused in the industrial market, where it has a share of over 17%.

The company continues to diversify into international markets, having sold gas in the Americas and Asia. This strengthens the Group's presence in the main international LNG markets, providing it with a medium-term position in countries with growth potential and in new markets.

In the retail market, Gas Natural Fenosa focuses on meeting its customers' energy needs. With a range of quality products and services, it has 12.3 million active gas, electricity and maintenance contracts, of which 579 thousand are in Italy.

In the Italian retail market, Gas Natural Fenosa has a portfolio of 434,753 gas supply contracts and 52,272 electricity supply contracts, with an overlap of 27 thousand between the two. Additionally, 91,856 customers have a maintenance contract.

Gas Natural Fenosa provides a comprehensive service by integrating the supply of both energies (gas and electricity) with maintenance services to achieve efficiencies and enhance customer satisfaction; it supplies both energies to over 1.5 million homes, a large percentage of which have a maintenance contract in place.

With a strong focus on continued growth in the retail business, the company sells products and services throughout Spain, having signed 849 thousand new contracts in 2017.

In the domestic gas segment, GNF updates its product portfolio with a view to offering electricity and natural gas tariffs that are tailored to each customer's profile. New products meet needs as a function of customers' energy usage, preferred form of payment, usage patterns over time and their interest in consuming renewable energy .

In the highly competitive SME market, Gas Natural Fenosa is adapting to customers' needs by expanding customised price offers in this segment, which attained 1.5 TWh/year in the second quarter. It also expands, updates and pursues flexibility in its product portfolio in order to match customer profiles as closely as possible through products indexed to pool prices, fixed-price products for business, and eco-type products.

In the SME segment, Gas Natural Fenosa distinguishes itself from competitors by offering its Energy Saving Service, which enables customers to optimise their contracted power and save. Over 114,000 SME customers have received consulting services in 2017. Additionally, the portfolio of gas and electricity maintenance services for SMEs continues to expand, having attained 28,000 contracts.

The broad, diversified offering of services for residential and SME customers has enabled the company to increase the number of active contracts to 2.8 million, managed through the group's own operating platform with 112 associated firms connected via an online system, through which it provides an excellent service and satisfies even the most demanding customers. As a result of this performance, the portfolio of energy and services contracts in the retail segment increased in value.

Gas Natural Fenosa remains committed to innovation to meet and even anticipate its customers' expectations by adding new functionalities in all digital channels, such as the ability to buy services and receive customer care online; its online platform receives 6 million queries per year.

Gas Natural Fenosa continues to develop its own network of natural gas service stations that are open to the public; at the end of June 2017, it had 49 service stations (both compressed and liquefied natural gas). A total of 28 stations are open to the public and 21 are private.

The integrated energy services solutions business continues to expand. A survey conducted by DBK identified Gas Natural Servicios as market leader in energy services to business.

Unión Fenosa Gas

Gas supplied in Spain by Unión Fenosa Gas (equity method, figures expressing 100%) amounted to 21,885 GWh in 1H17, compared with 17,083 GWh in the first half of the previous year. Additionally, a total of 12,537 GWh of energy was traded in international markets in the first half of 2017, compared with 10,792 GWh in 2016.

Electricity

2.5.9 Electricity in Spain

The electricity business in Spain includes electricity generation in Spain, electricity wholesale and retail in Spain's deregulated market, and electricity supply at the "voluntary price for small consumers" (PVPC).

Results

	2017	2016	%
Net sales	2,486	2,573	(3.4)
Procurement	(1,915)	(1,834)	4.4
Net personnel expenses	(68)	(68)	-
Other expenses/revenues	(313)	(295)	6.1
EBITDA	**190**	**376**	**(49.5)**
Depreciation, amortisation and impairment expenses	(224)	(263)	(14.8)
Change in operating provisions	(11)	(20)	(45.0)
Operating income	**(45)**	**93**	**(148.4)**

Net sales in the electricity business in Spain amounted to Euros 2,486 million, 3.4% less than in the same period of the previous year, while EBITDA amounted to Euros 190 million, 49.5% less than in the same period last year.

EBITDA performance was shaped by weather, as Gas Natural Fenosa's hydroelectric output shrank by 77.3%, since 2017 is proving to a very dry year, in contrast with 2016, which was classified as very wet. It was also affected by higher taxes caused by high market prices.

Depreciation, amortisation and impairment expenses amounted to Euros 224 million, a decline of Euros 39 million (-14.8%) with respect to the same period of the previous year, basically because of extending the useful lives of the combined cycle plants from 25 to 35 years on 1 January 2017 following technical surveys completed in the first quarter, in line with the practices adopted by the leading players in the industry.

Market context

Overall, demand in the first half of 2017 was 1.1% higher than in the same period of the previous year (1.6% after adjusting for the leap year effect).

The balance of physical interchanges amounted to 5,073 GWh in the first half of 2017, compared with 3,723 GWh in the same period of the previous year.

Year-to-date consumption for pumped storage amounted to 2,069 GWh, i.e. 40.4% less than in 1H16 due to high market prices in comparison with the first half of last year.

Net domestic electricity output declined by 1.2% with respect to the first half of 2016.

Renewable output declined by 25.8% in the first half of 2017 and covered 36.4% of demand, compared with 49.6% in 2016.

Wind output in the first half amounted to 25,184 GWh (-12.0% with respect to the same period of 2016) and covered 20.1% of demand, three points less than in the same period of 2016.

Non-renewable generation output increased by 22.8% in the first half.

The thermal gap increased by 67.7% in the first half, i.e. 10.2 points higher in the same period of 2016 (25.7% vs. 15.5%).

Nuclear output increased by 3.3% in the first half.

Coal-fired output increased by 98.8%. Year-to-date, utilisation of the former capacity guarantee units was 39%, compared with 55% for other coal-fired units.

CCGT output increased by 33.3% in the first half of 2017. CCGT output covered 9.7% of demand in the first half, i.e. 2.5 points more than in the first half of 2016.

Non-renewable thermal, cogeneration and waste-to-power experienced an increase of 11.3% in 1H17 with respect to the same period of last year.

The weighted average price in the electricity pool was Euros 52.9 €/MWh in the first half of 2017, i.e. 71.8% more than in the same period of 2016.

Movements in the main electricity and related market price indices (in addition to the indices mentioned in point 2.5.8.) are set out below:

	2017	**2016**	**%**
Arithmetic average daily market price (EUR/MWh)	51.3	30.1	70.4
Coal API 2 CIF (USD/t)	78.9	47.0	67.9
CO_2 EUA (EUR/ton)	5.0	5.7	(12.3)

Main aggregates

The main aggregates in Gas Natural Fenosa's electricity business in Spain were as follows:

	2017	2016	%
Installed capacity (MW):	12,716	12,714	-
Generation:	11,569	11,569	-
Hydroelectric	1,954	1,954	-
Nuclear	604	604	-
Coal	2,010	2,010	-
CCGTs	7,001	7,001	-
Renewable and cogeneration output:	1,147	1,145	0.2
Wind	979	977	0.2
Small hydroelectric	110	110	-
Cogeneration and other	58	58	-
Electricity generated (GWh):	13,161	12,767	3.1
Generation:	11,895	11,270	5.5
Hydroelectric	737	3,244	(77.3)
Nuclear	2,185	2,104	3.8
Coal	2,832	936	202.6
CCGTs	6,141	4,986	23.2
Renewable and cogeneration output:	1,266	1,497	(15.4)
Wind	987	1,135	(13.0)
Small hydroelectric	240	334	(28.1)
Cogeneration and other	39	28	39.3
Power generation availability factor (%)	92.1	84.3	7.8 p.p.
Electricity sales (GWh):	17,284	18,107	(4.5)
Liberalised market	14,674	15,454	(5.0)
PVPC/Regulated	2,610	2,653	(1.6)
Market share of generation	16.5	15.7	0.8 p.p.

Gas Natural Fenosa generated 13,161 GWh of electricity in mainland Spain, i.e. 3.1% more than in the same period of 2016 (5.5% more, considering only conventional sources).

Conventional hydroelectric output totalled 737 GWh in the first half, 77.3% less than in the same period of 2016.

The year could be classified as extremely dry, with an exceedance probability of 99%; i.e. 99 out of 100 years would be wetter than 2017.

Reservoirs in the Gas Natural Fenosa watersheds were at 34% of capacity, 21 points lower than at the same point in 2016.

Nuclear output increased by 3.8%.

Coal-fired output tripled, having increased by 202.6%, with 33% total capacity utilisation.

CCGT output increased by 23.2% in the first half of the year. Gas Natural Fenosa's CCGT utilisation in the first half was 20%, almost double that of the industry as a whole.

Emissions[4] of CO_2 in the second quarter of 2017 from Gas Natural Fenosa's coal-fired power plants and CCGTs that are affected by the regulation governing greenhouse gas emission trading totalled 5 million tons. This significant increase was due mainly to greater utilisation of coal-fired plants.

Gas Natural Fenosa applies a comprehensive approach to its portfolio of CO_2 emission rights for the post-Kyoto (2013-2020) period, acquiring the necessary emission rights and credits through active participation in the secondary market.

Gas Natural Fenosa's share of conventional output was 16.5% in the first half of 2017, 0.8 points more than in the same period of 2016.

In the area of renewables and cogeneration, in 2017 Gas Natural Fenosa Renovables (GNF Renovables) commenced construction of 7 of the 13 wind farms registered under the maximum quota of 450 MW authorised by the Ministry of Industry, Energy and Tourism for the Canary Islands. These 7 farms under construction will have a combined installed capacity of 27 MW. This capacity will enjoy a special remuneration system, conditional upon it being commissioned by 31 December 2018. At the same time, work continues to obtain the necessary permits to begin building the other 6 wind farms in the second half of 2017.

Additionally, Gas Natural Fenosa was awarded a total of 667 MW of wind capacity in an auction held by the Spanish government on 17 May, in which the leading domestic energy companies and numerous developers participated. Gas Natural Fenosa obtained 22% of the auctioned capacity, which enhances the group's pipeline, on which it has been working in recent years, enabling it to configure a very competitive, optimised portfolio of projects. The development and construction of these projects will cost a maximum of Euros 700 million and they must be commissioned by December 2019.

At 30 June 2017, GNF Renovables had a consolidable total operational capacity of 1,147 MW, of which 979 MW are wind, 110 MW are small hydroelectric and 58 MW are cogeneration and photovoltaic. Those figures include the 43 MW of slurry-based cogeneration plants that are in liquidation.

The Ministerial Order establishing the criteria for remunerating cogeneration plants based on slurry was published in June 2017. The first impact of this publication is that part of the remuneration that was repaid to the CNMC in 2014-2016 amounting to Euros 8 million.

The Order also makes it possible to make decisions as to bringing this cogeneration technology, which is currently mothballed, back into production either fully or partially.

[4] Greenhouse gases

2.5.10 International Electricity

Encompasses all of the international power generation assets and holdings in Mexico, Puerto Rico, the Dominican Republic, Panama, Costa Rica and Kenya and its power generation projects in Australia, Chile and Brazil, as well as assets operated for third parties via group company O&M Energy.

Results

	2017	2016	%
Net sales	466	353	32.0
Procurement	(259)	(166)	56.0
Net personnel expenses	(20)	(22)	(9.1)
Other expenses/revenues	(39)	(41)	(4.9)
EBITDA	**148**	**124**	**19.4**
Depreciation, amortisation and impairment expenses	(64)	(65)	(1.5)
Change in operating provisions	-	-	-
Operating income	**84**	**59**	**42.4**

EBITDA in 1H17 amounted to Euros 148 million, up 19.4% compared with the previous year, due mainly to higher EBITDA contribution of Mexico.

Depreciation, amortisation and impairment expenses amounted to Euros 64 million, a decline of 1.5% with respect to the same period of the previous year, basically because of extending the useful lives of the combined cycle plants from 25 to 35 years on 1 January 2017 following technical surveys completed in the first quarter, in line with the practices adopted by the leading players in the industry, partly offset by foreign currency conversion effect.

EBITDA in Mexico increased by 27.7% because the contribution margin increased, basically due to higher spare capacity, better availability, better performance, and favourable trends in the contracts' benchmark indices. Additionally, results at Bii Hioxo improved due to more efficient management of the sales mix.

EBITDA in the Dominican Republic declined by 26.8% due to the effect on margins of lower output and lower spot market prices after expiration of the PPA[5] with the distribution companies.

EBITDA in Panama increased by 15.9% due to higher precipitation in the areas where the plants are located.

Kenya experienced a 20.4% year-on-year increase in EBITDA as output increased due to greater dispatching.

[5] PPA: Power Purchase Agreement.

Main aggregates

The main aggregates are as follows:

	2017	2016	%
Installed capacity (MW):	2,702	2,702	-
Mexico (CC)	2,035	2,035	-
Mexico (wind)	234	234	-
Costa Rica (hydroelectric)	101	101	-
Panama (hydroelectric)	22	22	-
Dominican Republic (oil-fired)	198	198	-
Kenya (oil-fired)	112	112	-
Electricity generated (GWh):	9,065	8,657	4.7
Mexico (CC)	7,925	7,509	5.5
Mexico (wind)	306	387	(20.9)
Costa Rica (hydroelectric)	196	170	15.3
Panama (hydroelectric)	38	33	15.2
Dominican Republic (oil-fired)	466	485	(3.9)
Kenya (oil-fired)	134	73	83.6
Availability factor (%)			
Mexico (CC)	95.6	89.2	6.4 p.p.
Costa Rica (hydroelectric)	96.8	94.1	2.7 p.p.
Panama (hydroelectric)	90.1	92.7	-2.6 p.p.
Dominican Republic (oil-fired)	92.1	89.5	2.6 p.p.
Kenya (oil-fired)	97.8	95.1	2.7 p.p.

Output in Mexico increased year-on-year as a result of the different schedule of maintenance shutdowns and greater sales of surplus energy, mainly from Norte Durango and Tuxpan, which began selling surplus power in February 2017. These effects were offset by lower output at Bii Hioxo because of lower winds. Differences in maintenance calendars between years resulted in higher availability than last year.

Hydroelectric output in Costa Rica was favoured by higher precipitation. As discussed in section 2.2.3, the concessions in Costa Rica are recognised as finance leases in accordance with IFRIC 12.

Higher output in Panama was the result of greater precipitation as the first quarter of 2016 was especially dry in the areas where the plants are located. The lower availability with respect to last year is attributable to that fact that the Los Algarrobos hydroelectric plant underwent its annual overhaul in the second quarter of 2017.

Output in the Dominican Republic declined year-on-year due to higher hydroelectric generation and to the withdrawal of the more efficient plants from the system in 2016.

Oil-fired output in Kenya was higher than in the same period of 2016 as a result of increased dispatching this year due to withdrawal of the more efficient plants from the system.

Ecoeléctrica, the CCGT plant in Puerto Rico (equity accounted), increased its contribution to the consolidated figures to Euros 29 million (from Euros 21 million) as a result of higher capacity revenues. Output in the first half of 2017 amounted to 1,636 GWh (100%), in line with the same period of 2016 (1,646 GWh).

3. Main risks and uncertainties

3.1. Operating risks

3.1.1. Regulatory risk

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

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

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

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

3.1.2. Gas and electricity volume risk

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

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

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

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

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

3.1.3. Operational risk

a) Insurable risks

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

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

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

b) Image and reputation

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

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

c) Environment

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

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

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

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

d) Climate change

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

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

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

e) Geopolitical exposure

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

- Latin America

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

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

- Middle East and Maghreb

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

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

3.2. <u>Financial risks</u>

Financial risks (interest rate, exchange rate, commodity price, credit and liquidity risk) are detailed in Note 17 to the 2016 Consolidated Annual Accounts.

3.3. <u>Main opportunities</u>

- Generation mix: Gas Natural Fenosa's generating fleet, consisting mainly of CCGT facilities, has the necessary flexibility to adapt to different market circumstances; it is thus a valuable asset to leverage opportunities related to price and demand volume volatility in the gas and electricity markets.

- International generation: Increase renewable capacity internationally, given that renewable energies are cost-competitive and Gas Natural Fenosa's presence in growth markets.

- CO_2 market evolution: The mechanisms proposed by the European Commission to increase the cost of emission rights are intended to discourage the use of the more polluting technologies so as to counteract climate change. In this context, Gas Natural Fenosa's plants would be more competitive than coal plants and opportunities could also arise in the emissions market.

- NG/LNG procurement portfolio: Management of gas pipelines, investment in plants and the fleet of gas carriers enable the Group to meet its business needs in a flexible, diversified manner, optimising its approach to different energy scenarios. Specifically, the fleet of gas carriers makes Gas Natural Fenosa one of the world's leading LNG operators and a principal in the Atlantic and Mediterranean.
- A balanced structural position in terms of businesses and geographies, many with stable flows, irrespective of commodities prices, making it possible to take the maximum advantage of growth in energy demand and of new business opportunities in new markets.

4. Events after the reporting date

Events after closing data, i.e. 30 June 2017, are described in Note 19 to the condensed interim consolidated financial statements.

****

Glossary of terms

Gas Natural Fenosa'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.

Selected APMs are usefull to financial information users because they allow analysis of Gas Natural Fenosa financial performance, cash flows and the financial situation, as well as its comparative to other companies.

Below is a glossary of terms with the definition of the APMs used. APMs terms are, generally, directly traceable with the corresponding lines and subtotals of the interim consolidated balance sheet, the interim consolidated income statement, the interim consolidated cash flow statement or the notes to the condensed interim consolidated financial statements of Gas Natural Fenosa. For those whose terms are not directly traceable there is, below the Glossary, a breakdown of the calculations.

Alternative performance metrics	Definition and terms
Ebitda	"Operating income"(2) + "Depreciation, amortisation and impairment expenses"(2) + "Transfers to provisions"(4) (Note 13) – "Other results"(2)
Cash flow from operations (CFO)	"Operating cash flows"(3) before "Changes in working capital"(3)
Investments, net	Investment in intangible assets(4) (Note 5) + Investment in property, plant and equipment(4) (Note 5) + Investment in financial assets - Receipts for divestment of property, plant and equipment and intangible assets - Other investing receipts/payments(6)
Gross financial debt	"Non-current financial liabilities"(1) + "Current financial liabilities"(1)
Net borrowings	Gross financial debt(5) – "Cash and cash equivalents"(1) – "Derivative financial assets"(4) (Note 6)
Leverage (%)	Net borrowings(5) / (Net borrowings(5) + "Net equity"(1))
Cost of net borrowings	"Cost of borrowings"(4) (Note 14) – "Interest revenues"(4) (Note 14)
Ebitda / Cost of net borrowings	Ebitda(5) / Cost of net borrowings(5)
Net borrowings / Annualized Ebitda	Net borrowings(5) / Ebitda annualized(6)
Return on assets (ROA) (%)	Annualized attributable net income(6) / "Total Assets" (1)
Market capitalisation	No. of shares at end of period(6) * Market price at end of period(6)
Earnings per share	"Net income attributable for the period"(2) / Average number of shares of period(6)
Net equity attributable to the equity holders of the parent company per share	"Net equity attributable to the equity holders of the parent company" (1) / No. of shares at end of period(6)
Price-earnings ratio (P/E)	Closing share price(6) / Earnings per share in the last four quarters(6)

Enterprise value (EV)	Market capitalisation(5) + Net borrowings(5)
EV / Annualized Ebitda	Enterprise value(5) / Ebitda annualized(6)
Personnel expenses, net	Personnel expenses - Capitalised personnel expenses (Note 12) (4)
Other expenses/revenues	"Other operating revenues"(2), "Other operating expenses" (2) and "Release of fixed assets grants to income and others" (2)

(1) Interim consolidated balance sheet heading
(2) Interim consolidated income statement heading
(3) Interim consolidated cash flow statement heading
(4) Figures detailed in the Notes to the condensed interim consolidated financial statement
(5) Figures detailed in the APM
(6) Figures set out below this glossary

Additionally, set out below is a breakdown of the calculations of those APMs terms not directly traceable:

	EBITDA
3rd quarter 2016	1,183
4th quarter 2016	1,330
1st quarter 2017	1,104
2nd quarter 2017	1,072
Annualized Ebitda	4,689

	Attributable net income
3rd quarter 2016	285
4th quarter 2016	417
1st quarter 2017	298
2nd quarter 2017	252
Annualized attributable net income	1,252

	Net income	**Average number of shares (thousand)**	**Earnings per share**
3rd quarter 2016	285	1,000,689	0.28
4th quarter 2016	417	1,000,468	0.42
1st quarter 2017	298	1,000,689	0.30
2nd quarter 2017	252	1,000,519	0.25
Earnings per share in the last four quarters (euro)			1.25
Closing share price (euro)			20.49
Price-earnings ratio (P/E)			16.4

The number of issued shares at the end of the period is included in page number 3 of the Consolidated Directors' Report

Financial investments, proceeds from divestitures of property, plant and equipment and intangible assets and other proceeds/(payments) in investing activities are included in page number 8 of the Consolidated Directors' Report