



INDEPENDENT
AUDITORS'
REPORT



CONSOLIDATED
STATEMENT OF
FINANCIAL POSITION



CONSOLIDATED
ANNUAL ACCOUNTS



CONSOLIDATED
DIRECTORS'
REPORT

INDEPENDENT AUDITORS' REPORT



KPMG Auditores, S.L.
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Independent Auditor's Report on the Consolidated Annual Accounts

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

To the Shareholders of Red Eléctrica Corporación, S.A.

REPORT ON THE CONSOLIDATED ANNUAL ACCOUNTS

Opinion

We have audited the consolidated annual accounts of Red Eléctrica Corporación and subsidiaries (together the "Group"), which comprise the consolidated balance sheet at 31 December 2017, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and consolidated notes.

In our opinion, the accompanying consolidated annual accounts give a true and fair view, in all material respects, of the consolidated equity and consolidated financial position of the Group at 31 December 2017 and of its consolidated financial performance and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU) and other provisions of the financial reporting framework applicable in Spain.

Basis for Opinion

We conducted our audit in accordance with prevailing legislation regulating the audit of accounts in Spain. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Annual Accounts* section of our report.

We are independent of the Group in accordance with the ethical requirements, including those regarding independence, that are relevant to our audit of the consolidated annual accounts in Spain pursuant to the legislation regulating the audit of accounts. We have not provided any non-audit services, nor have any situations or circumstances arisen which, under the aforementioned regulations, have affected the required independence such that this has been compromised.

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



2

Key Audit Matters

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

Property, plant and equipment: Euros 8,747,376 thousand See note 6 to the consolidated annual accounts

| Key Audit Matters | How the Matter was Addressed in Our Audit |
|---|---|
| <p>Most of the Group's property, plant and equipment pertain to Red Eléctrica de España, the regulated activity of which mainly consists of managing the transmission network of the Spanish electricity system. Each year, Red Eléctrica de España makes substantial investments in property, plant and equipment in accordance with the Electricity Transmission Network Development Plan for 2015 – 2020 approved by agreement of the Council of Ministers on 16 October 2015. In 2017 additions totalled Euros 470,583 thousand.</p> <p>Considering the nature of Red Eléctrica de España's business, remuneration is set by the Ministry of Energy, Tourism and the Digital Agenda (MINETAD). The calculation method is stipulated in legislation and takes into account the costs necessary to construct, operate and maintain the technical electricity facilities, in accordance with Electricity Industry Law 24/2013 of 26 December 2013. As part of the Group's revenues are directly related to the recognised electricity transmission facilities, and bearing in mind the significance of the asset values in the consolidated annual accounts, we have considered the measurement of property, plant and equipment to be a relevant aspect of the audit.</p> | <p>Our audit procedures included evaluating the relevant controls associated with processes involving fixed assets and acquisitions, as well as performing substantive procedures on property, plant and equipment. We also assessed the compliance of the Group's accounting policies on fixed assets with the applicable accounting framework.</p> <p>Our procedures for evaluating and analysing the control environment were focused on:</p> <ul style="list-style-type: none"> - Testing the design, implementation and effective operation of key manual and automated controls related to the cycles of "additions and disposals of fixed assets", "calculation of depreciation charges and provisions for fixed assets", and "acquisition of assets and services, building stage certificates". <p>Our substantive procedures on fixed assets mainly consisted of:</p> <ul style="list-style-type: none"> - Analysing additions during the year and assessing the accuracy of their accounting recognition. We analysed documentation supporting the cost allocation for a sample of projects in progress, as well as documentation supporting stage certificates. - We assessed the depreciation charges for the year by means of analytical tests, considering the useful lives of these assets. <p>We also assessed whether the disclosures in the consolidated annual accounts meet the requirements of the financial reporting framework applicable to the Company.</p> |



Financial debt: hedging instruments (assets: Euros 12,970 thousand; liabilities: Euros 61,437 thousand)

See note 17 to the consolidated annual accounts

| <i>Key Audit Matters</i> | <i>How the Matter was Addressed in Our Audit</i> |
|--|---|
| <p>Net financial debt totals Euros 4,791,798 thousand, of which Euros 539,695 thousand is in foreign currency. The Group arranges financial instruments, including foreign currency and interest rate derivatives, to hedge exposures to exchange rate and interest rate fluctuations.</p> <p>Derivatives designated as accounting hedges must meet strict criteria with respect to documentation and the effectiveness of the hedge on inception.</p> <p>Furthermore, the fair value of derivative financial instruments is determined using valuation techniques that may take into consideration, among other factors, unobservable market data or complex pricing models that require a high degree of judgement.</p> <p>Given the complexity of complying with the legislation in force governing the identification and measurement of hedging instruments and the correct measurement of their effectiveness, we have considered this to be a key audit matter.</p> | <p>Our audit procedures included evaluating the relevant controls associated with the classification and measurement of hedging instruments, and performing substantive procedures thereon. We also assessed the compliance of the Group's accounting policies on financial instruments with the applicable accounting framework.</p> <p>Our procedures for evaluating the control environment were focused on:</p> <ul style="list-style-type: none"> - Testing the design, implementation and effective operation of key controls related to the cycles of "derivative financial instruments" and "recognition of financial transactions", as well as the controls in place to monitor these items. <p>Our substantive procedures on hedging derivatives mainly consisted of:</p> <ul style="list-style-type: none"> - Performing substantive tests to evaluate whether derivative financial instruments have been correctly measured. Our specialists in financial instruments were involved in these procedures. - Assessing compliance with hedge accounting criteria under International Accounting Standard (IAS) 39 as regards identifying hedging instruments and positions to be hedged. Our specialists in financial instruments were involved in these procedures. - We assessed the reasonableness of the measurement of the effectiveness of the Group's accounting hedges and whether the outcome is within the range defined by accounting legislation. Our specialists in financial instruments were involved in these procedures. <p>We also assessed whether the disclosures in the consolidated annual accounts meet the requirements of the financial reporting framework applicable to the Company.</p> |



Other Information: Consolidated Directors' Report

Other information solely comprises the 2017 Consolidated Directors' Report, the preparation of which is the responsibility of the Parent's Directors and which does not form an integral part of the consolidated annual accounts.

Our audit opinion on the consolidated annual accounts does not encompass the consolidated directors' report. Our responsibility as regards the content of the consolidated directors' report is defined in the legislation regulating the audit of accounts, which establishes two different levels:

- a) A specific level applicable to the consolidated statement of non-financial information and to certain information included in the Annual Corporate Governance Report, as defined in article 35.2. b) of Audit Law 22/2015, which consists solely of verifying that the aforementioned information has been provided in the director's report, or where applicable, in a separate report for the same year to which reference is made in the directors' report, and if not, to report on this matter.
- b) A general level applicable to the rest of the information included in the directors' report, which consists of assessing and reporting on the consistency of this information with the consolidated annual accounts, based on knowledge of the Group obtained during the audit of the aforementioned consolidated accounts and without including any information other than that obtained as evidence during the audit. Also, assessing and reporting on whether the content and presentation of this part of the consolidated directors' report are in accordance with applicable legislation. If, based on the work we have performed, we conclude that there are material misstatements, we are required to report them.

Based on the work carried out, as described in the preceding paragraph, we have verified that the specific information referred to in paragraph a) above has been provided in the directors' report and the rest of the information contained in the consolidated directors' report is consistent with that disclosed in the consolidated annual accounts for 2017, and that the content and presentation of the report are in accordance with applicable legislation.

In accordance with the requirements set forth in article 540 of the Revised Spanish Companies Act and Spanish National Securities Market Commission (CNMV) Circular 7/2015 of 22 December 2015, which provides the models for the Annual Corporate Governance Report for listed corporations, and for the purposes of the description of the System of Internal Control over Financial Reporting in Annual Corporate Governance Reports, and as mentioned in section F.7.1 of the Annual Corporate Governance Report, which forms part of the accompanying consolidated directors' report for 2017, on 19 February 2018, at the Company's request, we issued our Independent Reasonable Assurance Report on the System of Internal Control over Financial Reporting (ICOFR) of the Red Eléctrica Group for 2017, based on our examination, which was performed in accordance with ISAE 3000 (International Standard on Assurance Engagements 3000, Assurance Engagements Other than Audits or Reviews of Historical Financial Information) issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC) for the issue of reasonable assurance reports.



Directors' Responsibility for the Consolidated Annual Accounts

The Parent's Directors are responsible for the preparation of the accompanying consolidated annual accounts in such a way that they give a true and fair view of the consolidated equity, consolidated financial position and consolidated financial performance of the Group in accordance with IFRS-EU and other provisions of the financial reporting framework applicable to the Group in Spain, and for such internal control as they determine is necessary to enable the preparation of consolidated annual accounts that are free from material misstatement, whether due to fraud or error.

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

The Parent's audit committee is responsible for overseeing the preparation and presentation of the consolidated annual accounts.

Auditor's Responsibilities for the Audit of the Consolidated Annual Accounts

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

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

As part of an audit in accordance with prevailing legislation regulating the audit of accounts in Spain, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated annual accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.



- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Parent's Directors.
- Conclude on the appropriateness of the Parent's Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated annual accounts, including the disclosures, and whether the consolidated annual accounts represent the underlying transactions and events in a manner that achieves a true and fair view.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated annual accounts. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

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

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

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



7

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Additional Report to the Audit Committee of the Parent _____

The opinion expressed in this report is consistent with our additional report to the Parent's audit committee dated 19 February 2018.

Contract Period _____

We were appointed as auditor of the Group by the shareholders at the ordinary general meeting on 15 April 2016 for a period of three years, from the year commenced 1 January 2016.

Previously, we were appointed for a period of three years, by consensus of the shareholders at their general meeting, and have been auditing the annual accounts since the year ended 31 December 2013.

KPMG Auditores, S.L.
On the Spanish Official Register of
Auditors ("ROAC") with No. S0702

(Signed on the original in Spanish)

Ana Fernández Poderós
On the Spanish Official Register of Auditors ("ROAC") with number 15547

19 February 2018