

**ENDESA, S.A.
and Subsidiaries**

**Consolidated Management Report for
the year ended 31 December 2016**

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

Madrid, 22 February 2017

ENDESA, S.A. AND SUBSIDIARIES
CONSOLIDATED MANAGEMENT REPORT
FOR THE YEAR ENDED
31 DECEMBER 2016

Contents

1. Position of the entity	4
1.1. Main areas of business.....	4
1.2. Organisational structure.....	4
1.3. Main markets.....	5
1.4. Corporate Map.....	6
2. Business trends and results in 2016.....	8
2.1. Acquisition of ENEL Green Power España, S.L.U. (EPGE).....	8
2.2. Consolidated results.....	10
2.3. Analysis of results.....	11
2.4. Consolidation scope.....	17
2.5. Statistical Appendix.....	18
3. Regulatory Framework.....	21
4. Liquidity and Capital Resources.....	23
4.1. Financial Management.....	23
4.2. Capital Management.....	26
4.3. Credit Rating Management.....	27
4.4. Cash Flows.....	27
4.5. Investments.....	28
4.6. Contractual Obligations and Off-Balance Sheet Operations.....	29
5. Events after the Reporting Period.....	30
6. Outlook.....	30
6.1 Energy paradigm.....	30
6.2 Strategic pillars.....	30
6.3 Main financial indicators.....	33
7. Main risks and uncertainties in connection with ENDESA's business.....	33
7.1. Risk control and management policy.....	33
7.2. Main risks and uncertainties.....	35
8. Sustainability policy.....	45
8.1. ENDESA's sustainability commitment.....	45
8.2. Compliance with ENDESA's 2016-2019 Sustainability Plan.....	46
8.3. ENDESA's contribution to the United Nations Sustainable Development Goals (SDGs).....	47
9. Research, Development and Innovation Activities (R&D+i).....	48
9.1. Context and Objectives of the Research, Development and Innovation Activities (R&D+i).....	48
9.2 Investment in research, development and innovation activities (R&D+i).....	48
9.3 Main areas of activity.....	48
9.4. Innovation Model.....	52
9.5. Patents and Licences.....	53
10. Environmental Protection.....	53
10.1. ENDESA's environmental policy.....	53
10.2. Environmental investment and expenditure.....	54

10.3. ENDESA's Environmental Management Systems	54
11. Human Resources.....	56
11.1. ENDESA's workforce	56
11.2. Occupational health and safety.....	57
11.3. Responsible personnel management	57
11.4. Employment climate.	58
11.5. Leadership and personal development.....	58
11.6. Training.....	59
11.7. Attracting and retaining talent	60
11.8. Social dialogue	60
12. Treasury Shares	61
13. Other information.....	61
13.1. Stock Market Information.....	61
13.2. Dividend policy.....	62
14. Information on the Average Payment Period to Suppliers and Creditors	63
15. Proposed distribution of net income.....	63

ENDESA, S.A. AND SUBSIDIARIES
CONSOLIDATED MANAGEMENT REPORT
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ENDED 31 DECEMBER 2016

ENDESA drew up this Consolidated Management Report for the year ended 31 December 2016 in accordance with the "Guidelines for drawing up Management Reports of Listed Companies" issued by the Group of Experts appointed by the Spanish Securities Market Commission (CNMV).

1. Position of the entity.

1.1. Main areas of business.

ENDESA, S.A. was incorporated on 18 November 1944, and its registered office is in Madrid, calle Ribera del Loira 60.

Its corporate purpose is the electricity business in all its various industrial and commercial areas, the exploitation of all types of primary energy resources, the provision of industrial services or services relating to its main area of business, particularly gas business, and those preliminary or supplementary to the corporate purpose and management of the corporate Group, comprising investments in other companies. The Company will carry out the activities constituting its corporate purpose in Spain and abroad, either directly or through investment in other companies.

ENDESA, S.A.'s business purpose is mainly categorised in section E, division 40, subclass 40.10 of the Spanish Business Classification Index (CNAE).

ENDESA, S.A. and its subsidiaries (ENDESA or the "Company") operate in the electricity and gas business, mainly in the markets of Spain and Portugal. To a lesser extent, ENDESA also supplies electricity and gas in other European markets, and other value-added products and services (VAPS) related to its main business.

The organisation is divided into generation, supply and distribution activities, each of which includes electricity and, in certain cases, gas activities.

In view of the areas of business carried on by the subsidiaries of ENDESA, S.A., transactions are not highly cyclical or seasonal.

1.2. Organisational structure.

ENDESA and its subsidiaries are part of the ENEL Group, which is headed by ENEL Iberoamérica, S.L.U. in Spain.

At 31 December 2016, the ENEL Group held 70.101% of the share capital in ENDESA, S.A., through ENEL Iberoamérica, S.L.U.

At the date on which this Consolidated Management Report was drawn up, the composition of ENDESA's Executive Management Committee, the functions of which include implementation of Group strategies, was as follows:

Position	Member
Chief Executive Officer	José Damián Bogas Gálvez
General Manager - Communication	Alberto Fernández Torres
General Manager - Energy Management	Alvaro Luis Quiralte Abelló
General Manager - Human Resources and Organisation	Andrea Lo Faso
General Manager - Renewable Energies	Enrique de las Morenas Moneo
General Manager - Infrastructure and Networks	Francesco Amadei
General Manager - Sales	Javier Uriarte Monereo
General Manager – Institutional Relations and Regulation	José Casas Marín
General Manager - Media	José Luis Puche Castillejo
General Manager - Nuclear Power	Juan M ^a Moreno Mellado
General Manager - Audit	Luca Minzolini
General Manager - ICT	Manuel Fernando Marín Guzmán
General Manager - Generation	Manuel Morán Casero
General Manager - Sustainability	María Malaxechevarría Grande
General Manager - Purchasing	Pablo Azcoitia Lorente
General Manager - Administration, Finance and Control	Paolo Bondi
General Secretary to the Board of Directors and General Manager of Legal and Corporate Affairs	Francisco de Borja Acha Besga

The annual corporate governance report, which describes the organisation of the ENDESA, S.A. Board of Directors, and the bodies to which the Board delegates its decisions, is attached to this Consolidated Management Report as Appendix I.

The general principles established in ENDESA's corporate governance strategy, ensure that the company's internal rules are set up so as to guarantee transparency and the reconciliation of the interests of all parts of the shareholder structure, along with the equal treatment among all shareholders of the same kind and in the same situation.

1.3. Main markets.

ENDESA generates, distributes and sells electricity mainly in Spain and Portugal and, to a lesser extent, supplies electricity and gas to other European markets, in particular Germany, France, Belgium, France and the Netherlands, from its platform in Spain and Portugal.

ENDESA's electricity generation and supply businesses are managed in an integrated manner, in order to optimise its position as compared to managing these activities separately.

The markets in which ENDESA carries out its activities are described as follows:

Market in Spain.

- **Generation:** ENDESA carries out its electricity generation activities in the mainland system and in Non-Mainland Territories (“TNP” in Spanish), which include the Balearic and Canary Islands and the self-governing cities of Ceuta and Melilla.
 - Electricity generation is a deregulated activity, although there can be generation with renewable energies with specific remuneration.
 - Meanwhile, generation in Non-Mainland Territories is subject to specific regulations which address the particular nature of their geographical location, and their remuneration is regulated.
- **Supply of electricity, gas and value-added services and products (VAPS or “PSVA” in Spanish):** This activity consists of supplying energy on the market and value added services and products (VAPS) to customers. The supply of energy is a deregulated activity.
- **Distribution of electricity:** The purpose of the electricity distribution activity is to distribute electricity to the consumption points. Electricity distribution is a regulated activity.

Section 2.5. Statistical Appendix to this Consolidated Management Report provides a breakdown of ENDESA's main figures at 31 December 2016.

Market in Portugal:

- **Generation:** Electricity generation in Portugal is carried out in a competitive environment.
- **Supply of electricity and gas.** This activity is deregulated in Portugal.

1.4. Corporate Map

ENDESA, S.A.'s activity is structured by Business Lines, giving the Company flexibility and the ability to respond to the needs of its customers in the territories and businesses in which it operates.

For the organisation of its Business Lines, ENDESA works primarily through the following companies:

Electricity generation: ENDESA Generación, S.A.U.

This company was set up on 22 September 1999 to oversee ENDESA's generation and mining assets.

ENDESA Generación, S.A.U. comprises holdings in Gas y Electricidad Generación, S.A.U. (100%), Unión Eléctrica de Canarias Generación, S.A.U. (100%), ENEL Green Power España, S.L.U. (EGPE) (100%) and a 50% stake in Nuclenor, S.A., which owns the Nuclear Plant at Santa María de Garoña.

At 31 December 2016, Endesa's installed capacity at ordinary regime facilities was 21,069 MW, of which, 16,495 MW corresponded to the mainland electricity system and the remaining 4,574 MW to Non-Mainland Territories of the Balearic and Canary Islands and the cities of Ceuta and Melilla. At this date, the net installed capacity for renewables was 1,675 MW.

In Spain, ENDESA had total net output in 2016 of 69,831 GWh (see Section 2.5 Statistical Appendix to this Consolidated Management Report).

Energy distribution: ENDESA Red, S.A.U.

This company was set up on 22 September 1999 and marked the culmination of the integration of ENDESA's regional distribution companies in Spain.

Among other interests, this company holds 100% interests in ENDESA Distribución Eléctrica, S.L.U., which engages in regulated electricity distribution activities, and ENDESA Ingeniería, S.L.U. (100%).

At 31 December 2016 ENDESA distributed electricity in 27 Spanish provinces and across 10 Autonomous Communities (Andalusia, Aragón, the Balearic Islands, the Canary Islands, Castilla y León, Catalonia, Valencia, Extremadura, Galicia and Navarra), covering a total area of 194,687 km² with a total population of nearly 22 million. ENDESA had over 12 million distribution customers, and in 2016, its network supplied a total power output of 115,602 GWh, measured at busbar cost (see Section 2.5. Statistical Appendix to this Consolidated Management Report).

Energy supply: ENDESA Energía, S.A.U.

ENDESA Energía, S.A.U. was set up on 3 February 1998 to carry out supply activities, responding to the demands of Spanish electricity market deregulation. Its main business is the supply of energy and added-value products and services (VASP) to customers wishing to exercise their right to choose their supplier and take up the service on the deregulated market.

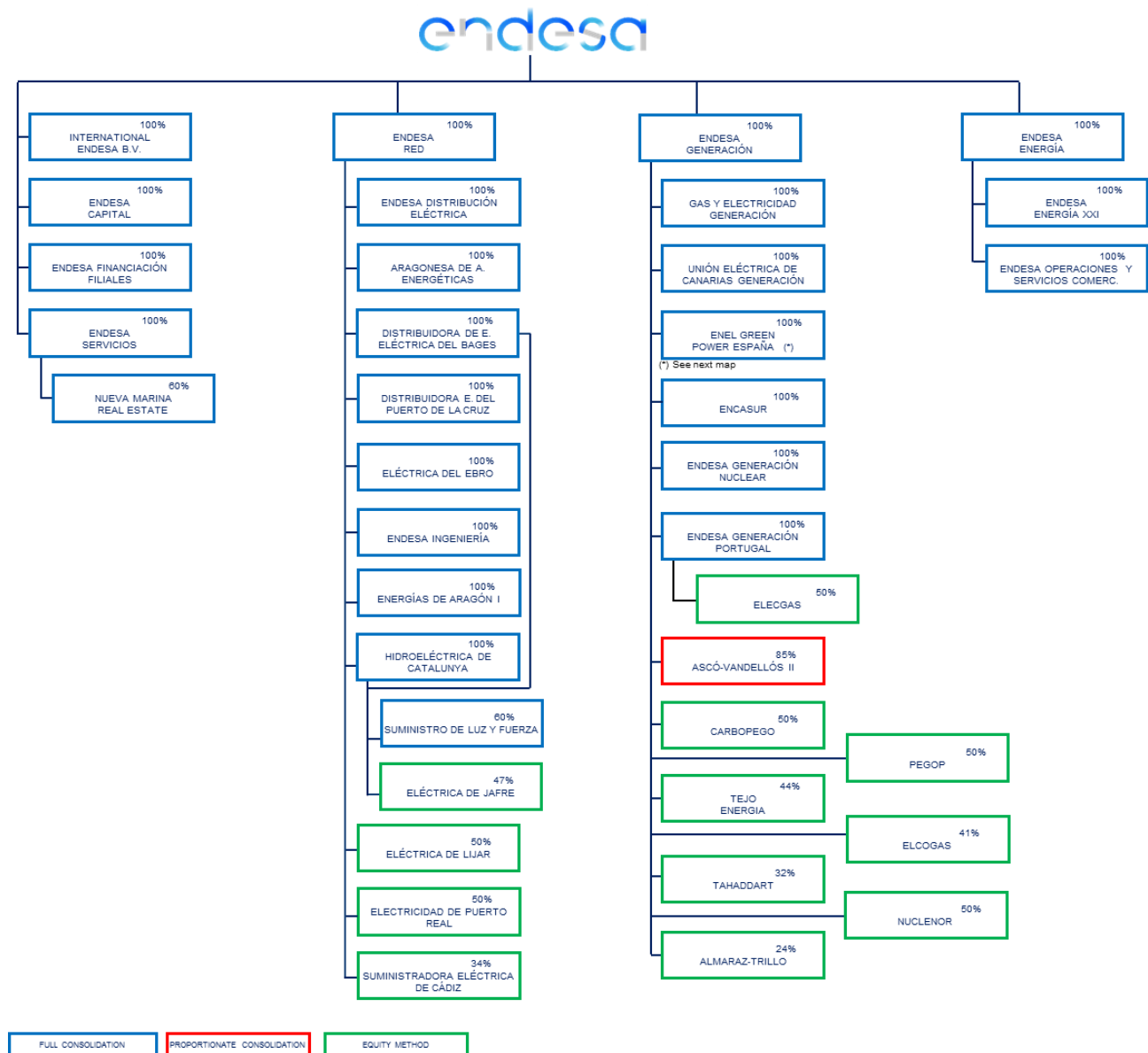
ENDESA Energía, S.A.U. also holds 100% of the equity of ENDESA Energía XXI, S.L.U., a company acting as a reference supplier for ENDESA and ENDESA Operaciones y Servicios Comerciales, S.L.U. which provides commercial services in relation to the supply of power. ENDESA Energía, S.A.U. supplies the deregulated markets of Germany, Belgium, France, the Netherlands and Portugal.

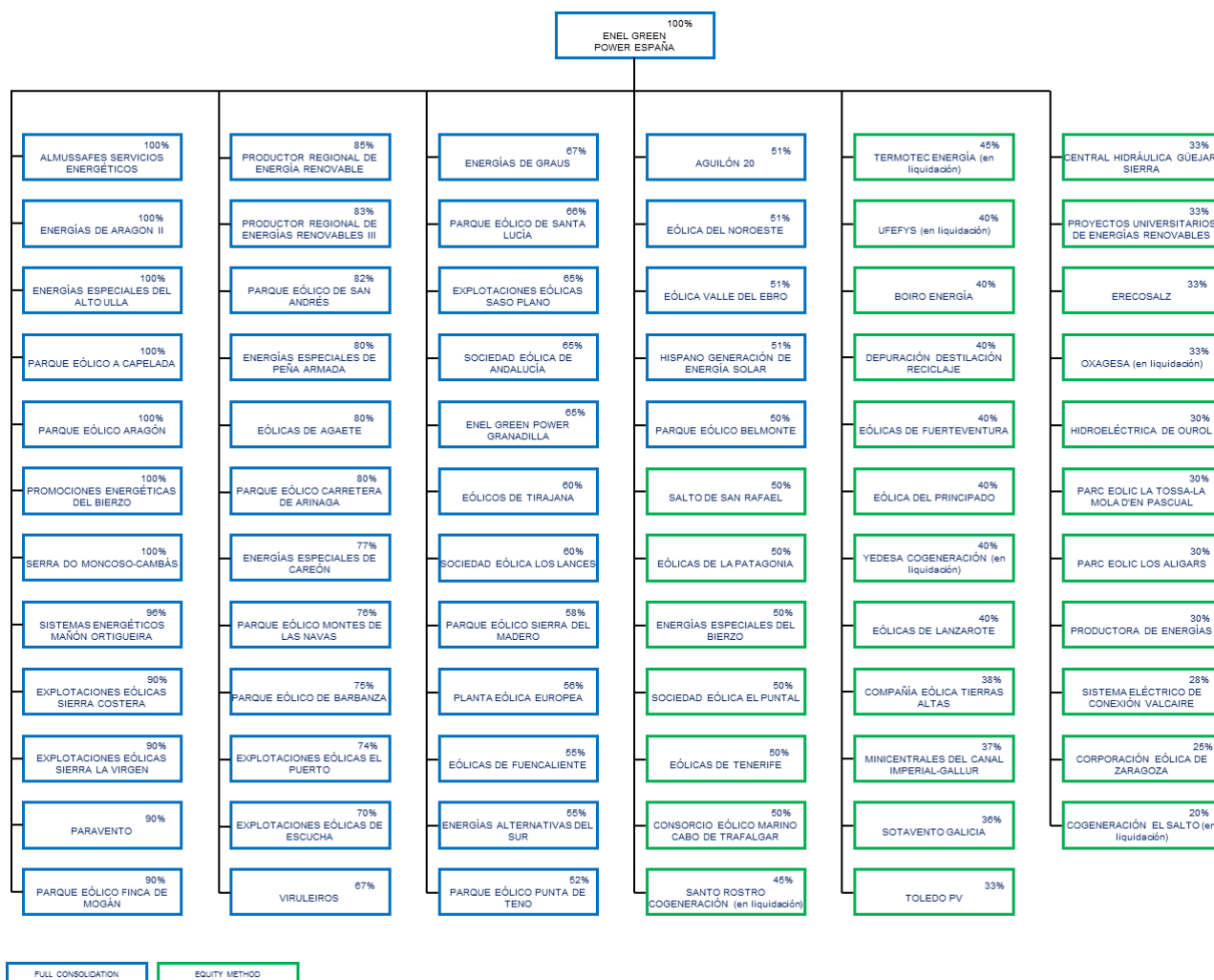
In 2016, ENDESA provided 93,490 GWh to 11.0 million supply points in the electricity market. ENDESA supplied total gas of 78,129 GWh in 2016, and at 31 December 2016, its customer portfolio in the conventional natural gas market was made up of 1.5 million supply points (see Section 2.5. Statistical Appendix to this Consolidated Management Report).

Appendix I to the Consolidated Financial Statements for the year ended 31 December 2016 lists ENDESA's Subsidiaries and Joint Operation Entities.

Appendix II to the Consolidated Financial Statements for the year ended 31 December 2016 lists ENDESA's Associates and Joint Ventures.

There follows a corporate map of ENDESA showing the situation of its main investees at 31 December 2016:





2. Business trends and results in 2016.

2.1. Acquisition of ENEL Green Power España, S.L.U. (EPGE)

On 27 July 2016 ENDESA Generación S.A.U., a company wholly owned by ENDESA S.A. (ENDESA), purchased a stake from ENEL Green Power International B.V. of 60% of ENEL Green Power España, S.L.U. (EGPE), a company in which it had previously held a 40% stake.

ENEL Green Power España, S.L.U. (EGPE) engages, directly or through companies it controls, in the production of electricity using renewable energy sources in Spain. It currently has approximately 91 wind power, hydroelectric and solar plants, with total installed capacity of 1,675 MW at 31 December 2016 and output of 3,704 GWh in 2016.

When the purchase materialised, it enabled ENDESA to take control of ENEL Green Power España, S.L.U. (EGPE), boosting the significant influence it already had via its 40% holding. The takeover did not lead to any changes in the corporate name of ENEL Green Power España, S.L.U. (EGPE).

Appendix IV to the Consolidated Financial Statements for the year ended 31 December 2016 lists the companies forming part of ENEL Green Power España, S.L.U. (EGPE) at the purchase date.

ENDESA's objective with this proposed acquisition is to reinforce its presence in the Iberian generation market by adding an attractive portfolio of renewable electricity production assets to its production mix.

The purchase price for the 60% holding was Euros 1,207 million, and was paid in full on 27 July 2016. To make the payment, ENDESA, S.A. issued Euro Commercial Paper (ECP) through International ENDESA, B.V., the renewals of which are backed by irrevocable lines of bank credit in the amount of Euros 1,200

million, and completed the amount with an additional drawdown on these lines (see Section 4.1. Financial Management of this Consolidated Management Report). ENDESA, S.A. used the habitual intercompany operation to finance ENDESA Generación, S.A.U.

The net cash outflow from the acquisition of 60% of ENEL Green Power España, S.L.U. (EGPE) was as follows:

Millions of Euros	
Cash and cash equivalents of the acquiree	(31)
Net amount paid in cash (*)	1,209
TOTAL	1,178

(*) Includes purchase costs booked under "Other fixed operating expenses" on the consolidated income statement in the amount of Euros 2 million.

In order to add ENEL Green Power España, S.L.U. (EGPE) to ENDESA's Consolidated Financial Statements, the purchase price was provisionally booked, on the basis of the fair value of the assets acquired and the liabilities undertaken (Net Assets Acquired) from ENEL Green Power España, S.L.U. (EGPE) at the purchase date under the following headings of the Consolidated Financial Statements:

Millions of Euros	
Non-current assets	2,328
Property, Plant and Equipment	1,248
Intangible Assets	757
Investments Accounted for using the Equity Method	34
Non-current Financial Assets	252
Deferred Tax Assets	37
Current assets	143
Inventories	29
Trade and other receivables	70
Current Financial Assets	13
Cash and Cash Equivalents	31
Non-current assets held for sale and discontinued operations	-
TOTAL ASSETS	2,471
NON-CONTROLLING INTERESTS	148
Non-current liabilities	445
Deferred income	9
Non-current Provisions	55
Non-current Interest-Bearing Loans and Borrowings	141
Other Non-current Liabilities	9
Deferred Tax Liabilities	231
Current liabilities	164
Current Interest-Bearing Loans and Borrowings	86
Trade and other Payables	78
Liabilities Associated with Non-current Assets Classified as held for Sale and Discontinued Operations	-
TOTAL LIABILITIES	609
Fair value of net assets acquired	1,714

The difference between the cost of the business combination and the fair value of the assets and liabilities booked as indicated above, in due consideration of the fair value of the previous 40% stake in ENEL Green Power España, S.L.U. (EGPE), generated provisional goodwill in the amount of Euros 298 million.

At 31 December 2016, not even one year after the purchase of ENEL Green Power España, S.L.U. (EGPE), the business combination had been entered in accounts on a provisional basis pending determination of the final conclusions concerning the appraisal of certain compensatory assets and contingent liabilities.

At the date on which this Consolidated Management Report was drawn up, therefore, ENDESA was still working on the final assignment of the purchase price, and this is expected to be completed within the timeframe of one year from the purchase date.

The contribution by ENEL Green Power España, S.L.U. (EGPE) to net profit in 2016 was Euros 38 million, broken down as follows:

Millions of Euros

	2016	2015
Net profit from previous 40% stake ⁽¹⁾	7	10
Net profit from 100% stake ⁽²⁾	-	N/A
Income	118	N/A
Contribution margin	104	N/A
Gross operating profit (EBITDA) ⁽³⁾	75	N/A
Operating profit (EBIT) ⁽⁴⁾	16	N/A
Net profit/loss of companies accounted for using the equity method and others	4	N/A
Investment		
Income tax	6	N/A
Impairment in the shareholding ⁽⁵⁾	(72)	-
Net result of fair value appraisal ⁽⁶⁾	(4)	N/A
Reversal of deferred tax liabilities ⁽⁷⁾	81	-
TOTAL	38	10

- (1) Corresponds to the previous 40% stake up to 27 July 2016, the date of the takeover.
(2) Corresponds to the 100% stake from 27 July 2016, the date of the takeover, to 31 December 2016.
(3) Gross operating profit (EBITDA) = Income - Supplies and Services + Work carried out by the Group for its assets - Personnel expenses - Other fixed operating expenses.
(4) Operating profit (EBIT) = Gross operating profit (EBITDA) - Depreciation and impairment losses.
(5) This corresponds to the booking of impairment of Euros 72 million prior to the takeover, considering that the recovery value of ENDESA's 40% holding in ENEL Green Power España, S.L.U. (EGPE) was lower than the carrying amount.
(6) This corresponds to the net profit at the takeover date, as a result of the fair value measurement of the non-controlling 40% stake in ENEL Green Power España, S.L.U. (EGPE).
(7) Following the takeover of ENEL Green Power España, S.L.U. (EGPE), there was a reversal of deferred tax liabilities in the amount of Euros 81 million booked by ENDESA as a result of gains not distributed by ENEL Green Power España, S.L.U. (EGPE) that were generated after control of the company was lost in 2010, which met the requirements for recognition.

At 31 December 2016 the main figures for ENEL Green Power España, S.L.U. (EGPE) were as follows:

	2016
Electricity Generation (GWh) ⁽¹⁾	1,212
Net installed capacity (MW) ⁽²⁾	1,675
Electricity sales (GWh) ⁽¹⁾	1,212

- (1) Since the date of the takeover, 27 July 2016.
(2) At 31 December 2016.

2.2. Consolidated results.

ENDESA reported net income of Euros 1,411 million in 2016 (+29.9%).

ENDESA reported net income of Euros 1,411 million in 2016, up by 29.9% against the Euros 1,086 million reported in 2015.

Net profit in 2016 includes a positive net impact of Euros 38 million from ENDESA's holding in ENEL Green Power España, S.L.U. (EGPE) (see Section 2.1. Acquisition of ENEL Green Power España, S.L.U. (EGPE) in this Consolidated Management Report). Net profit in 2015 also includes profit of Euros 10 million from the 40% stake in ENEL Green Power España, S.L.U. (EGPE).

The table below shows the breakdown of net income in ENDESA's businesses and changes with respect to the same period the previous year:

Million Euros	Net income			
	2016	2015	% chg	% contribution to the total
Generation and Supply ⁽¹⁾	751	506	48.4	53.2
Distribution	771	581	32.7	54.6
Structure and others ⁽²⁾	(111)	(1)	N/A	(7.8)
TOTAL	1,411	1,086	29.9	100.0

- (1) Includes net profit generated by ENEL Green Power España, S.L.U. (EGPE) in 2016 and 2015, in the respective amounts of Euros 38 million and 10 million.
(2) Structure, Services and Adjustments.

Information by segments may be found in Note 33 to the Consolidated Financial Statements for the year ended 31 December 2016, and the main figures are as follows:

Million Euros

	2016				2015			
	Generation and Supply	Distribution	Structure and others (1)	TOTAL	Generation and Supply	Distribution	Structure and others (1)	TOTAL
Revenue	16,628	2,538	(187)	18,979	17,911	2,582	(194)	20,299
Contribution margin	3,344	2,399	(91)	5,652	3,113	2,445	(77)	5,481
Gross operating profit (EBITDA) ₍₂₎	1,850	1,788	(206)	3,432	1,570	1,569	(100)	3,039
Operating profit (EBIT) ₍₃₎	1,065	1,131	(231)	1,965	814	906	(122)	1,598
Net financial profit/(loss)	(154)	(123)	95	(182)	(157)	(129)	100	(186)
Profit/(loss) before tax	822	1,020	(132)	1,710	623	786	(18)	1,391
Net gain/(loss)	751	771	(111)	1,411	506	581	(1)	1,086

(1) Structure, Services and Adjustments.

(2) Gross operating profit (EBITDA) = Income - Supplies and Services + Work carried out by the Group for its assets - Personnel expenses - Other fixed operating expenses.

(3) Operating profit (EBIT) = Gross operating profit (EBITDA) - Depreciation and impairment losses.

2.3. Analysis of results.

ENDESA's contribution margin in 2016 was Euros 5,652 million, up by Euros 171 million against the previous year (+3.1%). Gross operating profit (EBITDA) in 2016 was Euros 3,432 million (+12.9%), and operating profit (EBIT) increased by Euros 367 million (+23.0%) with respect to 2015, standing at Euros 1,965 million.

The table below shows the breakdown of gross operating profit (EBITDA) and operating profit (EBIT) in ENDESA's businesses and their year-on-year changes:

	Gross operating profit (EBITDA) ₍₃₎				Operating profit (EBIT) ₍₄₎			
	2016	2015	% chg	% contribution to total	2016	2015	% chg	% contribution to total
Generation and Supply ₍₁₎	1,850	1,570	17.8	53.9	1,065	814	30.8	54.2
Distribution	1,788	1,569	14.0	52.1	1,131	906	24.8	57.6
Structure and others ₍₂₎	(206)	(100)	N/A	(6.0)	(231)	(122)	N/A	(11.8)
TOTAL	3,432	3,039	12.9	100.0	1,965	1,598	23.0	100.0

(1) In 2016 this includes gross operating profit (EBITDA) and operating profit (EBIT) generated by ENEL Green Power España, S.L.U. (EGPE) since the takeover date on 27 July 2016, in the respective amounts of Euros 75 million and 16 million.

(2) Structure, Services and Adjustments.

(3) Gross operating profit (EBITDA) = Income - Supplies and Services + Work carried out by the Group for its assets - Personnel expenses - Other fixed operating expenses.

(4) Operating profit (EBIT) = Gross operating profit (EBITDA) - Depreciation and impairment losses.

The following factors must be taken into account concerning gross operating profit (EBITDA) for 2016:

- Consideration must be taken of the 2016 takeover of ENEL Green Power España, S.L.U. (EGPE), the contribution of which to gross operating profit (EBITDA) since 27 July 2016 was Euros 75 million.
- In 2015, gross operating profit (EBITDA) included profit of Euros 184 million from the forward sale on 17 December 2015 concerning the European Union Allowances (EUAs) obtained from the swap of Emission Reduction Units (ERUs) and Certified Emission Reductions (CERs) as per Regulation (EU) No 389/2013, Articles 58-61.
- Provision of Euros 226 million was made in 2016 and Euros 380 million in 2015 to cover the costs of staff reduction schemes as part of the various workforce optimisation projects in ENDESA's restructuring and reorganisation plan.

Stripping out these impacts, gross operating profit (EBITDA) in 2016 was up by Euros 348 million (+10.8%), due mainly to:

- Lower fuel consumption (-22.2%) and, due to lower liquid fuel prices, and fewer energy purchases (-15.4%), which was higher than the decrease in the average selling price.
- A fall of Euros 313 million in other variable supplies and services (-14.8%) mainly as the result of lower expenditure on emissions of carbon dioxide (CO₂) due to lower thermal output during the period, lower charges and taxes on electricity production due to lower production during the period, and regularisation of Catalonia's nuclear tax in the wake of the Constitutional Court ruling on 20 April 2016 declaring this unconstitutional (Euros 88 million).

Operating profit (EBIT) in 2016 was up by 23.0% against the previous year and stood at Euros 1,965 million, despite a 1.8% increase in depreciation and impairment losses, mainly due to the Euros 59 million increase following the takeover of ENEL Green Power España, S.L.U. (see Section 2.1. Acquisition of ENEL Green Power España, S.L.U. (EGPE) in this Consolidated Management Report).

Stripping out the takeover of ENEL Green Power España, S.L.U. (EGPE), the swap of carbon dioxide (CO₂) emission rights and the costs of the staff reduction plans referred to above, operating profit (EBIT) in 2016 increased by Euros 381 million (+21.2%).

Revenue: Euros 18,979 million (-6.5%).

Revenue totalled Euros 18,979 million in 2016 versus Euros 20,299 million in 2015, a decrease of 6.5%. Of this amount, revenue from sales accounted for Euros 18,313 million (-5.0%), while other operating income accounted for Euros 666 million (-34.6%). The table below shows the breakdown of sales and other operating revenues of ENDESA's businesses and their year-on-year changes:

	Million Euros							
	Sales				Other Operating Income			
	2016	2015	% chg	% contribution to total	2016	2015	% chg	% contribution to total
Generation and Supply ⁽¹⁾	16,190	17,166	(5.7)	88.4	438	745	(41.2)	65.8
Distribution	2,268	2,264	0.2	12.4	270	318	(15.1)	40.5
Structure and others ⁽²⁾	(145)	(149)	N/A	(0.8)	(42)	(45)	N/A	(6.3)
TOTAL	18,313	19,281	(5.0)	100.0	666	1,018	(34.6)	100.0

(1) Includes the 2016 sales of ENEL Green Power España, S.L.U. (EGPE) since the takeover date on 27 July 2016, in the amount of Euros 118 million.

(2) Structure, Services and Adjustments.

Sales

Sales in 2016 were as follows:

	Million Euros			
	2016	2015	Difference	%Var
TOTAL	18,313	19,281	(968)	(5.0)
Electricity Sales	13,541	14,168	(627)	(4.4)
Deregulated market sales	8,213	8,425	(212)	(2.5)
Supplies to customers in deregulated markets outside Spain	961	987	(26)	(2.6)
Sales at regulated prices	2,412	2,885	(473)	(16.4)
Wholesale Market Sales	875	815	60	7.4
Non-mainland Territories compensation	1,015	1,044	(29)	(2.8)
Other Electricity Sales	65	12	53	441.7
Gas Sales	2,079	2,378	(299)	(12.6)
Regulated Revenue from Electricity Distribution	2,054	2,048	6	0.3
Other Sales and Services Rendered	639	687	(48)	(7.0)

(1) In 2016 this includes the sales of ENEL Green Power España, S.L.U. (EGPE) since the takeover date, 27 July 2016, in the amount of Euros 118 million.

In 2016 mainland electricity demand continued the growth trajectory initiated in 2015 after 4 consecutive years of decreases, and rose by 0.6% against the previous year. Mainland electricity demand shrank by 0.1% against the previous year, corrected for working days and temperature. Overall non-mainland annual electricity demand ended 2016 with a 1.1% increase against the previous year.

The year 2016 featured low prices, where the arithmetic average price on the wholesale electricity market was Euros 39,7/MWh (-21.2%), mainly due to an increase in wind and hydro output covering more than 40% of mainland electricity demand, and also low commodity prices. For the first time since 2003, part of demand for electricity was covered by the import balance of international exchanges.

ENDESA's mainland ordinary regime electricity output totalled 55,985 GWh in 2016, 7.7% less than in 2015, as follows: coal plants (-21.6%), combined-cycle plants (+11.0%), nuclear plants (+0.6%) and hydroelectric (+0.0%).

Nuclear and hydroelectric energy accounted for 59.1% of ENDESA's mainland generation mix under the ordinary regime (54.3% in 2015), compared with 62.0% for the rest of the sector (52.0% in 2015).

ENDESA's production in 2016 with renewable technologies was 1,212 GWh, and non-mainland production was 12,634 GWh (+2.1%).

At 31 December 2016, ENDESA had obtained a market share of 35.1% of mainland generation under the ordinary regime, a 43.7% share of distribution and a 35.3% share of sales to customers in the deregulated market.

In 2016, gas demand was up by 2.1% year on year, and at 31 December 2016 ENDESA had secured a market share of 16.9% in sales to customers in the deregulated market.

Sales to customers in the deregulated market

At 31 December 2016, ENDESA had 5,423,040 customers in the deregulated market, a 6.7% increase on numbers at 31 December 2015:

ENDESA sold a total of 79,675 GWh to these customers in 2016, a 2.2% increase on 2015.

In economic terms, sales in the Spanish deregulated market amounted to Euros 8,213 million in 2016, Euros 212 million less than in 2015 (-2.5%), because the increase in physical units sold failed to offset the decrease in the average sales price to end customers. Revenue from sales to deregulated European markets other than Spain totalled Euros 961 million, down by Euros 26 million (-2.6%) vs. 2015, also due to the fall in the average selling price.

Sales at regulated prices

In 2016 ENDESA sold 13,815 GWh, through its supplier of reference, to customers to whom the regulated price applies, 7.5% less than in 2015. These sales generated revenue of Euros 2,412 million, down by 16.4% in year-on-year terms, as a result of fewer sales of physical units and the lower average selling price.

Gas sales

ENDESA sold 78,129 GWh to natural gas customers in 2016, which represents a 9.1% increase on 2015, mainly thanks to a 30.5% increase in sales on markets out of Spain.

Revenue from gas sales totalled Euros 2,079 million, down by Euros 299 million (-12.6%) against 2015 figure, due to the drop in average selling prices.

Compensation for Non-Mainland Territories systems ("TNP")

Compensation in 2016 for the stranded costs of non-mainland generation totalled Euros 1,015 million, down by Euros 29 million (-2.8%) against 2015, due mainly to the drop in fuel prices brought about by changing commodity prices.

Electricity distribution

ENDESA distributed 115,602 GWh in the Spanish market in 2016, in keeping with the energy distributed in 2015 (+1.2%).

Revenue from regulated distribution activities in 2016 totalled Euro 2,054 million, up by Euros 6 million (+0.3%) on 2015.

Other operating revenues

Other operating revenues totalled Euros 666 million in 2016, down Euros 352 million year on year (-34.6%).

2016 also saw a reduction of Euros 102 million in income from the valuation and settlement of energy derivatives, offset by the Euro 177 million reduction in valuation expenses and losses on the settlement of energy derivatives booked as other variable procurements and services.

In 2015, this item also included a gain of Euros 184 million from the forward sale of 25 million tonnes of European Union Allowances (EUAs) obtained in the Emission Reduction Units (ERUs) / Certified Emission Reductions (CERs) swap operation.

Operating expenses

The breakdown of operating expenses in 2016 is as follows:

Million Euros	Operating expenses			
	2016 ⁽¹⁾	2015	Difference	% Chg
Procurement and services	13,327	14,818	(1,491)	(10.1)
Fuel stock purchases	4,056	4,795	(739)	(15.4)
Fuel consumption	1,652	2,123	(471)	(22.2)
Transport costs	5,813	5,781	32	0.6
Other variable procurements and services	1,806	2,119	(313)	(14.8)
Personnel expenses	1,128	1,332	(204)	(15.3)
Other Fixed Operating Expenses	1,209	1,212	(3)	(0.2)
Depreciation and impairment losses	1,467	1,441	26	1.8
TOTAL	17,131	18,803	(1,672)	(8.9)

(1) In 2016 this included the operating expenses of ENEL Green Power España, S.L.U. (EGPE) since the takeover date on 27 July 2016, in the amount of Euros 102 million.

Procurements and services

Procurements and services (variable costs) totalled Euros 13,327 million in 2016, down by 10.1% against 2015.

The breakdown in ENDESA's businesses and the year-on-year change was as follows:

Million Euros	Procurement and services			
	2016	2015	% chg	% Contribution of the total
Generation and Supply ⁽¹⁾	13,284	14,798	(10.2)	99.7
Distribution	139	137	1.5	1.0
Structure and Others ⁽²⁾	(96)	(117)	N/A	(0.7)
TOTAL	13,327	14,818	(10.1)	100.0

(1) In 2016 this includes the procurements and services of ENEL Green Power España, S.L.U. (EGPE) since the takeover date on 27 July 2016, in the amount of Euros 14 million.

(2) Structure, Services and Adjustments.

Details of these costs are as follows:

- Fuel stock purchases in 2016 dropped by Euros 739 million (-15.4%) to Euros 4,056 million, largely as a result of the reduction in the average purchase price of electricity in the market (Euros 39,7/MWh, down 21.2%) and in the volume of gas acquired for sale to end customers.
- The cost of the fuel consumed in 2016 was Euros 1,652 million, down 22.2% (Euros 471 million) due to the drop in thermal output in the period and the fall in the average purchase price.
- "Other variable procurements and services" totalled Euros 1,806 million, down Euros 313 million on 2015, mainly due to:
 - o The decrease of Euros 177 million (-39.8%) in valuation expenses and settlement of energy derivatives, offset by a Euros 102 million decrease (-23.9%) in income in this connection, which is recognised under "Other operating income".
 - o The decrease of Euros 53 million in the costs of carbon dioxide (CO₂) emission rights due to lower thermal output.
 - o A fall of Euros 130 million in charges and taxes as a result of lower tax on electricity generation due to lower production during the period, and regularisation of the amount Catalonia's nuclear tax in the wake of the Constitutional Court ruling on 20 April 2016 declaring this unconstitutional (Euros 88 million).

The breakdown of the contribution margin in ENDESA's businesses and the year-on-year change was as follows:

Million Euros

		Contribution margin ⁽³⁾			% contributions to the total
		2016	2015	% chg	
Generation and Supply	(1)	3,344	3,113	7.4	59.2
Distribution		2,399	2,445	(1.9)	42.4
Structure and others	(2)	(91)	(77)	N/A	(1.6)
TOTAL		5,652	5,481	3.1	100.0

(1) In 2016 this included the contribution margin by ENEL Green Power España, S.L.U. (EGPE) since the takeover date on 27 July 2016, in the amount of Euros 104 million.

(2) Structure, Services and Adjustments.

(3) Contribution margin = income - procurements and services.

Personnel and other operating fixed expenses (fixed costs)

Fixed costs amounted to Euros 2,337 million in 2016, down by Euros 207 million (-8.1%) with respect to 2015.

The breakdown of fixed costs in ENDESA's businesses and the year-on-year change was as follows:

Million Euros

		Personnel expenses			Other Fixed Operating Expenses				
		2016	2015	% chg	% contribution to total	2016	2015	% chg	% contribution to total
Generation and Supply	(1)	544	549	(0.9)	48.2	958	999	(4.1)	79.2
Distribution		321	555	(42.2)	28.5	396	418	(5.3)	32.8
Structure and Others	(2)	263	228	15.4	23.3	(145)	(205)	(29.3)	(12.0)
TOTAL		1,128	1,332	(15.3)	100.0	1,209	1,212	(0.2)	100.0

(1) In 2016 this included staff costs and other fixed operating expenses of ENEL Green Power España, S.L.U. (EGPE) since the takeover date on 27 July 2016, in the respective amounts of Euros 7 million and 22 million.

(2) Structure, Services and Adjustments.

Personnel expenses in 2016 stood at Euros 1,128 million, down by Euros 204 million (-15.3%) with respect to 2015.

Personnel expenses in both 2016 and 2015 were affected by the changes in provisions and staff restructuring expenses booked in both years, particularly the allocation of provisions for contract suspensions (Euros 226 million in 2016 and Euros 380 million in 2015), the evolution of the update of provisions for workforce restructuring plans and contract suspensions (Euros 17 million in 2016 and Euros 19 million in 2015, both positive), and reduction of provisions to cover termination benefits and employment risks (net provision of Euros 14 million in 2016 and Euros 42 million in 2015).

Stripping out these impacts and the addition of ENEL Green Power España, S.L.U. (EGPE), personnel expenses would have fallen by Euros 31 million (-3.3%), largely due to a 4.1% reduction in the average workforce.

Other fixed operating expenses in 2016 totalled Euros 1,209 million, down by Euros 3 million (-0.2%), (-2.1%) stripping out the effect of the incorporation of ENEL Green Power España, S.L.U. (EGPE), with respect to the previous year.

Depreciation/amortisation and impairment losses

Depreciation/amortisation charges and impairment losses totalled Euros 1,467 million in 2016, Euros 26 million more (+1.8%) than in 2015, chiefly due to the following:

- The addition of ENEL Green Power España, S.L.U. (EGPE) (see Section 2.1. Acquisition of ENEL Green Power España, S.L.U. (EGPE) in this Consolidated Management Report, where the cumulative cost as of the date of the takeover was Euros 59 million.
- Net provision for asset impairment losses of Euros 17 million, of which Euros 12 million were accounted for by reversals of provision in previous years in respect of generating and distribution assets, and Euros 29 million for the impairment of land assets on the basis of an appraisal by independent experts. In 2015 this included net provision for asset impairment in the amount of Euros 53 million.

Stripping out these affects, depreciation and impairment losses would have totalled Euros 1,391 million (+0.2%).

The breakdown of depreciation and impairment losses in ENDESA's businesses and the year-on-year change was as follows:

Million Euros		Depreciation and impairment losses			% Contribution of the total
		2016	2015	% chg	
Generation and Supply	(1)	785	756	3.8	53.5
Distribution		657	663	(0.9)	44.8
Structure and Others	(2)	25	22	13.6	1.7
TOTAL		1,467	1,441	1.8	100.0

(1) In 2016 this includes the depreciation and impairment losses of ENEL Green Power España, S.L.U. (EGPE) since the takeover date on 27 July 2016, in the amount of Euros 59 million.

(2) Structure, Services and Adjustments.

Net financial loss: Euros 182 million (-2.2%).

Net financial income reported for 2016 was a negative Euros 182 million, a year-on-year decrease of Euros 4 million (-2.2%). The breakdown of net financial income in 2016 was as follows:

Million Euros		Net financial profit/(loss)			% Contribution of the total
		2016	2015	% chg	
Financial Income		44	55	(20.0)	(24.2)
Financial expenses		(222)	(229)	(3.1)	122.0
Net Exchange Differences		(4)	(12)	(66.7)	2.2
TOTAL	(1)	(182)	(186)	(2.2)	100.0

(1) The net financial income of ENEL Green Power España, S.L.U. (EGPE) since the takeover date on 27 July 2016 was negligible.

In 2016 net financial expenses totalled Euros 178 million, up Euros 4 million (+2.3%) year on year.

Movements in long-term interest rates in both 2016 and 2015 meant that provisions had to be adjusted to account for obligations relating to ongoing workforce restructuring plans and for contraction suspensions, entailing higher costs in the amount of Euros 45 million in 2016.

Stripping out the impacts referred to in the preceding sections, net financial expenses would have shed Euros 41 million (-23.6%) due to:

- Lower average gross financial debt in both periods, falling from Euros 5,946 million in 2015 to Euros 5,191 million in 2016.
- Lower average cost of gross financial debt, which fell from 2.7% in 2015 to 2.5% in 2016 (see section 4.1. Financial Management of this Consolidated Management Report).

Net income of companies accounted for using the equity method.

In 2016, companies accounted for using the equity method contributed a net income of Euros 59 million (negative), compared to Euros 15 million (negative) in 2015.

In 2016 this included the net income of ENEL Green Power España, S.L.U. (EGPE) since the takeover date on 27 July 2016, in the amount of Euros 69 million, broken down as follows:

- A positive Euros 7 million in respect of net income generated by the previous 40% stake in the company up to the takeover.
- A negative Euros 72 million booked for impairment prior to the takeover, in due consideration of the fact that the recovery value of the previous 40% stake in the company was lower than the carrying amount.
- A negative Euros 4 million in respect of the net income obtained from the appraisal of the previous 40% stake at fair value on the purchase date.

Following the takeover of ENEL Green Power España, S.L.U. (EGPE) (see Section 2.1. Acquisition of ENEL Green Power España, S.L.U. (EGPE) of this Consolidated Management Report), after 27 July 2016 the equity method was no longer used to book the results of ENEL Green Power España, S.L.U. (EGPE), and the full consolidation method was used instead.

In 2015, this item included net income of Euros 10 million from the 40% stake in ENEL Green Power España, S.L.U. (EGPE).

In addition, in 2016 and 2015, this heading also included a negative impact of Euros 38 million and 58 million respectively for the 50% holding in Nuclenor, S.A. due to the recognition of provision to be incurred by this company given the additional timeframe for the Nuclear Safety Council (CSN) and the decision by the Ministry of Energy, Tourism and Digital Agenda to issue its statutory report on the request to renew the operating licence for the Santa María de Garoña nuclear power plant.

Income from asset sales.

In 2016, this item mainly included expenditure on commissions on factoring operations in the amount of Euros 25 million (Euros 23 million in 2015).

In 2015, this item included gross capital gains of Euros 11 million on sales of assets associated with the Chira-Soria hydro plant, 100% of the shares in Compañía Transportista de Gas Canarias, S.A., the 22% holding in Ayesa Advanced Technologies, S.A. and the 100% stake held by ENDESA in Gasificadora Regional Canaria, S.A.

Income tax

Expenditure on income tax in 2016 stood at Euros 298 million, down by Euros 3 million against 2015 (-1.0%).

In 2016, following the takeover of ENEL Green Power España, S.L.U. (EGPE) (see Section 2.1. Acquisition of ENEL Green Power España, S.L.U. (EGPE) in this Consolidated Management Report), deferred tax liabilities were reversed in the amount of Euros 81 million booked by ENDESA as a result of gains not distributed by ENEL Green Power España, S.L.U. (EGPE) that were generated after control of the company was lost in 2010, which met the requirements for recognition.

Stripping out the impacts referred to in the preceding paragraph, expenditure on income tax would be Euros 379 million (+25.9%).

2.4. Consolidation scope

On 30 March 2016, ENDESA made a purchase from EDP – Gestão de Produção de Energia, S.A. of 48.854 shares representing 4.86% of the share capital of Tejo Energia - Produção e Distribuição de Energia Eléctrica, S.A., in which ENDESA previously held a stake of 38.89%. As a result of the transaction, the consideration of which amounted to Euros 7 million, ENDESA has increased its investment in the share capital of Tejo Energia - Produção e Distribuição de Energia Eléctrica, S.A to 43.75%.

On 24 May 2016, ENDESA sold its entire stake in ENEL Insurance N.V., representing 50% of its share capital, to ENEL Investment Holding B.V. in a deal worth a total of Euros 114 million. The transaction had no impact on the 2016 consolidated income statement.

On 27 July 2016, ENDESA Generación S.A.U. bought up 60% of ENEL Green Power España, S.L.U. (EGPE), a company in which it had previously held a 40% stake (see section 2.1. Acquisition of ENEL Green Power España, S.L.U. (EGPE) in this Consolidated Management Report).

On 28 July 2016, ENDESA purchased all the shares of Eléctrica del Ebro, S.A. for Euros 21 million. The purchase price was finally booked, on the basis of the fair value of the assets acquired and the liabilities undertaken (Net Assets Acquired) from Eléctrica del Ebro, S.A., under the following headings in the Consolidated Financial Statements:

Million Euros

Non-current assets		27
Property, Plant and Equipment		26
Deferred Tax Assets		1
Current assets		6
Trade and other receivables		3
Current Financial Assets		1
Cash and Cash Equivalents		2
TOTAL ASSETS		33
Non-current liabilities		8
Deferred income		3
Deferred Tax Liabilities		5
Current liabilities		6
Current Provisions		2
Trade and other Payables		4
TOTAL LIABILITIES		14
Fair value of net assets acquired		19

The difference between the cost of the business combination and the fair value of these assets and liabilities generated goodwill of Euros 2 million.

On 29 December 2016 an agreement was closed with ENCE Energía y Celulosa, S.A. for the sale of a 64.07% holding in Energía de la Loma, S.A. and a 68.42% holding in Energías de la Mancha Eneman, S.A. The transaction had no impact on the 2016 consolidated income statement.

2.5. Statistical Appendix

Key figures

GWh

Electricity generation	2016	2015	% chg	
Mainland				
Nuclear	55,985	60,686	(7.7)	
Coal	25,921	25,756	0.6	
Hydroelectric	19,033	24,277	(21.6)	
Combined-cycle (CCGT)	7,173	7,176	-	
Non-Mainland Territories				
	3,858	3,477	11.0	
Renewables and cogeneration				
	12,634	12,375	2.1	
	(2)	-	N/A	
TOTAL	(1)	69,831	73,061	(4.4)

(1) At power plant busbars

(2) In 2016 corresponded to the energy generated by ENEL Green Power España, S.L.U. (EGPE) since the date of the takeover, 27 July 2016.

MW

Gross installed capacity	31 December 2016	31 December 2015	% chg
Hydroelectric	4,765	4,765	-
Conventional thermal	8,130	8,278	(1.8)
Nuclear	3,443	3,443	-
Combined cycle (CCGT)	5,678	5,678	-
Renewables and cogeneration	(1)	-	N/A
TOTAL	23,691	22,164	6.9

(1) At 31 December 2016 this corresponded to the gross installed capacity of ENEL Green Power España, S.L.U. (EGPE).

MW

Net installed capacity	31 December 2016	31 December 2015	% chg
Hydroelectric	4,721	4,721	-
Conventional thermal	7,585	7,723	(1.8)
Nuclear	3,318	3,318	-
Combined cycle (CCGT)	5,445	5,445	-
Renewables and cogeneration	(1)	-	N/A
TOTAL	22,744	21,207	7.2

(1) At 31 December 2016 this corresponded to the net installed capacity of ENEL Green Power España, S.L.U. (EGPE).

GWh

Electricity sales	2016	2015	% chg
Regulated Price	13,815	14,934	(7.5)
Deregulated market	79,675	77,965	2.2
TOTAL	93,490	92,899	0.6

Thousands

Number of customers (electricity)	⁽¹⁾	31 December 2016	31 December 2015	% chg
Regulated market customers		5,593	6,029	(7.2)
Mainland Spain		4,692	5,053	(7.1)
Non-Mainland Territories		901	976	(7.7)
Supply on the deregulated market		5,423	5,083	6.7
Mainland Spain		4,505	4,212	7.0
Non-Mainland Territories		744	693	7.4
Outside Spain		174	178	(2.2)
TOTAL		11,016	11,112	(0.9)

(1) Supply points.

Percentage (%)

Trends in demand for electricity	⁽¹⁾	2016	2015	
Mainland	⁽²⁾		0.6	1.8

(1) Source: Red Eléctrica de España, S.A. (REE).

(2) Adjusted for working days and temperature, trends in mainland electricity demand fell by -0.1% in 2016 (+1.6% in 2015).

Percentage (%)

Market share (electricity)	⁽¹⁾	31 December 2016	31 December 2015	
Ordinary mainland generation			35.1	38.8
Renewable generation ⁽²⁾			3.5	N/A
Distribution			43.7	43.5
Supply			35.3	35.7

(1) Source: In-house.

(2) Does not include hydro.

GWh

Gas Sales		2016	2015	% chg
Deregulated market		48,270	47,034	2.6
Regulated market		1,464	1,039	40.9
International market		19,474	14,926	30.5
Wholesale business		8,921	8,588	3.9
TOTAL	⁽¹⁾	78,129	71,587	9.1

(1) Excluding own generation consumption

Thousands

Number of customers (gas)	⁽¹⁾	2016	2015	% chg
Regulated market		262	288	(9.0)
Mainland Spain		233	259	(10.0)
Non-Mainland Territories		29	29	-
Deregulated market		1,276	1,173	8.8
Mainland Spain		1,167	1,082	7.9
Non-Mainland Territories		86	86	-
Outside Spain		23	5	360.0
TOTAL		1,538	1,461	5.3

(1) Supply points.

Percentage (%)

Trends in demand for gas	⁽¹⁾	2016	2015	
Spain			2.1	4.4

(1) Source: Enagás, S.A.

Percentage (%)

Market share (gas)	⁽¹⁾	31 December 2016	31 December 2015	
Deregulated market			16.9	16.5
TOTAL			16.9	16.5

(1) Source: In-house.

GWh

Energy distributed		2016	2015	% chg
Business in Spain and Portugal		115,602	114,190	1.2
TOTAL		115,602	114,190	1.2

(1) At power plant busbars

Km

Distribution and transmission networks		31 December 2016	31 December 2015	% chg
Business in Spain and Portugal		316,562	317,675	(0.4)

Percentage (%)

Energy losses	2016	2015
Business in Spain and Portugal	11.0	11.3

Minutes

System Average Interruption Duration Index (SAIDI)	2016	2015
Business in Spain and Portugal (average)	(1) (2) 45	49

(1) Corresponds to Spain.

(2) In accordance with the calculation procedure set out in Royal Decree 1995/2000, of 1 December 2000.

Financial Data

Euros

Key figures	2016	2015	% chg
Net earnings per share	(1) 1.33	1.03	29.9
Cash flow per share	(2) 2.83	2.51	12.8
Book value per share	(3) 8.46	8.53	(0.9)

(1) Net profit per share = profit for the year of the parent / N° shares.

(2) Cash flow per share = Net cash flows from operating activities / N° of shares.

(3) Carrying amount per share = Equity of parent / N° of shares.

Profitability indicators (%)	2016	2015
Return on equity	(1) 15.69	12.33
Return on assets	(2) 4.69	3.62
Economic profitability	(3) 9.20	7.62
Return on capital employed (ROCE)	(4) 5.92	5.12

(1) Return on equity = profit for the year of the parent / average equity of the parent

(2) Return on assets = profit for the year of the parent / average total assets.

(3) Economic profitability = operating profit / average property, plant and equipment.

(4) Return on capital employed (ROCE) = operating profit after tax / (average non-current assets + average current assets).

Million Euros

	Leverage ratio	
	31 December 2016	31 December 2015
Net financial debt:	4,938	4,323
Non-current financial debt	4,223	4,680
Current financial debt	1,144	-
Cash and cash equivalents	(418)	(346)
Derivatives recognised as financial assets	(11)	(11)
Equity:	9,088	9,039
Of the parent	8,952	9,036
Of non-controlling interests	136	3
Leverage ratio (%)	54.3	47.8

(*) Leverage = Net financial debt / equity.

Financial indicators	2016	2015
Liquidity ratio	(1) 0.72	0.85
Solvency ratio	(2) 0.92	0.96
Debt ratio	(3) 35.21	32.35
Debt coverage ratio	(4) 1.44	1.42

(1) Liquidity = current assets / current liabilities.

(2) Solvency = (equity + non-current liabilities) / non-current assets.

(3) Debt = net financial debt / (equity + net financial debt) (%).

(4) Debt coverage = net financial debt / gross operating profit (EBITDA).

3. Regulatory Framework

Information on Spain's regulatory framework is set out in Note 4 to the Consolidated Financial Statements for the year ended 31 December 2016.

There follows an update of the Spanish regulatory framework - regulations that either were approved in 2016 or had a major effect on the Consolidated Financial Statements for that year.

Remuneration of the distribution activity

On 28 November 2015, the Official State Gazette published Royal Decree 1073/2015, of 27 November 2015, which modifies certain provisions in the Royal Decrees on the remuneration of electricity networks (Royal Decree 1047/2013, of 27 December 2013, for transmission, and Royal Decree 1048/2013, of 27 December 2013, for distribution). Among other aspects, the Royal Decree eliminates the yearly update of unitary values based on the CPI, in accordance with Law 2/2015, of 30 March 2015, on de-indexing the economy.

On 12 December 2015, Ministerial Order IET/2660/2015, of 11 December 2015, was published, establishing the types of installations and unitary value to be used in calculating distribution remuneration. This Order set the beginning of the first regulatory period as at 1 January 2016.

On 17 June 2016, Ministerial Order IET/980/2016, of 10 June 2016, was published in the Official State Gazette, setting remuneration on distribution activity for 2016 and awarding ENDESA Euros 2,014 million in remuneration for this activity. ENDESA has also been awarded quality and anti-fraud incentives of Euros 7 million and Euros 2 million, respectively.

Social Bonus

Law 24/2013, of 26 December 2013, required that the subsidised electricity tariff cost must be assumed, as a public service obligation, by parent companies or vertically-integrated groups of companies carrying out electricity generation, distribution and marketing activities, to assume the cost of the subsidised electricity tariff in proportion to a percentage based on both their number of supply connections to distribution grids and the number of customers supplied. For 2016, this percentage was established at 41.10% for Endesa through Ministerial order IET/1451/2016, of 8 September 2016.

Despite the foregoing, in a ruling on 24 October 2016 the Contentious-Administrative Section of the Supreme Court declared the Social Bonus financing system established by article 45.4 of Law 24/2013 of 26 December inapplicable, since it was incompatible with Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity, and acknowledged the right of companies to recover the amounts paid. The State authorities submitted an application for dismissal of the Supreme Court ruling, which was overruled through a ruling of 14 December 2016, and, on 2 February 2017, an appeal was submitted against this to the Constitutional Court (see Note 16.3 to the Consolidated Financial Statements for the year ended 31 December 2016).

On 24 December 2016, Royal Decree-Law 7/2016 of 23 December was published to regulate the financing of the costs of the Social Bonus and other measures to protect vulnerable electricity consumers.

By virtue of this Royal Decree Law, the Social Bonus will cover the difference between the Small Consumer Voluntary Price (SCVP or "PVPC" in Spanish) and a base value, which may vary depending on the categories of vulnerable consumers established, to be known as the last-resort tariff, which will be applied by the supplier of reference concerned on the bills of consumers on the scheme.

The Social Bonus will be funded by group parents with supply activities, or by companies acting directly. The CNMC will calculate the funding percentage annually, and it will be proportional to the number of customers. The Royal Decree Law establishes transitory funding percentages, and 37.67% was established for ENDESA.

Also, with the upper limit established by an order issued by the Ministry of Energy, Tourism and Digital Agenda, following an Agreement by the Government's Delegated Committee for Economic Affairs, these companies or groups of companies would undertake the amount they have to pay to co-fund along with public authorities the cost of supply to consumers deemed to be severely vulnerable in accordance with the

criteria established in regulations. This will make them essential supplies, and supplies cannot be suspended for consumers deemed to be severely vulnerable using last-resort tariffs who, for the purposes of these supplies, are covered by social services since their income makes them vulnerable to social exclusion, and the measure is confined to individuals in their habitual residence. The above will be accredited in a document issued by social services.

Regulations will also establish the categories of vulnerable consumers in respect of whom, 4 months after the first payment request (as opposed to 2 months at present), to no avail, the supply may be curtailed.

The Royal Decree Law contemplates that in the maximum term of 3 months from its validation, which took place on 31 January 2017, its development will be approved by Royal Decree.

Royal Decree on the methodology for calculating the trading margin to be added to the Small Consumer Voluntary Price.

On 25 November 2016 the Official State Gazette (BOE) published Royal Decree 469/2016 of 18 November establishing the methodology for calculating the trading margin on the Small Consumer Voluntary Price, thus complying with various rulings handed down by the Supreme Court that annulled the trading margin contained in Royal Decree 216/2014 of 28 March establishing the procedure for calculating Small Consumer Voluntary Prices for electricity and the legal framework for contracting power.

On 24 December 2016 Ministerial Order ETU/1948/2016 was published - this came into force on 1 January 2017, and establishes the trading margin on the Small Consumer Voluntary Price.

2016 electricity tariff

On 18 December 2015, Ministerial Order IET/2735/2015, of 17 December 2015, establishing access charges for 2016 was published in the Official State Gazette.

Pursuant to this Order, tariffs remained unchanged, except for high-voltage access tariff 6.1B (30<kV≤36). However, the unit prices paid by customers to finance capacity payments were reduced by 21.5% from those existing on 31 December 2015.

2017 electricity tariff

Ministerial Order ETU/1976/2016 of 23 December was published in the Official State Gazette on 29 December 2016, establishing access charges for 2017.

Access tariffs remained unchanged in the Order.

Natural gas tariff for 2016

Ministerial Order IET/2736/2015, of 17 December 2015, generally maintained the access tariffs with respect to 2015, having updated the Last Resort Tariffs (LRT or "TUR" in Spanish) with an average 3% reduction, resulting from lower raw material costs.

Natural gas tariff for 2017

Ministerial Order ETU/1977/2016 of 23 December generally maintained the access tariffs with respect to 2016, having updated the Last Resort Tariffs with an average 9% reduction, resulting from lower raw material costs.

Energy efficiency

Law 18/2014, of 15 October 2014, approving urgent measures to boost growth, competitiveness and efficiency, created, in the context of energy efficiency, the Energy Efficiency National Fund with the aim of achieving energy savings.

Ministerial Order IET/359/2016 of 17 March establishes ENDESA's contribution to the Energy Efficiency National Fund at Euros 29.9 million for 2016.

The Ministry of Energy, Tourism and Digital Agenda began to process a proposed Ministerial Order establishing the contribution obligations to the National Energy Efficiency Fund in 2017, increasing the amount proposed by the 2017 fiscal year for ENDESA to Euros 28.9 million.

4. Liquidity and Capital Resources

4.1. Financial Management

As part of an efficient cost management and optimisation policy, the finance function in Spain is centralised in ENDESA. At the date on which this Consolidated Management Report was drawn up, the Company had the necessary liquidity and access to medium/long-term financial resources to ensure the availability of the funds required to meet its future investment obligations and debt maturities.

ENDESA maintains the same principles of prudence as applied to date in its financial structure: obtaining medium/long-term funding that enables it to adjust its maturity calendar to the capacity of cash-flow generation envisaged in the business plan. To do this it uses external financing, especially through the banking and capital markets. It also obtains funds from public authorities that offer attractive terms for very long-term loans. The Company also has short-term financing that helps optimise the management of its working capital requirements and improve the cost of its debt. This financing is obtained through bank credit facilities with leading financial institutions or through the issue of Euro Commercial Paper (ECP).

ENDESA's also carries out transactions with ENEL Group companies in which the applicable transfer pricing regulations are followed.

The incorporation of ENEL Green Power España, S.L.U. (EGPE) in ENDESA did not entail any changes to the company's financial management criteria (see Section 2.1. Acquisition of ENEL Green Power España, S.L.U. (EGPE) in this Consolidated Management Report).

Financial position.

In 2016, European sovereign debt interest rates were still subject to action taken by the European Central Bank, which allowed minimum rates for 10-year Spanish government debt to fall below 1%. 10-year Spanish bond spreads against the German Bund stood at 118 basis points at the end of 2016, similar to the end of 2015, while other Eurozone economies shouldering debt increased their country risk. Italian and Portuguese 10-year bond spreads against the German Bund rose in 2016 to 161 and 356 basis points respectively at year-end, underperforming by 64 basis points and 167 basis points respectively compared to 2015.

The ECB kept interest rates in 2016 at the historic low of 0% and extended its expansionary monetary policies and supervisory measures for the banking system. The ECB continued with its asset purchase programme and broadened the financial assets it can include.

In 2016, euro long-term interest rates (10-year swap) fell from 1.00% at the beginning of the year to 0.66% by year-end. The short-term interest rate (3-month Euribor) dropped from -0.13% to -0.32%. The long-term interest rate on the US dollar rose in 2016 from 2.19% to 2.34%. Meanwhile, the 3-month interest rate for the US dollar increased from 0.61% to 1.00% at the end of 2016.

The euro depreciated by 3.2% in 2016 compared to the US dollar (USD), causing the EUR/USD exchange rate to drop from 1.09 at the beginning of 2016 to 1.05 at year-end, affected by the divergence in monetary policy between the ECB and the US Federal Reserve (FED).

Financial debt

The reconciliation of ENDESA's gross and net financial debt at 31 December 2016 is as follows:

Million Euros

	Financial debt			
	31 December 2016	31 December 2015	Difference	% chg
Non-current Interest-Bearing Loans and Borrowings	4,223	4,680	(457)	(9.8)
Current Interest-Bearing Loans and Borrowings	1,144	-	1,144	-
Gross financial debt	5,367	4,680	687	14.7
Cash and Cash Equivalents	(418)	(346)	(72)	20.8
Derivatives recognised as financial assets	(11)	(11)	-	-
Net financial debt	4,938	4,323	615	14.2

At 31 December 2016 ENDESA's net financial debt stood at Euros 4,938 million, rising by Euros 615 million (+14.2%) with respect to 31 December 2015, mainly due to the outstanding balance of Euro Commercial Paper (ECP) issued during the period to pay for the acquisition of ENEL Green Power España, S.L.U. (EGPE) (see Section 2.1. Acquisition of ENEL Green Power España, S.L.U. (EGPE) in this Consolidated Management Report).

For the purposes of assessing net debt in 2016, it must also be borne in mind that on 4 January 2016 ENDESA paid shareholders an interim dividend against 2015 income of Euro 0.4 per share, entailing a disbursement of Euros 424 million, and on 1 July 2016 it paid an additional gross dividend against 2015 income of Euro 0.626 per share (Euros 663 million).

The structure of ENDESA's gross financial debt at 31 December 2016 and 2015 was as follows:

Million Euros

	Gross financial debt			
	31 December 2016	31 December 2015	Difference	% chg
Euro	5,367	4,680	687	14.7
TOTAL	5,367	4,680	687	14.7
Fixed rate	3,661	3,537	124	3.5
Floating rate	1,706	1,143	563	49.3
TOTAL	5,367	4,680	687	14.7
Average lifespan (years) ⁽¹⁾	6.5	8.0	-	-
Average cost (%) ⁽²⁾	2.5	2.7	-	-

(1) Lifespan (years) = (principal * number of days of term) / (principal in force at 31 December * 365 days).

(2) Average cost (%) = (cost of financial debt) / gross average financial debt.

At 31 December 2016, 68% of the Company's gross financial debt accrued interest at fixed rates, while the remaining 32% accrued interest at floating rates. At this date, 100% of the Company's gross financial debt was denominated in euros.

Information concerning the maturities of ENDESA's gross financial debt is set out in Note 17 to the Consolidated Financial Statements for the year ended 31 December 2016.

Main Financial Transactions

In 2016, ENDESA issued Euro Commercial Paper (ECP) through International ENDESA, B.V., and the outstanding balance at 31 December 2016 was Euros 932 million, renewed by irrevocable lines of bank credit.

The increase in the outstanding balance was the result of issues made to pay for the 60% stake in ENEL Green Power España, S.L.U. (EGPE) (see Section 2.1. Acquisition of ENEL Green Power España, S.L.U. (EGPE) in this Consolidated Management Report).

On 30 December 2016, ENDESA S.A. renewed the uncommitted intercompany credit facility with ENEL Finance International N.V. in the amount of Euros 1,500 million, maturing on 31 December 2017. The price to be applied to drawdowns is based on the cost of issuing ENEL's commercial paper plus 6 basis points or, if this basis cannot be used, ENEL's 1-year profitability curve adjusted with a formula defined up to the specific timeline for the drawdown required. At 31 December 2016 the uncommitted intercompany credit facility had not been drawn on.

As part of the financial operation (ENDESA Network Modernisation) arranged with the European Investment Bank (EIB) in 2014, Tranche B was formalised on 14 July 2016 in the amount of Euros 150 million, and Tranche C on 14 December 2016 in the amount of Euros 150 million, completing the full operation in a total amount of Euros 600 million. The drawdowns on these tranches have been made in 2017.

Liquidity

At 31 December 2016 the breakdown of ENDESA's liquidity was as follows:

Million Euros	Liquidity			
	31 December 2016	31 December 2015	Difference	% chg
Cash and cash equivalents	418	346	72	20.8
Unconditional available on credit facilities ⁽¹⁾	3,202	3,187	15	0.5
TOTAL	3,620	3,533	87	2.5
Coverage of debt maturities ^{(months) (2)}	17	29	-	-

(1) At 31 December 2016 and 2015, Euros 1,000 million were accounted for by the line of credit with ENEL Finance International, N.V.

(2) Coverage of maturities = maturity period (months) for vegetative debt that could be covered with the liquidity available.

"Cash and cash equivalents" are highly liquid and there is no risk of a change in their value, they mature within 3 months from their contract date and earn interest at market rates for this type of deposit. Information on ENDESA's cash and cash equivalents is set out in Note 13 to the Consolidated Financial Statements for the year ended 31 December 2016.

Any restrictions that may affect the drawing of funds by ENDESA are set out in Notes 13 and 14.1.12 to the Consolidated Financial Statements for the year ended 31 December 2016.

4.2. Capital Management

ENDESA's capital management focuses on maintaining a solid financial structure that optimises the cost of capital and the availability of financial resources to guarantee business continuity over the long term. This policy of financial prudence makes it possible to maintain an adequate level of value creation for shareholders while guaranteeing ENDESA's liquidity and solvency.

ENDESA considers its consolidated leverage ratio to be an indicator of its ongoing financial position. Details of this ratio at 31 December 2016 and 2015 are as follows:

Million Euros	Leverage ratio	
	31 December 2016	31 December 2015
Net financial debt:	4,938	4,323
Non-current financial debt	4,223	4,680
Current financial debt	1,144	-
Cash and cash equivalents	(418)	(346)
Derivatives recognised as financial assets	(11)	(11)
Equity:	9,088	9,039
Of the parent	8,952	9,036
Of non-controlling interests	136	3
Leverage ratio (%) ^(*)	54.3	47.8

(*) Leverage = Net financial debt / equity.

The Company's directors consider that its leverage will enable it to optimise the cost of capital while maintaining a high solvency ratio. Therefore, in due consideration of expectations of earnings and the investment plan, the future dividend policy will maintain a leverage ratio to achieve the aforementioned capital management target.

At the date on which this Consolidated Management Report was drawn up, ENDESA had no commitments to obtaining funds through its own sources of finance.

Information on capital management is provided in Note 14.1.11 to the Consolidated Financial Statements for the year ended 31 December 2016.

Information on investments and shareholder remuneration is provided in Section 6.3. Main Financial Indicators and Section 13.2 Dividend Policy in this Consolidated Management Report.

4.3. Credit Rating Management.

Political uncertainty has been the keynote throughout most of the year, and Spain's rating hardly changed in 2016. Only Moody's downgraded its outlook from Positive to Stable, and maintained the Baa2 rating. This occurred in February, on the basis of disbelief that the acting Government at that time would continue its reforms.

With regard to the electricity sector, its fundamentals remained healthy both in terms of demand sufficiency and tariff sufficiency.

In the case of ENDESA, credit rating agencies maintained their ratings in 2016. Only Standard & Poor's downgraded the outlook from Positive to Stable, and maintained the BBB rating. This downward review on 26 February 2016 was mainly justified in terms of the agency's downward review of estimated electricity prices.

Developments in ENDESA's credit ratings in 2016 were as follows:

	Credit rating					
	31 December 2016 ^(*)			31 December 2015 ^(*)		
	Long-term	Short-term	Outlook	Long-term	Short-term	Outlook
Standard & Poor's	BBB	A-2	Stable	BBB	A-2	Positive
Moody's	Baa2	P-2	Stable	Baa2	P-2	Stable
Fitch Ratings	BBB+	F2	Stable	BBB+	F2	Stable

(*) At the respective dates of drawing up of the Consolidated Management Report.

At year-end 2016, ENDESA's credit rating was "investment grade" according to all rating agencies. It should be noted that ENDESA's credit rating is always limited by that of its Parent, ENEL, in accordance with the methods used by the rating agencies.

ENDESA works to maintain its investment grade credit rating to be able to efficiently access money markets and bank funding, and to obtain preferential terms from its main suppliers.

4.4. Cash Flows

At 31 December 2016, cash and cash equivalents stood at Euros 418 million (Euros 346 million at 31 December 2015).

At 31 December 2016 and 2015, ENDESA's net cash flows, broken down into operating, investing and financing activities, were as follows:

Million Euros

	Cash flows			
	31 December 2016	31 December 2015	Difference	%Var
Net cash flows from operating activities	2,995	2,656	339	12.8
Net Cash Flows used in Investing Activities	(2,317)	(773)	(1,544)	199.7
Net Cash Flows used in Financing Activities	(606)	(2,185)	1,579	(72.3)

In 2016, net cash flows from operating activities (Euros 2,995 million) helped cater for the net investment to conduct ENDESA's businesses (Euros 2,317 million), and the net cash flows from financing activities (Euros 606 million). Cash and cash equivalents rose by Euros 72 million during the period.

Net cash flows from operating activities

In 2016 net cash flows from operating activities totalled Euros 2,995 million, as against Euros 2,656 million generated in 2015, an increase of Euros 339 million (+12.8%) due to an increase in profits, net of adjustments, of Euros 207 million and of working capital (Euros 179 million) and a decrease in other payments for operating activities (Euros 311 million), among which lower expenditure on corporation tax (Euros 257 million).

At 31 December 2016 and 2015 working capital broke down as follows:

Million Euros	31 December 2016	31 December 2015
Current assets ⁽¹⁾	5,015	4,633
Inventories ⁽²⁾	1,202	1,262
Trade and other receivables	3,452	2,977
Current financial assets	361	353
Non-current assets held for sale	-	41
Current liabilities ⁽³⁾	6,377	5,871
Current Provisions	567	638
Trade and other Payables	5,810	5,233

(1) Excludes cash and cash equivalents and derivatives recognised as financial assets corresponding to debt.

(2) Among other items, this includes movements by redemption of carbon dioxide (CO₂), emission rights, which did not entail any cash outflows.

(3) Excludes current financial debt and derivatives recognised as financial liabilities corresponding to debt.

Net cash used in investing activities

In 2016 net cash flows applied to investing activities totalled Euros 2,317 million and included the following, among other aspects:

- Acquisition of a 60% stake in ENEL Green Power España, S.L.U. (EGPE) for the gross amount of Euros 1,207 million, plus the costs incurred by the transaction (Euros 2 million) and the cash and cash equivalents it contributed (Euros 31 million) (see Section 2.1. Acquisition of ENEL Green Power España, S.L.U. (EGPE) in this Consolidated Management Report).
- Acquisition of a 4.86% stake in Tejo Energia – Produção e Distribuição de Energia Eléctrica, S.A. for a net amount of Euros 7 million (see Section 2.4. Consolidation Scope in this Consolidated Management Report).
- Acquisition of 100% of the shares of Eléctrica del Ebro, S.A., with a net cash outflow of Euros 18 million (see Section 2.4. Consolidation Scope in this Consolidated Management Report).
- The sale of a 50% holding in ENEL Insurance N.V. for Euros 114 million (see Section 2.4. Consolidation Scope in this Consolidated Management Report).
- Net payments for investment in property, plant and equipment and intangible assets in the amount of Euros 1,144 million (Euros 746 million in 2015) (see Section 4.5. Investments of this Consolidated Management Report).

Net cash used in financing activities

In 2016 net cash flows applied to financing activities totalled Euros 606 million (Euros 2,185 million in 2015) and were mostly accounted for by the payment of Euros 1,089 million in dividends (Euros 805 million in 2015) (see Section 13.2 Dividend Policy in this Consolidated Management Report).

4.5. Investments

In 2016 gross investment by ENDESA totalled Euros 1,221 million (Euros 1,084 million in 2015), of which Euros 985 million related to capex, Euros 143 million to investments in intangible assets, and Euros 93 million to financial investments, as follows:

Million Euros

	Gross investments ⁽¹⁾		
	2016 ⁽²⁾	2015	% chg
Generation and Supply	388	328	18.3
Distribution	595	585	1.7
Other	2	2	-
TOTAL CAPEX	985	915	7.7
Generation and Supply	57	47	21.3
Distribution	55	37	48.6
Other	31	26	19.2
TOTAL INTANGIBLE ASSETS	143	110	30.0
FINANCIAL	93	59	57.6
TOTAL INVESTMENTS	1,221	1,084	12.6

(1) 2016 does not include investment in ENEL Green Power España, S.L.U. (EGPE) or in Eléctrica del Ebro, S.A. (see Section 2.1 Acquisition of ENEL Green Power España, S.L.U. (EGPE) and Section 2.4. Consolidation Scope in this Consolidated Management Report).

(2) Includes investment by ENEL Green Power España, S.L.U. (EGPE) since the takeover date on 27 July 2016, in the amount of Euros 14 million.

Gross investment in generation in 2016 largely related to plants that were already operating at 31 December 2015, including investments in the Litoral power plant (Euros 83 million), in order to adapt to European environmental law, which extended its useful life. It also includes investment in upgrading major components of renewable technology assets.

Gross investment in supply mainly related to the development of the activities related to added-value products and services.

Gross investment in distribution are related to network extensions and expenditure aimed at optimising the functioning and quality of the network to boost efficiency and quality of service. These also included investment for the widespread installation of remote management smart meters and their operating systems.

Gross investment in intangibles mainly related to software applications.

Financial investments mainly related to guarantees provided for operation in the electricity market (Euros 40 million) and contributions of funds to Nuclenor, S.A. (Euro 25 million).

4.6. Contractual Obligations and Off-Balance Sheet Operations

On 29 December 2016, through its wholly-owned investee ENDESA Servicios, S.L.U., ENDESA, S.A. and ENEL Iberoamérica, S.L.U. drew up a Contract for the Assignment of Systems and Telecommunications Business, whereby ENDESA, S.A. would purchase systems and telecommunications business within its sphere of activity from ENEL Iberoamérica, S.L.U. The effective date of the transaction was 1 January 2017. The operation entailed reorganisation of systems and telecommunications support activities to make them more flexible in order to adapt to ENDESA's corporate scope, simplifying procedures and administrative management. The stipulated purchase price was Euros 246 million, paid up on signature of the contract.

Information concerning future purchase commitments is provided in Notes 6, 8 and 11.2 to the Consolidated Financial Statements for the year ended 31 December 2016, broken down as follows:

Million Euros

	Future electricity purchase commitments	
	31 December 2016	31 December 2015
Property, Plant and Equipment	338	606
Intangible assets	2	2
Other intangible assets	-	-
Financial assets	-	-
Purchases of fuel stocks and others	20,652	26,478
Purchases of fuel stocks	20,596	26,411
Electricity purchases	-	-
Purchases of carbon dioxide (CO ₂) emission rights, Certified Emission Reductions (CERs) and Emission Reduction Units (ERUs)	56	67
TOTAL	20,992	27,086

ENDESA has no special purpose entities, understood as entities that ENDESA, even when it does not hold a controlling interest, effectively controls, understood as the fact that it substantially obtains most of the profits earned by the entity and retains most of the risks involved.

5. Events after the Reporting Period

Information concerning events after the reporting period is provided in Note 38 to the Consolidated Financial Statements for the year ended 31 December 2016.

6. Outlook

6.1. Energy paradigm

ENDESA favours a new energy paradigm with an efficient, sustainable economic and industrial model based on a decarbonised economy by the year 2050. To this end, the levers and key courses of action to be rolled out to meet decarbonisation targets will focus on the following aspects:

- **Electrification of demand:** in order to meet the target of a decarbonised economy, fossil fuel greenhouse gas emissions will have to be totally displaced by 2050. The only alternative for this scenario is en masse electrification of final energy demand through courses of action to encourage internalisation of the cost of carbon dioxide (CO₂) emission rights in all emission sectors, electrical mobility plans and recharging infrastructures, assisted by a proactive role by distribution operators, and rationalisation of the electricity tariff to bring about an energy model with efficient allocation of costs.
- **Emission-free production of electricity:** developments in the production of electricity towards an efficient mix of emission-free generation, helped along, among other aspects, by a national renewables plan in accordance with growing demand. In this regard conventional nuclear generation and efficient thermal generation are considered key factors to produce a smooth successful transition in terms of prices and supply security, with no new investment in production involving fossil fuels and a gradual shutdown of the current system.
- **Improvement of energy efficiency:** through an efficiency and electrification plan to introduce incentives to adopt energy efficiency measures in association with electrification.
- **Deployment of smart electricity grids:** through automation and digitalisation of the grid as a key factor to optimise investment in electricity and operation of the system, which will require a deployment plan with a remuneration plan attached.

6.2. Strategic pillars

In due consideration of the tendencies described, ENDESA's industrial plan is fully aligned with the new challenges and with the new energy paradigm, which will drive forward sustainable growth. It will therefore be based on the following strategic pillars:

- a) Decarbonisation of ENDESA's electricity production mix by 2050.
- b) Boosting the position with regard to smart electricity grids to cater for the expected growth.
- c) Focus on excellent customer service.
- d) Continuous commitment to improving the efficiency of all lines of business.

Also, on a transversal plane to the courses of action stipulated, ENDESA will use digitalisation as the main driver of transformation to meet the Strategic Plan's targets.

a) Decarbonisation of ENDESA's electricity production mix by 2050.

ENDESA has an ambitious plan to gradually reduce emissions to meet the final zero-emissions target by the year 2050. In this context, it is also considering major renewable energy targets using ENEL Green Power España, S.L.U. (EGPE) as an efficient sustainable renewable energy platform.

The courses of action planned to develop a renewable energy platform include investment to extend the lifespan of wind power facilities, capturing synergies by optimising the portfolio of ENEL Green Power España, S.L.U. (EGPE) and homing in on further growth opportunities.

Specifically, ENDESA plans to add approximately 300 MW within the next 3 years on top of the 1,705 GW added in 2016 following the purchase of 60% of ENEL Green Power España, S.L.U. (EGPE) (see Section 2.1. Acquisition of ENEL Green Power España, S.L.U. (EGPE) of the Consolidated Management Report), and, in the longer term, ENDESA will also invest in the organic growth of these technologies.

With regard to the conventional generation portfolio, this is deemed to be a key factor in guaranteeing a secure supply during the period of transition towards decarbonisation of the electricity production mix, and the following objectives and key courses of action are being considered:

- **Nuclear technology:** guaranteeing the long-term operation of nuclear plants safely and efficiently in terms of costs, by continuous measures to improve the plants.
- **Coal-fired electricity plants:** adaptation to best environmental practices through investment in relation to IED (Industrial Emissions Directive) and BREF (Best available techniques –BAT-) at imported coal plants. No investment is planned under current market conditions for Spanish coal plants.
- **Non-mainland territories production facilities:** maintaining a secure supply in due adherence to environmental regulations.

b) Boosting the position with regard to smart electricity grids to cater for the expected growth.

The future extension of the electricity network will be driven by electrification of demand and the incorporation of renewable energies.

ENDESA has identified the following initiatives to the prepare electricity network for the future:

- **Digitalisation projects** mainly focusing on smart meters, which will be fully implemented before the regulatory deadline of year-end 2018, automation of the network by fitting remote-control devices to reduce downtime, carry out technology modernisation projects and improve communications ("Simon" project).
- **Extension of the electricity network** with an investment plan focusing on development and improvement of the structure.
- **Modernisation and improvement of the electricity network** through investment in substitutions.

ENDESA also intends to continue working on initiatives to boost efficiency, loss reduction plans and anti-fraud measures, in order to secure maximum value for the current remuneration model.

Finally, ENDESA intends to carry out innovation projects in the electricity network to develop a wide range of new services (Growsmarter project, project Flexiciency, project ZeEUS, project Monica, project La Graciosa, among others) (see Section 8. Research, Development and Innovation Activities (R&D+i) in this Consolidated Management Report).

c) Focus on excellent customer service.

ENDESA will focus on sustainable leadership and growth of the retail market:

- **Electricity:** consolidation of its position on the Spanish market, development of sophisticated flexible products, and growth in Portugal in the Business-to-Consumer (B2C) and Business-to-Business (B2B) segments.
- **Gas:** consolidation of its current position on the Spanish market with new sales channels and products, growth in Portugal (Business-to-Consumer (B2C) and Business-to-Business (B2B)) and also in France (Business-to-Business).

The following plans have been made to this end:

- Making use of robust management of the integrated margin of production and supply business in the deregulated market.
- Maximizing the value of customer portfolios on the basis of experience, and contemplating the definition of a full range of action plans to segment the customer base and secure loyalty.
- Boost development of digital channels as the driver of service quality and new ways of working alongside customers.
- Growth of value-added products and services in the global supply business, on the strength of the experience attained.
- Innovation and development of new products as a growth level, mainly focused on electrical mobility, distributed generation and smart homes.

d) Continuous commitment to improving the efficiency of all lines of business.

ENDESA is heavily committed to a constant search for efficiency, and deploys efficiency plans in all its lines of business, seeking to reduce costs:

- In terms of Generation, unit costs will be brought down by deploying exchange practices and continuous improvement of all technologies, renegotiating operation and maintenance contracts, optimising management of fuels and introducing efficiency measures by applying digital plans to the assets base. In the specific case of renewable energies, plans have been made to secure cost synergies through the integration of control centres, unification of bidding processes and dispatch systems, among other measures.
- As regards Distribution, optimising staff, equipment and convergence systems and investing in technology and digitalisation to boost efficiency will help bring down costs.
- In terms of Supply, a review of the main processes and digitalisation initiatives will improve costs.

In this regard, ENDESA's digitalisation plan will act as the main driver of efficiency plans in the company's Business Lines:

- In Generation, through digital transformation of industrial assets for the purposes of maintenance, security and operation.
- In Distribution, through comprehensive application of smart meters, automation of the grid, deployment of remote-control devices and technology innovation.
- In terms of Supply, using digital platforms to interact with customers and the benefits of digitalisation to boost efficiency, service quality and development of new channels and services.

Finally, all the objectives set out in ENDESA's Strategic Plan are fully in line with the new energy paradigm and the sustainable development commitments in its Sustainability Plan (see Section 8. Sustainability Plan in this Consolidated Management Report):

- Decarbonisation of the energy mix by the year 2050, with a plan to reduce emissions and strengthen the position of renewable energies.
- Fostering digitalisation of both the grid and customers by means of solutions geared towards automation, supply quality, electrification and energy efficiency for demand.
- Cooperation with public authorities in terms of providing access to electricity for vulnerable customers.

- Commitment to education and social and economic development, mainly through the role played by the ENDESA Foundation.

6.3. Main financial indicators

The industrial plan approved by the Board of ENDESA, S.A. on 7 November 2016 contemplates an investment target, net of subsidies and assets assigned by customers, in the amount of Euros 4.7 billion between 2016 and 2019, broken down into maintenance investment (56%) and investment in growth (44%).

The breakdown of the investment plan by lines of business is as follows:

- Generation (53%) with mainland investment (30%), non-mainland investment (12%) and renewables (11%). Most of this focuses on recurring maintenance investment and selective environmental investment in imported coal-fired plants to comply with EU emissions legislation. Non-mainland investment contemplates maintenance, environmental protection and selective capacity substitutions. Investment in renewables will concentrate on developing new capacities.
- Distribution investment (38%) will focus on maintenance and growth investment to deploy smart meters, and development of the Quality Plan to expand grid automation.
- Supply (9%), with investment to develop the projects described.

ENDESA will also take stock of selective opportunities for inorganic investment in renewable energies, small European distribution companies and distribution concessions in Portugal, in addition to potential acquisitions of customer gas and electricity portfolios, and value-added products and services.

On the basis of the strategic pillars described above, in due consideration of estimates of economic indicators, market and regulatory trends in the years ahead, ENDESA has drawn up a business plan including, among other parameters, forecasts of economic indicators for the Group's consolidated results. ENDESA expects its gross operating profit (EBITDA)¹ to increase from Euros 3.4 billion in 2016 to Euros 3.7 billion by 2019.

Notwithstanding the foregoing, prospective information cannot be considered a guarantee of the Company's future performance in that plans and forecasts are subject to risks and uncertainties, which could result in ENDESA's future performance not matching the initial forecasts (see Section 7. Main risks and uncertainties in connection with ENDESA's business in this Consolidated Management Report).

7. Main risks and uncertainties in connection with ENDESA's business.

7.1. Risk control and management policy

The Risk Management and Control Policy involves guiding and directing strategic, organisational and operating activities to enable the Board of Directors identify precisely the acceptable risk level, with a view to the managers of the various Business Lines maximising Company's profit, maintain or increase its assets and equity and the certainty of this occurring above certain levels and prevent future events from undermining the Company's profit targets.

The Risk Management and Control Policy defines ENDESA's risk control system as an inter-linked network of legislation, processes, controls and IT systems, in which global risk is defined as the risk resulting from consolidation of all risks to which it is exposed, taking into account the mitigating effects between the various risk exposures and risk categories, enabling the risk exposure of the Group's business areas and units to be consolidated and evaluated, and the corresponding management information to be drawn up for decision-making on risk and appropriate use of capital.

The body responsible for implementing the Risk Management and Control Policy is the ENDESA S.A. Risk Committee, which relies on the internal procedures of the various business and corporate areas and is

¹ Gross operating profit (EBITDA) = Income - Supplies and Services + Work carried out by the Group for its assets – Personnel Expenses – Other fixed operating expenses.

supervised by the Audit and Compliance Committee of the Board of Directors of ENDESA, S.A. It consists of the parties responsible for each of the Company's Business Lines and Corporate Areas, and the following functions are assigned to it:

- Regularly provide the ENDESA, S.A. Board of Directors with an integrated view of current and foreseeable risk exposure.
- Ensure that senior management participates in strategic risk management and control decisions.
- Guarantee the coordination between the risk management units and those units responsible for their control, and compliance with the Risk Management and Control Policy and its associated internal procedures.
- Ensure the correct working of the Risk Control System and, in particular, that all major risks are identified, managed and adequately quantified.
- Actively participate in the preparation of risk strategy and in the major decisions about how to manage it.
- Ensure that the risk control and management systems adequately mitigate risks within the Risk Management and Control Policy framework.

The general guidelines for the Risk Management and Control Policy are developed and supplemented by other corporate and specific risk policies for each Business Line, as well as the limits established for optimum risk management.

The risk management and control model is based partly on the ongoing study of the risk profile, current best practices in the electricity sector or benchmark practices in risk management, criteria for standardising measurements and the separation of risk managers and risk controllers. It is also based on ensuring that the risk assumed is proportional to the resources required to operate the businesses, optimising their risk-return ratio, as determined by the Board of ENDESA, S.A.

The risk management cycle is the set of activities involved in identifying, measuring, controlling and managing the various risks incurred and its aim is to adequately control and manage those risks:

- **Identification:** the purpose of identifying risks is to maintain a prioritised and updated repository of all the risks assumed by the corporation through coordinated and efficient participation at all levels of the Company.
- **Measurement:** the purpose of measuring parameters is to allow risks to be aggregated and compared is to quantify overall exposure to risk, including all of ENDESA's positions.
- **Control:** the purpose of risk control is to guarantee that the risks assumed by ENDESA are appropriate to the objectives set, ultimately, by the ENDESA, S.A. Board of Directors.
- **Management:** the purpose of risk management is to implement actions aimed at adjusting risk levels at each level of ENDESA to the risk tolerance and predisposition established.

This process sets out to secure an overview of risk to assess and prioritise all risks. It covers the main financial and non-financial risks to which ENDESA is exposed, both endogenous (due to internal factors) and exogenous (due to external factors), set out on an annual map featuring the main risks, characterised and quantified, and establishing regular reviews.

Moreover, due to the increased interest in the control and management of the risk that companies are exposed to and given the complexity that identifying it from a comprehensive point of view is acquiring, the participation of employees is important at all levels of this process. A risk mailbox has now been created for employees to help identify market risks and come up with suggestions for measures to mitigate them, thereby completing the existing top-down risk management and control systems and mailboxes and specific procedures to send in communications in connection with breaches of ethical behaviour, criminal risks and employment risks.

To boost these initiatives, the ENDESA, S.A. Board of Directors also improved a Tax Risk Management and Control Policy to guide and direct strategic, organisational and operating activities to enable the Board to identify precisely the acceptable tax risk level, to help tax managers meet the policy's fiscal objectives. The Tax Risk Management and Control Policy is the specific documentary manifestation of tax control in the Fiscal Strategy approved by the Board of Directors of ENDESA, S.A.

Information regarding ENDESA's risk management and the use of derivative financial instruments is provided in Notes 18.3 and 19 to the Consolidated Financial Statements for the year ended 31 December 2016.

The Annual Corporate Governance Report is attached to this Consolidated Management Report as Appendix I, and describes ENDESA's risk management and control systems.

7.2. Main risks and uncertainties.

ENDESA's activities are carried out in an environment where outside factors may affect the performance of its operations and its earnings. The main risks to which ENDESA's operations are exposed are as follows:

7.2.1. Business and Sector-related Risks

ENDESA's activities are subject to extensive regulation, and regulatory changes could have an adverse impact on its business activities, results, financial position and cash flows

ENDESA's subsidiaries are subject to broad regulations on tariffs and on other aspects of their activities in Spain and Portugal, regulations which, in many ways, determine the manner in which ENDESA carries out its business and the revenue it receives from its products and services.

ENDESA is subject to a complex group of laws and other regulations applied by both public and private agencies, including the Spanish Markets and Competition Commission (CNMC). The introduction of new legislation or standards, or the amendment of those already in effect could have a negative impact on ENDESA's business, results, financial situation and cash flows.

In the past, regulatory changes and the different interpretations thereof by the related authorities have had a substantially adverse effect on ENDESA's business activities, results, financial position and cash flows and the same could occur in the future. Furthermore, they could demand ENDESA make significant investments in order to comply with the new legal requirements. ENDESA cannot predict the effects the new regulatory measures will have on its results, its financial position or its cash flows and, therefore, these circumstances could adversely affect ENDESA's business activities, results, financial position and cash flows.

Information regarding sectoral regulation may be found in Section 3. Regulatory Framework in this Consolidated Management Report, and also in Note 4 to the Consolidated Financial Statements for the year ended 31 December 2016.

In addition, the European Union has established an operating framework for the various Member States, which include, *inter alia*, objectives related to emissions, efficiency and renewable energies.

The introduction of new requirements, or amendments to existing ones, could adversely affect ENDESA's business activities, results, financial positions and cash flows if it cannot adapt and manage correctly the environment arising from them.

Information on likely trends in the new economic and industrial model and ENDESA's industrial plan may be found in Section 6.1 Energy Paradigm and Section 6.2 Strategic Pillars of this Consolidated Management Report.

ENDESA's activities are subject to wide-reaching environmental regulations and its inability to comply with current environmental regulations or requirements or any changes to the environmental regulations or requirements applicable could adversely affect its business activities, results, financial position and cash flows

ENDESA is subject to environmental regulations which affect both the normal course of its operations, as well as its operations and development of its projects, leading to increased risks and costs. This regulatory

framework requires licences, permits and other administrative authorisations be obtained in advance, as well as fulfilment of all the requirements provided for in such licences, permits and regulations. As in any regulated company, ENDESA cannot guarantee that:

- The laws or regulation will not be amended or interpreted in such a way as to increase the expenses necessary to comply with such laws or as to affect ENDESA's operations, facilities or plants;
- Public opposition will not lead to delays or changes in the projects that are proposed; and
- The authorities will grant the environmental permits required to develop new projects.

In addition, ENDESA is exposed to environmental risks inherent to its business, including those risks relating to the management of the waste, spills and emissions of the electricity production facilities, particularly nuclear power plants. ENDESA may be held responsible for environmental damages, for harm to employees or third parties, or for other types of damages associated with its energy generation, supply and distribution facilities, as well as port terminal activities.

Although the plants are prepared to comply with the prevailing environmental requirements, ENDESA cannot guarantee that it will be able to comply with the requirements imposed or that it will be able to avoid fines, administrative or other sanctions, or any other penalties and expenses related to compliance matters, including those related to the management of waste, spills and emissions from the electricity production units. Failure to comply with this regulation may give rise to significant liabilities, as well as fines, damages, sanctions and expenses, including, where applicable, facility closures. Government authorities may also impose charges or taxes on the parties responsible in order to guarantee obligations are repaid. In the event ENDESA were accused of failing to comply with environmental regulations, its business activities, results, financial position and cash flows could be affected adversely.

In this connection, ENDESA has taken out the following insurance policies:

- An environmental liability insurance policy which covers, up to a maximum of euros 100 million, claims arising from contamination.
- A third-party liability insurance policy which covers claims relating to damage to third parties or their property up to a maximum of Euros 200 million and an additional Euros 800 million for hydroelectric plants.
- In relation to risks arising from operating nuclear power plants, the storage and handling of low-level radioactive materials and the eventual dismantling of its nuclear power plants, an insurance policy up to Euros 700 million to cover any liabilities related to nuclear power plants up to the liability limit established by Spanish legislation.

The nuclear power plants are also insured against damage to their installations (including stocks of fuel) and machinery breakdowns, with maximum coverage of USD 1,500 million (approximately euros 1,355 million) for each generator Group.

On 28 May 2011, the Spanish government published Law 12/2011, of 27 May, on civil liability for nuclear damages or damages produced by radioactive materials, which raises operator liability to euros 1.200 million and allows coverage of this liability to be ensured in several ways. The entry into force of this regulation is in turn subject to entry into force of the Protocol of 12 February 2004, amending the Convention on Civil Liability for Nuclear Damage (Paris Convention), and the Protocol of 12 February 2004, amending the Convention which complements the latter (Brussels Convention) which, at the date on which this Consolidated Management Report was drawn up, was pending ratification by some European Union member states.

However, it is possible ENDESA may face third-party damage claims. If ENDESA were to be held liable for damages generated by its facilities for amounts greater than its insurance policy cover or for damages which exceed the scope of the insurance policy's cover, its business activities, financial position or operating results could be adversely affected.

ENDESA is subject to compliance with the legislation and regulations on emissions of pollutants and on the storage and treatments of waste from fuel from nuclear power plants. It is possible that the Company will be

subject to even stricter environmental regulations in the future. In the past, the approval of new regulations has required, and could require in the future, significant capital investment expenditures in order to comply with legal requirements. ENDESA cannot predict the increase in capital investments or the increase in operating costs or other expenses it may have to incur in order to comply with all environmental requirements and regulations. Nor can it predict if the aforementioned costs may be transferred to third parties. Thus, the costs associated with compliance with the regulations applicable could adversely affect ENDESA's business activities, results, financial position and cash flows.

Information concerning ENDESA's environmental management systems may be found in Section 10. Environmental Protection in this Consolidated Management Report.

Past or future infringements of competition and antitrust laws could adversely affect ENDESA's business activities, results, financial position and cash flows

ENDESA is subject to competition and antitrust laws in the markets in which it operates. Infringements of and failure to comply with the aforementioned laws and other applicable regulations, especially in Spain, ENDESA's main market, could give rise to legal actions against ENDESA.

ENDESA has been, is and could be the object of legal investigations and proceedings regarding competition and antitrust matters. Investigations regarding the infringement of competition and antitrust laws usually last several years and may be subject to strict rules which prevent the disclosure of information. Furthermore, infringements of these regulations may give rise to substantial fines and other types of sanctions which could adversely affect ENDESA's business activities, results, financial position and cash flows.

ENDESA's growth strategy has traditionally included, and continues to include, purchase transactions which are subject to various competition and antitrust laws. These regulations may affect ENDESA's ability to carry out strategic transactions.

ENDESA's business is largely dependent on the constant supply of large amounts of fuel to generate electricity; on the supply of electricity and natural gas used for its own consumption and supply; and on the supply of other commodities, the prices of which are subject to market forces which may affect the price and the amount of energy sold by ENDESA

ENDESA is exposed to market price and availability risks in relation to the purchase of the fuel (including gas and coal) used to generate electricity, for procuring gas and supply activities.

In this connection, fuel price fluctuations in international markets may affect the contribution margin. The prices of the offers of the various technologies are therefore established through the internationalisation, among others, of fuel CO₂ quoted prices. Therefore, in the event of fluctuation in fuel prices and carbon dioxide (CO₂), generation technologies will attempt to reflect such fluctuations in their wholesale market prices. At the same time, the order of economic merit of each generation technology when establishing the market price, will depend on its relative costs, which include those of fuel and CO₂ emission rights, among others.

Similarly, the price of oil influences the price of electricity through the natural gas supply contracts, the majority of which are indexed to oil.

The Company is also exposed to the prices of CO₂emission rights, Certified Emission Reductions (CERs) and Emission Reduction Units (ERUs). The price of carbon dioxide (CO₂) emission rights, Certified Emission Reductions (CERs) and Emission Reduction Units (ERUs) influences the cost of production at coal-fired and combined-cycle plants.

ENDESA has signed certain natural gas supply contracts which include binding "take or pay" clauses which compel it to either acquire the fuel it has agreed to contractually or to pay if it does not acquire such fuel. The terms of these contracts have been established based on certain assumptions regarding future electricity and gas demand. Any significant deviation from the assumptions used could give rise to an obligation to purchase more fuel than necessary or to sell excess fuel on the market at current prices. Over the last 3 years, ENDESA has managed its supply and demand, considerably expanding its international customer base in order to ensure its purchase commitments are balanced against the volume of its own consumption and customer sales. Furthermore, ENDESA has entered into electricity and natural gas contracts based on certain assumptions regarding future market prices for electricity and natural gas. ENDESA sells more

electricity than it generates and, therefore, it is obliged to acquire electricity on the spot market in order to meet its supply obligations.

Any significant deviation when the aforementioned supply contracts are signed could give rise to an obligation to purchase electricity or natural gas at prices which are higher than those included in the contracts. In the event there is a market price adjustment with respect to the estimates made, a deviation in ENDESA's obligations with regard to its fuel needs, or a regulatory change which affects prices as a whole and how they have been established, and if its risk management strategies are inadequate in the face of such changes, ENDESA's business activities, results, financial position and cash flows could be affected adversely.

Information regarding fuel stock purchase commitments may be found in Section 4.6. Contractual Obligations and Off-Balance Sheet Operations in this Consolidated Management Report and also in Note 11.2 to the Consolidated Financial Statements for the year ended 31 December 2016.

ENDESA's business could be adversely affected in the event it is unable to sustain its relationships with suppliers, customers and consumer and user rights organisations, or if the entities with which ENDESA maintains these relationships cease to exist

ENDESA's current relations with its main suppliers in the sector are essential for the development and growth of its business, and will continue to be so in the future. Furthermore, certain of these relationships are and will continue to be managed by ENEL, S.p.A.

ENDESA's dependence on these relationships could affect its ability to negotiate contracts with these parties under favourable conditions. Although ENDESA's supplier portfolio is sufficiently diverse and it does not have a concentration of suppliers, if any of these relationships is severed or terminated, ENDESA cannot guarantee the replacement of any significant service supplier or provider within an appropriate time frame. If ENDESA is unable to negotiate contracts with its suppliers under favourable terms, if such suppliers are unable to comply with their obligations or if their relationship with ENDESA is severed, and ENDESA is unable to find an appropriate replacement, its business activities, results, financial position and cash flows could be affected adversely.

In the electricity supply business, ENDESA maintains relationships with a large number of customers. Even if ENDESA were to lose individual customers it would not have a significant impact on its business as a whole, the inability to maintain stable relationships with key customers could adversely affect ENDESA's business activities, results, financial position and cash flows.

Furthermore, ENDESA cannot guarantee that it will maintain solid relationships and ongoing communication with consumers and users and with the associations which represent them and, therefore, any change in these relationships could entail negative publicity and a significant loss of customers, which could adversely affect ENDESA's business activities, results, financial position and cash flows.

Note 19.6 to the Consolidated Financial Statements for the year ended 31 December 2016 provides information on the concentration of customers and suppliers.

ENDESA's activities could be affected by rainfall patterns and climate and weather conditions.

ENDESA depends on the levels of precipitation in the geographical areas where its hydroelectric generation facilities are located. A year with low rainfall leads to a decline in hydroelectric output, in turn increasing the output of thermal power plants (with a greater cost) and, therefore, an increase in the price of electricity and costs of buying energy. In a wet year, the opposite effects occur.

Therefore, if there are droughts or other circumstances which adversely affect hydroelectric generation, ENDESA's business activities, results, financial position and cash flows could be adversely affected. Likewise, the Company actively manages its production mix when faced with changes in hydrological conditions. For example, in the event hydrological conditions are unfavourable, electricity generation will, to a large extent, come from other types of facilities and ENDESA's operating expenses arising from these activities will increase. ENDESA's inability to manage changes in hydrological conditions could adversely affect its business activities, results, financial position and cash flows.

Weather-related conditions and, in particular, seasons, have a significant impact on electricity demand. Electricity consumption levels reach their peak in summer and winter. The impact seasonal changes have on demand is reflected mainly in residential customer categories (with consumption of less than 50 MWh/year) and small businesses (with consumption between 50 MWh/year and 2 GWh/year). Seasonal changes in demand are attributed to various weather-related factors such as the climate, the amount of natural light, and the use of light, heating and air conditioning. Since ENDESA has high fixed costs, changes in demand due to weather conditions can have a major effect on the business's profitability.

The impact of seasonal variations on industrial electricity demand (with consumption of over 2 GWh/year) is less pronounced than in domestic and commercial industries, mainly due to the fact that there are various types of industrial activities which, due to their unique nature, have differing seasonal peaks. Furthermore, the effect of climate-related factors is more varied in these industries. Accordingly, ENDESA must make certain projections and estimates regarding climate conditions when negotiating its contracts and a significant divergence in the precipitation levels and other weather conditions envisaged could adversely affect ENDESA's business activities, results, financial position and cash flows.

ENDESA is also subject to the risk of fluctuations in global demand.

Likewise, adverse weather conditions could impact the regular supply of energy due to damages to the network, with the resulting interruption in services which could compel ENDESA to compensate its customers due to delays or disruptions in the supply of energy. The occurrence of any of the foregoing circumstances could adversely affect its business activities, results, financial position and cash flows.

ENDESA is exposed to risks associated with the construction of new electricity generation and supply facilities

The construction of power generation and supply facilities can be time-consuming and highly complex. This means that investment needs to be planned well in advance of the estimated start-up date of the facility and, therefore, the Group may need to adapt its decisions to changes in the market conditions. This may entail significant additional costs not originally planned that may affect the return on these types of projects.

In connection with the development of such facilities, ENDESA generally has to obtain the related administrative authorisations and permits, acquire land purchase or lease agreements, sign equipment procurement and construction contracts, operation and maintenance agreements, fuel supply and transport agreements, off-take arrangements and obtain sufficient financing to meet its capital and debt requirements.

Factors that may affect ENDESA's ability to construct new facilities include:

- Delays in obtaining regulatory approvals, including environmental permits;
- Shortages or changes in the price of equipment, materials or labour;
- Opposition from local groups, political groups or other stakeholders;
- Adverse changes in the political environment and environmental regulations;
- Adverse weather conditions, natural catastrophes, accidents and other unforeseen events that could delay the completion of power plants or substations;
- Proper compliance by suppliers with the contracts entered into; and
- Inability to obtain financing under conditions that are satisfactory to ENDESA.

Any of these factors may cause delays in completion or commencement of the Group's construction projects and may increase the cost of planned projects. In addition, if ENDESA is unable to complete these projects, any costs incurred in connection with such projects may not be recoverable.

If ENDESA faces problems related to the development and construction of new facilities, its business activities, results, financial position and cash flows may be adversely affected.

In addition, ENDESA makes investments to maintain and, where necessary, extend the technical life of its electricity power plants. The execution of these investments is dependent on market and regulatory conditions. If the necessary conditions enabling the viability of the plants do not exist, ENDESA may have to cease production at the installation and, where appropriate, and begin the task of dismantling them. These closures would involve a reduction in installed capacity and output that support customer energy sales and, therefore, could adversely affect ENDESA's business activities, results, financial position and cash flows.

Information concerning ENDESA's investment plan may be found in Section 6.3. Main Financial Indicators in this Consolidated Management Report.

7.2.2. Risks associated with the countries in which ENDESA operates.

ENDESA's business could be affected by adverse economic or political conditions in Spain, Portugal, the Eurozone and in international markets

Adverse economic conditions could have a negative impact on energy demand and the ability of ENDESA's consumers to fulfil their payment obligations. In times of economic recession, as experienced by Spain and Portugal in recent years, electricity demand usually falls off, adversely affecting the Company's results.

The economic conditions in Spain and Portugal in recent years have adversely affected electricity demand and, therefore, ENDESA's operating results. The Company cannot predict how the economic cycle in Spain, Portugal and the Eurozone will evolve in the short term, nor can it predict whether economic conditions will worsen or deteriorate.

If the economic situation in Spain, Portugal or other Eurozone economies deteriorates, it could adversely affect energy consumption and, consequently, ENDESA's business activities, financial position, operating results and cash flows would be negatively affected.

In addition, the financial conditions in the international markets represent a challenge for ENDESA's economic situation due to the potential impact on its business of, on the one hand, the government debt level, declining growth rates and possible downgrading of government bond ratings at the international level – and, in particular, in Eurozone countries – and, on the other hand, the new monetary expansion measures expected in the credit market. Changes in any of these factors could condition ENDESA's access to capital markets and the conditions under which it obtains financing, consequently affecting its business activities, results, financial position and cash flows.

In addition to any economic problems, which could arise at the international level, ENDESA faces a situation of uncertainty at political level, in Europe and internationally, which could adversely affect the Company's economic and financial position. Specifically, it is considered that the impact of “Brexit” on ENDESA is negligible.

ENDESA cannot guarantee that the international or Eurozone economic situation will not deteriorate, or that an event of a political nature will not have a significant impact on the markets, thus affecting its economic situation. All of these factors could adversely affect ENDESA's business activities, financial position, operating results and cash flows.

7.2.3. Risks associated with Operations carried out by ENDESA

ENDESA's activities may be affected by operating risks and other significant risks

In the course of ENDESA's business activities, direct or indirect losses could arise from inadequate internal processes, technological failures, human error or certain external events, such as accidents at facilities, workplace conflicts and natural disasters. These risks and dangers could cause explosions, floods or other circumstances which could cause the total loss of the energy generation and distribution facilities; damages to or the deterioration or destruction of ENDESA's facilities, or even environmental damages; delays in electricity generation and complete disruption of the activity; or could cause personal damages or deaths. The occurrence of any of these circumstances could adversely affect its business activities, results, financial position and cash flows.

The loss of essential workers or ENDESA's inability to recruit, employ and train qualified staff could adversely affect ENDESA's business activities, results, financial position and cash flows

In order for ENDESA to be able to continue to maintain its position in the industry, it must recruit, train and retain the staff necessary to provide the experience required within the framework of ENDESA's intellectual capital needs. The success of ENDESA's business depends on the continuity of the services provided by Company management and by other key employees with demonstrated experience, reputation and influence in the electricity industry, thanks to establishing beneficial and long-lasting relationships in the market over the years. The qualified labour market is highly competitive and ENDESA may not be able to successfully hire additional qualified staff or to replace outgoing staff with sufficiently qualified or effective employees.

ENDESA's inability to retain or recruit essential staff could adversely affect its business activities, results, financial position and cash flows.

Information on attracting and retaining talent, training, leadership and development of employees may be found in Section 11. Human Resources in this Consolidated Management Report.

ENDESA's insurance cover and guarantees may not be adequate or may not cover all of the damages

ENDESA's business is exposed to the risks inherent to the markets in which it operates. Despite the fact that ENDESA attempts to obtain adequate insurance cover in relation to the main risks associated with its business – including damages to the Company itself, general civil liability, environmental and nuclear power plant liability – it is possible that insurance cover may not be available on the market under commercially reasonable terms. Likewise, the amounts for which ENDESA is insured may not be sufficient to cover the incurred losses in their entirety.

In the event of a partial or total loss of ENDESA's facilities or other assets, or a disruption to its activities, the funds ENDESA receives from its insurance may not be sufficient to cover the complete repair or replacement of the assets or losses incurred. Furthermore, in the event of a total or partial loss of ENDESA's facilities or other assets, part of the equipment may not be easily replaced, given its high value or its specific nature, or may not be easily or immediately available.

Similarly, the cover of guarantees in relation to the aforementioned equipment or the limits to ENDESA's ability to replace the equipment could disrupt or hinder its operations or significantly delay the course of its ordinary operations. Consequently, all of the above could adversely affect ENDESA's business activities, results, financial position and cash flows.

Likewise, ENDESA's insurance contracts are subject to constant review by its insurers. It is therefore possible that ENDESA may be unable to maintain its insurance contracts under conditions similar to those currently in place in order to meet possible increases to premiums or to covers which become inaccessible. If ENDESA is unable to transfer a possible premium increase to its customers, these additional costs may adversely affect its business activities, results, financial position, and cash flows.

ENDESA manages its activities with information technology that uses the highest security and contingency standards according to the state of the art, such that it guarantees operating efficiencies, as well as the continuity of the businesses, systems and processes which contribute to attaining its corporate objectives

The business aggregates with regard to technical complexity, volume, granularity, functionality and varying situations handled by ENDESA's systems make their uses essential and represent a strategic distinguishing element with respect to industry companies. Specifically, ENDESA's main computer systems handle the following business processes:

- Sales systems: marketing processes, demand forecasts, profitability, sales, customer service, claim management, hiring and the basic revenue cycle (validation of meter reading, invoicing, collection management and debt processing).
- Technical distribution systems: processes for managing the grid, meter-reading management, handling of new supplies, network planning, field work management, management of meter-reading equipment with advanced remote management and energy management capabilities.

- Economic and financial systems: economic management, accounting, financial consolidation and balance sheet processes.

Moreover, ENDESA is in the midst of a process of digital transformation, which will raise its exposure to potential cyber attacks that might endanger the security of its systems and its customer databases, which in turn might impair the Company's performance and undermine its customers' trust.

Management of ENDESA's business activity through these systems is key in order to perform its activity efficiently and achieve its corporate objectives. However, the existence of these processes, methodologies, tools and protocols based on international standards and appropriately audited, and the development of a cyber security strategy that relies on a management framework and is aligned with international standards and government initiatives, does not imply that ENDESA is exempt from technical incidents which could adversely affect the continuity of ENDESA's business operations, the quality of its contractual relationship with its customers, its results, its financial position and its cash flows.

7.2.4. Financial Risks associated with ENDESA's Business

Note 19 to the Consolidated Financial Statements for the year ended 31 December 2016 lists the risk management and control mechanisms.

ENDESA is exposed to interest rate risk.

Borrowings at floating interest rates are mainly tied to Euribor. Changes in interest rates in relation to debt not covered or that is adequately covered may be adversely affect ENDESA's business activities, results, financial position and cash flows.

Information on interest rate risk is provided in Note 19.1 of the Notes to the Consolidated Financial Statements for the year ended 31 December 2016.

ENDESA is exposed to foreign currency risk

ENDESA is exposed to foreign currency risk, mainly in relation to the payments it must make in international markets to acquire energy-related commodities, especially natural gas and international coal, where the prices of these commodities are usually denominated in US dollars.

Therefore, this means that the fluctuations in the foreign exchange rate could adversely affect ENDESA's business activities, results, financial position and cash flows.

Information on foreign currency risk is provided in Note 19.2 of the Notes to the Consolidated Financial Statements for the year ended 31 December 2016.

ENDESA is exposed to credit risk

In its commercial and financial activities, ENDESA is exposed to the risk that its counterparty may be unable to meet all or some of its obligations, both payment obligations arising from goods already delivered and services already rendered, as well as payment obligations related to expected cash flows, in accordance with the financial derivative contracts entered into, cash deposits or financial assets. In particular, ENDESA assumes the risk that the consumer may not be able to fulfil its payment obligations for the supply of energy, including all transmission and distribution costs.

ENDESA cannot guarantee that it will not incur losses as a result of the non-payment of commercial or financial receivables and, therefore, the failure of one or various significant counterparties to fulfil their obligations could adversely affect ENDESA's business activities, results, financial position and cash flows.

Information on credit risk is provided in Note 19.5 of the Notes to the Consolidated Financial Statements for the year ended 31 December 2016.

ENDESA's business depends on its ability to obtain the funds necessary to refinance its debt and finance its capital expenses

ENDESA is confident that it will be able to generate funds internally (self-financing), access bank financing through long-term credit facilities, access short-term capital markets as a source of liquidity and access the long-term debt market in order to finance its organic growth programme and other capital requirements, including its commitments arising from the on-going maintenance of its current facilities. Furthermore, ENDESA occasionally needs to refinance its existing debt. This debt includes long-term credit facilities, obtained from both banks as well as companies of the Group headed by ENEL, and financial investments.

If ENDESA is unable to access capital under reasonable conditions, refinance its debt, settle its capital expenses and implement its strategy, the Company could be adversely affected. The capital and turmoil in the capital market, a possible reduction in ENDESA's creditworthiness or possible restrictions on financing conditions imposed on the credit facilities in the event financial ratios deteriorate, could increase the Company's finance costs or adversely affect its ability to access the capital markets.

A lack of financing could force ENDESA to dispose of or sell its assets to offset the liquidity shortfall in order to pay the amounts owed and this sale could occur under circumstances which prevent ENDESA from obtaining the best price for said assets. Therefore, if ENDESA is unable to access financing under acceptable conditions, ENDESA's business activities, results, financial position and cash flows could be adversely affected.

Information concerning ENDESA's financial function may be found in Section 4.1. Financial Management in this Consolidated Management Report.

On the other hand, the conditions in which ENDESA accesses the capital markets or other means of financing, whether within the Company or on the credit market, are highly dependent upon the credit rating of the ENEL Group, of which ENDESA is part. ENDESA's capacity to access the markets and financing could therefore be adversely affected, in part, by the credit and financial position of ENEL, to the extent that it could determine the availability of intercompany financing for ENDESA or the conditions under which the Company accesses the capital market

In this connection, the deterioration of ENEL's credit rating and, consequently, that of ENDESA, could limit ENDESA's ability to access the capital markets or any other means of financing (or refinancing) from third parties or increase the cost of these transactions which could adversely affect ENDESA's business activities, results, financial position and cash flows.

Information concerning ENDESA's rating may be found in Section 4.3. Credit Rating Management in this Consolidated Management Report.

7.2.5. Tax Risks

Technical tax risk

This is the possible risk that the tax authorities may demand more contributions from the taxpayer than expected in relation to tax returns or returns not presented, or in addition to the returns presented or unpaid tax, due to different interpretations of laws or regulations or new regulations that may be introduced retroactively, in connection with tax payable, late-interest penalties, fines or any other item entailing tax debt. This risk is associated both with compliance with current regulations and changes in their interpretation.

The information relating to the tax periods open for review is detailed in Note 3ñ of the notes to the Consolidated Financial Statements for the year ended 31 December 2016.

Any change to the tax legislation applicable or to its interpretation could affect ENDESA's tax obligations, entailing fines, extra costs or increases in its obligations which could adversely affect its business activities, outlook, operational results, financial position and cash flows.

Reputational risk arising from tax matters

This is the risk that the main audience's perception, assessment or opinion of the company may be seriously affected due to the company's own actions, events that are wrongly or unfairly attributed to it, or due to events of similar nature that affect the entire sector and are projected on the company.

ENDESA could be held liable for income tax and value added tax (VAT) charges corresponding to the tax group of which it forms part or has formed part.

Since 2010, ENDESA has filed consolidated tax returns for income tax purposes, as part of consolidated tax group no. 572/10, the parent of which is ENEL, S.p.A. and ENEL Iberoamérica, S.L.U. The representative in Spain. Likewise, since January 2010, ENDESA has formed part of the Spanish consolidated VAT group no. 45/10, the parent of which is also ENEL Iberoamérica, S.L.U. Until 2009, ENDESA filed consolidated tax returns as the Parent under group no. 42/1998 for income tax and under group no. 145/08 for VAT.

Also, ENEL Green Power España, S.L.U. (EGPE), a wholly-owned ENDESA subsidiary, has been fully consolidated between 2010 and 2016 as part of the Group number 574/10 of which ENEL Green Power España, S.L.U. (EGPE) is the Parent.

In accordance with the regime for filing consolidated tax returns for purposes of income tax and VAT for company groups, all of the Group companies which file consolidated tax returns are jointly responsible for paying the Group's tax charge. This includes certain sanctions arising from failure to comply with specific obligations imposed under the VAT regime for company groups.

As a result of this, ENDESA is jointly responsible for paying the tax charge of the other members of the consolidated tax Groups to which it belongs or has belonged for all tax periods still open for review. ENEL Green Power España, S.L.U. (EGPE) is also responsible for this with respect to the other members of the tax consolidation group of which it has formed part.

Even though ENDESA or, where applicable, ENEL Green Power España, S.L.U. (EGPE), has the right to recourse against the other members of the corresponding consolidated tax group, it could be held jointly liable if any outstanding tax charge were to arise which had not been duly settled by another member of the consolidated tax groups of which ENDESA or, where applicable, ENEL Green Power España, S.L.U. (EGPE), forms or has formed part. Any material tax liability could adversely affect ENDESA's business activities, results, financial position and cash flows.

7.2.6. Other Risks.

The ENEL Group controls the majority of ENDESA's share capital and voting rights and the interests of the ENEL Group could conflict with the interests of ENDESA.

At 31 December 2016 the ENEL Group, through ENEL Iberoamérica, S.L.U., held 70.101% of ENDESA's share capital and voting rights, enabling it to appoint the majority of ENDESA's Board members and, therefore, to control management of the business and its management policies.

In addition, certain of the relationships that ENDESA currently maintains with its principal international suppliers and providers in the sector are, and will continue to be, managed by ENEL, S.p.A.

The ENEL Group's interests may differ from the interests of ENDESA or those of its shareholders. Furthermore, both the ENEL Group and ENDESA compete in the European electricity market. It not possible to ensure that the interests of the ENEL Group will coincide with the interests of ENDESA's other shareholders or that the ENEL Group will act in support of ENDESA's interests.

Information on balances and transactions with related parties is provided in Note 34 to the Consolidated Financial Statements for the year ended 31 December 2016.

ENDESA is involved in court and arbitration proceedings

ENDESA is party to various ongoing legal proceedings related to its business activities, including tax, regulatory and antitrust disputes. It is also subject to ongoing or possible tax audits. In general, ENDESA is

exposed to third-party claims from all jurisdictions (criminal, civil, commercial, labour and economic-administrative) and in national and international arbitration proceedings.

Although ENDESA considers that the appropriate provisions have been made for any legal contingencies, it has not made provisions for all amounts claimed in each and every one of the proceedings. In particular, it has not made provisions in cases in which it is impossible to quantify the possible negative outcome nor in cases in which the Company considers such negative outcome unlikely. No guarantee can be made that ENDESA has allocated adequate provisions for contingencies, that it will be successful in the proceedings in which it expects a positive outcome, or that an unfavourable decision will not adversely affect ENDESA's business activities, results, financial position and cash flows. Furthermore, the Company cannot ensure that it will not be the object of new legal proceedings in the future, which, if the outcome were unfavourable, would not have an adverse effect on its business activities, operating results, financial position or cash flows.

Information on litigation and arbitration is provided in Note 16.3 to the Consolidated Financial Statements for the year ended 31 December 2016.

ENDESA is exposed to image and reputation impairment risk

ENDESA is exposed to the opinion and perception projected to different interest groups. This perception could deteriorate as a result of events produced by the Company or third parties over which it has little or no control. Should this occur, this could lead to economic detriment for the Company due, among other factors, to increased requirements on the part of regulators, higher borrowing costs or increased efforts to attract customers.

Although ENDESA actively work to identify and monitor potential reputational events and interest groups affected, and transparency forms part of its communications policy, there is no guarantee that it will not have its image or reputation impaired which, since the outcome would be unfavourable, will have an adverse effect on its business, operating results, financial situation or cash flows.

ENDESA is exposed to sustainability risks.

Sustainability issues are now much more relevant, and in the years ahead they could increasingly affect some of the risk factors faced by ENDESA. Among these emerging global tendencies, the following factors have been identified as those which could affect ENDESA most: loss of biodiversity, water availability restrictions, terrorism, waste and atmospheric pollution, protection of human rights, digitalisation, commodity shortages, demographic change, cybersecurity, inequality and climate change.

Information concerning ENDESA's commitment to sustainable development may be found in Section 8 Sustainability Policy in this Consolidated Management Report.

8. Sustainability policy.

8.1. ENDESA's sustainability commitment.

ENDESA believes that sustainability is responsible growth - in other words, making social and environmental opportunities part of its management model and strategy, helping it achieve its business objectives and maximising long-term value creation for the company and the local communities it serves.

This unswerving commitment to sustainability was boosted following approval of the Sustainability Policy on 21 December 2015 by the Board of Directors of ENDESA, S.A., which aims to determine and formalise the Company's commitment to sustainable development, laying this down in the mission, vision and values that make up ENDESA's principles of conduct.

ENDESA is an energy utility, which has electricity as its core business, a growing presence in the gas industry, and also supplies other related services. Its objective is to supply customers with quality service responsibly and efficiently, while providing a return to shareholders, promoting a culture of ethics and compliance, fostering employees' professional development, assisting with the development of the social environments where it operates and using the natural resources necessary for its activities in a sustainable manner, from the approach of creating value shared with all stakeholders.

Meeting ENDESA's economic, social and environmental responsibilities in a balanced way, on the basis of sustainability, is essential if it is to maintain its leading position and strengthen it in the future.

To this effect, the new commitments for the future, constitute the basis and guidelines for ENDESA's conduct in this area, and compliance with them is expressly supported by the Company's management, concerns employees, contractors and suppliers and is evaluated by third parties:

- These commitments are fully integrated in day-to-day work and are constantly reviewed and improved through the definition of objectives, programmes and actions, which are included in successive sustainability plans.
- ENDESA has monitoring and evaluation mechanisms available that exhaustively measure the achievement of these commitments.
- The Company's focus is on steady and fluid dialogue with stakeholders, with the aim of incorporating their expectations in a structured manner and in alignment with its strategy.
- ENDESA is committed to the application of responsible communication practices as its principal vehicle of transmitting the strength and solidity of its commitment to sustainable development to its various stakeholder groups.

ENDESA's new commitments for the future are:

- **Customers:** commitment to digital quality, commercial excellence and efficient energy consumption.
- **Shareholders and investors:** commitment to creating value and profitability.
- **People:** commitment to personal and professional development, diversity and work-life balance, and the occupational health and safety of the people who work for ENDESA.
- **Conduct:** commitment to good governance, transparency and ethical behaviour.
- **Environment:** commitment to reducing the environmental footprint and protecting the environment.
- **Innovation:** commitment to innovation in technology and the scope of services.
- **Society:** commitment to the socio-economic development of the communities in which the company operates.
- **Institutions:** commitment to developing public-private partnerships to promote sustainable development.
- **Employees:** commitment of those who work with us to be actively involved in sustainability.

To this effect, the future commitments set out in the policy constitute the basis and guidelines for ENDESA's management of its business, and in this regard compliance is expressly supported by the Company's management, concerns employees, contractors and suppliers, and is evaluated by third parties. Through its Audit and Compliance Committee, the ENDESA, S.A. Board supervises proper implementation of the principles of the Sustainability Policy throughout the company's entire value-creation chain.

The policy is implemented by means of several Sustainability Plans at ENDESA.

8.2. Compliance with ENDESA's 2016-2019 Sustainability Plan

ENDESA's 2016-2019 Sustainability Plan, focused on encouraging sustainable short-term and long-term economic growth by fostering a sustainable responsible value-creation chain, established 2 priority areas for action to be taken: promotion of a more sustainable electricity production model and a focus on sustainable urban development.

Moreover, in a bid to guarantee the highest levels of excellence in terms of responsible business management, 5 transversal strategic pillars were identified for all the Company's activities: integrity, human capital, environment, supply chain and social commitment.

With more than 80 quantitative management targets, ENDESA has responded to each of the priorities and strategic pillars defined in its 2016-2019 Sustainability Plan, and has achieved overall compliance of more than 97%.

As part of its commitment to transparency and in a bid to gain the confidence of its stakeholders, ENDESA discloses compliance with its objectives and the courses of action in its 2016-2019 Sustainability Plan in its Sustainability Report, available for consultation at its website.

8.3. ENDESA's contribution to the United Nations Sustainable Development Goals (SDGs)

In September 2015 the General Assembly of the United Nations adopted the 2030 Agenda for Sustainable Development, consisting of 17 Sustainable Development Goals (SDGs) as an action plan for people, the planet and prosperity, and also in a bid to boost world peace, access to justice and to help fight climate change, and in this regard businesses were called upon to provide proactive assistance.

ENDESA is firmly committed to the new United Nations Agenda for Sustainable Development, and acknowledges the historic opportunity of the new Sustainable Development Goals (SDGs) and the implication of the private sector to meet the main challenges faced by society.

The ENEL Group has publicly undertaken to make a specific contribution to 4 of the 17 Sustainable Development Goals:

- SDG4 (Quality education): Assistance with the education of 400,000 people by the year 2020, in a range of educational projects.
- SDG7 (Affordable and clean energy): Fostering access to sustainable, affordable modern energy, assisting 3 million people by the year 2020.
- SDG8 (Decent work and economic growth): Fostering employment and sustainable, inclusive and sustained economic development for 1.5 million people by 2020.
- SDG13 (Climate action): Adopting initiatives to combat climate change, in a bid to attain carbon neutrality by the year 2050.

On 23 November 2016 ENDESA presented the new 2017-2019 Strategic Plan to investors (see Section 6 Outlook in this Consolidated Management Report), which sets the roadmap to encourage a more sustainable energy model and decarbonise the energy mix by 2050, thereby falling into line with the UN's new Sustainable Development Agenda.

In this regard ENDESA has announced its specific contribution to the Sustainable Development Goals (SDGs):

- SDG7 (Affordable and clean energy): No vulnerable customers without access to electricity, taking action in 3 areas: signature of cooperation agreements with public authorities, training and awareness campaigns on the responsible use of energy and submission of a regulatory proposal concerning the Social Bonus.
- SDG9 (Industry, innovation and infrastructure): Investing Euros 1 billion up to 2019 to promote digital transformation and develop energy solutions.
- SDG13 (Climate action): Decarbonisation of the energy mix by 2050, setting intermediate targets to reduce absolute emissions of carbon dioxide (CO₂) by 47% by 2020 and by 61% by 2030 with respect to 2005.

ENDESA will also assist with ENEL's commitments to SDG4 (Quality education) and SDG8 (Decent work and economic growth) through the social initiatives implemented by the Company and its Foundation.

However, although these Sustainable Development Goals (SDGs) are the priorities for ENEL and ENDESA, and therefore the emphasis will be placed on them in the years ahead, they will also take decisive action on the rest of the 17 Sustainable Development Goals (SDGs) through the Sustainability Plan.

9. Research, Development and Innovation Activities (R&D+i).

9.1. Context and Objectives of the Research, Development and Innovation Activities (R&D+i)

The energy industry is in the midst of important changes which will intensify in the future due to the growing environmental awareness of governments and customers. ENDESA is aware that the objectives for reducing emissions and increasing efficiency are necessary, requiring an additional effort on its part in order to achieve them.

According to the European Union, in order to reach the targets set by the European Council in March 2007 regarding the 20-20-20 goal for 2020, electrification of European demand must increase to 22% by 2020 and in order to reach the targets set in the "2050 Energy Roadmap", aimed at reducing greenhouse gases by 90% in 2050, it must be more than 39% by the year 2050.

The foregoing will facilitate the transition from the current centralised one-directional energy model, where customers consume energy generated at large plants and distributed through large one-directional infrastructures, towards a more decentralised multi-directional model where customers can generate their own energy and exchange it with other players through multi-directional infrastructures.

In this context, the goal of ENDESA's research, development and innovation activities is to create a new, more sustainable energy model based on efficient electrification of energy demand thanks to the development, testing and application of new technologies and new business models.

ENDESA's R&D and Innovation activities, are developed in coordination with the rest of the ENEL Group, with joint research activities being undertaken in the areas of shared interest and in the markets in which both operate.

9.2 Investment in research, development and innovation activities (R&D+i).

Gross direct investment in Research, Development and Innovation (R+D+i) in 2016 amounted to Euros 16 million, distributed as follows:

Million Euros

	Gross direct investment in R+D+i	
	2016	2015
Generation and supply	12	19
Distribution	4	3
TOTAL	16	22
Gross direct investment in R+D+i / Gross operating profit (EBITDA) (%) ⁽¹⁾	0.47	0.72
Gross direct investment in R+D+i / Operating profit (EBIT) (%) ⁽²⁾	0.81	1.38

(1) Gross operating profit (EBITDA) = Income - Supplies and Services + Work carried out by the Group for its assets - Personnel expenses - Other fixed operating expenses.

(2) Operating profit (EBIT) = Gross operating profit (EBITDA) - Depreciation and impairment losses.

9.3 Main areas of activity

ENDESA's Research, Development and Innovation activities span all business areas. The following details the areas of activity, their future guidelines, and certain of the most relevant projects currently under way.

Electricity generation

Guidelines: reduce pollutants, boost digitalisation at plants, increase efficiency and improve flexibility of conventional plants in order to optimise operation and reduce their environmental impact.

Areas of activity:

- Digitalisation of generating plants:

- “IOT Besos”: Demo project to implement new digital technologies at the Besos combined-cycle plant (applications for advanced control systems, wireless communications, energy harvesting, virtual and enhanced reality, artificial vision and advanced predictive diagnosis).
- “Big Data”: Development of a platform and a predictive failure detection system based on big data technology and artificial intelligence for the main components of generating plants.
- “Acombo”: Development of software for advanced calculations of the integrity of dams at hydro power plants. Project co-financed by Spain's "I+D Retos Colaboración" programme.
- Reduction of emissions and environmental protection:
 - “GTTech”: evaluation and validation of the injection of large amounts of water into gas turbines with liquid fuel to reduce nitrogen oxide (NO_x) emissions in compliance with the future upper thresholds set by the Industrial Emissions Directive (IDE or “DEI” in Spanish).
 - “Ashreact”: a project aimed at recovering ash from the carbon combustion process at thermal power plants, through the use of an alkaline pre-activation process, to obtain substitutes for Portland cement products.
 - “Matching”: a project carried out alongside a number of other companies and R+D centres, co-financed by the EU's Horizon 2020 programme. The objective is to reduce water consumption in the energy sector through the use of new technology, and it involves validation of the various technologies at 3 pilot plants being installed at the As Pontes thermal power plant.
 - “Lessox”: Study of new operational strategies to reduce specific emissions of nitrogen oxide (NO_x) and sulphur oxide (SO_x) in variable-load coal-fired thermal units.
 - “Innovaalga”: Upgrading carbon dioxide (CO₂) from combustion gases at the Litoral (Almeria) thermal power plant, and the use of microalgae and recovery of the biomass generated to obtain high-value proteins and sustainable fertilisers.
 - “O2GEN”: Project aimed at optimising carbon dioxide (CO₂) capture using circulating fluidised bed oxy-combustion (OxyCFB) technology, through the use of higher ratios of oxygen and carbon dioxide (O₂/CO₂) in smaller boilers and with lower costs.
 - “ReCaL” and “CaO₂”: Optimisation of the process of capturing carbon dioxide (CO₂) using carbonation-calcination cycles with experimentation at the La Pereda 1.7 MWt pilot plant.
 - “Orpao”: Improvements to operation of desulphurisation plants by optimising the intermediate processes to reduce operating costs, improve the quality of gypsum and reduce liquid effluents, thereby improving quality and the environment.
- Increase the efficiency and flexibility of the power plants:
 - “Coalrel”: Study of strategies to boost the flexibility of fuels at coal-fired thermal units, reducing specific emissions.
 - “Coal Stockpiling”: Rollout of a project to avoid energy loss at coal facilities as a consequence of natural oxidation and spontaneous combustion processes, or coal particles being blown away by the wind.
 - “Conava”: Implementation at the Teruel thermal plant of an adaptive expert predictive control system to optimise combustion, control superheat temperature and reduce thermal fatigue damage.
 - “Rubber”: Development of a new inspection technique to test the integrity of rubber-metal joints in wet desulphurisation systems at coal-fired plants.
 - “Colifo”: System to monitor the remaining life of the principal components of the boiler, with the aim of improving the operation of coal-fired thermal units.

- “Protec”: Development of new claddings to protect boiler pipes against corrosion at high temperatures and also against erosion.
- Energy storage:
 - “El Hierro”: Assessment of the installation of an energy storage system to boost the quality of electricity supply on the El Hierro island grid.

Technology projects on advanced distribution grids.

Guidelines: to be the leader of communication technologies in the distribution network.

Areas of activity:

- Remote management project: The objective is to roll out an automatic remote electricity supply control and management system for domestic customers (less than 15 kW). This system, the first of its kind in Spain, will be installed in the homes of more than 12 million of the Company's customers (2010-2018), to replace conventional electricity meters, in compliance with prevailing Spanish legislation (Ministerial Order IET/290/2012, of 16 February), which will help boost efficiency and sustainability of the electricity network.
- Smart grid/Smart city projects: These ensure that the grids are able to offer a rapid response to users' needs.
 - ENDESA is developing its "SmartGrid" concepts on its SmartCity programmes, which have produced a number of projects. It has now been eight years since the "SmartCity" project was introduced in Málaga, and six since deployment of the "SmartCity" setup in Barcelona.
 - Monitoring and advanced control of medium/low voltage distribution networks (known as “Mónica”): The idea is to move forward from simple data capture to the management and use of information that helps decision-making and the use of smart electricity grids to optimise network performance. In 2016 ENDESA installed and started up a sensor multitude service at 56 medium/low voltage transformation centres in “SmartCity Málaga”.
 - “Dareed”: A European project carrying out tests in Sevilla on the contribution of the general public to local energy management, whereby an energy market has been set up to put individuals and professionals in contact with one another.
 - “Resilience to cope with Climate Change in Urban Areas”: This focuses on assessing the impacts of climate change on functional continuity and guaranteed critical city services and analysis of their interdependences. Three EU cities are participating in the project (Barcelona, Lisbon and Bristol).
 - “La Graciosa”: This project aims to establish the strategies and systems necessary to optimise energy flows in order to maximise the penetration of renewable energies on La Graciosa island.
- “Smartnet”: This project sets out to provide Information System solutions, market architectures and optimum interactions between transport operators, distributors and other participants, in the management of exchange of information and data to monitor and acquire ancillary systems within a pan-European context, for local needs and also to cover the requirements of the entire system, in due consideration of distributed generation and the flexibility it can provide.

Efficiency in end usage of energy

Guidelines: test the latest technologies in the field, define performance, identify areas of improvement and define operating processes.

Areas of activity:

- Active management of demand: The European EnergyTIC project enabling customers in subsidised housing to meet their water and energy savings targets.

- Large-scale energy storage ("Store" Project): Testing began in the Canary Islands of the first 3 plants with different energy storage technologies.

Electric vehicles.

Guidelines: ENDESA is still firmly committed to developing e-mobility technologies in the broadest sense, and plays an active role in this field in order to position itself as a leader in the e-mobility industry and to develop and test on a real scale recharge systems, which allow the energy stored to be used and are large scale examples aimed at promoting e-mobility in real environments.

Areas of activity:

- Rapid charging:
 - "Prototype For Alternative Operation Of Mobility Assets": Integration of a new rapid charging system for electrically-powered buses and analysis of the impact of these infrastructures on the electricity distribution network.
 - "Ultrafast": An ultra-rapid charger (400 kW) service available for all heavy electric vehicles in Barcelona; testing the technology and operating systems associated with the first fleet of 18-metre buses. The initiative forms part of the H2020 ZeUS "Zero Emission Urban System" Project, developed as part of a European consortium to demonstrate the economic, environmental and social viability of electric urban buses.
 - "CIRVE": European project to deploy a network with 40 rapid-charge stations in urban and peri-urban areas, and to encourage this kind of infrastructure in Spain.
 - "Ecar": A project in Majorca to install 6 rapid-charge stations with energy certified as 100% renewable.
- Inductive charge:
 - "Victoria": Development of a Spanish dynamic-induction charging technology for buses.
- Take advantage of energy stored in electric vehicles:
 - "Vehicle to Grid - V2G": Development of systems that allow vehicles to be charged and run down. In 2016 ENDESA worked alongside ENEL to demonstrate the validity of technology on international projects, creating the first commercial hub in Denmark and carrying out tests in Germany and the UK.

New products and services.

Guidelines: develop and test new energy efficiency services linked to communication technology applications, generation in consumption, storage, air-conditioning and lighting.

Areas of activity:

- "Flexiciency": Large-scale demonstration of new services for all agents in the European electricity market based on the access to almost-real-time data from meters. Operations were carried out in 2016 to inspect and select the best buildings and municipal sites to be included in the project. The technical specifications for the integration devices were also defined.

Network innovation projects

The main projects in this area were as follows:

- "Growsmarter": ENDESA was involved in this project as part of the European Union's Horizon 2020 Programme, and provided several solutions for the Barcelona demo, mainly in the areas of integration of infrastructure and sustainable urban mobility.

- “STEP”: The objective is to test the ENEL “Smartinfos” devices connected to ENDESA's Smart Meters, which will display consumption data to real users via a web platform and a mobile phone application.
- Project for the Interoperability of Substation Automation Units, “IdEAS”: The objective on this project is to develop and demonstrate a comprehensive fully interoperable network-integrated digital substation system.
- Standardisation-Security-Synchronisation Connected Substation project, “3S-CS”: The project sets out to develop an integral system to control electricity substations on the basis of the "IdEAS" digital substation project, with wireless capacity.

Occupational safety.

Developing and testing technologies which contribute to the objective of reducing the accident rate:

- Implementation of the application “APP5RO” to verify compliance with the 5 golden rules for working with electricity.
- Analysis and monitoring of tasks in businesses operated by ENDESA, conducting assessments of possible improvements that could be made to processes.
- Inspection plan to analyse and monitor hazardous tasks in ENDESA's main lines of business. 189,876 inspections were carried out among the various lines of business in 2016.
- Extra Checking On Site “ECoS” programme, whereby an expert team trained by co-workers at different companies visit production centres to inspect specific tasks, drawing up comparisons and spreading the good practices observed to the rest of the organisation.
- SPP Programme (Safety Personalised Plan) for generation facilities, where major contractors are invited to visit the plant for bottom-up remarks on the Risk Prevention activities they all agree are the most important. The plan is monitored on a regular basis, and the information is stored in a corporate application.

9.4. Innovation Model

ENDESA has an open innovation model and was the first Spanish electricity company to obtain UNE 166200 certification for this model.

ENDESA's Research, Development and Innovation (R+D+i) activities are carried out in close collaboration and cooperation with the rest of the ENEL Group, taking advantage both of the Group's research centres and the best research centres, universities, suppliers and emerging national and international companies.

The following is a summary of ENDESA's innovation model:

- **Identification of technological challenges:** in close collaboration with the businesses and after a trend analysis.
- **Generation of ideas:** in order to provide solutions to challenges. On two levels:
 - o Internal ideas:
 - (i) “Eidos Market”: a crowdsourcing platform to take advantage of the collective intelligence of all ENDESA's employees.
 - (ii) "90 minutes of innovation": Internal employee innovation encounters, focusing on the collaborative economy, blockchain or the impact of artificial intelligence.
 - (iii) “ENDESA Datathon”: to develop new proposals for the Spanish market through the analysis of the huge dataset provided to participants with simulated information on hourly usage.

- (iv) “Blockchain Lab”: Ideas laboratory to conduct a search for the best proposals and business models with blockchain technology in energy applications.
 - (v) “TEAM A”: A project to identify innovative proposals in relation to digitalisation and new products.
- o External ideas: With channels open to:
- (i) Entrepreneurs:
 - Incense: ENDESA, together with ENEL and two other European partners, won a European competition to finance start-ups in the communication technologies industry focused on energy efficiency.
 - (ii) Universities and research centres: ENDESA has an active relationship with the academic world through involvement and collaboration agreements with 14 universities and 10 research centres.
 - (iii) Associations and working groups: it collaborates with various technology platforms and working groups promoted by various administrations.
 - (iv) Suppliers: ENDESA works actively with its suppliers to incorporate and develop new technological solutions.
 - (v) Other industries: ENDESA participates in innovation forums with other industries.
- **Launch of projects:** after they have been assessed by ENDESA's experts (according to a common methodology based on the initiative's value creation), if the evaluation is positive the ideas are converted into projects which then embark upon a structured management and monitoring process.
 - **Capturing value:** Once the projects have been successfully completed, they move on to production in order to create value for ENDESA. Furthermore, ENDESA follows a prudent policy regarding the protection of intellectual property.

9.5. Patents and Licences

ENDESA owns various patents registered in Spain and/or the European Union and/or in other non-European countries. If appropriate, certain patents are transferred to ENEL Group companies with a licence for their use and, occasionally, they are sub-licensed to third parties.

At 31 December 2016, ENDESA had 23 patents in Spain.

10. Environmental Protection

10.1. ENDESA's environmental policy

Sustainable development is one of the main pillars of ENDESA's strategy, and environmental protection one of the Company's most important commitments. This commitment clearly distinguishes ENDESA from other companies, as it constitutes a basic ethical principle expressly stated in its corporate values.

Through this commitment, ENDESA undertakes to minimise the environmental impact of its industrial activity, addressing issues related to the battle against climate change, proper waste management, and controlling atmospheric emissions, spillages and soil pollution, and other potentially harmful impacts.

Environmental management focuses on the sustainable use of natural resources and energy, and sets out to preserve biodiversity and ecosystems in which it operates.

Evaluation of the environmental risks inherent to the Company's activities and environmental certifications obtained from third-party agents help ensure excellence in the company's environmental management, which is fully integrated and aligned with its corporate strategy.

ENDESA has therefore been defining its environmental policy with the initial aim of creating a business culture based on environmental excellence, and intends to achieve this through its environmental management systems and plans.

10.2. Environmental investment and expenditure

ENDESA's gross environmental investment and expenditure in 2016 and 2015 were as follows:

Million Euros			
	Annual gross environmental investment		
	2016	2015	% chg
Property, plant and equipment			
Generation and supply	93	75	24.0
Distribution	15	9	66.6
Structure and others	-	-	Na
TOTAL	108	84	28.6

Million Euros			
	Annual cumulative gross environmental investment		
	2016	2015	% chg
Property, plant and equipment			
Generation and supply	1,198	1,130	6.0
Distribution	327	311	5.1
Structure and others	-	-	Na
TOTAL	1,525	1,441	5.8

Million Euros			
	Annual environmental expense		
	2016	2015	% chg
Annual Expense			
Generation and supply	59	75	(21.3)
Distribution	17	17	-
Structure and others	4	7	(42.9)
TOTAL	80	99	(19.2)

(1) Of total environmental expenditure, Euro 25 million in 2016 and Euro 41 million in 2015 went to the depreciation and amortisation of the investments.

10.3. ENDESA's Environmental Management Systems

ENDESA's environmental management systems are widely implemented throughout all its businesses.

The businesses are monitored at an environmental level by environmental management systems and indicators through which they are implemented. The indicators include the facilities' environmental impact (atmospheric emissions, water consumption, conventional pollutants in effluents, waste, etc.) and enable compliance with all existing legal obligations regarding environmental matters in relation to the business operations to be verified, as well as alignment with the path laid out by ENDESA to evaluate the degree to which the strategic objectives and goals defined.

Advanced environmental management.

In 2016 ENDESA made further progress in the development of its environmental management in 2016, both in terms of certification, integrated environmental permits and environmental impact studies; measures were also implemented to improve the collection process and quality of the information submitted by the different areas.

At 31 December 2016, 100% of the installed power capacity, harbour terminals and all distribution business were certified to the ISO 14001 standard. With regard to office buildings, the Company has been awarded Energy Efficiency System (ISO 50001) and Environmental Management System (ISO 14001) at 16 of its offices in Spain and 5 buildings hold certificates for Indoor Air Quality (UNE 171330-3).

The certified environmental management system is the foundation upon which all management systems are integrated, depending on the business and the type of facilities, in an effort to complete and take advantage of the synergies these systems provide with respect to comprehensive management and additional reference to the International Standardisation Organisation (ISO) and/or the "UNE" Spanish standards. In this connection, some mention should be made of the EMAS Eco-Management and Audit Scheme rules applied to thermal power plants, the quality systems for coal-fired plants, laboratories and certain plants, the energy efficiency management systems (ISO 50001) and the interior environmental quality certification (UNE 171330-3) for office buildings.

Integrated water management.

ENDESA has identified water as a critical resource that will be affected by climate change and the integrated management of water is one of its major concerns. The main tasks in this area entail improvements to consumption efficiency, water quality by controlling dumping and wastewater and reservoir management, with an assessment of ecological potential for birdlife, control of invasive species and preventing dry-up in regulated rivers.

ENDESA has procedures to control and reduce water dumping and to boost quality, mainly by means of wastewater treatment facilities, and conducts regular analyses to pinpoint instances of hydric stress at its facilities.

Managing environmental risks and liabilities.

To comply with the requirements of the Spanish Environmental Responsibility Law, although the legislative framework accompanying this law has still not been fully completed, still lacking the Ministerial Order which sets the timelines, ENDESA has developed the MIRAT Project, which aims to establish the compulsory financial guarantee required by this law for conventional thermal and combined-cycle power plants with a thermal capacity of over 50 MW, through an environmental risk analysis. Subsequently, and pursuant to the time periods established in the pending legislation, the compulsory financial guarantee for those power stations which require it, will be set after looking at the results of the environmental risk analysis.

As a result of its commitment to protecting the environment, ENDESA feels obliged to eliminate environmental liabilities, and, therefore, each facility identifies these liabilities and addresses them within the framework of their environmental management programmes, which may be reflected in their elimination, disposal or reuse.

Environmental footprint

Atmospheric emissions.

ENDESA closely monitors all of its emissions to verify their characteristics and the volumes emitted. The Company meets the parameters required by the regulations applicable, implements technology to minimise emissions, and applies corrective measures to the impacts generated.

Between 2008 and 2015, when the National Emissions Reduction Plan was carried out for major combustion facilities, the Company worked hard at its facilities to reduce atmospheric emissions of the main conventional pollutants (sulphur dioxide (SO₂), nitrogen oxide (NO_x) and particles). Up to 2015, this brought about a reduction of 87% in emissions of sulphur dioxide (SO₂), a 62% reduction in nitrogen oxide (NO_x) emissions and an 83% reduction in particles with respect to the base year 2006.

The transposition of EU Directive 2010/75/EU on industrial emissions into Spanish law through Law 5/2013 of 11 June, and Royal Decree 815/2013 of 18 October, introduces new and stricter environmental restrictions in the area of pollutant emissions. Specifically, the existing facilities must adhere to new limits and subscribe to a number of mechanisms as of 2016.

All mainland coal-fired plants are on the National Transitory Plan, which establishes maximum annual emission thresholds for a gradual reduction of emissions between 2016 and mid-2020. The progressive reduction of emissions at ENDESA's facilities on the scheme will be more than 50% in terms of sulphur dioxide (SO₂), nitrogen oxide (NO_x) and around 40% of particles between 2016 and 2020.

This mechanism, the National Transitory Plan, possibly entails more stringent requirements and a greater commitment to reduce the current emissions by ENDESA's major thermal power plants.

With regard to the new mechanisms established by regulations for industrial emissions, island facilities affected by Directive 2010/75/EU of 24 November 2010 form part of the "small isolated system" mechanism, through which the deadline for compliance with the emission limits has been extended to allow time to make the investments for compliance after 2020.

Waste.

ENDESA has waste management and reduction systems in place, which are continually reviewed in order to identify ways to detect waste and make improvements. Waste-reduction measures focus on reusing oil, removing transformers contaminated with PCB (polychlorophenols), gradually removing components containing asbestos, recovering inert waste, and treating cleaning solvents for reuse.

Ash from coal-fired power stations, which is likely to be a part of this, has received certification under Standard UNE-EN 450 1/2 to be used as an additive in the production of concrete. In this way, its quality is certified and its recovery value is maximised. In addition, the EuroGypsum quality standard has been awarded to the gypsum from the desulphurisation unit at the Litoral (Almería) thermal power plant, which certifies both its purity and quality and increases its value in the market.

Likewise, 98.7% of the water captured by ENDESA for use in its facilities is returned to the environment so that it can be reused.

Conservation of biodiversity.

At the end of 2016, the Biodiversity Conservation Plan had 26 courses of action underway, of which 19 were launched in previous years (5 of them ended in 2016, and 14 are still in progress) and 7 new courses of action were begun last year. A breakdown of locations shows that 56% of them were carried out in areas affected by ENDESA's facilities and 23% were research projects that, in the majority of cases included the publication of articles and scientific papers.

These actions took place throughout Spain and Portugal, in both mainland (96%) and non-mainland (4%) territories, and included many of ENDESA's Business Lines. Specifically, generation accounted for 54% of the activities, distribution 27% and the remaining 19% were in the Corporate Area.

The Biodiversity Conservation Plan's objectives for 2016 remain on the same main action lines as in previous years:

- Adapting the physical environment of the Company's land and facilities and encouraging biodiversity in a manner that is biogeographically compliant.
- Managing environmental factors at our facilities to help improve the habitat of certain species or their biotopes.
- Recognising ENDESA's natural heritage and the ecosystems this is home to, their value and state of conservation.
- Protecting native species in and around ENDESA's plants and controlling invasive species that have a high ecological impact and an impact on ENDESA's business.

11. Human Resources

11.1. ENDESA's workforce

At 31 December 2016, ENDESA had a total of 9,694 employees, 3.1% less than a year earlier. ENDESA's average workforce in 2016 was 9,819 employees (-4.1%).

ENDESA's final and average headcounts in 2016 and 2015, by Business Lines, was as follows:

Number of Employees

	Final Headcount					
	31 December 2016			31 December 2015		
	Male	Female	Total (1)	Male	Female	Total
Generation and Supply	4,140	989	5,129	4,137	971	5,108
Distribution	2,707	467	3,174	3,019	483	3,502
Structure and others (2)	679	712	1,391	697	693	1,390
TOTAL EMPLOYEES	7,526	2,168	9,694	7,853	2,147	10,000

(1) At 31 December 2016 this included the final workforce of ENEL Green Power España, S.L.U. (EGPE) (188 employees) and Eléctrica del Ebro, S.A. (20 employees).

(2) Structure and services.

Number of Employees

	Average Headcount					
	2016			2015		
	Male	Female	Total (1)	Male	Female	Total
Generation and Supply	4,127	983	5,110	4,188	995	5,183
Distribution	2,841	474	3,315	3,105	490	3,595
Structure and others (2)	691	703	1,394	745	720	1,465
TOTAL	7,659	2,160	9,819	8,038	2,205	10,243

(1) In 2016 this included the average workforce of ENEL Green Power España, S.L.U. (EGPE) (86 employees) and Eléctrica del Ebro, S.A. (8 employees) since their respective takeover dates.

(2) Structure and services.

The breakdown by gender of the workforce at 31 December 2016 was 78% male, and the remaining 22% were female.

Information on ENDESA's workforce is provided in Note 37 to the Consolidated Financial Statements for the year ended 31 December 2016.

11.2. Occupational health and safety

ENDESA considers Occupational Health and Safety a priority and a fundamental value to preserve at all times for all who work for the Company, without distinction between own staff and its partner companies.

Integrating this goal in ENDESA strategy was materialised by the implementation of Occupational Health and Safety policies in all the companies comprising the Group, the implementation of specific plans that pursue the consolidation of the leadership model based on the example of the leader, and the implementation of a single global system for observing work conduct.

ENDESA also carries out various annual initiatives in its long-term strategy of continuous improvement of Occupational Health and Safety. The initiatives carried out by ENDESA within the framework of this strategy in 2016 focused mainly on specific accident action plans, the maintenance and creation of new alliances with partner firms and action plans with outside contractors experiencing high accident rates.

In 2016 and 2015, the main Occupational Health and Safety indicators were as follows:

	Main figures	
	2016	2015
Combined frequency index (1)	1.01	1.28
Combined seriousness index (2)	0.08	0.08
Number of accidents (3)	50.27	65.0

(1) Combined frequency index = (Number of accidents / Number of hours worked) x 106.

(2) Combined seriousness index = (Number of days lost / Number of hours worked) x 103.

(3) Of which 4 in 2016, 9 in 2015 were serious and fatal accidents.

11.3. Responsible personnel management

ENDESA endeavours to create a healthy, well-balanced working environment, where respect and personal consideration take priority, an environment that offers professional development opportunities based on merit and ability.

To achieve this responsible management of personnel, ENDESA encompasses all its CSR initiatives for human resources in its Global Corporate Social Responsibility Plan for Human Resources, known as "Plan Senda", and this was boosted in 2016 with initiatives in accordance with the Group's Diversity and Inclusion Policy.

In 2016 the company worked on each of the dimensions of the "Plan Senda", carrying out various initiatives:

- **Diversity and equal opportunities:** ENDESA maintains its commitment to the principles of gender equality and non-discrimination, and is working to become a company that respects and manages differences between people and ensures that all employees are treated equally and have the same opportunities. In 2016, it implemented the courses of action in the agreement on selection, promotion and life-work balance, among other issues, signed with the Spanish Ministry of Health, Social Services and Equality, which renewed its Equality Award.
- **Work-life balance and flexibility:** ENDESA also takes steps to consolidate its flexible working environment, which is designed to enable its employees to strike a balance between personal, family and professional life. ENDESA continues to strive to promote a culture of promotion and a proper work-life balance.
- **Integration of people with disabilities and people at risk of social exclusion:** ENDESA also developed its actions with regard to the integration of people with disabilities into the workforce, by direct or indirect contracting, via the purchase of goods and services, and by contracting services from specialist employment agencies.
- **Promotion of volunteer work:** ENDESA facilitates and encourages corporate volunteering among its employees. It is committed to the development of the communities in which it operates and contributes to their cultural, educational, environmental and social development.

11.4. Employment climate.

The Group's Employment Climate and Safety Survey was launched in September 2016 for all employees. The Survey comprised 42 multiple-choice questions and one open-ended question so that respondents could openly put forward proposed actions to improve the employment climate. The Employment Climate and Safety Survey closed on 7 October 2016. The response rate was high: 86% of employees took part, and 54% used their answers to the open-ended question to make suggestions.

The Employment Climate and Employment Safety Survey sought to ascertain the level of sustainable commitment, the safety index and other key data such as appraisals of supervisors, knowledge of strategy and safety policies.

The results of the Employment Climate and Safety Survey were similar to the outcome of the 2012 survey. Again, younger and newer employees tended to be more positive in their assessment. In 2016, the questionnaire engaged in a more in-depth exploration of safety management: safety was rated highly.

The final results were shared with Management across the board via a range of communication actions and access to the results platform. From then onwards, work was done on designing and implementing action plans at various levels, including top management.

The initiatives forming part of these plans aim to leverage strengths to address the areas of improvement identified. The key initiatives aim to continue to upgrade management skills in increasingly flexible and diverse settings.

11.5. Leadership and personal development

ENDESA constantly strives to identify and develop the potential of its employees, so that their performance can help make the Company a benchmark within the sector. In this regard, ENDESA's values and codes of conduct, its Management Model and Objective Management Systems guarantee personal development on the basis of merit and contributions.

The leadership model is based on the Group's vision, mission, values and codes of conduct. The Open Power values are present in all employee management and development systems, and they are as follows: Responsibility, Innovation, Confidence and Proactivity.

In 2016, 85.35% of ENDESA employees took part in processes to appraise their professional performance and development through one of ENDESA's assessment systems.

ENDESA has also continued to work on professional development in recent years, including individual interviews to get to know staff (“Conocer”), coaching, mentoring and reverse mentoring, consultations to develop teams, workshops to develop skills, talks on business knowledge and definition of succession plans.

11.6. Training

In 2016 ENDESA held 3,150 training events. 8,728 employees signed up for these activities. 444,063.4 training hours were given, with an average of 45.8 hours per employee (40.1 hours per employee in 2015). To undertake this activity, ENDESA invested Euros 27 million (including the cost of work time), of which Euros 4 million were accounted for by direct training costs.

ENDESA establishes its annual Training Plan to promote proper development of people within its organisation in terms of safety and efficiency, and to encourage professional development of its staff. The 2016 Training Plan centred on achievement of the Company's strategic objectives and on promoting its values of responsibility, innovation, proactivity and confidence.

New internal training procedures were implemented in 2016 to gain more of an insight into people's needs and priorities, and thus boost efficiency. These improvements were reflected in a general increase in training activity.

ENDESA's commitment to compliance with legislation in force concerning each and every area in which it operates entails a large number of training activities - safety, prevention of criminal risk, sustainability and the environment.

With regard to Occupational Health and Safety, the employment hazards prevention courses are compulsory for all employees, and consist of both an online methodology and practical classes, depending on contents and the target audience. Specific courses of action are carried out for positions with specific levels of responsibility in relation to prevention, such as the Prevention Representatives, Prevention Resources and members of emergency teams. Courses and recycling workshops are used to update knowledge of regulations and also of ENDESA's own procedures.

With respect to the prevention of criminal risks, in the wake of the 2015 campaign a new Criminal Risk Prevention course was rolled out for new employees, and a "catch-up" course for those who were unable to attend the previous year. The course was arranged by the Audit area, and aimed to instruct employees and make them aware of the responsibilities and risks involved in their habitual tasks, in order to prevent any criminal offences.

ENDESA's Code of Ethics and Zero Corruption Tolerance Plan furnish training courses to provide in-depth knowledge. Some mention must be made of the online "EDE" Conduct Course rolled out this year for all employees working in Distribution.

The major process of transformation towards a new energy model necessarily entails a focus on sustainability, and this is the objective of the Group's Open Power facility. An innovative training programme was set up in the course of the year 2016: "Súmate al reto energético" (Join the energy challenge). The aim is to spread awareness among ENDESA employees and inform and train them in sustainability and the Company's stance in this regard. The idea is that ENDESA employees will be able to take sustainability principles on board in both their professional and private lives, and their energy behaviour will act as a model for society at large.

In 2016 work also continued on environmental programs to comply with the requirements for renewal of the Company's ISO 14001 and Integrated Environmental, Energy Efficiency and Indoor Air Quality Management System certificates.

Within a digitalisation environment, digital transformation programs have become particularly important, and more than 11,142 hours were taught in the course of the year using methodologies such as: webinars, workshops, e-learning, in situ classes etc. An “e-talent” training program was devised to generate a change of cultures and mindsets. The "viralisers" identified during the program generated an impact on 15% of employees.

Courses in management skills, social skills and leadership were implemented transversally among different lines of business and support areas. These aim to fine-tune the skills of the different categories and

professional units in a bid to spread the corporate culture. Investment increased significantly in 2016, surpassing 65,000 hours of instruction.

Another of ENDESA's concerns over the years has been technical capacitation for its employees. This assists their professional development and gives them the qualifications to go about their tasks. Almost 379,000 hours of technical instruction were taught in 2016 at the Generation, Renewables, Distribution, Supply, IT, Purchases and Support Areas.

Finally, since it forms part of a multinational, ENDESA is keen to provide language classes, chiefly English and Italian, with a wide range of program in different formats.

11.7. Attracting and retaining talent

In order to attract the best talent, ENDESA focuses on Employer Branding to promote the Company in the job market and present itself as an attractive place to work. The emphasis in recent years has been placed on attracting young talent, and the Company has therefore attended job fairs at different universities, international job congresses and professional training centres. Its presence at these encounters seeks to demonstrate to young people the Company's focus on innovation, and attract profiles that match the values of the Group: confidence, responsibility, innovation and proactivity.

Ideas competitions have also been arranged for university students and students on professional training courses, as have initiatives such as the "Shadowing" scheme, enabling university students to spend a day with members of ENDESA's Management. Finally, the company also sponsors initiatives to bring about encounters of young talent in different countries, such as "Pangea-Unleash 2016".

In our digital environment, communication and relations with candidates are changing, and so the company's presence on social networks and other online platforms has been improved and enhanced, thus boosting recruitment.

In 2016, 154 young graduates were engaged on the Grants Program. The Program boosts their employability and allows them to put into practice the knowledge acquired at university, and begin a professional career. 20% of them were taken on after their grants expired, and work is ongoing to increase this percentage year by year.

ENDESA is also keen to cover vacancies through internal promotions, giving priority to employees who have shown themselves to be exceptional performers. The keynotes of selection processes are diversity, meritocracy and corporate values.

ENDESA not only carries out internal selection processes for each country, but also occasionally arranges professional employee swaps between countries. This aspect has come to the fore since ENDESA joined the ENEL Group.

11.8. Social dialogue

Working conditions at ENDESA are regulated by collective bargaining agreements to improve employment regulations in fields in which the Company operates. ENDESA guarantees the right to freedom of association for its employees and for all its contractors, suppliers and business partners.

In Spain and Portugal there were 4 collective agreements in operation at the end of 2016 affecting 9,103 employees, 93.9% of the workforce.

Existing Spanish employment legislation and ENDESA's employment regulations in Spain (IV Collective Framework Agreement and the Guarantees Framework Agreement for ENDESA SA and its electricity subsidiaries in Spain, Agreement on Voluntary Suspension) establish the criteria that should be adhered to in the event of business reorganisation and corporate restructuring (Chapter III of the Guarantees Framework Agreement). It is also established that corporate restructuring operations shall be made known to employee representatives at least 30 days before they come into effect.

The most important actions regarding collective bargaining in 2016 were as follows:

- Negotiation and agreement on the transfer of workers between different companies.

- Negotiation of reorganisation of the commercial cycle.
- Negotiation of the new organisation of the medium/low voltage network at ENDESA Distribución Eléctrica, S.L.U.
- Agreement to include ENDESA Servicios, S.L.U. within the functional scope of the IV Collective Framework Agreement.

With regard to ENDESA in Spain, negotiations for ENDESA's V Collective Framework Agreement will begin on 1 July 2017.

Spain has been an International Labour Organization (ILO) signatory since 1919, and ENDESA's conventional regulations meet the existing ILO Conventions ratified by Spain.

12. Treasury Shares

ENDESA did not hold any treasury shares at 31 December 2016, nor did it trade in treasury shares in 2016.

13. Other information

13.1. Stock Market Information

The performance of ENDESA's share price on the Madrid stock market and major indexes in 2016 and 2015 was as follows:

Percentage (%)

	Share price trend with respect to the previous year	
	2016	2015
ENDESA, S.A. ⁽¹⁾	8.6	11.9
Ibex-35	(2.0)	(7.2)
Eurostoxx 50	0.7	4.5
Eurostoxx Utilities	(7.8)	(5.1)

(1) Considering dividends distributed in 2016, in the gross amount of Euros 1.026 per share, the return for shareholders in 2016 was 14.2%. Considering the dividends distributed in 2015, in the gross amount of Euro 0.76 per share, the return for shareholders in 2015 was 16.5%.

Stock market information	31 December 2016	31 December 2015	% chg
Market capitalisation (Millions of Euros) (1)	21,307	19,613	8.6
Number of shares outstanding	1,058,752,117	1,058,752,117	-
Nominal share value (Euros)	1.2	1.2	-
Cash (Thousand Euros) (2)	10,783,803	16,500,861	(34.6)
Madrid stock exchange			
Trading volume (Shares) (3)	596,186,291	919,800,874	(35.2)
Average daily trading volume (4)	2,319,791	3,592,972	(35.4)
P.E.R. (5)	15.1	18.1	

(1) Market capitalisation = Number of shares at 31 December * Year-end price listing.

(2) Cash = Sum of all share transactions concluded during the reference period.

(3) Trading volume = total volume of ENDESA, S.A. shares traded during the period (Source: Madrid Stock Exchange).

(4) Average daily trading volume = arithmetic average of ENDESA, S.A. shares traded per session during the period (Source: Madrid Stock Exchange).

(5) Price to Earnings Ratio (P.E.R.) = Closing price / Earnings per share

Euros

	ENDESA, S.A. share price		
	2016	2015	% chg
Maximum	20,975	20,585	1.9
Minimum	15,735	15,565	1.1
Average in the period	18,151	18,234	(0.5)
Closing price	20,125	18,525	8.6

The year 2016 on the stock market was a year of surges and dips, with major political encounters generating much concern on markets. One such event was the decision of the United Kingdom in June to leave the European Union, and the Italian referendum in December with a proposed reform of the constitution, which was finally rejected. General elections were held in a number of countries, including the United States in November, leading to a change in the presidency that had not been anticipated in pre-election polls, and in Spain in July, although no actual government was formed until November.

Markets also kept a close watch on doubts as to a possible economic recession in China after the country took the decision to devalue its currency, and on interest rate decisions by the world's major Central Banks. The US Federal Reserve began to push up rates in December 2016, while the European Central Bank (ECB) decided to maintain and extend its debt purchase programme. This discrepancy in the monetary policies of the US and the European Union was reflected in the quasi-parity of the US dollar (USD) against the euro.

Despite this scenario of uncertainty and political risk, most of the world's stock exchanges finished the year in positive territory. The only exceptions were Italy, where the MIB lost 10.2%, and Spain, where the Ibex-35 fell by 2.01%, as the result in both cases of the pressure brought to bear by disruptions in the banking sector. The pan-European Eurostoxx 50 index closed with a slight gain of 0.7%, behind the French exchange (CAC-40: +4.86%) and its German counterpart (Dax: +6.87%), which were much more upbeat. However, the keynote among stock exchanges was the positive performance by the UK, where the FTSE 100 showed a considerable gain in the latter part of the year following the decision in the referendum to leave the European Union. The fall in sterling pound (GBP) turned in favour of British exporters, and the index closed the year with a satisfactory +14.43%, following some all-time highs.

Spain's Ibex-35 (-2.01%) finished its second year running with losses, but recovered well from the doldrums of 27 June 2016 after news of the result of the UK referendum, when it lost almost 20%. Its highest surge came during the last month of the year, 7.6%, its best December in the last 20 years, although this proved insufficient to finish the year in positive territory.

The general trend in Europe's electricity sector on the Dow Jones Eurostoxx Utilities index was also negative. The index finished the year down by 7.75% due to assets rotation in the last six months, in expectation of higher interest rates. The worst performers on the index were French and German companies, amid doubts concerning the ability of their balance sheets to cope with regulatory changes and adverse market situations. In the specific case of the 2 major German companies, E.On AG and RWE AG, both of them carried out restructuring processes, entailing division and the creation of 2 new companies which brought out stock market listings during the last quarter of the year, "Uniper SE" and "Innogy SE", respectively.

In terms of Spanish electricity companies, which finished the year with an overall loss of around 5%, ENDESA was perceived as one of the year's main defensive shares, and led the sector with a gain of 8.64%. From the point of view of investors, the main attraction of ENDESA lies in its proportional return for shareholders in its dividend policy (see Section 13.2. Dividend Policy in this Consolidated Management Report). Another much prized aspect of the 2017-2019 Strategic Plan presented on 23 November was the new investment cycle on which the company embarked (see Section 6. Outlook in this Consolidated Management Report).

In this regard, the positive market performance of 8.64% notched up by ENDESA in 2016 must be considered alongside a dividend yield of 5.54%, with a gross dividend of Euros 1.026 per share in respect of 2015 earnings, bringing the total return on the share, calculated as the sum of the stock market return and the dividend yield, to 14.18% in 2016.

ENDESA's listing finished the year at Euros 20.125 per share, very close to the maximum for the year of Euros 20.975 on 27 December 2016. The minimum, Euros 15.735 per share, was recorded on 11 February 2016, driven down along with the rest of the Ibex-35 by fears of a Chinese recession.

13.2. Dividend policy.

The Board of Directors of ENDESA, S.A. operates an economic-financial strategy to generate a significant amount of cash to maintain Company debt levels and maximise shareholder remuneration. This is also a guarantee of sustainability for the business project undertaken.

As a result of this economic-financial strategy, unless any exceptional circumstances arise, which will be duly announced, at a meeting on 22 November 2016 the Board of Directors of ENDESA, S.A. approved the following shareholder remuneration policy for 2016-2019:

- 2016: the ordinary dividend per share distributed against the year will be the equivalent of 100% of net income attributable to the Parent set out in the Consolidated Financial Statements, provided that this amount is higher than the result of applying a minimum 5% increase to the ordinary dividend paid with a charge to the previous year.

- 2017-2019: the ordinary dividend per share to be distributed in respect of these years will be the equivalent of 100% of ordinary net income attributable to the Parent set out in the Consolidated Financial Statements of the Group headed by the company. Specifically for the financial year 2017, the ordinary gross dividend will be at least Euros 1.32 per share.

The intention of the Board of Directors of ENDESA, S.A. is that the ordinary dividend will be paid solely in cash in two instalments (January and July) on a given date to be determined in each case, which will be duly notified.

However, ENDESA's capacity to pay out dividends to its shareholders depends on numerous factors, including the generation of profit and the availability of unrestricted reserves, and, therefore, the Company cannot ensure that dividends will be paid out in future years or the amount of such dividends if paid.

In respect of 2016, at a meeting on 22 November 2016 ENDESA's Board of Directors agreed to pay its shareholders a gross interim dividend against 2016 income of Euro 0.70 per share, which gave rise to a pay-out of Euros 741 million on 2 January 2017.

The proposed distribution of profit in 2016 to be presented at the General Shareholders' Meeting by ENDESA's Board of Directors will be a total gross dividend of Euros 1.333 per share (see Section 16. Proposed Distribution of Profit in this Consolidated Management Report). Taking into account the interim dividend referred to in the preceding paragraph, the complementary dividend in respect of 2016 will be a gross amount of Euro 0.633 per share.

Details of ENDESA, S.A.'s per-share dividends in 2016 and 2015 are as follows:

	2016	2015	% chg
Share capital ⁽¹⁾	1,270.50	1,270.50	-
Number of shares	1,058,752,117	1,058,752,117	-
Consolidated net profit ⁽¹⁾	1,411	1,086	29.9
Individual net profit ⁽¹⁾	1,419	1,135	25.0
Earnings per share ⁽²⁾⁽³⁾⁽⁴⁾	1,333	1,026	29.9
Gross dividend per share ⁽²⁾	1,333 ⁽⁵⁾	1,026 ⁽⁶⁾	29.9
Consolidated pay-out ^{(%)(7)}	100.0	100.0	-
Individual pay-out ^{(%)(8)}	99.4	95.7	-

(1) Millions of Euros.

(2) Data in Euros.

(3) Corresponding to the Consolidated Financial Statements.

(4) Earnings per share = profit for the year by parent / N° shares.

(5) Gross interim dividend of Euro 0.7 per share paid on 2 January 2017, plus an additional gross dividend of Euro 0.633 per share pending approval by the ENDESA, S.A. General Shareholders' Meeting. (see Section 16 Proposed Distribution of Profit in this Consolidated Management Report).

(6) Gross interim dividend of Euro 0.4 per share paid on 4 January 2016, plus an additional gross dividend of Euro 0.686 per share paid on 1 July 2016.

(7) Consolidated pay-out = (gross dividend per share * N° shares) / profit for the year by Parent.

(8) Individual pay-out = (gross dividend per share * N° shares) / profit for the year by ENDESA, S.A.

14. Information on the Average Payment Period to Suppliers

Information regarding the average payment period to suppliers in 2016 is provided in Note 22.1 of the Notes to the Consolidated Financial Statements for the year ended on 31 December 2016.

15. Proposed distribution of net income.

The profit for 2016 of ENDESA, S.A., the Parent, amounted to Euros 1,418,945,712.93 euros.

The Company's Board of Directors will propose to the shareholders at the General Shareholders' Meeting that this amount be used to make a dividend payment of Euros 1.333 gross per share with the rest taken to retained earnings.

	Proposed Distribution of Profit	
	Euros	
To dividends	(1)	1,411,316,571.96
To retained earnings		7,629,140.97
TOTAL		1,418,945,712.93

(1) Maximum amount to be distributed based on Euros 1.333 gross per share for all shares.

22 February 2017

