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Macroeconomic and regulatory environment

MACROECONOMIC SCENARIO

In 2017, the growth of the world economy experienced a slight rebound, registering an increase in Gross Domestic Product of 3.7%, almost half a point more than the previous year, driven by the good performance not only of the more developed economies, but also the emerging countries, and favoured by the stability and optimism prevailing in the financial markets within the framework of the expansionary monetary policies adopted by the central banks of most states to facilitate economic recovery.

In this regard, neither the inauguration in January of the new Government of the United States, nor the uncertain course

of negotiations on the conditions for the exit of the United Kingdom from the EU following the Brexit vote, nor other relevant political milestones nor the geopolitical conflicts and tensions that took place during 2017 have had a significant impact on the world economy. This confirms that the strength of the current expansionary cycle of global economic activity is allowing the impact of socio-economic factors to be offset.

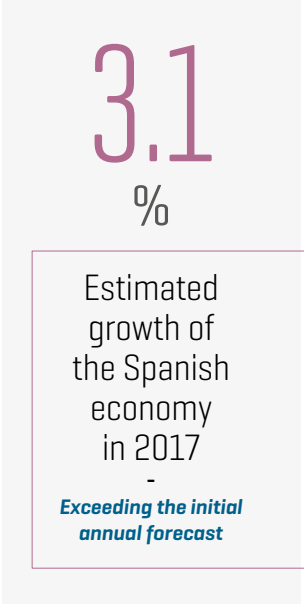
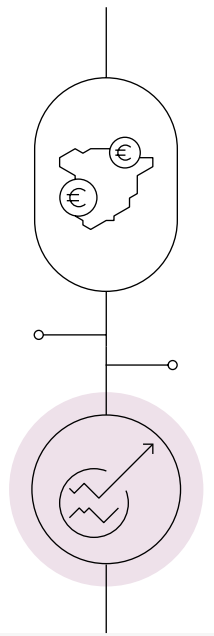


The strength of the current expansionary cycle of global economic activity is allowing the impact of socio-economic factors, such as unexpected results regarding the Brexit vote and Trump's election victory, to be offset.

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The evolution of oil prices during 2017 has also contributed to the good global economic growth figures. The average price of Brent crude oil stood at \$52 per barrel, which was almost \$10 per barrel higher than the 2016 price, although it increased less than expected following the agreement adopted by OPEC in May to extend the oil production cut until March 2018. This relatively small increase in the price of oil has been good news especially for the emerging economies, the main consumers of this raw material, as well as the countries which have a high dependence on crude oil as a source of energy, such as Spain.

In Spain, the latest quarterly preliminary data regarding gross domestic product (GDP) published by the National Institute of Statistics in January 2018 estimates that the Spanish economy will have grown by 3.1% in 2017, once again exceeding the initial annual forecast, and consolidating the recovery trend initiated in 2014.



Low growth in the price of Brent crude has been good news

especially for countries that have a high dependence on crude oil, such as Spain.

As was the case in 2016, a year in which Spain had an interim government for 10 months, in 2017 the Spanish economy performed well in an unstable political scenario during the last quarter of the year in spite of the secessionist challenge undertaken by the Government of Catalonia, which has generated a climate of political and social unrest that has not had an appreciable impact on the growth of economic activity in the year as a whole.

The solid growth in economic activity, registered since 2014, continues to be reflected in the pace of net employment creation, which grew again in 2017, closing the year with 490,300 jobs more than a year earlier, with a growth of 2.7% in the number of employed people. This has reduced the unemployment rate by 2.1%,

standing at 16.6% in December 2017, the lowest recorded since 2008, the year before the beginning of the crisis.

During the four years that have elapsed since the start of the economic recovery in 2014, the Spanish economy has grown at a sustained pace, with rates above 3% in the last three years, in a difficult national and international political environment, which seems to confirm the consistency of the underlying factors that drive it and the expectation that this favourable economic cycle will continue, although with growth rates that are expected to become more moderate in the coming years, in the range of 2 to 2.5%.



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Spain has maintained a **sustained growth rate** since 2014, although it is expected to become more moderate in the coming years.

ENERGY SCENARIO

Following the trend of recent years, the growth of electricity consumption in Spain in 2017 has been significantly lower than economic growth, 1.6%, after having factored in the seasonal and working patterns. This progressive loss of correlation between economic activity and electricity demand is one more indicator of the gradual transition towards a less energy-intensive production model, to which the implementation of energy saving and efficiency measures, coherent with the objectives of the Spanish and European energy policy, is largely contributing, in order to achieve a sustainable energy model and combat climate change.

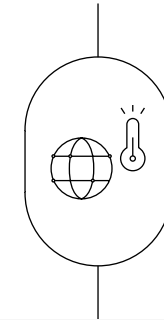
Within the framework of the European Union's firm commitment to the energy targets and the fight against climate change, in 2017

EU institutions took new steps to achieve the 'Energy Union' and to meet the specific targets of the European Union energy policy for 2030. Thus, during 2017, the debate and permitting process continued regarding the draft legislative package published by the European Commission at the end of 2016 under the generic title of 'Clean energy for all Europeans' informally known as the 'Winter Package'. This package is composed of various legislative proposals related to energy efficiency, renewable energy, the design of the electricity market, the security of the electricity supply and the governance standards of the Energy Union, whose approval will provide the regulatory framework needed to achieve a transition to clean energy in accordance with the principles of the EU's energy policy.

Furthermore, in the months of February and November, the European Commission published two reports on the State of the

'Energy Union', in which a detailed monitoring was conducted of the progress made in the energy transition process defined in this strategic package. In the latest of the referred reports, emphasis is placed on the existence of bottlenecks in the electricity interconnection infrastructure, including two documents that specifically referred to this problem as part of the various documents that accompany said report. The first of these reports is a European Communication on the strengthening of European energy grids, in which the Commission stresses that Spain will be one of the only four countries where the 10% interconnection target will not be met by 2020, and points out explicitly the need to make additional efforts to fully integrate the Iberian Peninsula into the internal electricity market, detailing the specific actions to be taken to that end.

ENERGY Targets



CLIMATE CHANGE

European Union's Commitment

During 2017, the debate and permitting process continued for the drafting of the 'Winter Package' and two reports on the State of the 'Energy Union' were published





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On the other hand, in the second of the aforementioned documents the Annex VII of the EU Regulation No. 347/2013 was amended, in which Community Projects of Common Interest (PCI) are listed, in compliance with the established requirement in said Regulation to review the PCI list every two years. The new list includes all the proposals from Spain and gives its own name and specifically defines the two interconnection projects with France through the Central Pyrenees, which in the previous list were only referred to generically.

The report on the State of the 'Energy Union' also assesses other elements of the EU's energy transition strategy, among which is the requirement to draw up national energy and climate plans. In this respect, with regard to Spain, the creation in July 2017 of a Group of Experts has been communicated. Said group has been assigned the task of defining the alternative scenarios for the energy transition consistent with the strategy of the 'Energy Union'. Similarly, it sets out the need to have the report of the Group of Experts during the first

quarter of 2018, in addition to the Government's goal to approve a Law on Climate Change and Energy Transition during the current term of office.

The Spanish energy regulation, fully aligned with the targets of the EU's energy policy, resumed its usual legislative activity during 2017 after the limited activity registered in 2016, due to the absence of a Government for almost the entire year. Among the numerous regulations published, noteworthy are those relating to the two auctions organised for the allocation of the specific remuneration framework for new facilities for the production of electricity from renewable energy sources in the peninsular electricity system. In these auctions 8,000 MW of new renewable generation capacity was allocated with a view to meeting the EU's targets regarding the share of these energies in final energy consumption mix, both for the 2020 and the 2030 horizon.



Usual legislative activity was resumed, with a view to meeting the EU's targets regarding renewable energy.



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Strategic plan

When defining its business strategy, Red Eléctrica takes into account the economic, energy and regulatory environment in which it carries out its activity. The Strategic Plan, currently in force, covers the 2014-2019 period and establishes three essential strategies (which define the actions that must be undertaken), as well as three cross-cutting strategies (which set out the criteria for how these should be accomplished).

As most of the period contemplated in the Strategic Plan has elapsed, the six strategies mentioned above show a high degree of fulfilment. On the following pages, some of the most relevant actions carried out in the period 2014-2017 are presented for each of the strategies, although in the different chapters of this report a more detailed analysis is made of those actions carried out in 2017.





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ESSENTIAL STRATEGIES

DEVELOPMENT OF THE TSO ROLE



The main activity of Red Eléctrica is linked to its status as sole transmission agent and operator of the Spanish electricity system. Therefore, the main strategy of the Company is based on:

- The development of an increasingly meshed and robust transmission grid that is better interconnected.
- The maximum integration of renewable energy.
- Energy efficiency and innovation.



Execution of the 2014-2017 Plan

- Approval of the new regulatory framework that guarantees the stability of the electricity transmission activity, incentivises efficiency and availability of the grid.
- Approval of the 2015-2020 Electricity Transmission Grid Development Plan.
- Auctions for the provision of the interruptibility service.
- Advancing in interconnections: new interconnection with France through Catalonia, strengthening of the interconnection with Portugal via Puebla de Guzmán and start of the project of a new interconnection with France across the Bay of Biscay.
- Commissioning of the Majorca-Ibiza interconnection that connects the two electricity systems of the Balearic Islands and strengthens the integration of the Islands with the Peninsular system.
- Commissioning of more than 1,870 km of new line and more than 404 new substation bays in the period 2014-2017.
- Incorporation into CORESO (COoRdination of Electricity System Operators), the coordinating body for regional security, composed of several European TSOs, in order to maintain the security of the European electricity system.
- Commissioning of the Arkale phase shifter that favours the flow of international exchanges, increasing the electricity exchange capacity with Europe and the security of supply.

EFFICIENCY



Improvement of efficiency levels in order to mitigate the impact derived from the lower profitability of new investments pursuant to the new remuneration model, generating value through the optimisation of operating margins.



Execution of the 2014-2017 Plan

- Review of the infrastructure maintenance, renovation and improvement policy in accordance with the new regulatory framework.
- Review of the construction criteria and the definition of a stakeholder management model in investment projects.
- Definition of the process for the planning of activities and the requirements for materials and services.
- Containment of operating and structural costs.
- Optimisation of financing through the repurchase of bonds, the financing agreement with the EIB and the refinancing of Redesur.

EXPANSION OF THE BUSINESS BASE



Development of regulated activities other than current and non-regulated activities in the field of telecommunications and infrastructure management, as well as the expansion into other geographical areas.



Execution of the 2014-2017 Plan

- Commercial operation and management of ADIF's dark-fibre network and the consolidation of the telecommunications business with the positioning of the Company as a neutral operator of reference in Spain in the management of fibre optic networks.
- Acquisition of 50% of Transmisora Eléctrica del Norte (TEN) in Chile and 45% of the shareholding of Redesur in Peru.
- Awardee of the concession contracts for the Azángaro-Juliaca-Puno, Montalvo-Los Héroes and Tintaya-Azángaro lines in Peru and more than 258 kilometres of line in Chile.
- Chira-Soria energy storage project on the island of Gran Canaria to guarantee the security of supply and the integration of renewables.



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CROSS-CUTTING STRATEGIES

INNOVATION



Promote innovation as an integral part of the operational process, boosting technological innovation as a lever for growth that will allow us to respond to the great challenges of the future.



Execution of the 2014-2017 Plan

Investment of €35.8 million in the period, with the following projects being the most noteworthy:

- Installation of a flywheel in Lanzarote.
- Installation of a large-scale energy storage battery [ALMACENA project].
- Implementation of the PRICE project for the deployment of demand-side management measures.
- Completion of the ESP-Líder project [re-directing of power flows] of the INNFACTO programme.
- Development of European projects: BEST PATHS [integration of massive amounts of renewable energy] and MIGRATE [improvement of the behaviour of the electricity system with a high penetration of devices based on power electronics].

PEOPLE



Commitment to a healthy working environment that favours the organisation of work and the well-being of employees, enabling the Company to optimise resources and foster talent in order to tackle the challenges it faces.



Execution of the 2014-2017 Plan

- Design of a comprehensive Talent Management model.
- Definition of the healthy workplace model and the publication of the first Healthy Workplace Annual Report.
- Updating and dissemination of the Functions Handbook.
- Creation of the Red Eléctrica Campus.
- Launching of the project 'New Ways of Working and Transformation of Workspaces', whose objective is to redesign the Group's workspaces and implement more collaborative and flexible ways of working.

EXCELLENCE



Consolidate ourselves as a sustainable company, through a management that is both ethical and committed to the stakeholders, maintaining a position of reference in the field of excellence.



Execution of the 2014-2017 Plan

- Completion of the process of separation of the executive functions and duties corresponding to the CEO, from those of control and supervision corresponding to the Chairman.
- Approval of the Climate Change Action Plan for the period 2015-2020 and the 2017-2021 Biodiversity Action Plan.
- As proof of the Company's pursuit of excellence and responsibility in the execution of all its activities, Red Eléctrica has obtained numerous recognitions. Noteworthy are the following:
 - Obtaining +700 points in the assessment of the EFQM model.
 - Leading position granted in the Dow Jones Sustainability Index
 - Recognition for the commitment in the fight against climate change in the annual assessment conducted by the Carbon Disclosure Project.



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STRATEGIC PLAN SNAPSHOT

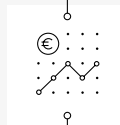
TARGETS 2014-2019

ACHIEVEMENTS 2014-2017



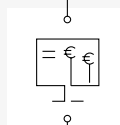
Investment
2014-2019

4,575 M€



Efficiency
2014-2019

≥ 200 basis points
EBITDA margin in 2019



Financial structure

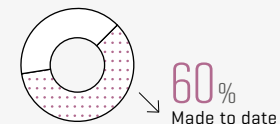
3.5 X
Net debt / EBITDA (average)



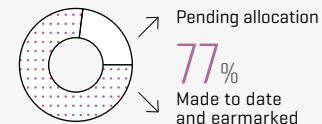
Growth
2014-2019

5-6% 7%
EPS [CAGR] DPS [CAGR]

CONSOLIDATED ACTIVITIES 3,575 M€

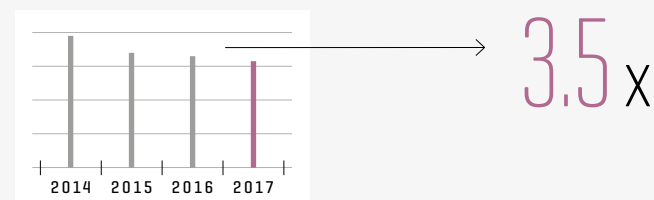


NEW ACTIVITIES 1,000 M€



• EBITDA margin → 78.3%

• Control of operating costs



• EPS growth → 6.1% CAGR 2014-17 (1)

• DPS growth → 7% CAGR 2014-17

(1) Calculated using 2013 as the base year.

Legend

EPS: Earning Per Share

DPS: Dividend Per Share

CAGR: Compound Annual Growth Rate.