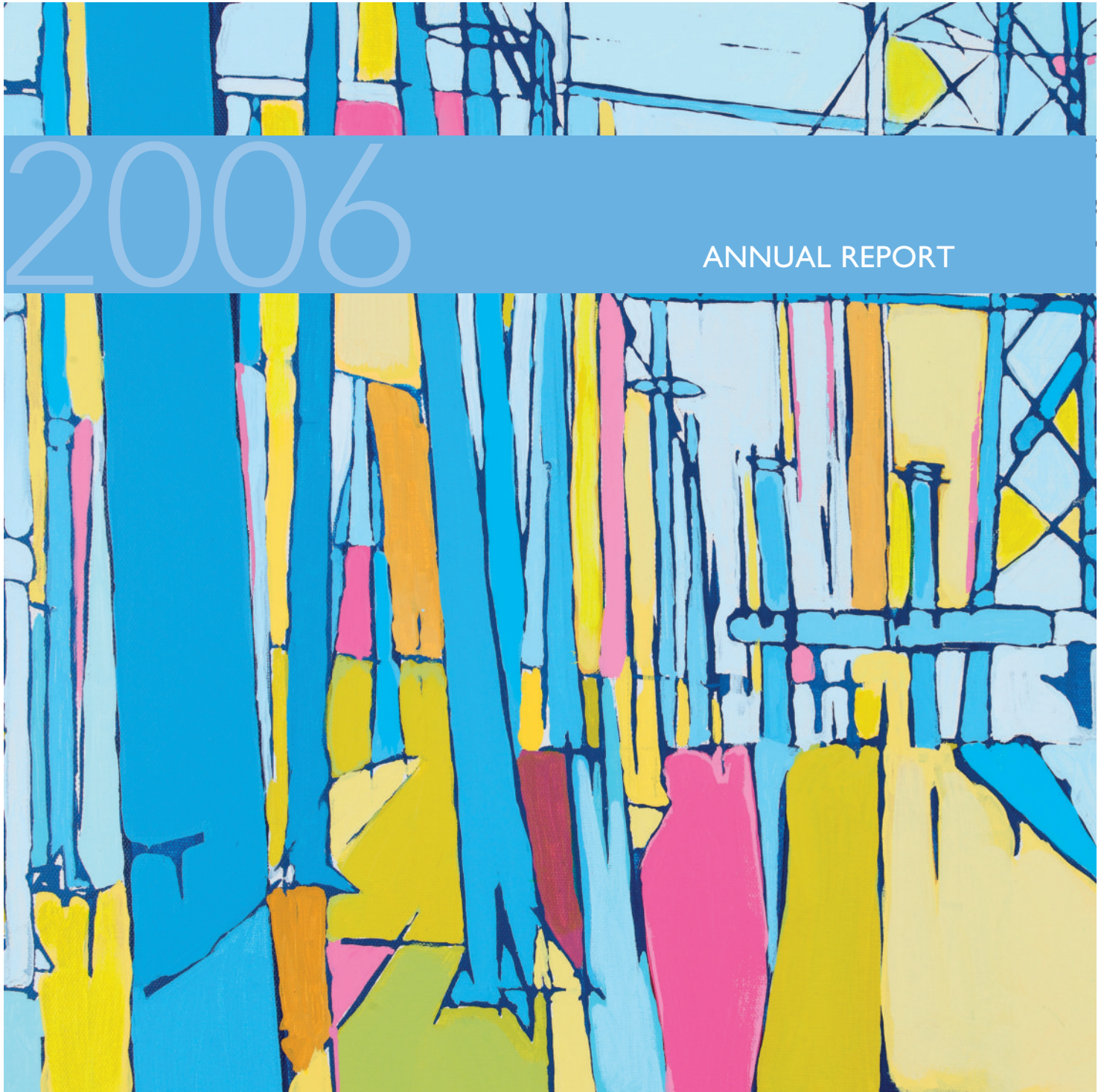




**RED ELÉCTRICA**  
DE ESPAÑA



2006

ANNUAL REPORT

# 2006

ANNUAL REPORT



RED ELÉCTRICA DE ESPAÑA

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## Red Eléctrica, A guarantee for our future and wellbeing

### in figures...

... **950** million euros  
in turnover

... **200** million euros  
in net profits

... **more than 500** million  
euros invested in the  
transmission grid

... **more than 33,500**  
kilometres of high voltage  
electrical cables

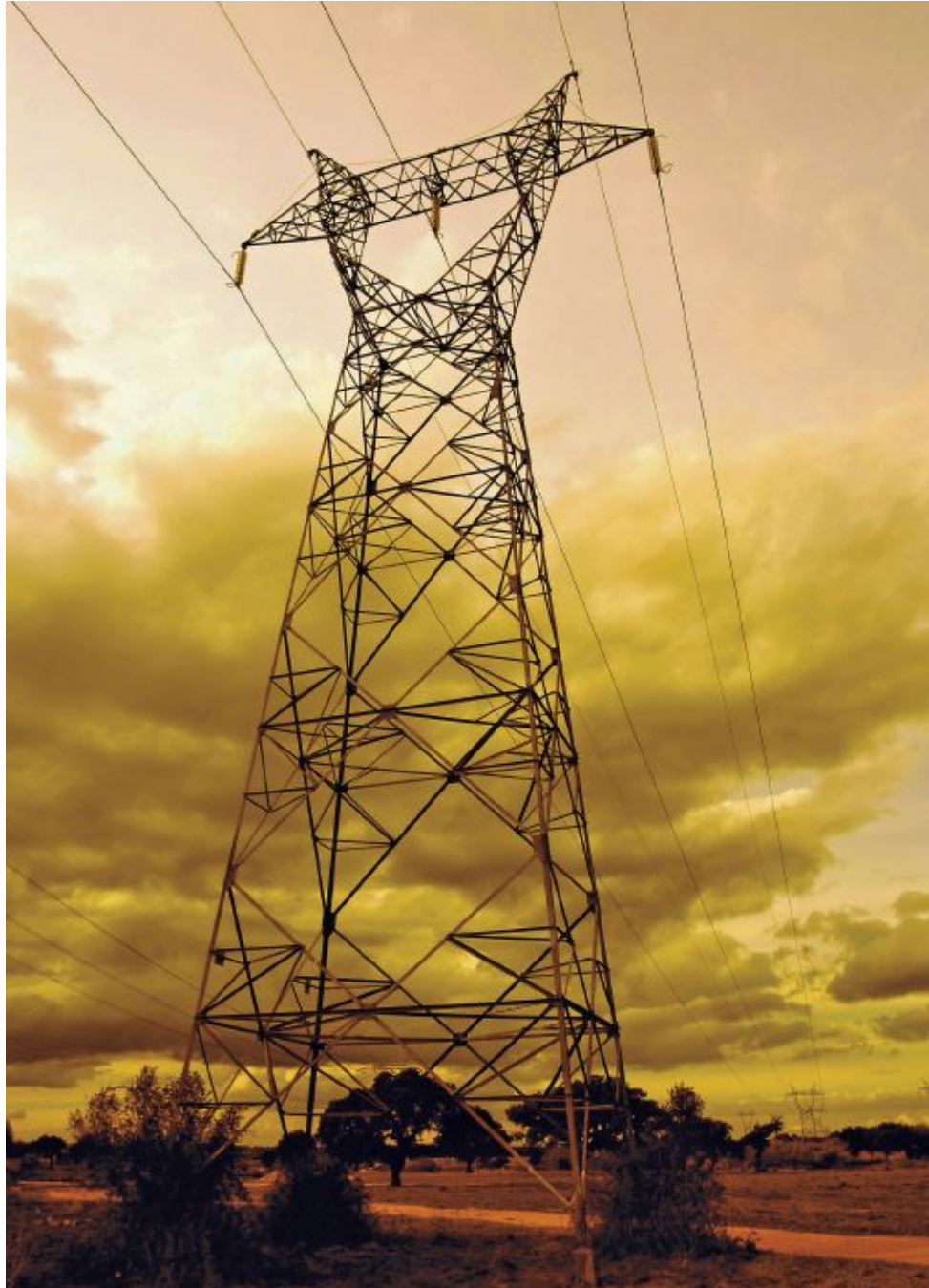
... **4,395** million euros in  
market capitalisation at the  
close of the financial year

... **1,442** employees  
in the Group

### Its value

- The company is a key element in Spanish electrical system operations, guaranteeing the reliability of the system at all times and the continuing supply of electricity.
- Its electrical transport assets form a safe, reliable network that is designed to offer the maximum service guarantee to the electrical system.
- It is an international model of reference due to its operating efficiency and the excellent quality of service provided by its electrical installations.
- It has an enormous fund-generating capacity, which enables it to tackle an important investments plan for enlarging and improving its electrical infrastructures and offer shareholders an attractive return on their investment.
- It applies the strictest environmental criteria in all its activities, by ensuring that its projects are integrated into the community with the least possible impact on the environment and the maximum social consensus.

- It is a leader in technological research and innovation. It uses high-tech equipment and systems and makes an important effort in R+D+I investments.
- Its business model is based on excellence. Its processes and operating systems are quality-driven and aimed at achieving efficiency and satisfying the expectations of its customers and shareholders.
- It is the company that is most highly valued for its corporate responsibility due to its commitment to social projects, sustainability and responsible corporate governance.
- Its staff is highly qualified and has great potential for development. Its professionals have earned themselves a solid reputation in the electrical sector.
- It is a profitable, solvent company that is concerned for the environment, adding value to the electrical system and making a great contribution to the economic progress of society and the wellbeing of citizens.

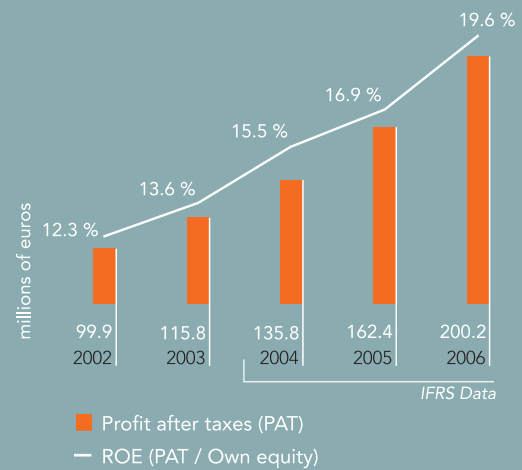


# Key figures

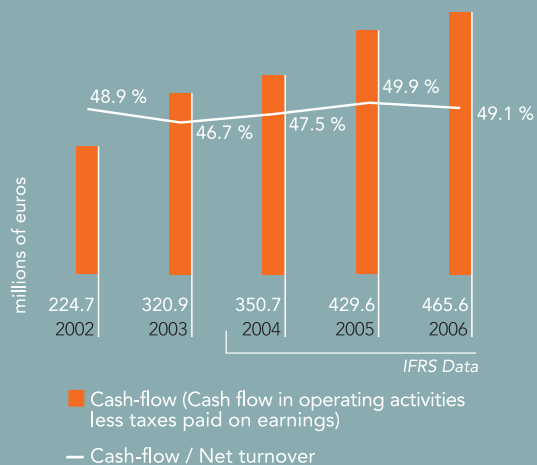
## Net turnover



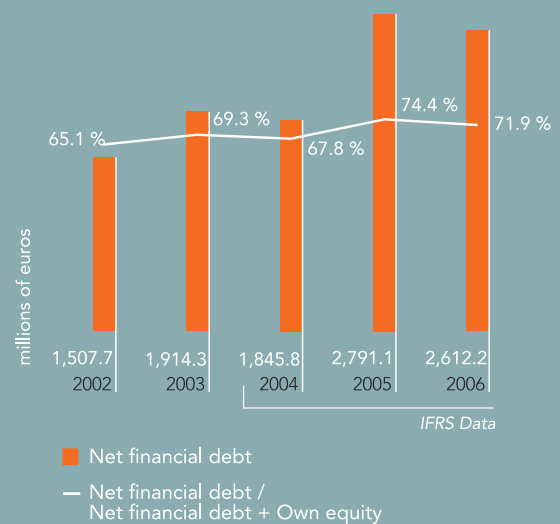
## Profit after taxes



## Cash-flow

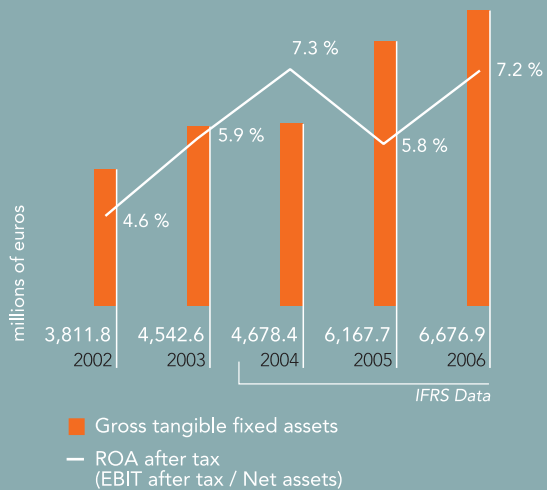


## Net financial debt

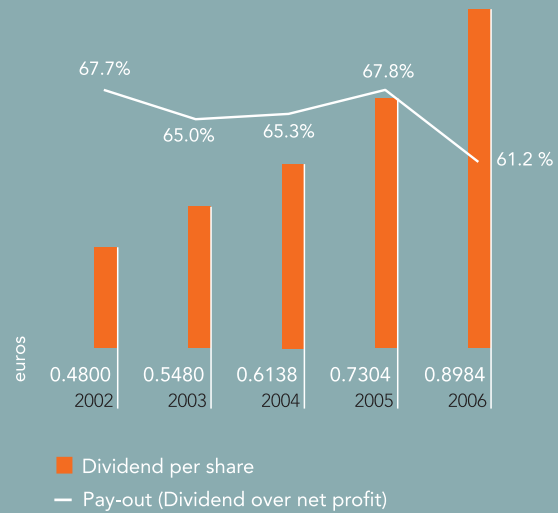


IFRS (International Financial Reporting Standards)

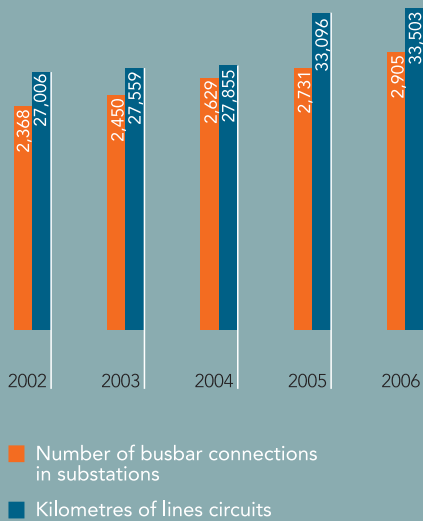
### Tangible fixed assets



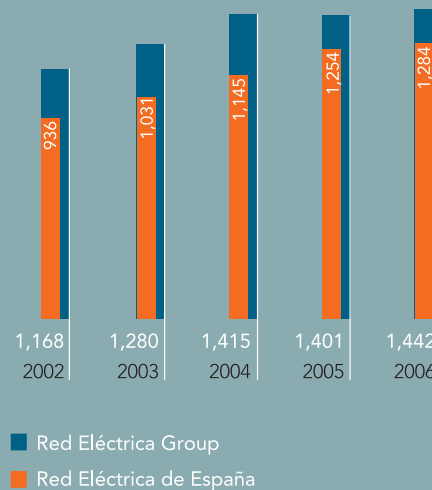
### Dividends per share\*



### Key figures for the network\*



### Number of employees



\* Separate figures for the head company

## Letter from the President



### *Dear shareholders*

*2006 was a very important year for Red Eléctrica. There is no doubt that it was a year of consolidation and enormous growth. The year was characterised by a strong increase in investment in the transmission grid, and a general improvement in the company's economic and financial ratios. Furthermore, during the year, we have witnessed the culmination of the transformation process started by Red Eléctrica four years ago, through acquiring transport assets from the electrical companies.*

*During this period, the company has taken on a new dimension, as can be seen by the increase in its key economic figures: electrical transport assets have almost tripled, whereas regulated earnings and gross operating profit (EBITDA) have more than doubled compared to the figures prior to these acquisitions. The company's market capitalisation has also followed the same trend of growth, and tripled during this period of time.*

*This new business scenario has led to the consolidation of our position as a Spanish TSO and caused us to redouble our efforts in terms of organic growth of our main business, the transporting of energy. Our goal is to continue to build an electrical infrastructures network that is robust and trustworthy, that will provide a competitive environment for generators and facilitate sustainable growth through the integration of the renewable energy maxim into the electrical system, making this compatible with offering an efficient, high-quality service to consumers.*



*Consequently, in addition to investing in additional network infrastructures, one of our principal tasks will be to complete the integration of the acquired assets, by adapting them to our quality standards, in order to reach a standard of excellence in terms of the efficiency and service quality that have become the hallmarks of our company.*

*With respect to investment in the transmission grid, our objective has been focused on offering a response to the huge construction volume in new facilities as set forth in the document “Planning in the electrical and gas sectors for the period 2005-2011”, approved by the Ministry of Industry, Tourism and Trade in March, 2006. This plan, in whose review Red Eléctrica has taken an active part, has a twofold objective: firstly, to provide the electrical system with sufficient capacity and flexibility to guarantee supply and secondly, to successfully deal with the constant increase in demand that is foreseen in the future.*

*To convert this plan into reality, this year we have implemented an ambitious expansion programme and improvements in the network that have led to a record investment figure of 510 million euros, 21 % more than the previous year, which exceeds our initial average annual investment objective in the network by 70 million. The most relevant activities consisted of creating new lines for evacuating the new power capacity installed, mostly combined circuits and wind farms; in strengthening the mesh in the network in areas with high increases in electrical demand and in consolidating international interconnections. In relation to the latter, I should mention the start-up, in June 2006, of the second underwater electrical interconnection between Spain and Morocco, which has given rise to an increase in the power exchange capacity between both countries, to 1,400 MW, with the subsequent improvement in safety and reliability of supply.*

*Moreover, this second interconnection is a clear example of our commitment to sustainable development, since in executing the project, not only have we assumed the responsibility of generating the least possible impact on the environment, but also developed a whole series of specific actions carried out parallel to laying the infrastructures, defined as compensatory measures to protect the fragile natural and social ecosystem in which the project was developed.*



*On the international plane, through its subsidiaries in Bolivia and Peru, TDE and REDESUR, the group has continued to show extremely positive development. Both companies continue to be leaders in their markets due to the excellent service quality of their facilities, and have also had excellent results that will enable them to increase profits for their shareholders. For its part, Red Eléctrica Internacional has continued to consolidate its international presence through the signing of new technical advisory agreements and business agreements in countries with emerging economies.*

*From the economic standpoint, 2006 was marked by an improvement in the company's ratios and economic figures. Its turnover now stands at around 950 million euros, with an increase of 10.4 % over 2005 and the EBITDA margin of the turnover has stabilised at 68.7 %, despite the increase in expenses incurred in adapting the facilities acquired to the company quality standards. In turn, profit after tax for the group has reached 200 million euros, 23 % more than the previous year, and very much above the objective of the 15 % per annum that we had set. These results merely confirm the strong pace of growth of the company and the attractiveness of our business proposal.*

*From the financial standpoint, our strategy has been based on optimising sources of finance to adapt them to the nature of our core business. During this year, a point of inflexion has occurred in the spiralling evolution of our debt, since the important volume of funds generated has enabled us to reduce net financial debt by 179 million euros, meaning that leverage stands at around 71.9 %. Similarly, the increase in the amounts and maturity dates that have taken place over the past years , together with the reduced exposure to fluctuations in interest rates, by maintaining 72 % of our debt at a fixed rate, have provided a very competitive financial structure in the long term, and this fact is acknowledged by the credit rating agencies who have maintained our ratings yet another year, once again confirming the solvency and financial robustness of the company.*

*I should also mention that the important improvement in both operating cash flows and debt ratios, making the increase in investments compatible with a strong policy of dividend distribution, has made it possible for us to consolidate an effective capital structure.*

*Insofar as the stock market is concerned, Red Eléctrica's value can be considered as extremely positive. It has closed the year with an increase of 24.2 %, and has been among the leading companies in most of the important stock markets in terms of revaluation. In turn, returns for shareholders in the form of dividends has increased by 23 %, exceeding our market commitment, which is proof of the company's interest in offering its shareholders increasingly attractive profits.*

*Red Eléctrica considers that the development of business activity must be tackled based on a ethical, responsible approach with society and from respect for human rights and the rights of employees. As a result, in the year 2006, together with the redesigning of corporate values, we have undertaken, jointly with our employees, a new ethical code that is based on consensus and is more complete, which will be implemented and disseminated to all groups of interest in 2007.*

*This approach, together with our commitment in the social projects area, sustainability and good corporate governance, has enabled us to be the best valued company listed on the IBEX-35 in the field of corporate responsibility and we have become consolidated in international and european Dow Jones Sustainability Indexes (DJSI). This recognition places great value on our business management model and our commitment to sustainable development. The fact that we have set up the Special Regime Control Centre (CECRE) with the objective of integrating maximum renewable energy production into the electrical system is proof of this, and we continue to work on creating new mechanisms for controlling demand, aimed at energy efficacy.*

*Lastly, we can assure that the strategic forecasts stemming from this business scenario for the next five years are quite realistic. On the operating plane, our challenge will be to tackle an investments programme for developing the network amounting to three billion euros, and completing an efficient integration of the assets acquired; from the financial standpoint, the strength of our business will enable us to maintain the following objectives: annual growth in profit per share of over 15 % and an increase in dividends, in line with the increase in profit per share. In addition, all this will be achieved through improving the debt ratios, thereby consolidating an effective capital structure. In short, our business proposal combines high profit growth with attractive profits for shareholders.*

A handwritten signature in blue ink that reads "Luis Atienza". The signature is written in a cursive style and is positioned above a horizontal line that extends to the right.

Luis Atienza Serna  
President of  
Red Eléctrica de España

## The board of directors and senior management



### Board of Directors

Executive president:

Luis Atienza Serna

Proprietary directors:

Juan Gurbindo Gutiérrez (SEPI)

Manuel Alves Torres (SEPI)

Rafael Suñol Trepát (SEPI)

Independent directors:

Pedro Rivero Torre

Antonio Garamendi Lecanda

José Riva Francos

José Manuel Serra Peris

María de los Ángeles Amador Millán

Martín Gallego Málaga

Francisco Javier Salas Collantes

Non-voting secretary:

Rafael García de Diego Barber

Non-voting assistant secretary:

Fernando Frías Montejo

## Auditing Committee

Francisco Javier Salas Collantes	President	Independent
Manuel Alves Torres	Member	Proprietary
Pedro Rivero Torre	Member	Independent

## Appointments and Remuneration Committee

Antonio Garamendi Lecanda	President	Independent
Luis Atienza Serna	Member	Executive
Pedro Rivero Torre	Member	Independent
Juan Gurbindo Gutiérrez	Member	Proprietary

## Senior Management

President:	Luis Atienza Serna-President
General Manager of Operations:	Alberto Carbajo Josa
General Manager of Transmissions:	Carlos Collantes Pérez-Ardá
General Manager of Administration & Finance:	Esther Rituerto Martínez

## Management Committee

President:	Luis Atienza Serna
General Manager of Operations:	Alberto Carbajo Josa
General Manager of Transmissions:	Carlos Collantes Pérez-Ardá
General Manager of Administration & Finance:	Esther Rituerto Martínez
Director of Communications and IR:	Antonio Calvo Roy
Director of Human Resources:	José García Moreno
Director of the Technical Secretary:	Agustín Maure Muñoz
Deputy Manager:	Javier de Quinto Romero

## Most important events during the year



### Credit ratings

03-01-2006

Once again, the credit rating agencies have confirmed the solvency and financial robustness of the company by maintaining its credit ratings: AA-/A-1+ (Standard & Poor's) and A2 (Moody's). The prospect of a stable business, due to the predictability of regulated earnings and the visible investments, together with the low risk involved in the activity of transporting electrical power and its strategic importance are the strong points of Red Eléctrica.

### Second underwater interconnection between Spain and Morocco

06-15-2006

Red Eléctrica and l'Office National de l'Electricité set up the second underwater electrical interconnection between Spain and Morocco. This new interconnection, which will contribute to strengthening the electrical ring in the Mediterranean, increases the energy exchange capacity between both countries to 1,400 MW. Through this interconnection, the safety and reliability of supply is improved, in addition to consolidating the stability of both interconnected systems.

### Opening of headquarters in the Balearic and Canary Isles

06-16 & 22-2006

Red Eléctrica opens its headquarters in the autonomous regions of the Balearic and Canary Isles, where it is an operator of both electrical systems. Its presence as an independent operator alongside other agents, is not only a guarantee of transparency and neutrality in operations, but also makes an effective contribution to the liberalisation process and competition in these electrical markets.



### Special Regime Control Centre (CECRE)

06-30-2006

Red Eléctrica sets up a special control centre for supervising and controlling the special regime facilities (renewable energies and cogeneration). This centre has the mission of integrating the maximum generation of renewable energies into the electrical system.

### Dow Jones Sustainability World Index

09-08-2006

Red Eléctrica consolidates its position in the most important sustainability indexes, the Dow Jones Sustainability Indexes (DJSI), and is incorporated for the first time into the DJSI World index, whilst maintaining its position in the DJSI STOXX for the second year running. Being included in these indexes means recognition for the actions carried out by the company in the fields of reputation, social projects, sustainability and corporate responsibility.

### Conference on compensatory measures

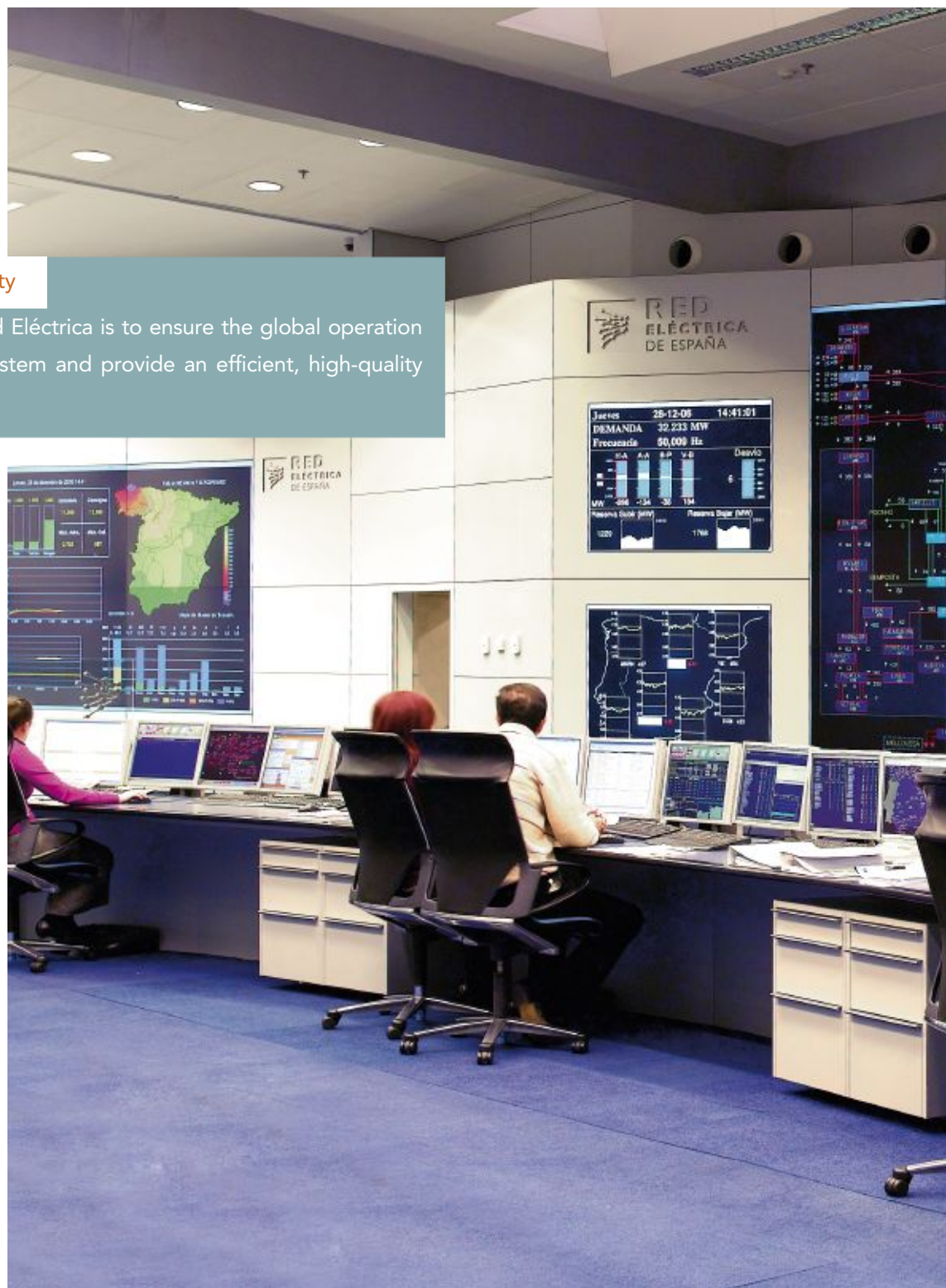
11-28-2006

Within the framework of the 8th National Environmental Congress, Red Eléctrica presents the conclusions of the conference organised on the topic “Compensatory measures in linear infrastructures” organised during the year in Seville, Oviedo, Barcelona and Madrid. The aim of the conference is to promote an open discussion with the participation of all those affected, on what the compensatory measures to be incorporated by linear infrastructure promoters into projects for compensating their impact on nature and society consists of and how they must be implemented.

# 01 Business activities

## Serving society

The mission of Red Eléctrica is to ensure the global operation of the electrical system and provide an efficient, high-quality service to citizens.





# Electricity system operation



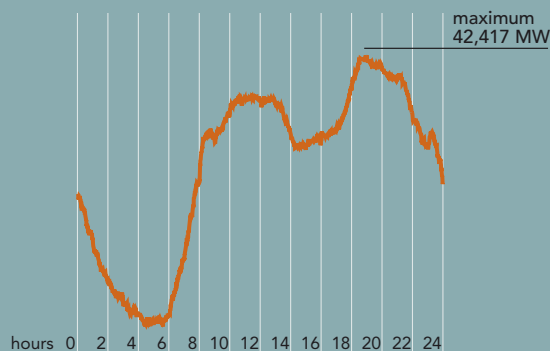
Red Eléctrica guarantees a constant balance between production and electrical consumption in our country, 24 hours a day, 365 days a year. It operates the system based on the strictest standards of efficiency, transparency and equality of conditions for agents, with the aim of assuring continuity and safety in the electrical supply.

In 2006, the most import figures with respect to operation of the Spanish electricity system were as follows:

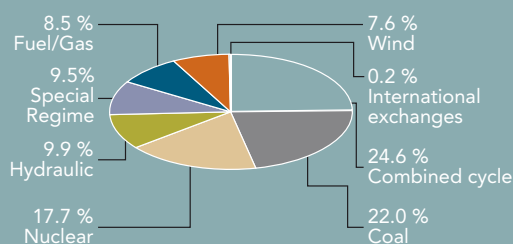
## Mainland system

- The annual demand for electricity reached 253,450 GWh, showing a growth of 2.7 % compared to the previous year. After discounting the effect of labour and temperature factors, growth in demand for 2006 was 3.7 %.
- The demand for electricity in monthly and daily terms exceeded their respective maximum highs. During the month of January, monthly demand reached 23,337 GWh. Maximum demand for daily energy was recorded on December 20, with 854 GWh. Similarly, during this year, new historical highs occurred during the summer. On July 11, an average hourly power record was recorded, of 40,275 MW and on July 18, a maximum daily power high was recorded of 826 GWh.
- The power installed showed a net growth of 4,213 MW, with an increase of 5.7 % compared to 2005. This increase is mainly due to the incorporation of six new combined cycle units with a combined power of 3,132 MW and 1,210 MW in new wind farms. With respect to closures, we should mention the closing of the José Cabrera nuclear power station, leading to a fall of 160 MW in total power.
- With respect to coverage of demand, we should mention the progressive importance of combined cycle production stations which this year, favoured by the reduced hydro-electrical production during the first nine months of the year, have shown an increase of 25 % in the share, equal to the

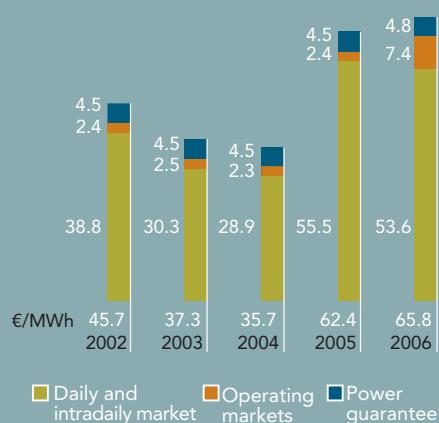
Day of maximum power demand  
12 · 20 · 2006 (854 GWh)



Coverage of maximum hourly demand  
01 · 30 · 2006, time: 19 / 20 h.



Average final price of power in the  
production market



contributions of coal and nuclear technologies. This has led to natural gas becoming the most important raw material in the ordinary regime production in 2006, with 30 %.

- In turn, power from special regime stations covered 19 % of demand, with almost half being power from wind farms. In this regard, we should say that on December 8 the maximum high in wind farm production was exceeded with average daily power of 159,291 MWh and hourly power of 8,010 MWh at 15 h. This wind farm production covered 23.3 % of electrical demand for that day.
- With respect to international interchanges, for the third year running, the net annual balance showed exports of 3,275 GWh. This figure accounts for an increase of 145 % compared to 2005. This increase was mainly due to the important increase in exports to Morocco and the lower important balance from France.

### Non-mainland systems

- Annual electricity demand reached 15,149 GWh, 4.1 % more than last year. 52.4 % of this demand was covered by fuel units, 20.7 % by coal power stations, 21.3 % by combined cycle units and 5.6 % by power obtained under the special regime.

### Operating markets

Among its functions as the system operator, Red Eléctrica controls **the operating markets** whose objective is to adapt the production programmes resulting from the daily and intradaily markets to the quality and safety standards of the system.

These markets provide a solution to technical restrictions, the assigning of complementary services and deviations management.

In 2006 the power managed for all these markets was much higher than that recorded during the same period of the previous year, amounting to 53,363 GWh. This volume represents 35 % of the total power acquired in the production market and is five times higher than that of 2005.

This increase is due to the fact that in the daily market, there was insufficient generation with respect to the foreseen demand, and this has led to that power having to be programmed in the operating markets in the following way:

- The power programmed for restrictions amounted to 15,214 GWh, which is considerably higher than the 3,093 GWh of the previous year.
- The management of complementary services for secondary and tertiary regulation and power programmed for emergencies reached a total of 9,149 GWh, 29.8 % more than the previous year.
- Deviations management recorded 29,000 GWh, as opposed to the 1,350 GWh that were managed using this procedure in 2005.



### Non-mainland systems operator

On April 10, 2006, the provisions governing Royal Decree 1474/2003 were passed, regulating island and non-mainland electrical systems, through which Red Eléctrica was authorised to exercise its functions as an operator of the electrical systems in the Balearic and Canary Isles, Ceuta and Melilla. However, Red Eléctrica had already been executing these functions since July 2004, although on a non-binding basis for the agents.

The peculiarities of these electrical systems due to their small size and isolation hinders the development of synergies and mutual support offered by large interconnected systems. For this reason, in 2006, Red Eléctrica carried out studies prior to the future electrical interconnection between Spain and the Balearic Isles through an underwater continuous current network. The project is scheduled to be put into operation in 2009.

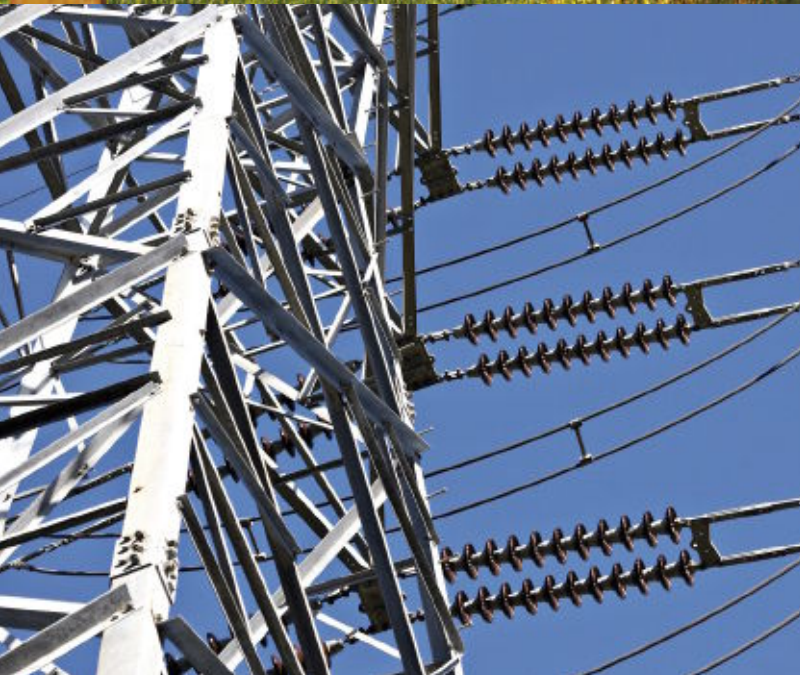
### Special Regime Control Centre

In June 2006, Red Eléctrica put a special control centre into operation (CECRE) for the supervision and control of the special regime facilities (renewable energies and cogeneration). This unit, associated with the CECOEL (Electrical Control Centre) will permit the integration of the maximum possible renewable energy production into the electrical system, ensuring its compatibility with the safe operation of the system.

## Transmission grid management



Red Eléctrica transports high voltage electricity. To do this, it has a series of electrical transmission assets that make up a meshed network which is reliable and safe, providing the electrical system with maximum quality service indicators.



### Planning of the grid

In March 2006, the Ministry of Industry, Tourism and Trade approved the review of the transmission grid development plan for forthcoming years, by publishing the document “Planning of the Electricity and Gas Sectors 2002-2011. Review 2005-2011”.

This new plan, in the review of which Red Eléctrica took part, presents a significant programme for the construction of new transport facilities, based on the following objectives:

- Providing the system with sufficient capacity and flexibility to guarantee quality and safety in supply.
- Permit the evacuation of the increase in the installed capacity by putting into operation new combined cycle stations and wind farms.
- Continue supporting the expansion of the high speed railway network.
- Complete the electrical connection between mainland Spain and the Balearic Isles, and strengthen international interconnections.

## Forecast of electricity demand and coverage thereof

Among its functions as the system operator, Red Eléctrica has the task of preparing the annual forecasts of electricity demand in the medium and long term, and the coverage thereof. In this respect, in 2006 it drew up a report forecasting mainland electricity demand for the period 2006-2017. This report includes, among other estimates, forecasts of annual electricity demands, hourly power peaks in winter and summer, the minimum hourly power curve (valle) and the monotonous load curve.

In turn, it has also prepared the electrical demand coverage forecasts report that evaluates needs for new production facilities for that same period based on specific hypotheses of growth in demand, the evolution of the generator equipment and the availability of the units. Similarly, the directives given in the planning documents that serve as a general reference framework have been considered, such as the Spanish Renewable Energies Plan 2005-2010 and Planning of the Electricity and Gas Sectors 2002-2011 (Review 2005-2011).

In addition as the operator of non-mainland systems Red Eléctrica has drawn up demand and power peak forecasts as well as estimated the need for new generator equipment for the period 2006-2016.

Within the scope of the work of the Iberian Electricity Market (MIBEL), and in collaboration with the Portuguese electrical system operator (Rede Eléctrica Nacional), Red Eléctrica has developed a study on demand forecast and coverage of the Iberian system for the period 2006-2015. The results obtained, in addition to providing additional needs for new generation capacity, allow for the prediction of the most appropriate geographical location.

## Studies for strengthening international interconnections

### INTERCONNECTION WITH PORTUGAL

As part of the MIBEL Joint Planning and Coverage Forecast work group, Red Eléctrica and Rede Eléctrica Nacional have started to conduct studies into two new interconnections of 400 kV for reaching a commercial exchange capacity of 3,000 MW between Spain and Portugal. The interconnections proposed initially for the analysis are the following:

- **North interconnection:** through a 400 kV line between the substations of Pazos (Spain) and Vila do Conde (Portugal), which will require the following actions on the Spanish side: a new 400 kV line between Cartelle and Pazos, and a 400/220 kV transformation in Pazos.
- **South interconnection:** through a 400 kV line between the substations of Guillena (Spain) and Sotavento (Portugal).

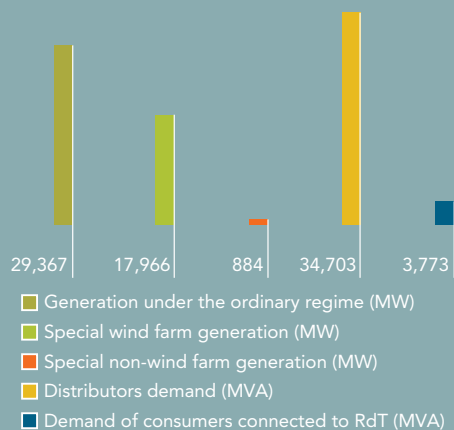
### INTERCONNECTION WITH FRANCE

Red Eléctrica and Réseau de Transport d'Electricité (RTE) continue to make progress in studies for defining the frontier corridor through which the course of the new interconnection line in the eastern Pyrenees will pass, between the substations of Bescanó (Spain) and Baixas (France). As well as increasing the interconnection capacity, this line will enable the reliability and quality of the supply to be guaranteed in the area of Gerona and support to be given to the future high speed railway line between Barcelona and Perpignan.

### INTERCONNECTION WITH MOROCCO

In June 2006 the second underwater cable circuit in the strait of Gibraltar was put into operation. Through this incorporation, the transport capacity of the interconnection between Spain and Morocco has been doubled to 1,400 MW.

Access requests managed during the period 2002-2006



Red Eléctrica own transmission grid

	2004	2005	2006
km circuit	27,855	33,096	33,503
400 kV	16,547	16,808	17,005
220 kV and less	11,308	16,288	16,498
Number busbar connections	2,629	2,731	2,905
400 kV	835	877	950
220 kV and less	1,794	1,854	1,955
Transformers (MVA)	36,553	54,209	55,409

## Access to the transmission grid

Red Eléctrica has continued to manage the procedures for accessing and connecting to the transmission grid with full transparency and equality of conditions for all electrical system agents. In 2006, 156 access requests to the network were processed, broken down as follows:

- 11,920 MW in ordinary regime generation (combined cycles).
- 1,850 MW in special wind farm generation.
- 302 MW in special non-wind farm generation.
- 9,712 MVA in distributor demand.
- 1,525 MVA in demand from consumers connected to the transmission grid.

## Development of the transmission grid

The Red Eléctrica investment plan has focused on the development and consolidation of the transmission grid and has included the following key actions:

- Improvement in the network mesh on the line in the Eastern seaboard and south-east Spain.
- Strengthening the network in areas with high growth in demands for electricity, such as Madrid, Andalusia and Murcia.
- The evacuation of the new installed combined cycle generation capacity and wind farms.
- The evacuation of the new installed combined cycle generation capacity and wind farms.

2006 was a record year in terms of the development of electrical transport infrastructures with an investment of 510.1 million euros, 21 % more than the previous year. 407 km of lines and 174 positions in substations have been put into operation, and the transport capacity has been increased in another 287 km of existing lines.

## Facilities put into operation

## BUSBAR CONNECTIONS

Facility	400 kV	220 kV
Albatarrec		3
Alcira		1
Almodóvar del Río		5
Alvarado		2
Aragón	2	
Bechí		6
Benadresa		6
Benejama	1	2
Bienvenida	3	
Brovales	5	
Cabra	12	
Cartujos		3
Castellet		5
Costa Sol		1
Daganzo		6
El Palmar		10
Escucha		1
Espartal		1
Fausita	7	
Güñes	1	
JM Oriol	1	
La Selva		3
Logroño		1
Mérida		1
Miranda		1
Moraleja	1	1
Olmedilla	1	
Palmar	11	
Parla		6
Patraix		6
Picón		1
Pierola	4	
Puerto de la Cruz	3	
Puerto Real		1
Quintos		3
Roda de Andalucía	7	
Rojales		1
Romica	4	
Sagunto		2
Saladas		1
Sant Celoni		2
Segorbe		6
Segovia	7	
Sentmenat	1	
Talavera		3
Torrente		2
Torrijos		4
Vandellós	2	
Villares del Saz		4
	<b>73</b>	<b>101</b>

## TRANSFORMERS

Facility	MVA Transform.
Jordana	600
Morvedre	600
	<b>1,200</b>

## 400 kV LINES

	km circuit
E/S Cabra-L/Guadame - Tajo	1.5
E/S El Palmar-L/Litoral - Rocamora	95.6
E/S Fausita-L/Asomada - Escombreras	0.5
L/ Cabra - La Roda	82.0
E/S Brovales L/Balboa - T Alqueva	0.6
Brovales-Balboa	0.4
2 <sup>nd</sup> Circuit Spain - Morocco (underwater)	16.0
Escombreras-Rocamora (modification)	0.3
	<b>196.8</b>

## 220 kV LINES

	km circuit
E/S Almodóvar-L/Casillas - Villanueva	2.0
E/S Castellet-L/Foix2 - Viladecans	0.8
L/ Fausita 400 kV-Fausita 220 kV (underground)	0.2
L/ Puerto Real-T Alcores - Pinar	41.0
E/S Benadresa-L/ La Plana - Castellón	1.6
E/S Fuenlabrada-L/ Moraleja - Retamar (aerial)	0.7
E/S Fuenlabrada-L/ Moraleja - Retamar (underg.)	0.1
E/S Patraix-L/Torrente-F S Luis (underground)	6.4
L/ Val D'Uxó - Segorbe	46.0
E/S Cartujos-L/Montetorrero-Peñaflor	0.7
E/S Cervelló-L/Can Jordi - San Boi (aerial)	2.1
E/S Cervelló-L/Can Jordi - San Boi (underground)	0.1
E/S Torres del Segre Mangraners-Mequinenza	36.0
Lleida (Mangraners) - Mequinenza	1.4
E/S La Selva L/ Tarragona-Escatrón B (aerial)	0.8
E/S La Selva L/ Tarragona-Escatrón B (underg.)	0.1
E/S Puigpelat (aerial)	5.0
E/S Puigpelat (underground)	0.1
E/S Villafranca del Penedés (underground)	0.1
L/ Alvarado - Mérida	41.9
L/ Magallón - Jalón (circuit 2)	19.0
L/ San Sebastián de los Reyes - AENA (aerial)	2.5
L/ San Sebastián de los Reyes - AENA (underg.)	1.0
E/S Daganzo-L/S.S. de los Reyes - Meco	0.7
	<b>210.3</b>

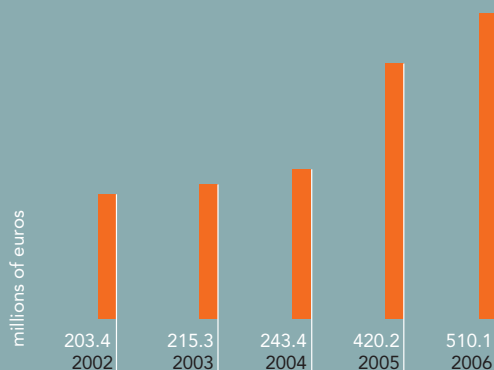
## INCREASE IN CAPACITY

	MVA/line
220.19 km in 400 kV lines	862
66.94 km in 220 kV lines	315



2006 was a record year in terms of the development of electrical transport infrastructures, with an investment of 510 million of euros, 21 % more than last year.

Investment in the transmission grid



The most important actions undertaken as part of the network expansion and improvements plan were the construction of new lines and power evacuation corridors throughout mainland Spain.

### NORTHERN AREA

Engineering and construction work has continued on the northern line. This line will increase the transport and power evacuation capacity in Asturias, Cantabria, the Basque Country and Navarre.

### ARAGON and CATALONIA

In this area, work has been focused on strengthening the network to give service to the high speed railway line between Lérida-Barcelona-the French border and setting up new electrical interconnections between Spain and France, including power evacuation from wind farms along the whole course.

### CENTRAL AREA

Engineering and construction work has continued on the power transport line between the regions of Galicia, Castilla y León and Madrid, as well as work on reinforcing the electrical ring of Madrid, providing support to the high speed railway line and studies prior to executing the new Transmanchego line.

### GALICIA

In this region, engineering work has been done on the power evacuation line to Asturias and the line to the central area of the Spain.

### EASTERN SEABOARD

Engineering work has continued on facilities for evacuation from wind farms as well as work in strengthening the power supply line to Murcia and preliminary studies for the future connection between mainland Spain and the Balearic Isles.



## ANDALUSIA

In this region, work has continued on strengthening the network mesh, together with the construction of facilities to provide support to the high speed railway line between Córdoba and Málaga.

## EXTREMADURA

Engineering work has been done on strengthening the line between Extremadura and Andalusia.

### Lines being constructed (as at 12-31-2006)

400 kV	Kilometres of circuits
Line from Pamplona to Magallón	120
Line from Nort to East	150
Line from Nort to West	60
International connections	25
Wind Farm connections	105
Eastern Seaboard line	30
Murcia Supply Line	76
Line from West to Centre	150
Line from Asturias to Galicia	50
Strengthening in Catalonia and HST	10
Combined Cycle Connection	140
Increase in Capacity	264
<b>Total</b>	<b>1,180</b>
<b>220 kV</b>	
Pamplona Ring	15
Increase in Capacity	60
<b>Total</b>	<b>75</b>



### Substations being constructed (as at 12-31-2006)

400 kV	Busbar connections		Transformers	Reactance/Condensers
	Transport	Access		
Line from Pamplona to Magallón	8	2	1 x 600 MVA	
Line from Nort to East	3		1 x 600 MVA	
International connections	8			
Wind Farm connections	10	4		
Line from West to Centre	6	3	2 x 600 MVA	
Eastern Seaboard line	10	3	1 x 600 MVA	
Line from Asturias to Galicia	4	3	1 x 600 MVA	
Alimentación Murcia	4	4	2 x 600 MVA	
Strengthening in Catalonia & HST French border	10	2	1 x 600 MVA	1 X 150 MVAr
Combined Cycle Connection	11	4	1 x 600 MVA	
Several substations	3	2	1 x 450 MVA	
<b>Total</b>	<b>77</b>	<b>27</b>		
<b>220 kV</b>				
Several substations	17	9		
<b>Total</b>	<b>17</b>	<b>9</b>		



Behaviour of the transmission grid



## Maintenance of transmission grid facilities

The excellent availability ratios for the equipment and systems comprising the high voltage transmission grid are determined mainly by three factors:

- The application of strict quality criteria in maintenance work.
- The use of predictive maintenance techniques.
- The execution of work with live facilities.

The continuous execution of this type of actions contributes to enabling Red Eléctrica to be at the forefront in international terms with respect to the operating efficiency and service quality of its electrical facilities.

## Maintenance of lines

In 2006 all the line inspections programmed in the maintenance plan were carried out. To do this DVD recording equipment was used for the most part, using a helicopter as the transport means. In addition, with the objective of detecting latent faults, a great many electrical lines were thermographed in addition to all the new transport assets acquired during recent years, and the international interconnections and lines providing support to high speed railway lines.

Many maintenance jobs were also performed on live facilities, including those developed for laying fibre optic cable, replacements and cleaning of insulation chains and bird-saving devices put in place in areas in which birdlife conservation is considered important.

On the other hand, anticorrosive protection work was carried out on many metal structures with painting done on almost 160,000 m<sup>2</sup>. Important work was also

done in felling trees and clearing streets under lines in addition to other necessary activities required on a sporadic basis.

### Maintenance of substations

The maintenance plan for substation equipment and systems was implemented by applying different techniques depending on the equipment characteristics:

- Regular maintenance work was carried out on power transformers and reactances, including predictive maintenance: analysis of gases and PCBs, power factor measuring and measuring of leak reactances.
- With respect to measuring transformers, the maintenance plan included the use of different diagnosis techniques such as precision verifications, oil analysis and infrared thermography.
- In the maintenance of high voltage switches telediagnosis techniques were used, which enabled a reduction to be obtained in the time this equipment was out of service.
- In the protection systems, the dynamic testing plan set up in 2005 was continued, and completed with the execution of closing tests and the real disconnecting of switches from the protection equipment. The efficacy ratio for the protection systems was 98.7 %.

### Maintenance of telecommunications equipment

The Red Eléctrica telecommunications network is comprised of 15,260 kilometres of fibre optic cable and more than 18,700 pieces of equipment. In December 2006, the Telecommunications Supervision Centre (TSC) was inaugurated, from where the correct operation of this network is controlled.

In 2006 almost 2,700 maintenance jobs were carried out, of which 51.6 % were corrective. In turn, the annual availability of the teleprotection and telecontrol services was practically 100 %.

### Behaviour of the transmission grid

As in previous years, the behaviour of the transmission grid was extremely satisfactory in terms of availability and continuity of supply:

- The network availability rate was 98.24 % (the reference value is 97 %).
- Power not supplied to the system due to incidents occurring in the network was 851.4 MWh.
- Average interruption time was 1.77 minutes (the reference value is 15 minutes).

### Integration of transmission assets

In 2006 most of the operating and maintenance contracts associated with the purchase of transmission assets from electrical companies expired.

For this reason the assets integration programme was aimed at adapting these facilities to Red Eléctrica standards in order to achieve the service quality and efficacy levels that are the norm within the company.

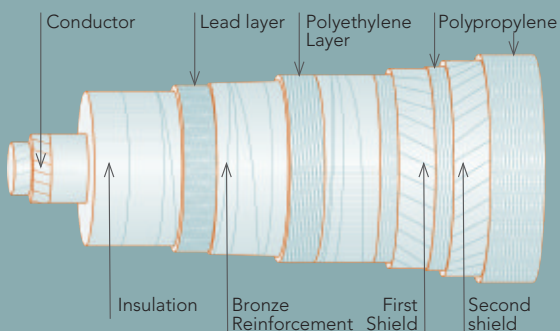
The most important actions consisted of renovating equipment and substituting components and implanting telecontrol systems.



### Technical characteristics of the project

System	Three-phase alternating current
Frequency	50 Hz
Nominal voltage	400 kV
Transport capacity	700 MW
Number of circuits	1
Number of conductors by phases	1
Number of single-pole cables	3
Type of conductor	Fluid oil cables
Number of fibre optic cables	2
Total approximate length	31.3 km

### 1 x 800 mm<sup>2</sup> underwater cable



## Second electrical interconnection between Spain and Morocco

The electrical interconnection infrastructures constitute a vehicle of union that reinforces cooperation between both countries not only with respect to the exchange of goods and services, but in terms of energy cooperation which is of vital importance for the social and economic development of any country. In this respect the electrical interconnection between Spain and Morocco is one of the best examples of energy cooperation between Europe and the countries of the southern Mediterranean region.

The first electrical interconnection between Spain and Morocco was put into operation in October 1997, with an energy exchange capacity of 700 MW. The saturation in commercial exchange in this first circuit made it necessary to set up a second interconnection that would double the transport capacity to 1,400 MW, with the subsequent improvement in the safety and reliability of supply.

The second electrical interconnection was developed under the name of the REMO project “Refuerzo Eléctrico Mediterráneo Occidental” (Western Mediterranean Electrical Reinforcement) and was executed jointly by Red Eléctrica and l’Office National de l’Electricité (ONE). Due to its technical characteristics, it has required a joint approximate investment of 130 million euros. The project was financed by the European Investment Bank and the African Development Bank, and also by a grant from the European Union.

The interconnection consisted of laying three power cables and two fibre optic cables that connect the Spanish and Moroccan electrical systems through the

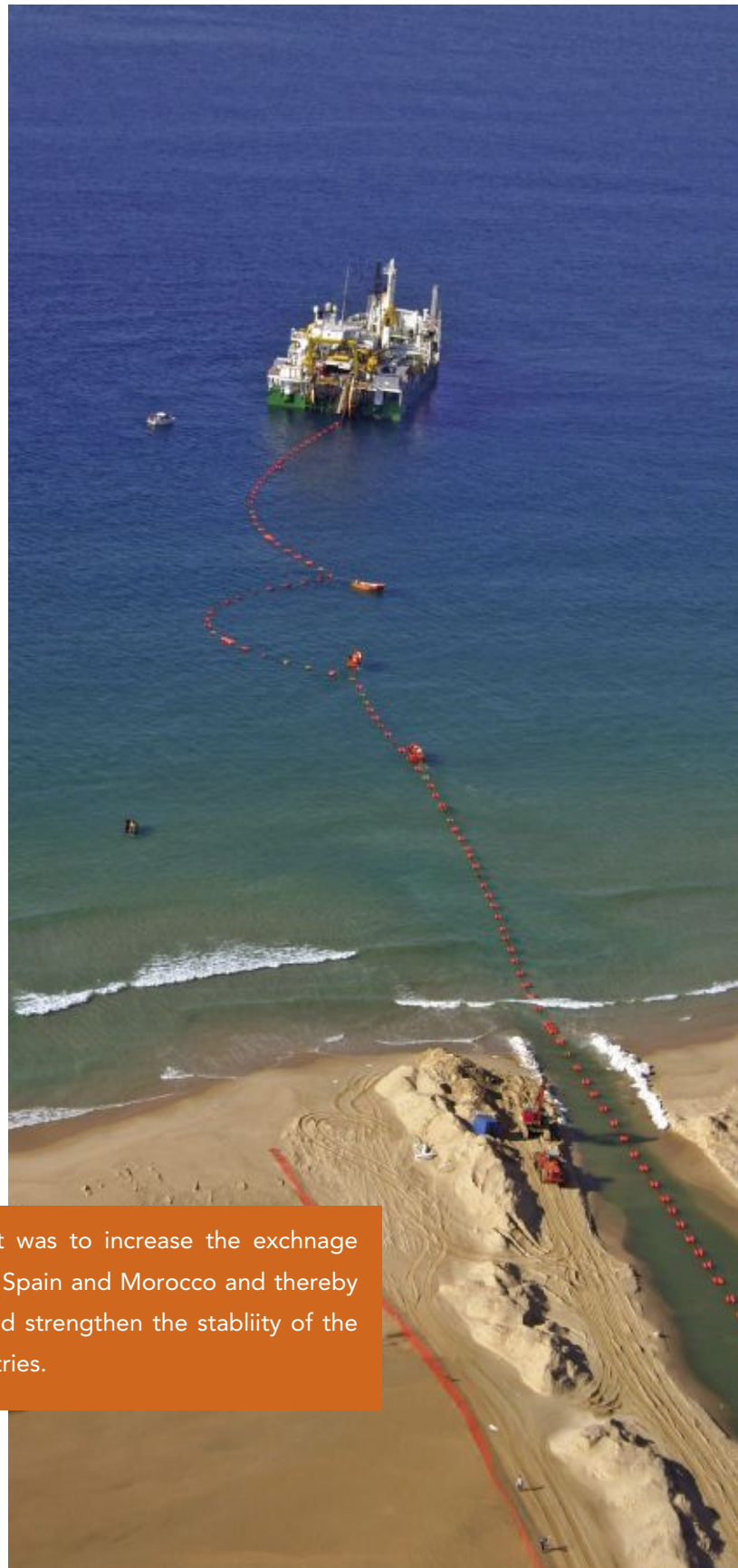
Strait of Gibraltar between Tarifa, in Spain and Fardioua, in Morocco, at a maximum depth of 618 m. The total length of the interconnection is 31.3 km and includes two land sections, one on the Spanish coast and another on the Moroccan coast, of approximately 2 km and 0.3 km respectively.

The underwater cables reach the shore and are joined by transition splices to the underwater cables which, in turn, are connected to the terminal stations on both sides of the Strait, which have also been extended.

The technological features of the project include the underwater laying of the cables, which was done by a latest-generation vehicle equipped with water cameras to ensure the correct laying of the cables on the sea bed.

From the standpoint of the environment, this project, which was declared of community interest by the European Union and which crosses the Nature Reserve of the Strait, included in the Natura 2000 Network, meant that Red Eléctrica had to implement not only the necessary measures to minimise the impact on the environment caused by an infrastructure of this type, but also a series of compensatory measures aimed at protecting the fragile natural and social ecosystem of the area in which the project was executed.

The aim of the REMO project was to increase the exchange capacity of electricity between Spain and Morocco and thereby improve reliability in supply and strengthen the stability of the electrical systems in both countries.



## International activity

The Group's international activity is carried out by Red Eléctrica Internacional and is aimed at investments in transport infrastructures and advisory and technical assistance projects for foreign customers.

### Investment in transmission infrastructures

Red Eléctrica Internacional develops its investment activity through its Peruvian subsidiary Red Eléctrica del Sur (REDESUR), in which it has a stake of 33.75 % and is also the strategic operator of the Bolivian company Transportadora de Electricidad (TDE), in which it holds a stake of 99.94 %.

In 2006, the Peruvian company REDESUR maintained an excellent service quality standard with an availability rate of 99.51 %. This has enabled it to maintain its leading position in the ranking of Peruvian transport companies. This year, REDESUR has also obtained important achievements in its operations, including the satisfactory culmination of its refinancing process and the incorporation into its contract with the Peruvian government of an addendum that allows it to stabilise its earnings through operations and maintenance.

Furthermore, the excellent operating results obtained have enabled it to pay out a dividend of 2.7 million dollars, 14 % more than those paid out in 2005. As part of its commitment with society and the environment, in 2006 REDESUR managed important initiatives with different groups of interest that will without doubt, give rise to great improvements in the Peruvian electrical system, with the ensuing repercussion in the country's development. Among these we should mention its presiding over the committee responsible for orga-



nising the 41st Meeting of Senior Executives of the Regional Energy Integration Commission (CIER), and the foundation of the Andean Committee of CIGRÉ (International Council of Large Electrical Networks).

For its part, the Bolivian subsidiary TDE has also shown excellent results in its plans for the growth and the extension of its network in Bolivia. The year was marked by two important projects:

- the construction of the line between Carrasco and Santiváñez, one of the most important works for increasing capacity and safety in the system in general, and
- the renovation of the SCADA system, which constitutes a guarantee for the control and handling of the Bolivian electrical system.

With respect to service quality, TDE has achieved a total availability ratio of almost 99.83 % in its transmission grid, exceeding the levels of previous years.

In its objective of achieving maximum profitability for shareholders, TDE intends to pay out dividends amounting to 8.14 million dollars, the highest figure in the company's history.

In terms of corporate responsibility, TDE has implemented several initiatives in the educational field. On the one hand it has signed a partnership agreement to create the first Tropical Technical University in Cochabamba. Similarly it has satisfactorily concluded the External Action Educational Programme in rural areas, which has directly benefitted more than eight thousand children and one hundred teachers.

Furthermore TDE has signed the United Nations Global Organisation Pact, the chief aim of which is to

ensure that ethical and human values are converted into a basis for reaching fair and sustainable development within organisations.

## Consultancy and technical advisory service

Red Eléctrica Internacional continues to consolidate its presence in external markets by participating in different management consultancy projects for networks and in operating electrical systems.

2006 marked the conclusion of the following technical and business advisory projects:

- **Rumania.** Extension of the Due Diligence contract for the Rumania-Hungary interconnection.
- **Chile.** Technical *Due Diligence* for the company Transelec.
- **Morocco.** Study on wind penetration (FEV Funds).
- **Regional Southeast Europe.** Study on investment proposals for reinforcing the regional electricity market (ECSEE).
- **Ecuador.** Electrical studies in the National Transmission System.
- **Albania.** Training programme for OST managers.
- **Cyprus.** Seminar on engineering and the construction of high voltage substations.



# 02 Business management

## Our people project

Improvements in organisation efficiency, the professional and personal development of employees, together with the promoting of communication activities are the priority objectives of our human resources strategy.







## Our people commitment

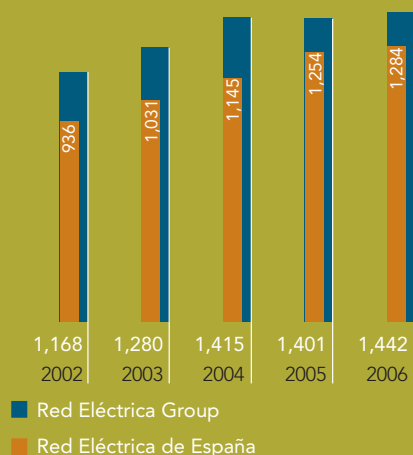
The Red Eléctrica Group is well aware that the development of business activities must be tackled using an ethical and responsible approach with society from a position of respect for the human and labour rights of people.

This approach, which is based on an attitude of commitment and involvement with the employees, is expressed through a human resources policy that has as its essential objectives the development and satisfaction of people, the improving of internal efficacy, taking advantage of the employees' skills.

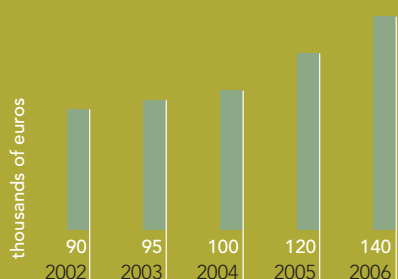
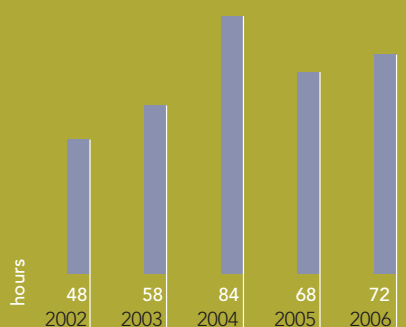
The actions arising from implementing this policy: teamwork, delegation, the encouraging of know-how, the professional development of people, together with the due acknowledgement of their effort, are the basic pillars of the Group's human resources philosophy.

Applying these values has helped to create a sense of commitment to the company and its business project among our employees, as is shown by the preliminary results of the social climate survey conducted this year. According to the quantitative analysis of this survey, satisfaction with working in Red Eléctrica on the part of the staff has improved

## Number of employees



## Net profit per employee

Training hours per employee  
(of the REE staff)

considerably since the last survey which was carried out in 2003. This is also corroborated by other satisfaction indicators such as the low rate of external rotation (1.52 %) or the large number of years that staff remain in the company (10.9 years).

## We continue to grow

The increase in staff in 2006 consolidated the growth trend that started in 2002, as a result of the integration of the transport assets acquired and the new operating responsibilities in non-mainland systems.

This has led Red Eléctrica to become a reference of stability and quality. In 2006, 30 new net jobs were created, causing the total number of staff to reach 1,284 persons at the close of the year in Red Eléctrica. In turn, the average Group staff has increased by 5.2 %, reaching a total of 1,442 employees at the close of the year.

As a modern, dynamic company, Red Eléctrica is committed to hiring highly qualified, versatile professionals that are ready to respond effectively to the future evolution of its business. In this respect, persons with high potential are encouraged to join the company, who are offered the appropriate professional and salary conditions to match their qualifications.

The new employees form part of an integration programme on the company philosophy. In 2006 the third edition of this programme was implemented, in which around 250 employees joining the company recently took part throughout the different phases: adaptation, integration, training and consolidation, to which more than 7,000 training hours were devoted.

In this respect, we should mention the positive light in which the company is viewed by persons outside it, as is shown by the latest ranking of the best companies in which to work, drawn up by Actualidad Económica, in which Red Eléctrica occupies one of the top positions.

### Improvement in organisational efficacy

The organisational model of Red Eléctrica is aimed at optimising available resources to obtain maximum profits and efficiency in all its business activities. For this reason, during recent years it has made great efforts to improve its organisational structure by reducing supportive staff and the percentage of management staff and encourage the increased incorporation of technical staff.

In 2006 the company went a step further by setting up a project for reviewing processes and the organisation model (PROA), to enable it to respond effectively and efficiently to the challenges of its current and future business. The new organisation model resulting from this will be gradually implemented in 2007.

### Professional development of employees

Red Eléctrica is committed to the development of talent and know-how in people to ensure excellence in carrying out their responsibilities and at the same time make this a part of the professional development of its employees.

Based on this, great progress has been made in launching individual talent-management programmes that will allow the persons with the highest potential in the organisation to be identified and developed in professional terms.

Furthermore, special programmes have been set up for other groups within the organisation, to improve their contribution and effort.

In 2006, 164 training courses were given on skills and expertise which have accounted for approximately 22 % of the hours devoted to the training plan. This has meant that in 2006 the policy of succession and coverage of the company's management needs has been met through internal promotion.

Also, a special effort has been made to improve leadership skills and the training of persons with management responsibilities. This, together with other actions planned as part of the training plan for this group, has represented more than 140 hours of training for each member of the management staff.

On the whole, the training activities foreseen in the 2006 Training Plan have been attended by 95 % of the staff, with a total of 92,450 hours of training, 12 % more than in 2005, equivalent to an average of 72 hours per employee.





The objective of the internal communication plan is to encourage the participation and commitment of the employees with the company's business activity.



## Internal Communication

The development of internal communication is one of the basic pillars of the human resources strategy in Red Eléctrica. The internal communication programmes are aimed at encouraging the participation of all employees and facilitating smoother communications in both directions: vertically and horizontally. The dissemination at all company levels of the strategic plan through forums for debate and cascade presentations by the management team with employees is a clear example of this.

In 2006 the final launch of the employees portal took place (miRED) for the purpose of renovating the internal website of Red Eléctrica. The new platform offers an updated information system that is adapted to all user levels. It also integrates the most frequently-used work applications, favouring participation and communication through innovative tools.

In 2006 a study was also conducted on the working climate to evaluate the commitment and involvement of employees with the company's business activity. The participation rate was 66 %, the highest percentage obtained for a survey of this kind in Red Eléctrica, which indicates that there is a positive perception of the working climate at all levels within the organisation.

This study includes a subsequent qualitative analysis that includes interviews with the representatives of different groups to examine in greater depth the conclusions drawn from the satisfaction survey. The results will be presented to all the employees and will serve to design the main lines of the internal communication plan for 2007-2009.

## Electricity system operation school

The Electricity System Operation School is the most obvious example of the importance that Red Eléctrica places on the transfer of knowledge. The School has become an institution of reference in training operators and constitutes a model for the ongoing updating of specialised knowledge of the electrical business.

During 2006 a total of 1,235 students received training at the school. This figure consolidates its trend of growth and participation. This year, as a new element, initiatives for the external public have been included. Two editions of the Operating Markets course for electrical company technicians have been given, with such great success that future editions are planned.

The school has the latest technological innovations and also a training simulator that permits complex exercises to be performed, by replicating both the electrical power system in real time and the power management system. It uses a face-to-face course methodology, provides on-the-job training in the laboratory,

arranges visits to facilities and workshops combined with apprenticeship sessions in the training simulator and virtual training.

The reliability of the Spanish electrical system in which hardly any incidents occur, limits the possibility of operators having to face especially complex situations that subject them to great stress. The training they receive in this school is essential, as it enables them to reproduce real situations and know exactly how the electrical system behaves with the greatest precision.

For this reason, in addition to technical training, the operators receive training on stress management and decision-taking.

This programme is also recognised in the academic sphere: this year, the second promotion of the electrical system specialist operator course was developed, given in conjunction with the School of Technical Engineers (ICAI) of the Comillas Pontifical University.

The Red Eléctrica Operating School is the only one in Europe that offers specialised training to electrical operators.



# Management excellence and corporate responsibility



Excellence in business management is one of the essential leadership values for Red Eléctrica.

## Management excellence

After being awarded the Prince Philip Prize for Corporate Excellence in 2005, Red Eléctrica has devoted its efforts during this year to the consolidation of its management excellence system.

The most important projects in this field were:

- **Designing the comprehensive excellence management chart.** This innovative management and measuring tool will enable the company to monitor the degree of excellent in management and business results. The objective is to help senior management in taking strategic decisions.
- **Implementation of the virtual training courses “Management excellence and the EFQM excellence model”.** This course offers all employees in the company the chance to know the principles on which the EFQM excellence model is based and the company management excellence system.
- **Improvements in human resources management excellence.** Among the improvement projects in this area is the redesigning of the method used to measure the working climate. In addition the project for reviewing process and the organisational model was put into practice (PROA), in order to achieve more effective company management.

## Recognition for corporate responsibility

- Best IBEX-35 company in terms of corporate responsibility, according to the Corporate Responsibility Observatory.
- Among the top 100 Spanish companies with the best reputation in the 6<sup>th</sup> edition of MERCO “Monitor Español de la Reputación Corporativa”.
- 36<sup>th</sup> place in the global ranking global and 5<sup>th</sup> place in the energy sector in the first edition of “MERCO Personas”.
- 19<sup>th</sup> place in the ranking of best companies in which to work, according to Actualidad Económica magazine.

Within the framework of certification and accreditation of management systems, Red Eléctrica has achieved accreditation for the calibration of measuring equipment by the National Accreditation Entity (ENAC) of the Calibration and Testing Laboratory. This accreditation is added to the one obtained in 2005 for the inspection of electrical measurements. Likewise, the AENOR quality certificate (ISO 9001), environmental (ISO 14001) and occupational safety and health (OHSAS 18001) certificates have been maintained, after passing the pertinent follow-up audits.

Since 2005, Red Eléctrica is in possession of the *Social Accountability* (SA 8000) certificate in recognition of its respect for the human and labour rights of people and the ethical treatment of people.

Satisfaction of the requirements and expectations of the interest groups is one of the keys of corporate excellence in Red Eléctrica. In this regard, special attention has been paid to the interest group “employees” with whom the following actions have been carried out, among others: evaluation of the working climate, prevention of obesity and identifying the importance of psychosocial risks in the company. External clients, financial analysts, trade unions and minority shareholders are the other groups of interest evaluated.

## Corporate responsibility

The Red Eléctrica Group is aware that corporate responsibility is an element that sets our corporate management apart from others. We assume this as a strategic approach that affects decision-taking and contributes to obtaining competitive advantages and creating long-term value; in short, achieving a better corporate reputation.

2006 marked the consolidation of Red Eléctrica in the most important sustainability indexes, the Dow Jones Sustainability Indexes (DJSI), after being included for the first time in the DJSI World, and maintaining its position in the European DJSI STOXX for the second year running.


The redesigning of corporate values and the preparation of the new ethical code were the most relevant strategic elements of the year in this respect. The ethical code, which was developed by the Management Commission and the company’s Corporate Responsibility Operating Team, received the collaboration of all the employees, giving rise to a code that is more complete and based on consensus. This code and its management system will be approved and disseminated to all the groups of interest in 2007.

Similarly, the corporate voluntary group known as “EnREDando” was consolidated. This group was set up with the objective of disseminating external social projects carried out by the company, promoting the collaboration of the greatest possible number of employees in solidary activities in response to social needs, problems and interests. Some of the most important projects for this year are: the 1st solidary sports week, the 1st fair trade campaign and the programme for sending books to Guinea.

In addition to the projects, the corporate responsibility report includes all the indicators and a description of the work done by the company in this respect.



## Environmental responsibility and sustainability



We apply strict environmental criteria in all our activities, thereby ensuring that projects are integrated into the community with the least possible impact on the environment and the maximum social consensus.

Red Eléctrica implements all its activities in accordance with a strict Environmental Policy and based on an ethical commitment with the environment and society.

In implementing this policy, it has an Environmental Management system in place for all its activities, which was certified in May 1999, based on the UNE-EN ISO 14001 standard, and registered in the EMAS Community Ecomanagement and Ecoauditing System since October 2001.

In 2006 the principles of our Environmental Policy were updated and targeted at ensuring a firmer commitment with sustainable development.

### Environmental activities

Based on the principles assumed in its environmental policy, Red Eléctrica conducts **environmental impact studies** in all projects for new facilities, whether or not they are subject to the Environmental Impact Evaluation Procedure.



The result of this is that in 2006 a positive environmental impact declaration (DIA) was obtained for seven projects for lines and substations in Andalusia and the north of Spain. Also, the Environmental Impact Evaluation Procedure was initiated for five new projects, thereby making a total of 36 files involved in this procedure during the year (previous consultations, public information or decisions).

In addition, **environmental supervision** was carried out during the construction of different facilities, consisting of applying preventive and corrective measures and designing zones for placing hazardous waste for the appropriate disposal thereof.

With reference to activities aimed at **protecting birdlife**, in 2006, signalling of potentially dangerous sections of lines posing a risk of birds colliding with them was again done using “bird spirals”. Also, due to the great increase in the stork population, devices were again used to prevent them from nesting in different supports on electrical lines, thereby preventing risks for both birds and for the facility.

Finally we should say that in 2006 **the electrical field, magnetic field and noise-measuring plan** was continued that was started in 2004. The objective was to ascertain the values of these measurements in the facilities acquired during recent years from electrical companies that are located near towns and cities.

## Research projects and environmental studies

Red Eléctrica continues to make an important effort to develop new lines of research to make our business compatible with environmental conservation.

## Protection of birdlife

- A study has commenced that will enable us to ascertain the interactions between **Bonelli's eagle** (*Hieraaetus fasciatus*) and the electrical power transport lines. This study was the result of the agreement signed with the Animal Biology Department of the University of Barcelona.



- An experimental study was started on the effects of moving a crow's nest (*Corvus corax*) located on the electrical line between Casares and Puerto Real (Cádiz). The results will enable a protocol to be developed for taking action in situations that require the moving of a nest from a conflictive point for normal operations to a safer place. The study is being conducted in collaboration with the Migres Foundation.

- The study for analysing the incidence of electrical lines on **steppeland birds** has continued during this year. The study includes the developing of measures for managing the habitat of this type of bird, to reduce the risk of collision with the cables. It is being developed with the cooperation of the Scientific Research Council (CSIC), with the participation of researchers from the Biological Station of Doñana and the Museum of Natural Science of Madrid.



We are making an important effort in the development of new research lines for environmental protection.



- The project that is being implemented in conjunction with the Regional Wildlife Department of Valladolid is still in force, with the aim of protecting the **pilgrim hawk** (*Falco peregrinus*) in this province, by placing artificial nests in the electrical supports and the reconstruction of existing natural nests.

Likewise, research work has continued into the effectiveness and useful life of the “bird spiral” signalling by monitoring the kilometres of lines bearing these signs, both the current model and the new experimental model that is being developed.

### Electromagnetic fields

Red Eléctrica is well aware of the social interest and concern aroused by electromagnetic fields. For this reason in addition to carefully examining all the scientific studies developed in this respect, we collaborate with universities, official institutions and companies from the sector in research into this subject.

For three years now, we have been participating in the project “Induced currents in the human body by industrial-frequency electromagnetic fields”, in conjunction with the “Salvador Velayos” Institute of Applied Magnetism (associated with the Complutense University of Madrid and the CSIC) and UNESA.

### Noise and light pollution

Red Eléctrica is in the process of conducting studies into noise emissions generated by the substations with a view to establishing preventive measures to reduce noise.

It also carries out research into potential light pollution generated in these electrical facilities. Based

on the data obtained, the recommendations are being put into practice, in installing lights.

### Environmental activities in the REMO project

The second electrical interconnection between Spain and Morocco (REMO project) is a clear example of the commitment of Red Eléctrica with sustainable development.

In designing this project, the company has undertaken a series of actions aimed at minimising the effects of the facility on the natural and social environment. In this respect, not only has it acquired the commitment to generate the least possible environmental impact, but also developed a series of specific measures in parallel to the execution of the infrastructure, defined as compensatory measures, for protecting the fragile natural and social ecosystem in which the project has been implemented.

These compensatory measures, which have been based on consensus between social, institutional and collective agents from the area and the coordination and monitoring of the Migres Foundation, are included in several projects grouped into three areas of action: environmental conservation, research and education.

Among these projects is the conservation of the rivers and streams on the coast of the southern part of the province of Cádiz, the development of different research studies into the biological communities linked to the Strait of Gibraltar or the design and fitting out of a station for monitoring migrating birds.

### Conference on the compensatory measures

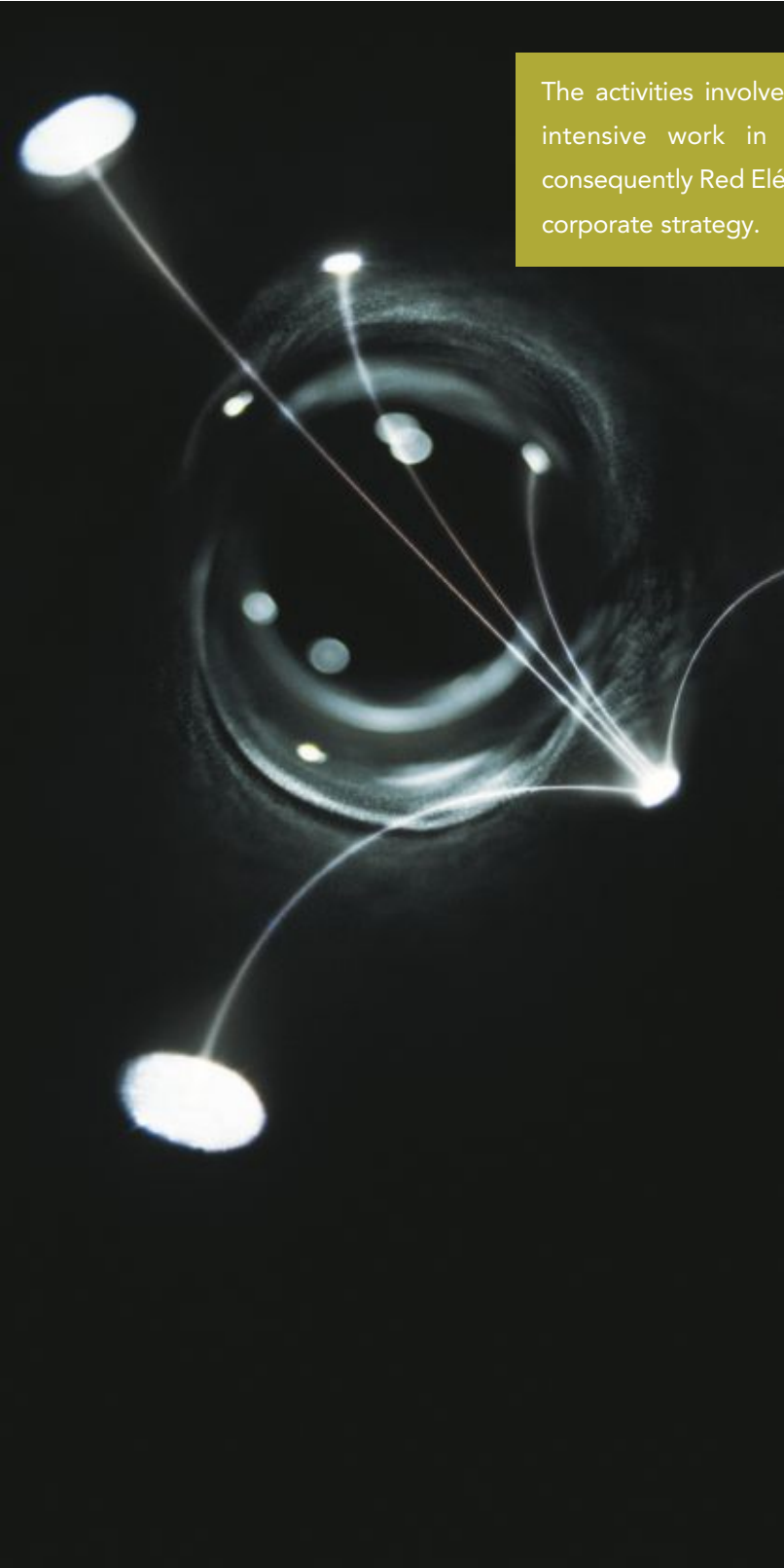
During the year, Red Eléctrica has organised a series of conferences in Seville, Oviedo, Barcelona and Madrid for the purpose of promoting open discussions on the compensatory measures that the promoters of the linear infrastructures must incorporate into projects to compensate their impact on the natural and social environment, and how they are to be managed.

The conclusions of these conferences were presented in the dynamic room that Red Eléctrica has organised at the 8<sup>th</sup> National Environmental Congress.

“The projects that include compensatory measures are targeted at protecting the most fragile elements of the ecosystem and strengthening other aspects associated with the social and cultural environment of the area, as essential elements for achieving sustainable development”.



## Technological development and innovation



The activities involved in operating and transmission electricity require intensive work in the sphere of technological innovation, and consequently Red Eléctrica considers R+D+i activity a basic element of its corporate strategy.

During 2006, investment of R+D+i projects underwent significant growth, reaching 3.7 million euros. This is an increase of 27 % compared to the previous year. This amount was distributed among a total of 60 projects and accounts for 0.42 % of Red Eléctrica's regulated earnings.

From the technological standpoint, we should highlight research into integrating renewable energies into the electrical system and the application of management mechanisms for demand to promote energy efficacy.

2006 marked the consolidation of Red Eléctrica in European research projects. In addition to the WIND ON THE GRID project, we should mention the following important projects with the European Union: the IS-POWER project (study of insulated electrical systems) in which it acts as coordinator, and the EWIS project (study on the integration of wind energy into the system). The list of projects financed with European funds is completed by the RELIANCE, VITA, ENCOURAGED, IRRIIS, FENIX and GRID projects.

Red Eléctrica also played an active role in different technological platforms, among which are the Spanish

Electrical Networks Platform (FUTU- RED), of which it is the Vice-President.

## Most significant research projects

### VITA *Vital Infrastructures Threats and Assurance*

The objective of this project is to define and simulate scenarios with exceptional emergency situations (due to terrorism or natural catastrophes) in order to ensure and protect critical facilities in the electrical system.

### GEMAS

The objective is to analyse the maximum wind production that can be safely integrated into the electrical system. For this purpose, an application was developed to analyse the integration of the special regime generation into the system.

### EMERGIE

The objective of this project is to create new mechanisms for operating the system based on solutions involving demand management, aimed at achieving energy efficacy and causing less impact of the electricity supply on the environment.

### PELICANO

This project enables an unmanned helicopter for inspecting aerial lines that is capable of performing a semi-automatic inspection of the supports. In 2007, the second phase will be launched with the objective of improving the inspection quality and increasing the helicopter's radius of action.

### WIND ON THE GRID

This is a demonstration project for preparing the European electrical network for the integration of wind energy. The project aims to develop a series of applica-

tions and design services for the planning, control and operation of the network in a competitive market.

### Acoustic screening of transformers

The aim of this project is to analyse noise generated by power transformers in the substations.

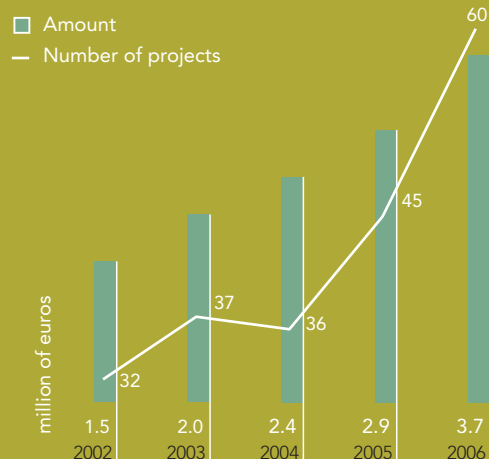
After analysing the type of noise and evaluating the different options, the best option was considered to be the construction of a wall using noise-screening materials near the transformers.

### Evaluation of limiting sections in the transport capacity

The aim of this project is to develop a prototype for identifying and evaluating bottlenecks occurring in the transport capacity of underground lines and partly-buried aerial lines.

Increasing the efficacy and safety of the infrastructures providing support to the electrical system are the objectives pursued by technological innovation.

Evolution of investment in R+D+i



## Creating value and profits



The important volume of funds generated has enabled the company to finance its ambitious investment plan and reduce financial debt, in addition to providing the Group with additional liquid funds.

### Economic and financial management

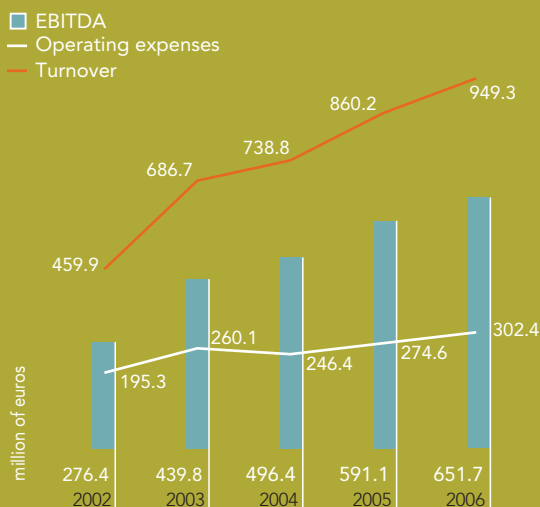
2006 was a year of strong growth in terms of investment in the transmission grid, consolidation of the acquisitions of assets in previous years and a general improvement in the Group's economic and financial ratios.

The key figures of the Group are as follows:

- **Turnover** amounted to 949.3 million of euros, with an increase of 10.4 % over the previous year's figure, mainly as a result of the following:
  - The earnings associated with the facilities put into operation in 2005.
  - The earnings from Inalta transport assets which adds one and a half month's more income in relation to the same period for the previous year.
  - Increase in the work executed for third parties, mostly network accesses.

Earnings from work done on modifying the network for third parties, rendering telecommunication services and other services provided by the Group has also undergone strong growth compared to the previous year.

Gross operating profit (EBITDA)



## Key figures

thousands of euros	2002	2003	2004	2005	2006	06/05 (%)
Turnover	459,931	686,732	738,830	860,163	949,262	10.4
Gross operating profit (EBITDA)	276,372	439,832	496,369	591,129	651,689	10.2
Net operating profit (EBIT)	162,242	250,001	307,229	332,164	401,843	21.0
Profit before taxes	145,515	176,126	240,453	262,044	280,857	7.2
Profit attributed by the controlling company	99,858	115,784	135,806	162,422	200,154	23.2
Investments in the national transmission grid	203,396	215,347	243,368	420,182	510,070	21.4
Cash-Flow before taxes	258,764	366,849	433,308	500,658	559,762	11.8
Net financial debt	1,507,661	1,914,255	1,845,826	2,791,134	2,612,170	-6.4
EBITDA/Turnover	60.1 %	64.0 %	67.2 %	68.7 %	68.7 %	-0.1
ROE	12.3 %	13.6 %	15.5 %	16.9 %	19.6 %	16.1
ROA after taxes	4.6 %	5.9 %	7.3 %	5.8 %	7.2 %	25.0
Leverage ratio	65.1 %	69.3 %	67.8 %	74.4 %	71.9 %	-3.4

■ **Consolidated operating expenses** rose to 302.4 million euros, as compared with the 274.6 million of euros of 2005, representing an increase of 10.1 %, mainly due to the following factors:

- The significant increase in renovation and improvement programmes for increasing the quality of the assets acquired.
- The increase in the average Group staff, due mostly to the integration of transport assets and the provision of new system operation services.

The average Group staff increased by 5.2 % compared to 2005, and now stands at 1,426 employees. The final Group staff figure is 1,442 employees.

■ **The gross consolidated operating profit (EBITDA)** amounts to 651.7 million of euros, 10.2 % more than 2005.

Despite the increase in expenses in adapting the assets acquired to the standards of Red Eléctrica, the EBITDA margin compared to the turnover remained stable at 68.7 %.

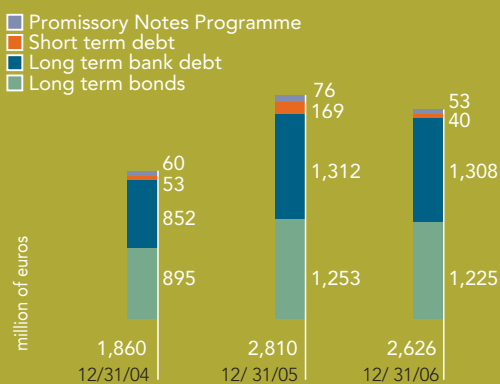
■ **The net consolidated operating profit (EBIT)** amounts to 401.8 million of euros, showing an improvement of 21.0 % with respect to 2005.

Financial expenses have been significantly reduced in 2006, amounting to 102.1 million of euros compared to the 108.4 million of euros recorded in 2005. The increase in both average balances withdrawn and the average interest rates has not offset the impact of last year after the cancellation and subsequent refinancing of the debt in Inalta.

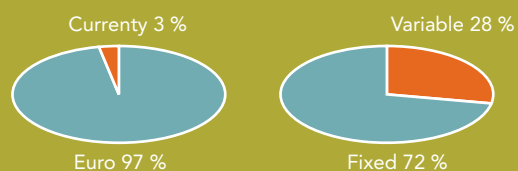
■ **Profit before tax for continuous operations** amounted to 280.9 million of euros, showing an increase of 7.2 % compared to 2005.

This result includes the negative impacts of the review carried out on the value of the Group's international investments (17.8 millions of euros before taxes) and the correction of the value applied to the electrical facilities the construction of which was halted due to reasons beyond the company's control (11.7 million of euros before taxes).

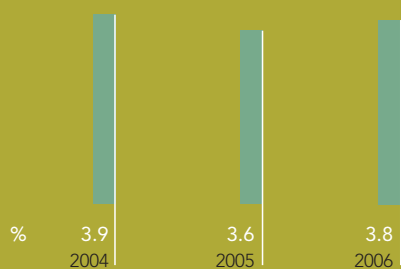
## Debt per instrument



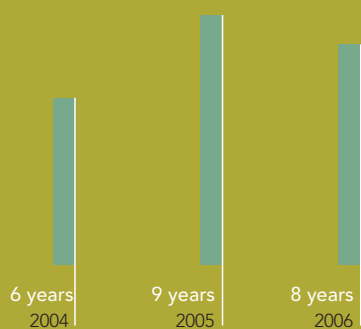
## Debt structure



## Average cost of debt



## Average long term of debt



- **Profit after tax for continuous operations** amounted to 200.2 million euros, 13.3 % more than for 2005. The effective tax rate was 28.7 % compared to 32.6 % for the previous year.

Act 35/2006 (November 28 2006) entering into force on January 1 2007, modifies the Corporation Tax Act, reducing the general tax of 35 % gradually over two years, in such a manner that from 2007 it is set at 32.5 % and at 30 % from 2008. For this reason, the balance corresponding to early tax and deferred expenses for 2006 was adjusted, resulting in a positive effect for the Group of 15.6 million of euros.

- **Profit after tax** amounts to 200.2 million of euros compared to 162.4 million of euros for 2005, representing an increase of 23.2 %.
- **Cash flow from operating activities before tax** amounted to 559.8 million of euros, representing an increase of 11.8 % compared to the 500.7 million of euros of 2005.

## Finance

The considerable volume of funds generated by the company during 2006 has enabled it to finance its ambitious investments plan, and reduce net financial debt by 179 million of euros with respect to the close of the previous year.

In this respect, 2006 showed a point of inflexion in the growing trend in the evolution of the debt and has been characterised by stability and the consolidation of the financial structure developed during recent years, as a consequence of the new dimension of the Group.



In turn, financial expenses have also been reduced which is even more significant during a year when there has been a considerable worsening of monetary conditions as a result of the important increases in interest rates imposed by the Central European Bank.

We should also mention the reduction in the rise of the average cost of debt for the Group, as a result of the interest rate management policy implemented. This has been aimed at maintaining a high proportion of debt at a fixed rate, thereby limiting the rises in market rates recorded.

The maintenance of an important volume of funds available during the year has also made a positive contribution to strengthening the Group's financial structure by adding an additional guarantee of liquid funds.

Also, in order to move forwards in the financial coverage of future investments, this year a new line of finance was obtained through the European Investment Bank for the amount of 300 million euros.

Red Eléctrica has maintained the credit ratings awarded by Standard & Poor's y Moody's (AA-/A-1+ y A2, respectively), which clearly show its enormous solvency and financial robustness, and the low risk and strategical importance of the main activity carried out by the Group.

### Red Eléctrica Group investments

Consolidated investments for 2006 amounted to 529.6 million euros. Of these investments, 510.1 million were allocated to the development and improvement of the national transmission grid, with an increase of 21.4 % over last year's figure.

The most important projects developed in the transmission grid were the following:

- Installation of the second interconnection circuit with Morocco, which concluded in the month of June 2006.
- The development of the Eastern Seaboard line.
- The reinforcing of the transport infrastructures in Andalusia and Murcia.

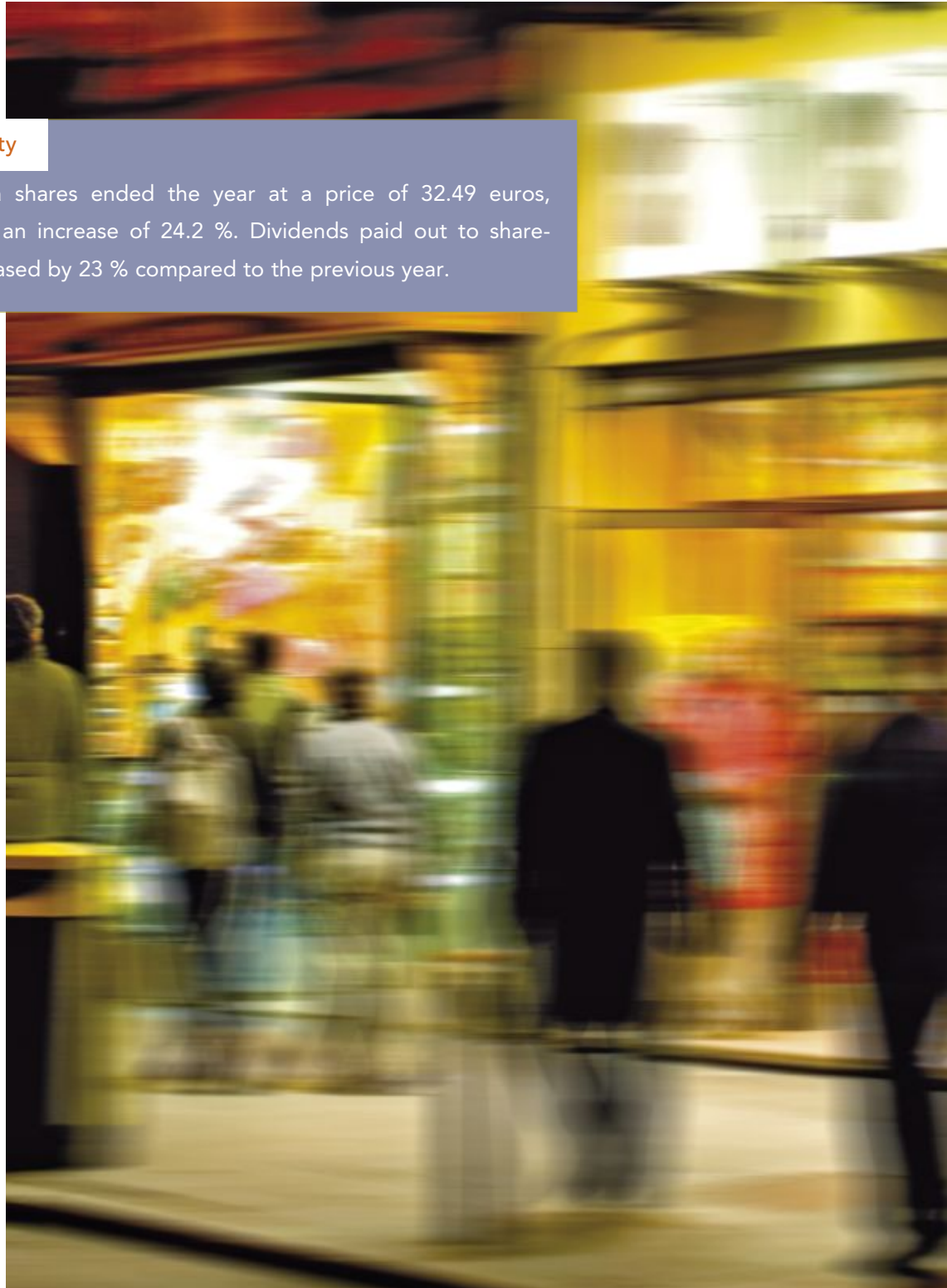
#### Investments

thousands of euros	2002	2003	2004	2005	2006	06/05 (%)
Transmission grids acquisitions in Spain	815,929	535,177	-	45,098	-	-
Investment in the transmission grid in Spain	203,396	215,347	243,368	420,182	510,070	21.4
Investment in the international transmission grid	-	1,956	7,256	7,199	13,551	88.2
Purchase of company shares	91,668	-	-	247,335	-	-
Investment in telecommunication equipment and networks	39,677	10,751	-	-	-	-
Other investments	8,040	17,038	23,946	35,725	5,976	-83.3
<b>Total</b>	<b>1,158,710</b>	<b>780,269</b>	<b>274,570</b>	<b>755,539</b>	<b>529,597</b>	<b>-29.9</b>

# 03 Stock market evolution

## Share profitability

Red Eléctrica shares ended the year at a price of 32.49 euros, representing an increase of 24.2 %. Dividends paid out to shareholders increased by 23 % compared to the previous year.





### Shareholders structure

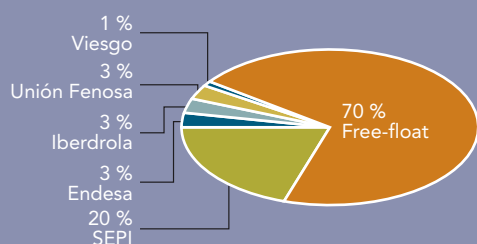
As at December 31, 2006, the fully subscribed, paid up share capital of Red Eléctrica amounted to 270,540,000 euros, represented by 135,270,000 shares of 2 euros, each in face value. During 2006 no changes have occurred that could affect the number of shares in circulation or their face value.

The total share capital is listed in the four Spanish stock exchanges and is negotiated in the Spanish continuous market. In addition, Red Eléctrica is included in the IBEX-35 and its weight in this index at the close of 2006 was 0.86 %.

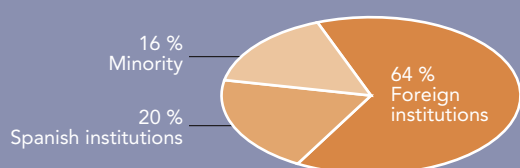
In 2006, Red Eléctrica's free- float accounted for 70 % of the share capital, consisting of 94,689,000 shares. At the date of the last General Shareholders Assembly on May 26, 2006, it was estimated that 16 % of this capital was in the hands of minority shareholders, 20 % in the hand of Spanish institutional investors and 64 % in the hands of foreign institutions shareholders, located for the most part in the United Kingdom, the United States and Germany.

The number of own shares as at December 31 2006 was 1,645,183 shares, representing 1.22 % of the total shares in circulation.

## Share capital distribution



## Free-float structure

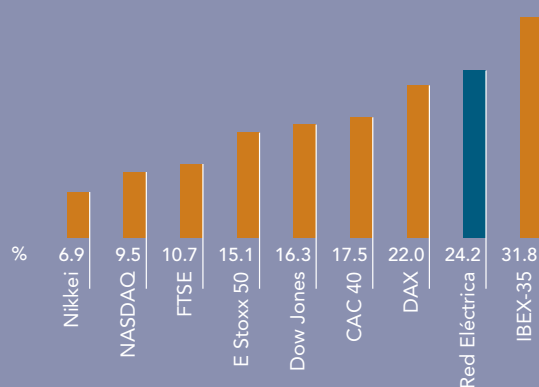


## Share capital distribution

May 26, 2006 (General Shareholders's Meeting)

Groups (by shares)	number of shareholders	%	number of shares	%
From 1 to 1,000	37,759	90.16	7,513,457	5.55
From 1,001 to 5,000	3,380	8.07	5,962,040	4.41
From 5,001 to 25,000	529	1.26	5,119,798	3.78
From 25,001 to 80,000	106	0.25	4,476,615	3.31
More than 80,000	99	0.24	71,617,090	52.94
Electrical shareholders	4	0.01	13,527,000	10.00
Significant shareholders	1	0.00	27,054,000	20.00
<b>Total</b>	<b>41,878</b>	<b>100.00</b>	<b>135,270,000</b>	<b>100.00</b>

## Evolution of the main market indexes · 2006



## Stock market evolution

In 2006, and specifically during the second half of the year, we have witnessed the generalisation of gains in the most important international Stock markets, due to the convergence of several positive factors. Among these is the moderation of prices of raw materials, in particular oil, which has dispersed the fears of economic recession and higher inflation. Also, the high number of corporate transaction has meant an additional impulse for stock exchanges all over the world.

In 2006 the most important continental European stock markets again experienced enormous increases, whereas the US and London markets showed more modest growths. In turn, the Japanese Nikkei index showed the most moderate behaviour of all the important Stock Markets, perhaps to offset the great increase of 2005.

Shares in Red Eléctrica closed the year 2006 at a price of 32.49 euros, with an increase of 24.2%. The share price evolution can be termed extremely positive, as it has exceeded the revaluation of most market indexes.

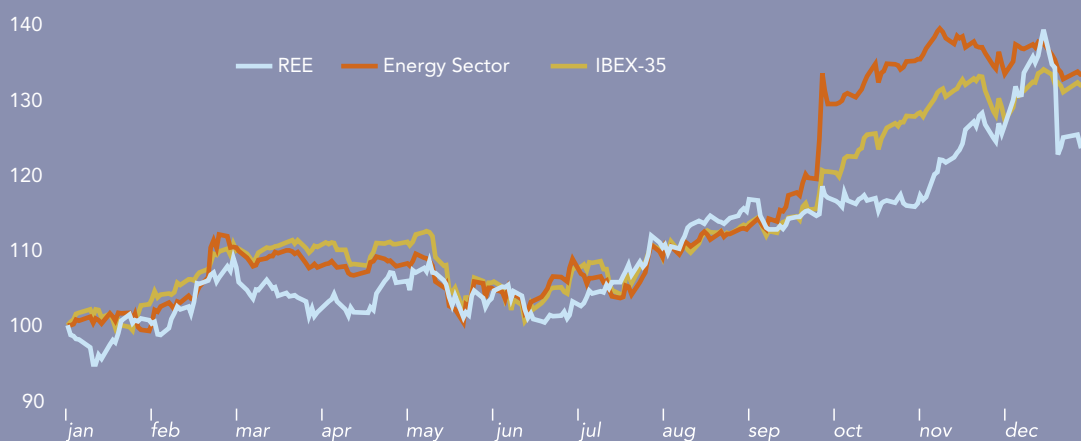
However, the final period of the year was marked by the announcement of a probable review of the regulatory framework affecting the energy transport sector. This announcement led to a sudden fall in the price of the shares which had until that time had a similar behaviour to the IBEX 35 and the general index for the energy sector.

2006 was a year of great market activity for Red Eléctrica, in which almost 250 millions of securities were negotiated, representing 1.83 times the company share capital. Effective trading amounted to almost 7,300 million euros, 23.7% during the month of December.

## Monthly share price evolution

	Days listed	Maximum	Monthly movements (€)			Close	Variation % Month	Trading Volume	
			Minimum	Average	Securities			Cash (€)	
January	21	26.87	24.70	25.54	26.23	0.3	22,865,744	584,105,223	
February	20	28.50	25.71	26.93	28.07	7.0	14,331,567	386,193,033	
March	23	28.70	26.32	27.23	26.62	-5.2	11,417,532	311,056,795	
April	18	28.03	26.38	27.06	27.65	3.9	13,167,712	356,391,147	
May	22	28.51	26.28	27.44	27.00	-2.4	14,762,336	405,198,080	
June	22	27.87	25.98	26.79	26.99	0.0	33,408,316	895,020,740	
July	21	29.45	26.50	27.66	29.04	7.6	18,099,891	499,629,628	
August	23	30.45	28.58	29.30	30.13	3.8	16,275,071	477,007,336	
September	21	31.90	29.22	30.07	30.61	1.6	19,618,103	590,427,683	
October	22	30.80	30.05	30.46	30.41	-0.7	16,551,965	504,292,415	
November	22	33.78	30.33	32.44	32.84	8.0	17,203,571	558,628,523	
December	19	37.09	31.11	33.27	32.49	-1.1	52,081,866	1,730,918,676	
<b>Annual Total</b>	<b>254</b>	<b>37.09</b>	<b>24.70</b>	<b>29.22</b>	<b>32.49</b>	<b>24.2</b>	<b>249,783,674</b>	<b>7,298,869,281</b>	

## Comparison Red Eléctrica - IBEX-35 – Energy Sector



## Trading and daily volume evolution



## Dividends paid out to shareholders

In 2006, remuneration paid directly to shareholders in the form of dividends grew by 23 % with respect to the previous year. The gross dividend proposed to the General Shareholders Assembly to be charged to 2006 was 0.8984 euros per share.

On January 2 2007 a gross interim dividend of 0.3250 euros per share was paid out, with 0.5734 euros per share pending distribution as part of a gross additional dividend for 2006.

### Dividend per Share

	2002	2003	2004	2005	2006
Dividend per Share (in euros)	0.4800	0.5480	0.6138	0.7304	0.8984
Interim	0.1900	0.2120	0.2375	0.2708	0.3250
Additional	0.2900	0.3360	0.3763	0.4596	0.5734
Dividend over Net Profit (*)	67.7 %	65.0 %	65.3 %	67.8 %	61.2 %

(\*) Estimated on the profit of Red Eléctrica S.A.

Red Eléctrica maintains its commitment to maximise the return on the investment of its shareholders by offering, firstly an attractive remuneration in dividends and secondly, by contributing to revalue the shares through its effective business management.

### Main market indicators

	2002	2003	IFRS		
			2004	2005	2006
Total number of shares	135,270,000	135,270,000	135,270,000	135,270,000	135,270,000
Number of shares in circulation	42,610,050	80,485,650	80,485,650	94,689,000	94,689,000
Face amount of share (€)	2	2	2	2	2
Daily trading (in securities)					
Maximum	865,787	42,935,482	6,714,657	12,587,045	13,951,206
Minimum	42,618	110,021	104,761	115,238	146,521
Price (€)					
Maximum	11.95	13.34	16.75	23.75	37.09
Minimum	7.91	9.54	12.75	15.95	24.70
Mean	10.18	11.29	14.32	21.09	29.22
Close	9.64	13.00	16.50	26.16	32.49
Market Capitalisation at the close of year (€)					
	1,304,002,800	1,758,510,000	2,231,955,000	3,538,663,200	4,394,922,332
Profit per share (BPA) (€)	0.74	0.86	1.00	1.20	1.48
Net Cash Flow per Share (CFPA) (€)	1.66	2.37	2.59	3.18	3.44
Price / BPA (PER) (number of times)	13.06	15.19	16.43	21.79	21.96
Price / CFPA (PCF) (number of times)	5.80	5.48	6.36	8.23	9.44
Price / Book Value per Share (PVC) (number of times)	1.61	2.07	2.55	3.68	4.30

## Communication with shareholders and investors

Communication between Red Eléctrica and its shareholders and investors takes place with the maximum of fluidity and transparency, providing them with all the available information at the same time as it is received by the rest of the agents in the stock or financial markets.

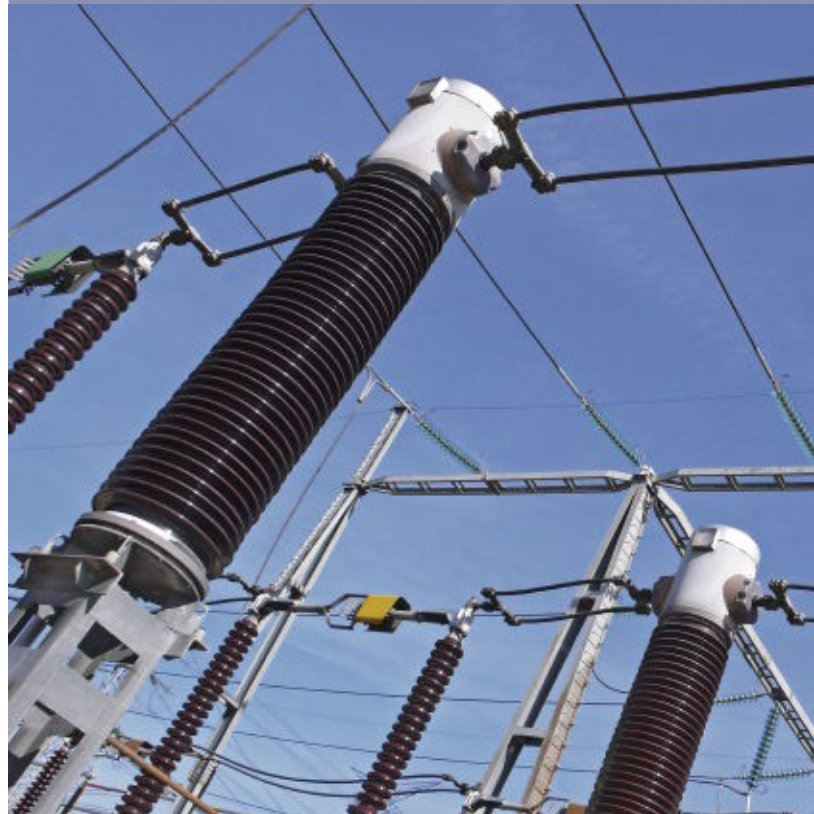
In 2006, the management team of the company took part in presentations and meetings with investors in the most important financial markets in Spain, Europe and the United States. A total of 234 meetings were set up with analysts and institutional investors in more than 30 important financial markets. In addition, 21 visits were organised with national and international investors and 13 presentations were made to institutional investors for fixed and variable interest investments.

Continuing with the line of improving communication with shareholders, this year, for the first time, Red Eléctrica retransmitted the presentation of its annual results and strategic plan, and also the General Shareholders's Meeting live over the internet.

Furthermore, within the scope of the General Meeting, the functionalities of the delegation and electronic voting system were extended in order to encourage the participation of a larger number of shareholders.

## Communication channels with shareholders

- Shareholders office  
Toll free number: 900 100 182  
[accionistas@ree.es](mailto:accionistas@ree.es)
- [www.ree.es](http://www.ree.es)  
("shareholders and investors" section)
- Quarterly shareholders newsletter
- Investors relations unit  
[relacioninversores@ree.es](mailto:relacioninversores@ree.es)



# 04 Our commitment to the future

## We invest in sustainable growth

Our strategic plan is characterised by a strong increase in investments in order to continue building a robust, reliable electrical infrastructures network that will facilitate competition amongst generators and enable sustainable growth through the integration of a maximum of renewable energies into the electrical system.







## Corporate strategy

The 2007-2011 strategic plan which continues with the same essential approach in the main business of electrical transport in Spain, is based on the following basic lines:

- Implementing an investment plan of 3,000 million euros over the next 5 years to deal with the needs involved in planning national electrical infrastructures, in response to the following objectives:
  - Provide the system with sufficient capacity and flexibility to guarantee supply.
  - Complete the electrical interconnection between mainland Spain and the Balearic Isles.
  - Permit the evacuation of the increase in the installed capacity, mainly from combined cycles and wind farms.
  - Continue expanding the high speed rail network.
  - Strengthen international connections to increase the energy exchange capacity with neighbouring countries.
  
- Achieve operative excellence through the effective integration of the assets acquired in recent years. Adapting these facilities to the quality standards of Red Eléctrica through renovation and improvement programmes will enable us to maintain our usual excellent standards of efficacy and service quality.



Our business project offers excellent prospects for the future and confirms that Red Eléctrica is an attractive company with potential to continue to create value for its shareholders.

Moreover, the control of operating costs, the increase in revenues from putting new facilities into service during the forthcoming years and the synergies obtained through the integration of the assets acquired will result in an improvement in the EBITDA margin compared to turnover of at least 3 %.

- Maintain our proactive and cooperative role with the regulating entity in order to promote regulatory stability and an adequate remuneration of the transport activity.
- On the other hand, the company's important fund-generating capacity together with its solid financial standing will continue to enable us to carry out an ambitious investments plan to improve and expand the network, which is compatible with an attractive dividend-distribution policy for shareholders.

Furthermore, the strength of our business plan will enable us to establish as a priority objective for forthcoming years, an annual growth in profit per share of over 15 % and offer our shareholders a per share dividend that is in line with the per share profit.

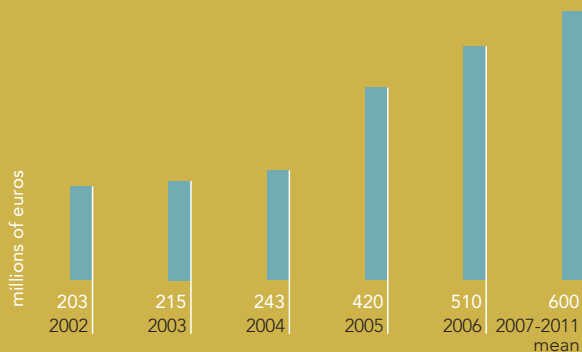
All this, in addition, will be achieved by improving the leverage and net debt/EBITDA ratios, thereby consolidating an effective capital structure that is in keeping with the company's solid and excellent credit rating.

In short, our business proposal combines a high profit growth with an attractive remuneration for shareholders.

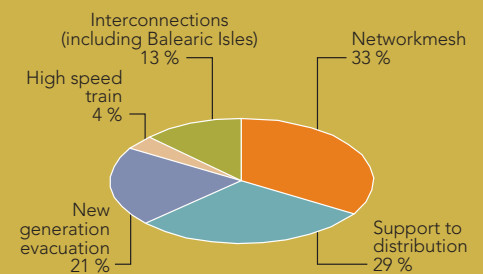
## 2007-2011 Strategic objectives

- 3.000 millions of euros in investments in the transmission grid.
- Improvement of the EBITDA margin over the turnover of at least 3 %.
- Annual per share profit growth of over 15 %.
- Increase in per share dividend in line with the increase in per share profit.
- Maintenance of an efficient capital structure.

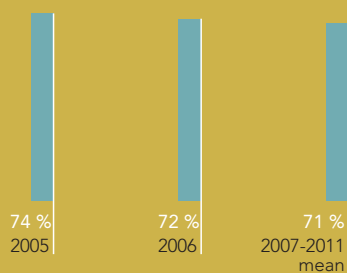
Annual investment



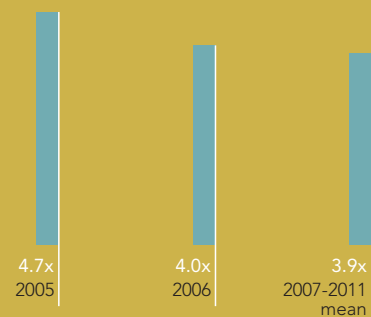
Type of investment (2007-2011)



Leverage evolution



Net debt/EBITDA





# 05 consolidated annual accounts 2006

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**A free translation of the report on the consolidated annual accounts originally issued in Spanish and prepared in accordance with International Financial Reporting Standards adopted by the European Union**

### AUDITOR'S REPORT ON THE CONSOLIDATED ANNUAL ACCOUNTS

To the Shareholders of Red Eléctrica de España, S.A.

We have audited the consolidated annual accounts of Red Eléctrica de España, S.A. (Parent Company) and its subsidiaries (the Group), consisting of the consolidated balance sheet at 31 December 2006, the consolidated income statement, the consolidated cash flow statement, the consolidated statement of changes in equity and the related notes to the consolidated annual accounts for the year then ended, the preparation of which is the responsibility of the Directors of Red Eléctrica de España, S.A.. Our responsibility is to express an opinion on the consolidated annual accounts taken as a whole, based on the work performed in accordance with auditing standards generally accepted in Spain, which require the examination, on a test basis, of evidence supporting the consolidated annual accounts and an evaluation of their overall presentation, the accounting principles applied and the estimates made.

In accordance with Corporate Law, the parent Company's Directors have presented, for comparative purposes only, for each item of the consolidated balance sheet, the consolidated income statement, the consolidated cash flow statement and the consolidated statement of changes in equity, the corresponding amounts for the previous year as well as the amounts for 2006. Our opinion refers exclusively to the consolidated annual accounts for 2006. On 24 March 2006, another firm of auditors issued their audit report on the 2005 consolidated annual accounts, in which they expressed an unqualified opinion.

In our opinion, the accompanying consolidated annual accounts for 2006 present fairly, in all material respects, the consolidated financial position of Red Eléctrica de España, S.A and its subsidiaries as at 31 December 2006 and the consolidated results of their operations, changes in consolidated net equity and consolidated cash flows for the year then ended and contain all the information necessary for their interpretation and comprehension in accordance with International Financial Reporting Standards adopted by the European Union which are consistent with those applied in the preparation of the consolidated financial statements for the previous year.

The accompanying consolidated Directors' Report for 2006 contains the information that the Red Eléctrica de España, S.A.'s Directors consider relevant to the Group's position, the development of its business and other matters and does not form an integral part of the consolidated annual accounts. We have verified that the accounting information contained in the aforementioned Directors' Report agrees with that of the consolidated annual accounts for 2006. Our work as auditors is limited to checking the consolidated Directors' Report within the scope already mentioned in this paragraph and it does not include a review of information other than that obtained from the accounting records of Red Eléctrica de España, S.A. and its subsidiaries.

PricewaterhouseCoopers Auditores, S.L.

Francisco J. Martínez Pérez  
Partner

23 March 2007

# Consolidated financial statements

## Red Eléctrica Group

Consolidated Balance Sheet at 31 december 2006 and 2005 (in thousands of euros)

ASSETS	2006	2005
Property, plant and equipment (note 5)	4,433,642	4,174,430
Investment property (note 6)	2,734	3,666
Goodwill (Note 7)	-	15,056
Intangible assets (Note 8)	5,433	8,686
Non-current financial assets (note 17)	13,029	4,355
Investments carried under the equity method (note 9)	7,204	7,142
Deferred tax assets (Note 21)	38,921	33,973
Other non-current assets	436	688
<b>Non-current assets</b>	<b>4,501,399</b>	<b>4,247,996</b>
Inventories (note 10)	28,974	35,640
Current trade and other receivables (note 11)	264,853	347,642
Current financial assets	1,671	31
Current tax assets (Note 21)	7,813	1,481
Other current assets	316	5,791
Cash and cash equivalents	13,374	18,768
<b>Current assets</b>	<b>317,001</b>	<b>409,353</b>
<b>Total Assets</b>	<b>4,818,400</b>	<b>4,657,349</b>
<b>LIABILITIES</b>	<b>2006</b>	<b>2005</b>
Share capital	270,540	270,540
Other reserves	264,546	264,546
Other reserves	486,887	427,693
Minority interests	58	74
<b>Equity (note 12)</b>	<b>1,022,031</b>	<b>962,853</b>
Bonds and other marketable securities (Note 15)	1,224,956	1,252,696
Bank loans and overdrafts (Note 15)	1,277,270	1,284,828
Other non-current financial liabilities (Note 17)	20,627	-
Deferred tax liabilities (Note 21)	144,024	156,776
Provisions (Note 13)	19,166	34,618
Other non-current liabilities (Note 14)	366,207	311,669
<b>Non-current liabilities</b>	<b>3,052,250</b>	<b>3,040,587</b>
Bonds and other marketable securities (Note 15)	16,429	16,894
Bank loans and overdrafts (Note 15)	129,377	282,974
Trade and other payables (Note 19)	142,333	117,177
Other current financial liabilities (Note 18)	-	2,854
Provisions	1,477	1,505
Current tax liabilities (Note 21)	34,628	31,026
Other current liabilities (Note 20)	419,875	201,479
<b>Current liabilities</b>	<b>744,119</b>	<b>653,909</b>
<b>Total Liabilities</b>	<b>4,818,400</b>	<b>4,657,349</b>



## Red Eléctrica Group

## Consolidated income statement 2006 and 2005 (in thousands of euros)

INCOME STATEMENT	2006	2005
Net turnover (Note 22-a)	949,262	860,163
Other operating income	4,788	5,520
Raw materials and consumables (note 22-b)	(36,390)	(26,432)
Staff costs (note 22-c)	(84,902)	(78,080)
Other operating expenses (note 22-c)	(181,069)	(170,042)
Non-current asset depreciation (Notes 5, 6 and 8)	(249,846)	(258,965)
<b>Net operating profit/(loss)</b>	<b>401,843</b>	<b>332,164</b>
Financial income	2,549	4,604
Financial expense	(102,130)	(108,437)
Exchange differences	237	(243)
Net profit/(loss) due to value changes in financial instruments	2,677	4,753
Net profit/(loss) due to asset value impairment (Note 22-d)	(31,193)	(312)
Profit share in companies carried under the equity method (Note 9)	847	556
Net profit/(loss) on disposal of non-current assets (Note 22-e)	114	23,510
Other profits or losses	5,913	5,449
<b>Profit/(loss) before taxes from ongoing operations</b>	<b>280,857</b>	<b>262,044</b>
Corporate income tax expense (Note 21)	(80,699)	(85,340)
<b>Profit/(loss) for the year from ongoing activities</b>	<b>200,158</b>	<b>176,704</b>
Results after taxes from discontinued operations	-	(14,271)
<b>Results for the year</b>	<b>200,158</b>	<b>162,433</b>
Minority interests	(4)	(11)
<b>Profit/loss attributed to parent company</b>	<b>200,154</b>	<b>162,422</b>
Basic earnings per share (Note 32)	1.48	1.20
Diluted earnings per share (Note 32)	1.48	1.20

# Consolidated balance sheet

## Red Eléctrica Group

### Consolidated statement of changes in equity 2006 and 2005

(in thousands of euros)

EQUITY	Share capital	Other reserves	Rest of reserves	Minority interests	Total equity
<b>Balances at 1 January 2005</b>	<b>270,540</b>	<b>264,546</b>	<b>341,064</b>	<b>55</b>	<b>876,205</b>
Distribution of 2004 profits:					
To complementary dividend 2004	-	-	(50,838)	-	(50,838)
Interim dividend 2005	-	-	(36,588)	-	(36,588)
Movement in treasury shares	-	-	(1,128)	-	(1,128)
Conversion differences	-	-	7,195	8	7,203
Valuation of financial derivatives	-	-	3,305	-	3,305
Profit for 2005	-	-	162,422	11	162,433
Other	-	-	2,261	-	2,261
<b>Balances at 31 December 2005</b>	<b>270,540</b>	<b>264,546</b>	<b>427,693</b>	<b>74</b>	<b>962,853</b>
Distribution of 2005 profits:					
To complementary dividend 2005	-	-	(62,043)	-	(62,043)
Interim dividend 2006	-	-	(43,428)	-	(43,428)
Movement in treasury shares	-	-	(49,163)	-	(49,163)
Conversion differences	-	-	(5611)	(12)	(5,623)
Valuation of financial derivatives	-	-	11,651	-	11,651
Profit for 2006	-	-	200,154	4	200,158
Other	-	-	7,634	(8)	7,626
<b>Balances at 31 December 2006</b>	<b>270,540</b>	<b>264,546</b>	<b>486,887</b>	<b>58</b>	<b>1,022,031</b>

## Red Eléctrica Group

### Consolidated cash flow statement 2006 and 2005 (in thousands of euros)

CASH FLOW STATEMENT	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	<b>601,091</b>	<b>289,032</b>
Cash flows from operating activities	559,762	500,658
Profit/(loss) before taxes from ongoing operations	280,857	262,044
Non-current asset depreciation	249,846	258,965
Other results not generating cash movements	11,167	12,337
Capital grants and other deferred income released to income statement	(10,510)	(9,178)
Net profit/(loss) on disposal of non-current assets	28,402	(23,510)
Income taxes paid	(94,115)	(71,017)
Changes in operating working capital	151,792	(140,609)
Increase in inventories, debtors, receivables and other current assets	79,798	(152,699)
Reduction in trade creditors, current advances and other current liabilities	71,994	12,090
Payments of provisions	(16,348)	-
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	<b>(308,764)</b>	<b>(502,422)</b>
Acquisition and disposal of PPE and intangible assets	(365,546)	(293,949)
Acquisitions and disposal of other investments	360	6,672
Acquisition and disposal of shareholdings and joint ventures	(618)	(243,815)
Capital grants and other advances received	57,040	28,670
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>	<b>(297,421)</b>	<b>217,797</b>
Equity movements	(47,554)	1,284
Drawdown on long-term financing facility	111,687	1,422,078
Repayments of long-term financing facility	(106,927)	(564,473)
Drawdown on short-term financing facility	1,065,795	1,276,630
Repayments on short-term financing facility	(1,221,791)	(1,834,791)
Dividends paid	(98,631)	(82,931)
<b>NET CASH FLOW</b>	<b>(5,094)</b>	<b>4,407</b>
Changes in exchange rate in cash and cash equivalents	(300)	1,403
<b>CHANGE IN CASH AND EQUIVALENTS IN THE YEAR</b>	<b>(5,394)</b>	<b>5,810</b>
Cash and cash equivalents at the beginning of the year	18,768	12,958
Cash and cash equivalents at year end	13,374	18,768

# Notes to the consolidated annual accounts 2006

## (1) ACTIVITIES OF GROUP COMPANIES

Red Eléctrica de España, S.A., (hereinafter the Parent company or the Company) was incorporated in 1985. The principal activities carried out by the Parent company are the transmission of electricity, operation of the system and management of the transmission grid, coordination of international electricity exchanges and the administration of international electricity agreements. The Red Eléctrica Group, through its Parent company, carries out additional activities such as the acquisition, holding and management of foreign securities, provision of consultancy services, engineering and construction work and electrical activities outside the Spanish electrical system through Red Eléctrica Internacional, S.A.U. (hereinafter REI) and subsidiaries (Appendix I). At their annual meeting held on 26 May 2006 the Shareholders of the Parent company approved the merger by absorption by the Parent company of Red de Alta Tensión, S.A.U. (hereinafter REDALTA) and Infraestructuras de Alta Tensión, S.A.U. (hereinafter INALTA) (owners of the transmission assets acquired in 2002 from Iberdrola), after having acquired in 2005 75% of the shares in those companies, increasing its holding to 100% of the same.

In July 2003 the Parent company incorporated the Dutch company Red Eléctrica de España Finance, B.V., the activity of which consists of attracting funds, performing financial transactions and rendering services to Group companies (Appendix I).

In June 2005 the Parent company sold 100% of the shares in Red Eléctrica Telecomunicaciones, S.A. (hereinafter Albura), through which the Group carried out telecommunication activities.

## (2) BASIS OF PRESENTATION OF CONSOLIDATED ANNUAL ACCOUNTS

### a) General information

The consolidated financial statements have been prepared by the Directors of the Parent company to present fairly the consolidated equity and the consolidated financial position at 31 December 2006, the results of the operations, and changes in consolidated equity and cash flows of the Group for the year then ended.

The consolidated financial statements are expressed in thousands of euros and have been prepared in accordance with International Financial Reporting Standards adopted by the European Union, in accordance with EC Regulation 1606/2002 of the European Parliament and Council and the interpretation (IFRIC) endorsed by the European Union. The consolidated financial statements for the year ended 31 December 2005 were the first to be prepared under EU-IFRS.

All mandatory accounting principles which would have a significant effect on the preparation of these consolidated financial statements have been applied.

These consolidated financial statements, prepared by the Directors of the Company at the Board meeting held on 22 March 2007, have been prepared on the basis of the individual accounting records of the Company and other companies which comprise the Red Eléctrica Group (Appendix 1). The companies prepare their financial statements in accordance with the accounting principles in effect in the country where they operate. Therefore the consolidated financial statements include certain adjustments and reclassifications made to bring

the accounting principles followed by the Group companies in preparing their financial statements into line with EU-IFRS. Similarly, the accounting policies of the consolidated companies are changed when it is necessary to ensure consistency with the accounting policies adopted by the Company.

The consolidated financial statements for 2005 were approved by the shareholders at their annual general meeting held on 26 May 2006. The consolidated financial statements for 2006 are pending approval at the General Shareholders' Meeting. Nonetheless, the directors of the Company consider that those consolidated financial statements will be approved without changes.

#### b) New EU-IFRS and IFRIC interpretations

The Group has adopted the new accounting standards (EU-IFRS) and interpretations (IFRIC), which have been approved and published, and are effective starting on 1 January 2006. The adoption of these standards and interpretations has not had a significant impact on these consolidated financial statements.

With respect to the new accounting standards and interpretations to be applied to the years starting on and after 1 January 2007, the Group does not expect them to have a significant effect on the consolidated financial statements.

#### c) Accounting estimates and assumptions

The preparation of the financial statements under IFRS requires Group management to make judgements, estimates and assumptions that affect the application of standards and the reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The consolidated financial statements for 2006 include the estimates of management of the Group and conso-

lidated companies on the value of assets, liabilities, income, expenses and commitments recognised, which were subsequently ratified by the Board of Directors. These estimates mainly comprise:

- Estimates on the recovery of assets and goodwill. Calculation of impairment of assets and goodwill is based on discounted cash flows according to the financial projections used by the Group. The discount rate used is the weighted average cost of capital taking into account the country risk premium. This has resulted this year in the complete impairment of goodwill relating to the Group's shareholding in Transportadora de Electricidad, S.A. (hereinafter TDE).
- Estimates of the useful lives of property, plant and equipment.
- Assumptions used in the actuarial calculations.
- As a general rule, liabilities are accounted for when an obligation is likely to give rise to an indemnity or payment. The Group assesses and estimates the necessary amounts to be paid in the future, including additional amounts relating to income taxes, contractual obligations, the settlement of outstanding litigations or other liabilities. Those estimates are subject to interpretations of current events and circumstances, projections of future events and estimates of the financial effects of those events.

Although estimates were based on the best information available at 31 December 2006, future events may require these estimates to be modified (increased or decreased) in subsequent years. Any change in accounting estimates would be recognised prospectively in the corresponding consolidated income statement in accordance with IFRS.

#### d) Basis of consolidation

Consolidation of the results generated by entities for which control was acquired during the year is carried out taking into consideration only those results rela-

ting to the period between the date of acquisition and the close of that year.

Details of the type of companies consolidated and the respective methods of consolidation are as follows:

#### ■ Subsidiaries

Subsidiaries are entities controlled by the Parent Company. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control is presumed to exist when the Parent company owns, directly or indirectly through subsidiaries, more than half of the voting rights. Control also exists when the Parent company owns half or less of the voting rights of an entity where there is power over more than half of the voting rights by virtue of an agreement with other investors or where it has power to cast the majority of votes at the meetings of the Board of Directors and control of the entity is by that Board or body.

The financial statements of subsidiaries are fully consolidated. Consequently, all significant balances and contingent liabilities between fully consolidated companies have been eliminated.

Assets and liabilities and contingent liabilities of a subsidiary are calculated at fair value on the acquisition date. The excess of acquisition cost over the fair value of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of identifiable net assets of the subsidiary acquired (i.e., discount on acquisition), the difference is recognised directly in the consolidated income statement in the period of acquisition. Minority interests are established in proportion to the fair value of the identifiable assets and liabilities recognised. Consequently, any loss attributable to the minority which exceeds the carrying value of the minority interest is recognised with a charge to the equity of the Parent company:

- Minority interests in Group equity are included under minority interests in the consolidated balance sheets.
- Minority interests in consolidated results for the

year are included under minority interests in the consolidated income statement.

The financial year end closing dates of the financial statements of consolidated subsidiaries coincide with those of the Parent company.

#### ■ Associates

Associates are entities over which the Company has significant influence but not control or joint control. Usually significant influence in an investee (director indirect) is when a company holds an interest equal to or more than 20 % of the voting rights.

The financial year end closing dates of the financial statements of associates coincide with those of the Parent company.

Investments in associates are accounted for by the equity method of accounting (except for those held for sale), that is, at the percentage share in the equity of the associate once dividends received from the associate and other balances have been eliminated less impairment of individual shareholdings (in the event of transactions with associates the corresponding profit and loss should be eliminated to the extent of the Group's interest in the associate).

Any excess of cost of acquisition over the fair value of identifiable net assets of the associate attributable to the Group on the acquisition date is considered as goodwill and recognised in the consolidated balance sheet under associates. If the cost of acquisition is less than the fair value of the part of the fair value of the identifiable net assets of the associate held by the Group on the acquisition date (i.e. discount on acquisition) the difference is recognised directly in the income statement.

Information on consolidated subsidiaries and associates of Red Eléctrica, S.A., the consolidation or valuation methods applied in the preparation of the accompanying consolidated financial statements and other information are included in Appendix 1.

The financial statements of each Group company are expressed in the functional currency of the primary

economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in euro, which is the parent company's functional and presentation currency.

Operations of Red Eléctrica, S.A. and subsidiaries have been consolidated in accordance with the following basic principles:

- The accounting principles and criteria used by the Group companies have been brought into line with those used by the Parent company.
- The financial statements of foreign companies have been translated by applying the year-end exchange rates at the date of the balance sheet for assets and liabilities and the average exchange rate for the period for income and expenses.
- Exchange rate differences resulting from translation to euro are recognised in the consolidated balance sheet at the year end as a separate component of Equity named Conversion differences.
- All significant balances and transactions between fully and proportionally consolidated companies have been eliminated in the consolidation.
- Margins on sales of capitalised goods and services between Group companies are eliminated when the relevant operations are carried out.
- Positive differences between the acquisition cost and the underlying carrying value of the shareholdings acquired which cannot be allocated to the fair value of assets and liabilities acquired are considered Goodwill.

#### Changes in the consolidated Group

On 26 July the deed for the merger by absorption of REDALTA and INALTA by the Parent company was executed, bringing the related legal procedure to an end.

In February 2006 REI acquired an additional 6.25 % shareholding in Tenedora de Acciones de Redesur, S.A. (hereinafter TENEDORA).

#### e) Business combinations

All business combinations are accounted for by applying the purchase method. This consists of identifying the acquirer (the entity which obtains control over the other entities which comprise the business combination), measurement of the cost of the business combination and allocation, on the acquisition date, of the business combination's cost to the assets acquired and liabilities and contingent liabilities assumed.

The cost of the business combination is measured as the aggregate of the fair values at the date of exchange of the assets contributed, the liabilities incurred or assumed and net equity instruments issued by the acquirer in exchange for control over the acquiree, plus any costs directly attributable to the business combination.

The excess of the cost of the business combination over the acquirer's interest in the identifiable net fair value of the assets, liabilities and contingent liabilities is recognised as Goodwill.

If the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the difference remaining after reassessment is recognised by the acquirer in profit or loss for the year.

### (3) INDUSTRY REGULATION

#### Electricity sector in Spain

The legal framework for the electricity sector is contained in the Electricity Act (Law 54 of 27 November 1997). This Act recognises that electricity transmission is a natural monopoly due to the economies of scale provided by the single grid. The deregulation of transmission is arranged through generalised third-party access to the grid, which is available to the various parties to the electricity system and consumers in exchange for the payment of access tariffs. Remuneration for this activity is established by the Administrations and is determined based on the costs of investment, operation and facility maintenance, as well as other necessary costs incurred in operations.

The Parent company has been assigned the functions of System Operator and transmission grid manager under the Act. The operation of the system aims to guarantee the quality and safety of power supplies and the correct coordination of the production and transmission systems. In its capacity as manager of the transmission grid, the Parent company is in charge of the development and extension of the high voltage network, and must ensure that it is maintained and improved in accordance with consistent and coherent criteria. It is also responsible for the administration of power transmission between external systems using the Spanish grid, as well as withholding access to the grid when capacity is insufficient.

Law 54/1997 deregulated intra—EU and international electricity exchanges, which may be carried out freely by agents. The Parent company, in its capacity as system operator, is responsible for short-term exchanges aimed at ensuring supply quality and safety, as well as the administration of long-term intra-EU and international electricity contracts concluded by the Parent Company.

Since the entry into force of Law 54/1997 various provisions have been published, developing aspects of the Parent company's operations. Particularly noteworthy is Royal Decree Law 5/2005, of 11 March 2005, on urgent measures for boosting productivity and improving public contracting, amends the Electricity Act and some of its enabling regulations, with respect to the maximum permitted shareholding of the Parent company and the role of System Operator regarding settlement, payment and collection and management of guarantees relating to supply and deviations with regard to generation and consumption units.

With respect to shareholding limitations, Law 54/1997 establishes, following its amendment by Royal Decree Law 5/2005, of 11 March 2005, that any private individual or legal entity may invest in the System Operator (activity attributed to the Parent company) provided that their direct or indirect shareholding or voting rights in the Company do not exceed 3 %, which may not be syndicated for any purpose. This limitation is reduced to 1% for those parties which carry out activities in the electricity sector and those private indivi-

duals or legal entities which hold directly or indirectly more than 5 %. Furthermore, the Act establishes that the sum of investment of electricity sector entities, direct or indirect, should not exceed 40 %. These shareholding limitations are not applicable to SEPI which will, in any event, hold a shareholding in the Parent company of at least 10 %. At 31 December 2006 SEPI holds a significant investment in the Parent company amounting to 20 % of share capital.

#### International electricity sector

At international level, the Red Eléctrica Group has investments in the electricity sector in Bolivia and Peru.

Both of these countries have deregulated their electricity industry and use a regulation model supported by regulated tariffs for transmission.

#### (4) ACCOUNTING PRINCIPLES

The main accounting principles used in the preparation of these consolidated financial statements are as follows:

##### a) Property, plant and equipment

Property, plant and equity mainly comprise electricity plants which are measured, as appropriate, at production or acquisition cost. Cost includes, where applicable, the following items:

- Finance costs on external financing accrued during the construction period.
- Operating costs, directly related to the construction of property, plant and equipment in projects controlled or managed by Group companies.

Group companies transfer work in progress to property, plant and equipment in operation when the asset enters service.

Enlargement or improvement expenses which lead to an increase in productivity or capacity or lengthen the useful lives of the assets are stated as an increase in the carrying value of the asset.



Repair and maintenance costs of property, plant and equipment which do not improve performance or lengthen its useful life are recognised in the consolidated income statement when incurred.

Property, plant and equipment is depreciated on a straight-line basis over its estimated useful life, which reflects the period in which the companies expect to use the asset, applying the following rates:

	Annual rate
Buldings	2%-10%
Electrical energy technical installations	2.5%-7.14%
Other installations, machinery, tooling, furnishing and other fixed assets	4%-25%

#### b) Investment properties

Investment property is measured at acquisition cost. The market value of the Group's investment property is broken down in note 6 to the accounting consolidated financial statements.

Investment property is depreciated on a straight-line basis over its estimated useful life, which reflects the period in which the companies expect to use the asset.

#### c) Goodwill

In 2005 Goodwill reflected the positive difference between the acquisition cost and the fair value of assets and liabilities of the acquired subsidiaries. Goodwill is expressed in the functional currency of the company acquired (note 7).

Goodwill is not amortised systematically but is subject to annual impairment testing (note 4-e).

#### d) Intangible assets

Intangible assets are stated at acquisition cost and tested and adjusted on a regular basis for impairment.

The assets included under this heading are as follows:

#### Software

Software licences are capitalised based on their acquisition cost and preparation for the use.

Software maintenance and development costs are expensed as incurred.

Software is amortised on a straight-line basis over a period of between three and five years from the installation date of each program.

#### Development expenses

Development expenses are recognised as an expense as incurred. Costs incurred in development projects (associated with the design and testing of new products or upgrades) are capitalised when there is evidence of the project's technical success and economic feasibility and where expenditure attributable to the asset during the development can be measured reliably. Capitalised development costs with a finite useful life are amortised on a straight-line basis over a period not exceeding five years from commencement of the project.

#### e) Financial assets

The Group classifies investments, except those accounted for using the equity method and those held for sale, in the following four categories:

- Credits and receivables: are non-derivative financial assets with fixed or determinable payments which are not listed on an active market and with respect to which there is no intention to trade in the short term. They are classified as current assets except for assets maturing in more than 12 months of the balance sheet date which are classified as non-current assets. Credits and receivables are initially recognised at fair value, including transaction costs incurred on inception and subsequently measured at amortised cost. Amortised cost mainly comprises the amount extended less any repaid principal, plus accrued interest receivable.

- Held-to-maturity investments are initially recognised at fair value, including direct costs incurred in the transaction and subsequently measured at amortised cost.
- Marketable securities are carried at fair value, with changes in this value recognised under financial income or financial expense in the consolidated income statement, depending on the market's performance.
- Available-for-sale financial assets: are non-derivative financial assets which are initially recognised at fair value. Unrealised gains and losses resulting from changes in fair value are recognised by credit or debit to equity. In the event of disposal or impairment losses, cumulative adjustments in the reserve for value adjustments are included in the consolidated income statement.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option price models refined to reflect the issuer's specific circumstances.

#### f) Inventories

Inventories of materials and replacement parts are measured at the lower of acquisition cost, which is determined using the average weighted price method, or market value.

Group companies review the net realisable value of inventories at each year end, recognising value adjustments where cost exceeds market or where doubts exist over their use. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear of an increase in net realisable value because of changed economic circumstances, the amount of the write-down is reversed.

#### g) Receivables

Receivables are initially recognised at fair value and subsequently at amortised cost using the effective interest rate method.

Furthermore, current advances generally deriving from multi-year contracts or commitments are taken to the income statement on a straight-line basis over the period during which such contracts or commitments are in effect.

#### h) Cash and cash equivalents

Cash and cash equivalents include cash on hand, demand deposits in credit institutions and other highly liquid short-term investments.

#### i) Impairment of assets

Group companies analyse the recoverability of non-current assets at the year end each year and whenever some event or change in circumstances indicates that the carrying value may not be recoverable. If the recoverable amount of an asset is less than its carrying value, an impairment loss is recognised immediately. The impairment loss is therefore the difference between the carrying value of an asset and its recoverable value.

#### j) Share capital

Share capital consists of ordinary shares. The issue costs of new shares, net of taxes, are deducted from equity. Dividends on ordinary shares are recognised as a decrease in equity when approved.

#### k) Other non-current liabilities

##### ■ Employee benefits

##### (i) Pension commitments

The Group has defined contribution plans establishing the pension amounts employees receive upon

retirement, normally based on one or more factors such as age, length of service or remuneration. Under the defined contribution plan, the Group pays set contributions to an external entity and has no legal or implicit obligation to make further contributions if the fund lacks sufficient assets to satisfy payments to employees for services rendered in the current and prior years.

**(ii) Other long-term employee benefits**

Other long-term employee benefits include benefits other than pensions such as: electricity and health-care for serving and retired Parent company employees and length-of-service bonuses in the Bolivian company TDE. Expected costs of benefits are recognised over the term of employment of personnel. These commitments are measured annually by qualified independent actuaries. Changes in actuarial assumptions are debited or credited to the consolidated income statement as soon as they occur. The total cost of past services is recognised immediately.

**■ Government grants and non-current advances**

Outright capital grants received from government agencies to finance the acquisition of assets are recorded by the Group, following compliance with investment requirements and assurance that the grant will be received.

The Group recognises grants under other gains in the income statement for each year over the term in which depreciation of the related asset is charged.

Non-current advances generally received in connection with multi-year contracts or commitments are taken to net revenues or other gains on a straight-line basis over the term of the contracts or commitments.

**l) Provisions**

The Group makes provisions for the amount required to settle present contractual obligations, legal or implicit, deriving from past events provided that the Group expects that it will probably have to settle through the outflow of resources and the amount involved can be

reliably estimated. Provision is made when the liability or commitment is incurred.

Provisions are valued at the present value of the cash outflows which are expected to be necessary to settle the obligation using a rate before taxes which reflects the current market assessment of the temporary interest rate and specific risks of the obligation. The increase in the provision as a result of the passage of time is recognised as an interest expense.

**m) Borrowings**

Loans, obligations and similar are initially recognised at the amount received less costs incurred in the transaction and subsequently measured at amortised cost, using the effective interest rate method, except for hedged operations.

Borrowings are classed as current liabilities unless they mature in more than 12 months from the balance sheet date or include tacit renewal clauses.

**n) Foreign currency transactions**

Foreign currency transactions are translated into euro using the exchange rate prevailing at the date of the transaction. Differences between the value at which foreign currency balances were recorded and the exchange rate prevailing at the date of collection or payment are recognised in the consolidated income statement.

Fixed-income securities and credits and debits in foreign currency at 31 December are translated to euro at the closing exchange rate. Foreign exchange differences arising on translation are taken to exchange gains and losses in the consolidated income statement, as appropriate.

Operations in foreign currency which the Group has hedged using financial derivatives or other hedging instruments are stated according to the principles described in Derivative instruments and hedges.

### o) Financial derivatives and hedging operations

Financial derivatives are initially recognised at fair value at the contract date (acquisition cost) in the consolidated balance sheet and subsequently the gain or loss on measurement to fair value is accounted for. The method used to recognise the resulting gain or loss depends on whether the derivative has been designated as a hedge and if so, the nature of the item hedged.

The Group classifies some derivatives as hedging the fair value of assets or liabilities recognised as a firm commitment (fair value hedge) or as hedges of highly foreseeable transactions (cash flow hedge) or as net investment hedges on foreign operations.

The Group documents the relation between the hedging instruments and the assets or liabilities hedged at inception, as well as the purpose of the risk management and the strategy to carry out hedging transactions. The Group also documents its assessment, both at inception and on an on-going basis, of whether the derivatives used in the hedge are highly efficient to offset changes in fair value or cash flows from the items hedged.

The fair value of various derivatives used for hedging purposes is set out in note 18. Movements in equity are set out in note 12.

- For cash flow hedges, the effective part of changes in fair value of the derivatives which are designated and classed as cash flow hedges is recognised in equity. The gain or loss on the non-effective part is recognised directly in the consolidated income statement.
- Net investment hedges on foreign operations are recorded in a similar manner to cash flow hedges. Any gain or loss on the hedge related to the effective part of the hedge is recognised in equity. The gain or loss on the non-effective part is recognised directly in the consolidated income statement. Accumulated gains and losses in equity are included in the income statement when the foreign operation is sold.

When a hedge matures or is sold or when the requirements to account for it as a hedge are not met, any accu-

mulated gains or losses in equity to that time continue to be recorded in equity and are recognised when the forecast transaction is finally recognised in the consolidated income statement. When the forecast transaction is not expected to arise, the accumulated gain or loss in equity is recognised in the consolidated income statement.

The market price of different financial derivative instruments is calculated as follows:

- The fair value of derivatives quoted on official markets is measured at its closing quotation price.
- The Group values derivatives not held for trading in official markets using assumptions based on market conditions at year end. Specifically, the market value of interest rate swaps is calculated at the revalued market rate. Future exchange rate contracts are valued discounting future flows calculated using the future exchange rate at the year end.

### p) Trade payables

Trade payables are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method.

### q) Income and expense

Income and expense are recorded on an accruals basis, i.e. in the period in which the income or expense deriving from the goods or services in question is earned or incurred rather than the period in which the cash is actually received or disbursed.

Where the Parent company acts as an agent in international exchange purchases and sales of electricity are made on account of the system and the Company receives a margin for the intermediation activity which is recorded under services rendered in the consolidated income statement.

Interest income is recognised using the effective interest rate method.

Income from dividends is recognised when the collection right is established.

#### r) Tax situation

Income tax expense / (income) for the year comprises current and deferred tax. Income tax, both current and deferred, is recognised in the income statement and in determining net profit or loss for the year, except if it relates to items recognised directly in equity or a business combination.

Current tax is the estimated tax payable on taxable income for the year using tax rates prevailing at the balance sheet date and any adjustment to tax payable in respect of previous years.

Deductions and credits relating to the year are recorded as a reduction in the accrued income tax expense unless there are doubts as to their realisation.

The corporate income tax expense is recorded using the balance sheet liability method.

Deferred tax is calculated using the liability method, on differences between assets and liabilities for financial reporting purposes and the amounts used for tax purposes. The corporate income tax expense is recognised using the balance sheet liability method. This method comprises the determination of deferred tax assets and liabilities for differences between the carrying value of assets and liabilities at the amounts for tax purposes, using tax rates which are expected to come into effect when these tax assets are realised and tax liabilities are settled.

Deferred tax assets are recognised to the extent that future tax profits are expected to arise against which to offset temporary differences.

Deferred tax liabilities are recognised on temporary differences arising on investments in subsidiaries and associates, except in those cases where the Group may control the date on which they reverse and they are unlikely to reverse in the foreseeable future.

#### s) Dividends

Interim dividends are recorded as a reduction in equity for the year to which they relate. Complementary dividends are not charged to equity until approval from the shareholders at their Annual General Meeting.

#### t) Earnings per share

Earnings per share are calculated on the net profit attributable to the Parent company and a weighted average number of ordinary shares outstanding during the year, excluding the average number of Parent company shares held in Group company portfolios.

#### u) Insurance

The Red Eléctrica Group has contracted various insurance policies to cover the risks to which companies are subject through their activities. These risks mainly comprise damages to electricity plants and potential claims for third party damages which could arise from the Group's activities.

#### v) Environment

The expenses resulting from business actions aimed at environmental protection and improvement are expensed in the year incurred. When they relate to acquisitions of property, plant and equity the purpose of which is to minimise the environmental impact and protect and improve the environment, they are recorded as an increase in the value of fixed assets.

### (5) PROPERTY, PLANT AND EQUIPMENT

The movement in 2006 and 2005 in property, plant and equipment and the relevant accumulated depreciation and impairment is as follows:

**Red Eléctrica Group****Movements in Property, plant & equipment at 31 december 2006 and 2005**  
(in thousands of euros)

	31 december 2004	Additions	Changes to scope	Exchange rate variations	Disposals, reductions and write-downs
<b>COST</b>					
Land and buildings	41,013	21,017	-	1,005	(77)
Electrical energy facilities	4,321,741	91,301	1,101,849	22,960	(139,010)
Other plant, machinery tooling, furnishings and other fixed assets	67,120	3,312	-	256	(80)
Electrical energy facilities in progress	195,646	374,950	-	936	(10)
Advances and Property, plant and equipment in progress	52,834	10,751	-	187	-
<b>Total Cost</b>	<b>4,678,354</b>	<b>501,331</b>	<b>1,101,849</b>	<b>25,344</b>	<b>(139,177)</b>
<b>ACCUMULATED AMORTIZATION</b>					
Buildings	(9,580)	(918)	-	(324)	77
Electrical energy facilities	(1,597,034)	(245,555)	(81,867)	(11,590)	12,960
Other plant, machinery, tooling, furnishings and other fixed assets	(49,687)	(9,652)	-	(157)	61
<b>Total Accumulated Amortization</b>	<b>(1,656,301)</b>	<b>(256,125)</b>	<b>(81,867)</b>	<b>(12,071)</b>	<b>13,098</b>
<b>VALUE IMPAIRMENT</b>	<b>(4)</b>	<b>-</b>	<b>-</b>	<b>(1)</b>	<b>-</b>
<b>Net Value</b>	<b>3,022,049</b>	<b>245,206</b>	<b>1,019,982</b>	<b>13,272</b>	<b>(126,079)</b>

The main investments in 2006 and 2005 have been made in the electricity transmission grid in Spain. In 2005 INALTA's transmission assets were included in the Group following its consolidation as from 15 February 2005. Also in 2005 electricity plant disposals amounted to a book value of Euro 126,079 thousand.

In 2006 companies capitalised finance costs of Euro 7,809 thousand as an increase in property plant and equipment (Euro 3.427 thousand at 31 December 2005).

Operating expenses directly related to construction in progress of property, plant and equipment capitalised in 2006 amount to Euro 8,656 thousand (Euro 9,805 thousand in 2005).

Impairment records the adjustments to carrying value of those facilities where construction has been interrupted for reasons beyond the Company's control (note 22-d).

**(6) INVESTMENT PROPERTY**

Movements in 2006 and 2005 in investment property owned by the Group are described below:

Transfers relate to investment properties owned by the Parent company for own use.

Investment property has a market value of approximately Euro 3 million.

Transfers	31 december 2005	Additions	Exchange rate variations	Disposals, reductions and write-downs	Transfers	31 december 2006
1,041	63,999	314	(837)	-	1,222	64,698
237,252	5,636,093	16,212	(18,656)	(423)	404,405	6,037,631
19,612	90,220	2,868	(236)	(3)	4,955	97,804
(215,244)	356,278	507,630	(398)	(799)	(393,642)	469,069
(42,661)	21,111	2,314	(527)	-	(15,159)	7,739
-	<b>6,167,701</b>	<b>529,338</b>	<b>(20,654)</b>	<b>(1,225)</b>	<b>1,781</b>	<b>6,676,941</b>
-	(10,745)	(1,265)	262	-	(239)	(11,987)
-	(1,923,086)	(235,776)	8,407	115	-	(2,150,340)
-	(59,435)	(9,966)	146	43	-	(69,212)
-	<b>(1,993,266)</b>	<b>(247,007)</b>	<b>8,815</b>	<b>158</b>	<b>(239)</b>	<b>(2,231,539)</b>
-	(5)	(11,756)	1	-	-	(11,760)
-	<b>4,174,430</b>	<b>270,575</b>	<b>(11,838)</b>	<b>(1,067)</b>	<b>1,542</b>	<b>4,433,642</b>

### Red Eléctrica Group

#### Movements in Property, plant & equipment at 31 december 2006 and 2005 (in thousands of euros)

	31 december 2004	Additions	Exchange rate variations	31 december 2005	Additions	Exchange rate variations	Transfers	31 december 2006
<b>COST</b>								
Investment propertys	1,572	2,519	69	4,160	-	(52)	(1,136)	2,972
<b>Total Cost</b>	<b>1,572</b>	<b>2,519</b>	<b>69</b>	<b>4,160</b>	<b>-</b>	<b>(52)</b>	<b>(1,136)</b>	<b>2,972</b>
<b>ACCUMULATED AMORTIZATION</b>								
Investment propertys	(356)	(118)	(20)	(494)	(10)	27	239	(238)
<b>Total Acc. Amortization</b>	<b>(356)</b>	<b>(118)</b>	<b>(20)</b>	<b>(494)</b>	<b>(10)</b>	<b>27</b>	<b>239</b>	<b>(238)</b>
<b>Net Value</b>	<b>1,216</b>	<b>2,401</b>	<b>49</b>	<b>3,666</b>	<b>(10)</b>	<b>(25)</b>	<b>(897)</b>	<b>2,734</b>

**(7) GOODWILL**

Goodwill in the consolidated balance sheet at 31 December 2005 resulted from the difference between the cost of acquisition of TDE on 30 June 2002, by Red Eléctrica Internacional, S.A.U., and the price paid in

the operation, less amortisation until the date of the first application of IFRS.

At 31 December 2006, following the relevant impairment testing, it has been considered necessary to write off such goodwill. The effect of this impairment is

**Red Eléctrica Group****Details of movement in goodwill at 31 december 2006 and 2005**  
(in thousands of euros)

	31 december 2004	Exchange rate variations	31 december 2005	Exchange rate variations and write-downs	31 december 2006
Goodwill	13,040	2,016	15,056	(15,056)	-
	<b>13,040</b>	<b>2,016</b>	<b>15,056</b>	<b>(15,056)</b>	<b>-</b>

**Red Eléctrica Group****Details of movement in intangible assets at 31 december 2006 and 2005**  
(in thousands of euros)

	31 december 2004	Additions	Changes to scope
<b>COST</b>			
Research and development expenses and computer applications	35,752	2,496	38
<b>Total Cost</b>	<b>35,752</b>	<b>2,496</b>	<b>38</b>
<b>ACCUMULATED AMORTIZATION</b>			
Research and development expenses and computer applications	(26,908)	(2,722)	(10)
<b>Total Accumulated Amortization</b>	<b>(26,908)</b>	<b>(2,722)</b>	<b>(10)</b>
<b>Net Value</b>	<b>8,844</b>	<b>(226)</b>	<b>28</b>

**Red Eléctrica Group****Details of movement in investments accounted for using the equity method at 31 december 2006 and 2005 (in thousands of euros)**

	31 december 2004	Equity consolidation	Dividends	Differences on conversion	Transfers to full consolidation
REDESUR, REDINSUR and TENEDORA DE ACCIONES DE REDESUR	6,215	590	(694)	1,031	-
REDALTA and INALTA	(2,212)	(34)	-	-	2,246
	<b>4,003</b>	<b>556</b>	<b>(694)</b>	<b>1,031</b>	<b>2,246</b>



recorded under Net result on asset impairment in the consolidated income statement (note 22-d).

The movement in 2006 and 2005 in goodwill is described below:

### (8) INTANGIBLE ASSETS

Movements in 2006 and 2005 in intangible assets and accumulated amortisation and impairment are as follows:

### (9) INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

Movements in 2006 and 2005 in investments accounted for using the equity method are as shown below:

Additions for 2006 relate to the acquisition by REI of an additional 6.25% in TENEDORA.

In 2005 REDALTA and INALTA were fully consolidated instead of being accounted for using the equity method.

Exchange rate variations	Disposals, reductions and write-downs	31 december 2005	Additions	Exchange rate variations	Transfers	31 december 2006
203	(38)	38,451	259	(167)	(645)	37,898
<b>203</b>	<b>(38)</b>	<b>38,451</b>	<b>259</b>	<b>(167)</b>	<b>(645)</b>	<b>37,898</b>
(137)	12	(29,765)	(2,829)	129	-	(32,465)
<b>(137)</b>	<b>12</b>	<b>(29,765)</b>	<b>(2,829)</b>	<b>129</b>	<b>-</b>	<b>(32,465)</b>
<b>66</b>	<b>(26)</b>	<b>8,686</b>	<b>(2,570)</b>	<b>(38)</b>	<b>(645)</b>	<b>5,433</b>

31 december 2005	Additions	Equity consolidation	Dividends	Differences on conversion	Other	31 december 2006
7,142	618	847	(510)	(753)	(140)	7,204
-	-	-	-	-	-	-
<b>7,142</b>	<b>618</b>	<b>847</b>	<b>(510)</b>	<b>(753)</b>	<b>(140)</b>	<b>7,204</b>

**(10) INVENTORIES**

Details of inventories at 31 December 2006 and 2005 in the consolidated balance sheet are as follows:

	thousands of euros	
	2006	2005
Inventories	34,756	39,803
Value adjustments	(5,782)	(4,163)
	<b>28,974</b>	<b>35,640</b>

**(11) CURRENT TRADE AND OTHER RECEIVABLES**

At 31 December 2006 and 2005 this heading in the consolidated balance sheet breaks down as follows:

	thousands of euros	
	2006	2005
Debtors	264,326	316,409
Current receivables	450	31,157
Amounts due from associates	77	76
	<b>264,853</b>	<b>347,642</b>

Receivables mainly comprise amounts pending invoicing and / or receivable in respect of electricity transmission and system operation activities.

Current advances at 31 December 2005 mainly included Euro 19,877 thousand relating to restatements from the electricity import contract (note 27).

**(12) EQUITY****a) Share capital**

At 31 December 2006 and 2005 the share capital of the Parent company comprises 135,270,000 fully subscribed and paid in bearer shares, with a par value of Euro 2 each which carry equal voting and dividend rights. The Parent company's shares have been listed on the four Spanish stock exchanges since 7 July 1999 after the public offering for their sale.

At 31 December 2006 and 2005 la Sociedad Estatal de Participaciones Industriales (SEPI) holds 20 % of the share capital in the Parent company.

**b) Other reserves**

This heading comprises statutory reserves including the Euro 247,022 thousand appropriated to the 1996 revaluation reserve on revaluation of property plan and equipment by the Parent company. This reserve may be used, if taxed, to offset tax losses, increase share capital or, following 10 years after its recording, to unrestricted reserves, in accordance with Royal Decree-Law 2607/1996.

**c) Other reserves****■ Retained earnings**

This heading includes:

**■ Legal reserve**

Companies in Spain are obliged to transfer 10 % of profits each year to the legal reserve until this reserve reaches an amount of at least 20 % of share capital. This reserve is not distributable to shareholders and may only be used to offset losses in the event that no other reserves are available. Under certain conditions it may be used to increase share capital. At 31 December 2006 and 2005 it amounts to Euro 54.199 thousand.

**■ Voluntary reserves**

This heading includes the voluntary reserves of the Parent company, profit for the year, reserves in consolidated companies and first application reserves. All of these items are freely available. At 31 December 2006 and 2005 they amount to Euro 519,865 thousand and Euro 410,708 thousand, respectively.

**■ Treasury shares**

At 31 December 2006 treasury shares held by the Parent company and subsidiaries (or a third party acting on behalf of the Parent company) comprise

1.22 % of the Parent company's share capital and. This corresponds to 1,645,183 shares, with a par value of Euro 3,290 thousand and an average acquisition price of Euro 32.20 per share (at 31 December 2005, 160,982 shares which represented 0.12% of share capital, with a par value of Euro 322 thousand and an average acquisition price of Euro 23.75 per share).

The Parent company has complied with the requirements of Article 75.2 and Additional Provision Two of the Spanish Companies Act, which establishes that the par value of acquired shares listed on official secondary markets, together with those already held by the parent company and its subsidiaries must not exceed 5% of the share capital. The subsidiaries do not hold treasury shares or shares in the Parent company.

These shares are recognised as a decrease in equity of Euro 52,986 thousand and Euro 3,823 thousand, at 31 December 2006 and 2005, respectively.

#### ■ Conversion differences

This heading includes translation differences in respect of foreign subsidiaries (mainly the Bolivian company TDE), which at 31 December 2006 and 2005 amount to Euro 2,976 thousand and Euro 2,635 thousand, respectively.

#### ■ Other valuation adjustments

This heading includes variations resulting from derivative financial instruments. At 31 December 2006 and 2005 they amount to Euro 12,213 thousand and Euro 562 thousand, respectively.

#### ■ Interim dividends and proposed distribution of Parent company dividends

Interim dividends approved by the Board of Directors in 2006 and 2005 are recorded as a decrease in Group equity at 31 December 2006 and 2005, respectively.

On 30 November 2006 the Board of Directors of the Parent company agreed to pay an interim dividend

against 2006 profits amounting to Euro 0.3250 per share, which was payable as from 2 January 2007 (Euro 0.2708 per share on account from 2005 profits). The interim dividend approved at 31 December 2006 and 2005 amounts to Euro 43,428 thousand and Euro 36,588 thousand, respectively (note 20).

The Parent company's Board of Directors has also proposed to the shareholders at their Annual General Meeting the distribution of a complementary dividend of Euro 0.5734 per share, resulting in a total dividend for 2006 of Euro 0.8984 per share (Euro 0.7304 per share in 2005).

#### d) Minority interests

Minority interests recorded under equity in the consolidated balance sheet reflects the shareholding of minority interests held in the Bolivian companies TDE and Cybercia, S.A.. At 31 December 2006 and 2005 they amount to Euro 58 thousand and Euro 74 thousand, respectively.

### (13) PROVISIONS

The movements in this heading under liabilities in the consolidated balance sheet in 2006 and 2005 are set out in page 84:

Provisions mainly comprise allowances made by Group companies to cover the possibility of unfavourable rulings in respect of third -party claims and the provision made on the basis of actuarial studies to cover the voluntary redundancy plan to adapt the personnel profile to the Parent company's new requirements. The collective redundancy plan 24/05 was approved by employee representatives and subsequently by the Spanish employment authorities on 13 July 2005. In 2006 the Parent company externalised the commitments entered into with affected employees under such plan through an insurance policy.

**Red Eléctrica Group**

## Details of movement in provisions at 31 december 2006 and 2005 (in thousands of euros)

	31 december 2004	Additions	Applications
PROVISIONS	30,329	5,178	(608)
	<b>30,329</b>	<b>5,178</b>	<b>(608)</b>

**Red Eléctrica Group**

## Details of movement in commitments with employees at 31 december 2006 and 2005 (in thousands of euros)

	31 december 2004	Additions	Applications
COMMITMENTS WITH EMPLOYEES	23,596	7,235	(264)
	<b>23,596</b>	<b>7,235</b>	<b>(264)</b>

**(14) OTHER NON-CURRENT LIABILITIES**

Details of this heading in the consolidated balance sheet in 2006 and 2005 are as follows:

	thousands of euros	
	2006	2005
Commitments with employees	38,266	30,831
Capital grants	81,898	84,116
Non-current advances	245,831	196,650
Other non-current liabilities	212	72
	<b>366,207</b>	<b>311,669</b>

Commitments with employees reflect future obligations (medical insurance and electricity) which are based on actuarial studies and entered into by the Parent company with its employees on their retirement, and a provision made for TDE to cover a length-of- service bonus.

Movements in obligations with personnel in 2006 and 2005 are as shown above:

In 2006 and 2005 additions are mainly a result of the review of the estimate of such commitments. These additions are recognised under Staff costs or Financial costs, in accordance with their nature.

Details of the actuarial assumptions used by the Parent company in 2006 to make these provisions are as follows:

	Helth insurance	Electrical energy
Discount rate	4.7%	4.7%
Cost Growth	4.0%	2007: 3.3% as from 2007: 3.5%
Survival		PERM/F 2000 New

Capital grants mainly include the financing received by the Parent company for the construction of electricity plants.

Movements in grants 2006 and 2005 are shown in page 85:

Non-current advances mainly reflect revenues from the agreements for the constructions of electricity plants (Euro 146,402 thousand in 2006 and Euro 73,967 thousand in 2005). It also includes revenues from the transfer of use of the capacity of the telecommunications network under the contracts signed in 1997 between Cable Europa, S.A., Unipersonal (formerly Netco Redes, S.A. (NETCO), Auna Telecomunicaciones, S.A. (formerly Retevisión, S.A.)

Reversals and conversion differences	31 december 2005	Additions	Applications	Reversals and conversion differences	31 december 2006
(281)	34,618	2,186	(15,555)	(2,083)	19,166
<b>(281)</b>	<b>34,618</b>	<b>2,186</b>	<b>(15,555)</b>	<b>(2,083)</b>	<b>19,166</b>

Reversals and conversion differences	31 december 2005	Additions	Applications	Reversals and conversion differences	31 december 2006
264	30,831	8,437	(792)	(210)	38,266
<b>264</b>	<b>30,831</b>	<b>8,437</b>	<b>(792)</b>	<b>(210)</b>	<b>38,266</b>

### Red Eléctrica Group

#### Details of movement in capital grants at 31 december 2006 and 2005 (in thousands of euros)

	31 december 2004	Additions	Applications	31 december 2005	Additions	Applications	31 december 2006
CAPITAL GRANTS	85,381	2,670	(3,935)	84,116	1,138	(3,356)	81,898
	<b>85,381</b>	<b>2,670</b>	<b>(3,935)</b>	<b>84,116</b>	<b>1,138</b>	<b>(3,356)</b>	<b>81,898</b>

and the Parent company and with T-Online Telecommunications Spain, S. A. (formerly Albura Telecomunicaciones, S.A..) amounting to Euros 73,889 thousand at 31 December 2006 (Euro 77,944 thousand at 31 December 2005) (note 27).

At 31 December 2006 and 2005 this heading also includes the portion attributable to the Company of the compensation paid by EDF on the adaptation of the electricity supply contracts signed on 8 January 1997 which amounts to Euro 23,625 thousand.

#### (15) BONDS AND OTHER MARKETABLE SECURITIES ISSUED AND BANK LOANS

Details of bonds and other marketable securities and bank loans at 31 December 2006 and 2005 are as follows:

	thousands of euros	
	2006	2005
<b>Issues in dollars</b>		
Long term	379,140	403,077
	<b>379,140</b>	<b>403,077</b>
<b>Issues in euros</b>		
Long term	845,816	849,619
Short term	53,169	75,591
	<b>898,985</b>	<b>925,210</b>
<b>Euro bank loans</b>		
Long term	1,219,174	1,213,557
Short term	62,562	192,178
	<b>1,281,736</b>	<b>1,405,735</b>
<b>Bank loans in foreing currency</b>		
Long term	58,096	71,271
Short term	7,587	4,640
	<b>65,683</b>	<b>75,911</b>
<b>Total non current debt</b>	<b>2,502,226</b>	<b>2,537,524</b>
<b>Total current debt</b>	<b>123,318</b>	<b>272,409</b>
	<b>2,625,544</b>	<b>2,809,933</b>

At 31 December 2006 accrued interest payable on these loans amount to Euro 22,488 thousand (Euro 27,459 thousand in 2005).

At 31 December 2006 issues in euro comprise Eurobonds of Euro 845,816 thousand issued by Red Eléctrica de España Finance, BV in relation to the Eurobond framework programme (Euro 849,619 thousand in 2005) and Euro 379,140 thousand (US\$ 500,000 thousand covered in euro) obtained in 2005 from private placement issues in the United States (USPP). At 31 December 2006 this heading also includes issues of short-term promissory notes amounting to Euro 53,169 thousand (Euro 75,591 thousand in 2005).

At 31 December 2006 bank loans include a new syndicated credit facility, which at 31 December is drawn down in an amount of Euro 817,622 thousand (Euro 897,247 thousand in 2005). The limit amounts to Euro 900,000 thousand and the credit facility matures in 2012. Similarly, this heading includes long-term loans and credit facilities amounting to Euro 464,114 thousand (Euro 508,488 thousand in 2005).

Details of maturity of these issues and bank loans at 31 December 2006 are as shown below:

The average interest rate in 2006 was 3.8%. The fair values of issues in dollars and in euro at 31 December 2006 amount to Euro 384,678 thousand and Euro 882,937 thousand, respectively.

At 31 December 2006 Group companies have contracted credit facilities with a long-term credit limit

available for draw down of Euro 80,000 thousand (Euro 110,000 thousand at 31 December 2005) and a short-term limit of Euro 289,663 thousand (Euro 128,490 thousand at 31 December 2005).

At 31 December 2006 the Parent company has a Spanish Securities and Exchange Commission registered programme to issue promissory notes up to a maximum limit of Euro 250,000 thousand (Euro 250,000 thousand at 31 December 2005).

## (16) FINANCIAL RISK MANAGEMENT POLICY

The Group's financial risk management policy establishes principles and guidelines to ensure that the relevant risks which could affect the aims and activities of the Red Eléctrica Group, are identified, analysed, evaluated, managed and controlled and that these processes are carried out systematically and consistently.

The main guidelines which comprise this policy may be summarised as follows:

- Risk management should be fundamentally proactive and also directed towards the middle and long-term, taking into account possible scenarios in an ever-increasing global environment.
- Risks should generally be managed in accordance with coherent criteria, distinguishing between the importance of the risk (probability/impact) and the investment and resources required to reduce it.
- Financial risk management should seek to avoid

### Red Eléctrica Group Details of maturity of these issues and bank loans at 31 december 2006 (thousands of euros)

	2007	2008	2009	2010	2011 and thereafter
Issues in dollars	-	-	-	-	379,140
Issues in euros	53,169	-	-	-	845,816
Euro bank loans	62,562	21,581	23,528	19,926	1,154,139
Bank loans in dollars	6,386	4,733	4,886	5,047	42,621
Bank loans in Swiss francs	1,201	809	-	-	-
	<b>123,318</b>	<b>27,123</b>	<b>28,414</b>	<b>24,973</b>	<b>2,421,716</b>

undesired variations in the Group's base value and not to generate extraordinary profits.

The Group's financial managers are responsible for managing financial risks to ensure consistency with the Group's strategy and to coordinate the management of risk across the various Group companies, identifying the main financial risks and defining the actions to be taken, based on establishing different financial scenarios.

The methodology for identifying, measuring, monitoring and controlling risks as well as management indicators and measure and control tools specific to each risk, is documented in the financial risk manual.

The financial risks to which the Group is exposed are as follows:

■ **Market risk.**

Market risks reflect market variations such as prices, interest and exchange rates, credit facility conditions and other variables which affect short, middle and long-term financial costs.

Management of these risks is carried out both on liability operations, currency, maturity and interest rates and through the use of hedging instruments which allows the aforementioned financial structure to be modified. Particularly noteworthy market risks are:

(i) **Interest rate risks**

Interest rate variations change the fair value of assets and liabilities which accrue interest at a fixed rate and the future flows of assets and liabilities linked to a variable interest rate. The management of interest rates mainly aims to maintain the structure of the debt ratio between the fixed and hedged rate and risks linked to variable interest rates is approximately 70%-30%. At 31 December 2006 the structure is 72%-28%.

(ii) **Exchange rate risks**

Exchange risk management comprises translation risks which the company is subject to on consolidation of its subsidiaries and / or assets located in countries where the functional currency is not the euro and to transaction risks derived from collection and payment of cash in currencies in other than the euro. In order to mitigate the exchange rate risk, the

Group has arranged financial instruments, mainly currency swaps and cross currency swaps.

■ **Credit risks**

The characteristics of income from electricity transmission and electrical systems operation and the solvency of the electrical system agents mean that the level of risk is not relevant to the Group's principal activities.

Credit risk management for the Group's other activities is mainly carried out through the control instruments to reduce or delimit such risk.

■ **Liquidity risks**

Liquidity risks arise due to differences between amounts and the collection and payment dates of the different assets and liabilities of the Group companies.

Maintaining a significant volume of funds available during the year contributes positively to the strengthening of the Group's financial structure and contributes an additional guarantee of liquidity.

These risks are mainly managed by the controlling the temporary financial debt structure, setting maximum net volume limits for each defined period.

Group borrowings have an average maturity of approximately 8 years at 31 December 2006.

## (17) FINANCIAL ASSETS AND LIABILITIES

Details of non-current Financial Assets and Liabilities of the Red Eléctrica Group at 31 December 2006 and 2005 are as follows:

	thousands of euros	
	2006	2005
<b>FINANCIAL ASSETS:</b>		
Financial instruments at fair value (note 18)	11,718	3,752
Long term credits	1,311	603
<b>Total non-current financial assets</b>	<b>13,029</b>	<b>4,355</b>
<b>FINANCIAL LIABILITIES:</b>		
Financial instruments at fair value (note 18)	20,627	-
<b>Total non-current financial liabilities</b>	<b>20,627</b>	<b>-</b>

	Principal covered	Maturity date	thousands of euros					
			2006		2005			
			Non-current Asse	Liability	Non-current Asse	Liability	Current Asse	Liability
<b>INTEREST RATE COVERAGE:</b>								
<b>CASH FLOW COVERAGE</b>								
Interest rate Swap	350,000 euros	To 2012	10,494	-	766	-	-	-
Interest rate Swap	75,000 euros	To 2015	1,185	-	-	-	-	-
Collar	25,000 euros	To 2006	-	-	-	-	-	(53)
Fair value hedges								
Interest rate Swap	3,005 euros	To 2008	39	(35)	140	-	-	(128)
<b>INTEREST RATE AND EXCHANGE RATE COVER:</b>								
Cash flow coverage								
Cross currency swap	500,000 dollars	To 2035	-	(20,592)	2,846	-	-	-
<b>NON-HEDGING DERIVATES</b>								
Interest rate derivatives								
Collar (*)	560,000 euros	To 2008	-	-	-	-	-	(2,673)
			<b>11,718</b>	<b>(20,627)</b>	<b>3,752</b>	<b>-</b>	<b>-</b>	<b>(2,854)</b>

(\*) This instrument, derived from INALTA, was written off in June 2006.

## (18) DERIVATIVE FINANCIAL INSTRUMENTS

The Red Eléctrica Group contracts derivatives in compliance with its financial risk management policy. Details of the derivatives contracted by the Group at 31 December 2006 and 2005 are shown above:

At 31 December 2006 operations to hedge interest rate risks on borrowings of Euros 428,005k thousand (Euro 938,005 thousand at 31 December 2005) and exchange rate risks totalling US\$ 500,000 thousand.

## (19) TRADE AND OTHER PAYABLES

Details of trade and other payables in the consolidated balance sheet at 31 December 2006 and 2005 are as follows:

	thousands of euros	
	2006	2005
Trade payables	5,178	6,155
Creditors for services rendered	64,022	56,717
Current advances	23,489	22,489
Bills	49,644	31,816
	<b>142,333</b>	<b>117,177</b>

## (20) OTHER CURRENT LIABILITIES

Details of this heading in the consolidated balance sheet at 31 December 2006 and 2005 are as follows:

	thousands of euros	
	2006	2005
Dividends	43,428	36,588
Fixed-assets suppliers and other	376,447	164,891
	<b>419,875</b>	<b>201,479</b>

## (21) TAX SITUATION

The tax group of which Red Eléctrica de España, S.A. is the Parent company has filed consolidated tax returns in Spain since 2002. The tax payable is distributed among the companies forming the tax group based on the agreements established between the Group companies, adapted to the Resolutions of the Spanish Institute of Accountants and Auditors of 9 October 1997 and 15 March 2002.

Legislation applicable in their respective countries is applied to companies that do not form part of the tax group.



At 31 December 2006 the tax group includes the Parent company and Red Eléctrica Internacional S.A.U.

A reconciliation of the statutory tax rate prevailing in Spain to the effective tax rate applicable to the Group is as follows:

	thousands of euros	
	2006	2005
Consolidated accounting results for year and taxes	280,857	262,044
Permanent differences and consolidation adjustments	2,392	1,768
<b>Consolidated tax base for accounting purposes</b>	<b>283,249</b>	<b>263,812</b>
Tax at current rate in each country	98,175	91,625
Deductions	(1,834)	(6,285)
<b>Corporate income rate</b>	<b>96,341</b>	<b>85,340</b>
Changes in tax rate (Law 35/2006)	(15,642)	-
<b>Corporate income tax</b>	<b>80,699</b>	<b>85,340</b>

Law 35/2006, of 28 November 2006, which came into effect on 1 January 2007, which amends the Corporate Income Tax Act and reduces the general tax rate from 35 % to 32.5 % in 2007 and 30 % as from 2008, has triggered net accounting income in 2006 of €15,642k which relates to the tax effect on results that that restatement has had on the balance of deferred tax assets and liabilities recorded by the Group companies.

Current balances payable to and receivable from public bodies at 31 December are as follows:

	thousands of euros	
	2006	2005
<b>CURRENT RECEIVABLE</b>		
VAT refundable	273	441
Taxes refundable	1,030	1,040
Incorrectly paid taxes refundable	6,510	-
<b>Total receivable</b>	<b>7,813</b>	<b>1,481</b>
<b>CURRENT PAYABLE</b>		
VAT refundable	262	1,286
Taxes refundable	3,173	3,308
Corporate income tax payable	31,193	26,432
<b>Total payable</b>	<b>34,628</b>	<b>31,026</b>

Deferred tax assets and liabilities at 31 December are as follows:

	thousands of euros	
	2006	2005
<b>DEFERRED TAX ASSETS</b>		
Retirements and commitments with employees	18,117	19,963
Capital grants	3,646	1,909
Tax losses	-	4,622
Other	17,158	7,479
<b>Total deferred tax assets</b>	<b>38,921</b>	<b>33,973</b>
<b>DEFERRED TAX LIABILITIES</b>		
Accelerated depreciation	47,068	52,391
Non-deductible assets (note 30)	77,819	97,347
Other	19,137	7,038
<b>Total deferred tax liabilities</b>	<b>144,024</b>	<b>156,776</b>

In 2006 tax loss carryforwards corresponding to REDALTA and INALTA, which were absorbed by the Parent company, with effect 1 January 2006, have been offset.

Non-deductible assets include those generated from the REDALTA and INALTA business combination in 2005 (note 30).

Additionally, Group companies have all returns for applicable taxes for the last four years open to inspection. Due to the different possible interpretations of

tax legislation applicable to the transactions carried out by the Company, additional contingent tax liabilities could arise as a result of an inspection of the years open to inspection. Nonetheless, the directors do not expect that these liabilities should they arise would significantly affect the Group's consolidated financial statements.

## (22) INCOME AND EXPENSES

### a) Net turnover

Details of net turnover in the consolidated income statement for 2006 and 2005 are as follows:

	thousands of euros	
	2006	2005
Transport services rendered in Spain	856,473	781,923
Transport services rendered in Bolivia	19,896	18,980
System operation services	36,532	34,552
Other services rendered and sales	36,361	24,708
	<b>949,262</b>	<b>860,163</b>

Income from transmission services rendered is fixed annually by Royal Decree (for 2006 Royal Decree 1556/2005 of 23 December 2005 whereby electricity rates are established).

Income from system operation services rendered is set annually by Royal Decree (for 2006, Royal Decree 1556/2005, of 23 December 2005), and corresponds exclusively to Spain.

Other Services rendered and sales mainly include income from the Group's other activities such as the assignment of the use and maintenance of telecommunication networks, international consulting work and engineering, construction and installation maintenance work carried out for third parties.

### b) Materials consumed and other operating expenses

Details of this heading in the consolidated income statement for 2006 and 2005 are as follows:

	thousands of euros	
	2006	2005
Raw materials and consumables	36,390	26,432
Other operating charges	181,069	170,042
	<b>217,459</b>	<b>196,474</b>

Materials consumed and other operating expenses mainly comprise repair and maintenance expenses incurred in electricity plants as well as IT and advisory services, rental costs and other services.

### c) Staff costs

Details of staff costs in the consolidated income statement for 2006 and 2005 are as follows:

	thousands of euros	
	2006	2005
Wages and salaries	58,671	51,155
Social Security contributions	12,367	12,889
Contributions to pension funds and similar commitments	1,035	942
Other social welfare charges and items	12,829	13,094
	<b>84,902</b>	<b>78,080</b>

Group companies have capitalised staff costs amounting to Euro 7,608 thousand at 31 December 2006 and Euro 7,797 thousand at 31 December 2005.

The pension plans adopted by Group companies are voluntary defined contribution pension plans. These pension plans have been inscribed in the Pension fund in accordance with prevailing legislation.

### Current employees

The average headcount of the Group in 2006 and 2005, distributed by professional category, is as follows:

	no. of persons	
	2006	2005
Directors	31	31
University graduates (5 year degree)	479	454
University graduates (3 year degree)	484	459
Specialists and unqualified technical support staff	432	411
	<b>1,426</b>	<b>1,355</b>

#### d) Net loss on asset impairment

In 2006 this heading records the value adjustment on certain electrical installations of the Parent company, the construction of which has been brought to a standstill for reasons beyond the Company's control. Additionally, it reflects the impairment of goodwill relating to TDE.

#### e) Net profit on disposal of non-current assets

In 2006 there were no major asset disposals and profit on disposals amounted to Euro 114 thousand. In 2005 the profit of Euro 23,510 thousand mainly relates to the sale by the Parent company of electricity technical installations in that year.

### (23) BALANCES AND TRANSACTIONS WITH ASSOCIATES AND RELATED PARTIES

All transactions with associates and related parties have been carried out at market prices.

Balances and transactions with associates

The main transactions carried out by fully and

proportionally consolidated Group companies with equity accounted companies in 2005 and 2006 were shown below:

#### Balances and transactions with related parties

There are balances and there have been no transactions with related parties.

### (24) REMUNERATION OF MEMBERS OF THE BOARD OF DIRECTORS

In 2006 and 2005 the members of the Board of Directors of the Parent company and Group companies accrued total remuneration of Euro 2,374 thousand and Euro 2,269 thousand, respectively. The aforementioned amounts include estimated performance linked bonuses and the salaries of directors who are also employees of the Group. A breakdown of remuneration in accordance with the information model introduced by the National Securities Market Commission, which was approved in Circular 1/2004 of 17 March 2004 for the Annual Corporate Governance Report, is as follows:

#### ■ Remuneration from the Parent Company:

	thousands of euros	
	2006	2005
<b>Salary item:</b>		
Fixed compensation	396	360
Variable compensation	1,232	1,095
Per diems	746	780
<b>Total Remuneration</b>	<b>2,374</b>	<b>2,235</b>

### Red Eléctrica Group

#### Details of the balances and transactions with associates and related parties (thousands of euros)

	thousands of euros							
	2006				2005			
	Balances		Transactions		Balances		Transactions	
	Receivables	Payables	Expenses	Revenues	Receivables	Payables	Expenses	Revenues
Red Eléctrica del Sur S.A. (REDESUR)	77	227	11	709	76	11	-	421
Red Internacional de Comunicaciones del Sur, S.A. (REDINSUR)	-	-	5	-	-	-	-	-
<b>Total</b>	<b>77</b>	<b>227</b>	<b>16</b>	<b>709</b>	<b>76</b>	<b>11</b>	<b>-</b>	<b>421</b>

- Company directors' remuneration from directorship or senior management of other Group companies:

Salary item:	thousands of euros	
	2006	2005
Fixed compensation	-	-
Variable compensation	-	-
Per diems	-	34
<b>Total Remuneration</b>	<b>-</b>	<b>34</b>

In 2005 remuneration related to the telecommunications subsidiary, albura, sold in June 2005.

Total remuneration by type of Director is as follows:

Type of director:	thousands of euros			
	Parent company		Group	
	2006	2005	2006	2005
Executive	755	698	-	-
External nominee	490	620	-	-
External independent	1,129	917	-	34
<b>Total Remuneration</b>	<b>2,374</b>	<b>2,235</b>	<b>-</b>	<b>34</b>

Total remuneration accrued by members of the Board of Directors of Red Eléctrica de España, S.A., in 2006, both from the Parent company and Group companies, by director, is as follows:

The Company has also established a three year plan for performance-linked remuneration for the executive director and which will be paid, if appropriate, at the end of 2008.

The Executive director contract contains clauses regarding guarantees and safeguards in respect of dismissal or changes in control. This contract has been approved by the Committee of Appointments and remuneration and the Board of Directors of the Parent company.

These clauses follow usual market practice and include clauses regarding termination of employment and indemnities of up to one year unless applicable legislation requires a greater indemnity to be paid.

At 31 December 2006 and 2005 no loans, advances or guarantees to members of the Board of Directors of the Parent company are reflected in the consolidated balance sheet. Nor are there at that date any pension commitments with members of the Board of Directors.

In 2006 the members of the Board of Directors have performed no extraordinary operations or transa-

Parent Company	thousands of euros			
	Fixed comp.	Variable comp.	Diems	Total
D. Luis M <sup>a</sup> Atienza Serna	396	282	77	755
D. Pedro Rivero Torre	-	95	104	199
D. Juan Gurbindo Gutiérrez (1)	-	95	77	172
D. Antonio Garamendi Lecanda	-	95	79	174
D. Manuel Alves Torres (1)	-	95	77	172
D. José Riva Francos	-	95	51	146
D. José Manuel Serra Peris	-	95	51	146
D. Rafael Suñol Trepas	-	95	51	146
Dña. Ángeles Amador Millán	-	95	51	146
D. Francisco Javier Salas Collantes	-	95	77	172
D. Martín Gallego Málaga	-	95	51	146
<b>Total Remuneration accrued</b>	<b>396</b>	<b>1,232</b>	<b>746</b>	<b>2,374</b>

(1) Amounts received by Sociedad de Participaciones Industriales (SEPI).

ctions under conditions other than market, directly or through intermediaries, with the Parent company or Group companies.

Details of the interests held by the members of the Parent company at 31 December 2005 in the share capital of companies with a similar or complementary activity to that of Red Eléctrica de España, S.A., as well as the posts they hold and functions they perform and where applicable, the direct or indirect performance of identical, similar or complementary activities to that of the Parent company are included in Appendix II, in accordance with the correspondence received from the directors of the Parent company.

## (25) MANAGEMENT REMUNERATION

Staff costs (monetary remuneration, benefits in kind, Social Security, pension systems etc) of senior management of the Parent company amounted to Euro 1,386 thousand in 2006 (Euro 1,013 thousand in 2005) and are recognised under staff costs in the consolidated income statement. The company has also established a three year plan for performance linked remuneration which covers all senior management members and which will be paid, if appropriate, at the end of 2008.

Senior managers who have provided their services in 2006 are as follows:

Name	Office
Carlos Collantes Pérez-Ardá	General Manager, Transport
Esther M <sup>a</sup> Rituerto Martínez	General Manager, Administration and Finance
Alberto Carbajo Josa	General Manager, Operations
Ángel Landa López de Ocaíz	Asistant General Manager

No loans or advances have been paid to senior management at 31 December 2006 and 2005.

Senior management contracts contain guarantee or safeguard clauses in respect of dismissals. These contracts are approved by the Committee of Appointments and Remuneration and the Board of Directors of the Parent company.

Two senior managers are affected by these contracts. The clauses of the contracts follow usual market practice and include clauses regarding termination of employment and indemnities of up to two years unless the applicable legislation requires a greater indemnity to be paid.

## (26) SEGMENT REPORTING

The main activity of the Red Eléctrica Group is the transmission of electricity in Spain, which represents 90% of the Group's consolidated net turnover and more than 96% of its total assets. Other activities, System Operation, Other electrical activities in Spain, and consultancy and electrical activities outside Spain account for the remaining 9% of turnover and a volume of assets of less than 3%. Consequently, as these segments do not reach the levels established by IFRS, no segment reporting breakdown has been prepared.

## (27) GUARANTEES AND OTHER OBLIGATIONS WITH THIRD PARTIES AND OTHER CONTINGENT LIABILITIES

At 31 December 2006 the principal long-term contracts and commitments to which Group companies are party are as follows:

- Contracts between EDF and the Parent company for the import and export of electricity until 2010. The power quotas established in these two contracts range from 550 to 300 MW until maturity.
- A contract entered into in 1997 between the Parent company, Cable Europa, S.A.U. (formerly NETCO) and Auna Telecomunicaciones, S.A. for the assignment of the use of capacity and maintenance of the telecommunications network.

- A contract signed in June 2005 for the assignment of rights to use fibre optics by the Parent company to T-Online Telecommunications Spain, S.A. (formerly Albura Telecomunicaciones, S.A.U.) which expires in 2016.

At 31 December 2006 the Group has bank guarantees in favour of third parties amounting to Euro 9,656 thousand.

Additionally, REI is the warrantor of the loan granted by International Finance Corporation (hereinafter referred to as IFC) to the Bolivian company TDE. Some of REI's commitments towards IFC include holding a minimum share in TDE, taking an effective control over such company and being subsidiarily answerable for the payments to be made to IFC.

#### (28) ENVIRONMENTAL INFORMATION

During 2006 Group companies incurred ordinary expenses of Euro 9,323 thousand to protect and improve the environment (Euro 5,891 thousand in 2005). These expenses mainly relate to the introduction of preventative and corrective measures in the Parent company's installations, the protection of bird life and vegetation, waste and pollution management and the organisational unit within the Parent company responsible for such tasks, various environmental communication and training activities and environmental research and preparation of an electromagnetic filed and noise measurement plan in the Company's installations.

Similarly, in 2006 environmental impact and supervision studies have been performed in relation to new electricity installations, valued at Euro 6,305 thousand (Euro 2,080 thousand in 2005), which were added to the value of property, plant and equipment.

Group companies are involved in no litigations relating to environmental protection or improvements which may give rise to significant contingencies.

#### (29) OTHER INFORMATION

The auditor of the accounts of the Group companies is PricewaterhouseCoopers Auditores, S.L.. Accrued remuneration in respect of the audit of the Group's 2006 annual accounts amounts to approximately Euro 98 thousand (in 2005 the auditor of the Group's accounts was KPMG Auditores, S.L. and its remuneration amounted to Euro 102 thousand). Remuneration accrued by companies directly and indirectly related to the auditors for professional services other than the audit of the accounts, which do not affect the Group companies' strategy or general planning amount to approximately Euro 77 thousand in 2005 (Euro 79 thousand in 2005).

#### (30) BUSINESS COMBINATIONS

On 15 February 2005 the Parent company acquired an additional 75% of the share capital of REDALTA and INALTA following which they were merged in 2005.

The fair values of the main assets and liabilities contributed by these companies at the date of their acquisition were as follows:

	million of euros
Property, plant and equipment	1.019
Financial	-592
Other long-term debt	-40
Other assets and liabilities	-157
Cash at bank in hand	17
	<b>247</b>

#### (31) POST-BALANCE-SHEET EVENTS

In March 2007 Red Eléctrica de España, S.A. and Energías de Portugal, S.A. (EDP) entered into an agreement, effective, as from that time, whereby Red Eléctrica de España acquires 5% of Redes Energéticas Nacionais, SGPS, S.A. (REN), the holding company which comprises the operation and use of the electricity transmission assets and various gas infrastructures in Portugal.

**(32) EARNINGS PER SHARE**

Details of earnings per share for 2006 and 2005 are as follows:

	2006	2005
Net profit (thousands of euros)	200,154	162,422
No. shares (shares)	135,270,000	135,270,000
Average number of treasury shares held (shares)	271,860	272,626
Basic earning per share (euros)	1.48	1.20
Diluted earning per share (euros)	1.48	1.20

At 31 December 2006 and 2005 the Group has not performed any operations which would result in any differences arising between basic earnings per share and diluted earnings per share.

**(33) SHARE -BASED PAYMENTS**

In 2006 the Parent company has implemented a share acquisition plan under which managers are able to receive shares from the Company as part of their ordinary annual remuneration. The valuation of such share-based remuneration is based on the closing price of the Company's share at a specific date. The expense recorded under staff costs in the consolidated income statement for this item amounts to Euro 370 thousand for 12,065 shares. All shares delivered derive from the Parent company's treasury shares.

## Appendix I

## Red Eléctrica Group

## Details of shareholdings at 31 december 2006 (in thousands of euros)

Company - Registered offices - Principal activity	Percentage ownership of Parent company		Net book value in holding company
	Direct	Indirect	
<b>A) FULLY CONSOLIDATED COMPANIES</b>			
<b>Red Eléctrica Internacional, S.A.U. (REI)</b>	<b>100%</b>	<b>-</b>	<b>60,000</b>
- Paseo Conde de los Gaitanes, 177. Alcobendas (Madrid) - International shareholdings. Provision of consultancy, engineering and construction services. Electrical activities outside the Spanish electrical system.			
<b>Transportadora de Electricidad, S.A. (TDE)</b>	<b>-</b>	<b>99.94% (1)</b>	<b>74,555</b>
- C/ Colombia, N° O0655, casilla, N° 640 Cochabamba (Bolivia) - Transmission of electrical energy			
<b>Cybercia, S.R.L. (CYBERCIA)</b>	<b>-</b>	<b>75% (4)</b>	<b>31</b>
- C/ Colombia, N° O0655, casilla, N° 640 Cochabamba (Bolivia) - General service and commercial activities			
<b>Red Eléctrica de España Finance, B.V.</b>	<b>100%</b>	<b>-</b>	<b>2,000</b>
- Amsteldijk, 166. Amsterdam (Holanda) - Financing activities			
<b>Red Eléctrica Andina, S.A.C. (REA)</b>	<b>-</b>	<b>100% (1)</b>	<b>3</b>
- Juan de la Fuente, 453. Lima (Perú). - International Shareholdings International shareholdings. Provision of consultancy, engineering and construction services. Electrical activities outside the Spanish electrical system			
<b>B) COMPANIES CARRIED UNDER THE EQUITY METHOD</b>			
<b>Red Eléctrica del Sur, S.A. (REDESUR)</b>	<b>-</b>	<b>33.75% (2)</b>	<b>4,597</b>
- Juan de la Fuente, 453. Lima (Perú) - Electrical energy transmission			
<b>Tenedora de Acciones de Redesur, S.A. (TENEDORA)</b>	<b>-</b>	<b>14.58% (1) and (5)</b>	<b>2,112</b>
- Paseo Conde de los Gaitanes, 177. Alcobendas (Madrid) - Holding, management and administration of REDESUR shares			
<b>Red Internacional de Comunicaciones del Sur, S.A. (REDINSUR)</b>	<b>-</b>	<b>27.64% (3)</b>	<b>70</b>
- Juan de la Fuente, 453. Lima (Perú) - Telecommunications			

(1) Investment made through Red Eléctrica Internacional.

(2) Investment made through Red Eléctrica Internacional (25%) and Tenedora de Acciones de Redesur (6,25%).

(3) Investment made through Redesur.

(4) Investment made through TDE.

(5) Internacional has an 6.25 % additional shareholding classified as held for sale.

This Appendix forms an integral part of Note 1 to the consolidated annual accounts.



## Anexo II

### Red Eléctrica Group

#### Information on members of the board of directors of the Parent company at 31 december 2006

Members of the Board of Directors	Direct or indirect interests held, by Members of the Board of Directors of the Parent company in the share capital of companies with a similar or complementary activity to that of the Parent company	Positions held and functions performed by Members of the Board of Directors of the Parent company in companies outside the Red Eléctric Group with an identical, similar or complementary statutory activity to that of the Parent company
D. Luis M <sup>a</sup> Atienza Serna	-----	-----
D. Pedro Rivero Torre	-----	Director of the Iberian Energy Market Operator - Polo Español, S.A.
D. Juan Gurbindo Gutiérrez	-----	-----
D. Antonio Garamendi Lecanda	12 shares in Iberdrola, S.A.	-----
D. Manuel Alves Torres	-----	-----
D. José Riva Francos	853 shares in Iberdrola, S.A.	-----
D. José Manuel Serra Peris	3,232 shares in Endesa, S.A. 3,932 shares in Iberdrola, S.A. 3,254 shares in Gas Natural, S.A. 3,800 shares in Enagás, S.A.	-----
D. Rafael Suñol Trepas	-----	-----
Dña. Ángeles Amador Millán	-----	-----
D. Francisco Javier Salas Collantes	-----	-----
D. Martín Gallego Málaga	-----	-----

None of the members of the Board of Directors has carried out other activities with an identical, similar or complementary statutory activity to that of the Parent company.

# Consolidated Directors' Report

## 2006 Financial Year

## EVOLUTION OF BUSINESS. MOST SIGNIFICANT EVENTS.

In 2006, RED ELÉCTRICA GROUP continued to render excellent service to the Spanish electricity market. As a TSO (Transmission System Operator), we have provided safe, high quality and environmentally sustainable services which have strengthened the Spanish energy sector.

The RED ELÉCTRICA GROUP, which has established itself as a clear reference in the world, has once again demonstrated in 2006 its flexibility and ability to deal with continuous increases in demand, with high levels of operating efficiency and availability, configuring a safe transmission network based on long term reliability standards. The soundness and prestige of RED ELÉCTRICA GROUP have been demonstrated once again by the coordinated actions of a staff that is fully dedicated to the business project, in positive interaction with interest groups (shareholders and investors, social agents, the media, suppliers, etc.) and with electricity agents.

In the 2006 financial year, RED ELÉCTRICA GROUP, in addition to obtaining satisfactory economic results, also made significant achievements in the company's different business activities.

### The Electricity Transmission Activity in Spain

As part of its strategy to be the sector's pillar, RED ELÉCTRICA GROUP, through RED ELÉCTRICA, continued in 2006 with its programme of significant investments in the transmission network in order to guarantee the quality and safety of the electricity supply. This programme is reflected in the record investments made in the national transmission system which totalled 510.1 million euros (21.4% higher than 2005). Furthermore, the merger of REDALTA and INALTA during the financial year, the latter of which

is the owner of the transmission assets acquired from Iberdrola in 2002, strengthened RED ELÉCTRICA's position as the owner of almost the entire peninsular transmission network with more than 33,500 km. of high voltage lines, nearly 3,000 substation positions and a transformation capacity of approximately 55,500 MVA.

During this financial year, 174 new substation positions, 407 Km. of line circuits and 287 km of existing lines for increased transmission capacity were added to the national transmission network owned by the company. Some of the most notable projects carried out by RED ELÉCTRICA in 2006 include the reinforcement of the interconnection with Morocco by adding a second underwater cable circuit in the Strait of Gibraltar, the development of installations to integrate the Levante artery and the reinforcement of the transmission infrastructure in Andalucía and Murcia.

Furthermore, some of the most noteworthy actions in relation to expansion plans and network improvements for the years to come, consisting primarily of the creation of new arteries and corridors for the evacuation of energy on the Peninsula, include the following:

- providing service to new high speed trains
- reinforcing the transmission network grid in the central and southern zones of the Peninsula
- developing the energy evacuation artery between the communities of Galicia, Castilla-León and Madrid.
- increasing the energy transmission and evacuation capacity in Asturias, Cantabria, Basque Country and Navarra.
- developing the interaction between the Peninsula and the Balearic Islands by means of underwater cables, reinforcing the electricity supply to the eastern part of the Peninsula.

- increasing the transmission capacity of the interconnection with France via the Pyrenees.

In terms of the continuity and safety of the electrical supply, the total availability of the company's transmission network reached 98.24% in 2006 and the average outage time was 1.77 minutes.

Thanks to the maintenance policies and techniques systematically applied by RED ELÉCTRICA, its operating efficiency and service quality, which are reflected in the availability rates of its installations, have positioned it at the forefront of the international sector.

### Operation of the Electrical System in Spain

As the operator of the Spanish system, RED ELÉCTRICA estimates electricity demand and the satisfaction of that demand in the medium to long term within the domestic context. In 2006, it drafted a study on the expected demand and the coverage of that demand by the Iberian system for the period 2006-2015 in collaboration with the operator of the Portuguese electricity system (Red Eléctrica Nacional) within the framework of the Iberian Electricity Market (MIBEL). The work group composed of these two operators has also undertaken a study of new interconnections to increase the exchange capacity between Spain and Portugal.

RED ELÉCTRICA and the operator of the French system, Réseau de Transport d'Électricité (RTE), continued to make progress on the definition of the interconnection via the Pyrenees. In 2006, the mechanism coordinated by Spain and France for the assignment of capacity in the interconnection between the two countries, based on explicit auctions and managed jointly by RED ELÉCTRICA and RTE, became operational.

The domestic context has been characterised in recent years by a steady increase in the demand for electricity on the Peninsula. In 2006, demand grew by 2.7 % over 2005, reaching new historical highs of daily energy demand in both winter and summer.

As far as the satisfaction of that demand is concerned, the installed power in Spain grew by 5.7% in 2006, primarily due to the incorporation of new combined cycle groups and new wind energy farms. The growing importance of combined cycle power plants in the coverage of demand counteracted the scarce hydro-electrical production in the early months of the year, making natural gas the leading raw material in electricity production, accounting for approximately 25%.

With regard to the management of operating markets, the objective of which is to adapt the programmes and production resulting from the daily and intraday markets to the quality and safety requirements of the system, in 2006 RED ELÉCTRICA started to perform the functions referred to in Royal Decree-Law 5/2005 regarding settlement, notification of payment and collection and the management of supply guarantees, system adjustment services and power guarantees.

Furthermore, in relation to its functions as the operator of insular and extrapeninsular electrical systems which RED ELÉCTRICA has been performing since 2004, the regulation that developed Royal Decree 1474/2003 which regulates these electricity systems was approved in 2006. The presence of RED ELÉCTRICA in the Balearic Islands, Canary Islands, Ceuta and Melilla contributes effectively to the liberalisation and competition in these electricity markets and is at once a guarantee of operating transparency and neutrality, basic operating principles of the Spanish electricity market.

### Other Electricity Business Spain

In 2006, the balance of the electricity exchange programmes was an export balance for the second year in a row, with a value of 3.275 GWh, due to the increase in exports to Morocco and the decrease in imports from France. The average usage of the energy supply contract with Électricité de France (EDF) was 66 % for the year.

## Business Outside of Spain

The business activities of RED ELÉCTRICA GROUP outside of Spain are handled by Red Eléctrica Internacional which, with investments in South America including Bolivia (through TDE) and PERU (through REDESUR) and its consulting and technical assistance work for third parties, is responsible for the development of the GROUP's international business.

The turnover from international business rose to 22.7 million euros with EBITDA of 14.4 million euros.

Based on the analyses and assessments conducted, the consolidated results of the Group's international business were negative due to the depreciation of the Bolivian investment. However, TDE has made an effort to lay the foundation for its consolidation as the transporter of reference in Bolivia, with construction projects to build new transport infrastructure in Bolivia valued at 17.6 million dollars.

Both REDESUR in Peru and TDE in Bolivia have focused their activities on their electricity markets where they have achieved certain standards of quality in the operation and maintenance of their installations that have resulted in availability rates in excess of 99 %.

In 2006, consulting and technical assistance projects were completed in Romania, Hungary, Yugoslavia, Albania, Cyprus, Morocco, Ecuador and Chile and similar projects are currently underway in Bolivia, Libya, Algeria and Albania.

The companies TDE and REDESUR have contributed to the creation of value for the GROUP, paying dividends which translate into revenues of 5.5 and 0.5 million euros, respectively.

## CORPORATE RESPONSIBILITY

2006 was a year of consolidation for RED ELÉCTRICA GROUP on the leading sustainability indexes, the Dow Jones Sustainability Indexes (DJSI), where the Group was included for the first time on the DJSI World list and remained for the second year in a row on the European DJSI STOXX list.

As part of its strategy of ongoing improvement, RED ELÉCTRICA GROUP continued its work in 2006 on several aspects: structural, corporate governance, social, environmental and technical-economic, developing the fourth annual Corporate Responsibility Programme with a total of 35 projects. The corporate responsibility report, which has been verified externally in compliance with Global Reporting Initiative (GRI) requirements, describes all of the projects carried out as well as the indicators and a description of the company's efforts in this area.

In 2006, the corporate volunteer programme known as "En RED ando" was further consolidated. This group arose out of a desire to publicise the company's external social action and to encourage the collaboration of as many employees as possible in activities that respond to social interests, needs and problems.

The redesign of corporate values and the preparation of a new Code of Ethics were key strategic elements in 2006. All employees were involved in the process of drafting the Code of Ethics in order to ensure consensus and completeness. The Code and its management system will be approved and distributed to interest groups in 2007.

Throughout 2006, RED ELÉCTRICA GROUP, at the forefront in corporate governance, continued incorporating best practices in this area into its management system which go above and beyond the legal requirements, including the widespread practice of electronic voting at General Meetings of Shareholders, among others.

## THE STAFF

RED ELÉCTRICA GROUP believes that its business activities must be carried in an ethical and socially responsible manner which ensures the respect for human rights and the employment rights of people.

The actions arising out of this policy: teamwork, delegation, the fostering of knowledge, the professional development of employees and fair recognition of their work, are designed to achieve business objectives and strategies and constitute the basic pillars of the corporate culture of RED ELÉCTRICA GROUP. The embracing of these values by staff members reflects their commitment to the company and its business project as demonstrated by the preliminary results of the social climate questionnaire administered this year.

Internal communications continued to be one of the basic lines of management. In this regard, internal communication programmes were geared toward fostering participation and facilitating more fluid communications, placing special emphasis on making the corporate strategy known. Publicising the Strategic Plan at all levels through debate forums and presentations by management staff and the definitive launch of the new employee portal (miRED) are both clear examples of this.

RED ELÉCTRICA GROUP is committed to developing the talent and knowledge of its staff which enables them to perform their duties with the highest level of excellence and can also be used as a component of professional promotion. Taking this approach, the Group has made strides in launching individual talent management programmes for the identification and professional development of talent within the organisation. The training activities carried out by RED ELÉCTRICA have reached 94.6% of the staff with a total of 92,450 training hours which is equivalent to an average of 72 hours per employee.

## THE ENVIRONMENT

RED ELÉCTRICA GROUP is committed to making the protection of the environment compatible with the sustainable development of its electrical infrastructures. The Group applies strict environmental standards in all of its activities to ensure that its projects have the very least ecological impact and the very highest social consensus possible.

The second interconnection between Spain and Morocco is a clear example of the commitment of RED ELÉCTRICA GROUP to sustainable development. When designing this project, not only did the Group assume the commitment of generating the lowest possible environmental impact but it also developed a series of specific actions parallel to the construction of the infrastructure, known as compensatory measures, to protect the fragile natural ecosystem and social environment where the projects were being implemented. These compensatory measures, which were agreed upon with social agents, institutions and interest groups in the area and coordinated and monitored by the Migres Foundation, are broken down into three types of actions: environmental conservation, investigation and education.

In keeping with the commitments assumed in its environmental policy, RED ELÉCTRICA GROUP conducts environmental studies for all of its projects involving new installations, regardless of whether or not they are subject to the legal procedure for environmental impact assessment. Furthermore, preventive and corrective measures are applied to all construction work.

In 2006, RED ELÉCTRICA GROUP continued its efforts to protect birds and to measure the electrical and magnetic fields and noise levels. It also made significant strides in the development of new lines of investigation to make its activities compatible with environmental conservation, such as the development of signalling with bird-saving spirals, research studies related to electric and magnetic fields and studies related to preventive measures which minimise acoustical emissions and potential light contamination generated by electrical installations.

## RESEARCH, DEVELOPMENT AND INNOVATION (R+D+i)

RED ELÉCTRICA GROUP considers R+D+i to be a basic component of its corporate strategy. Consequently, the objectives in this area are geared toward making the infrastructures that support the electricity system as efficient and safe as possible.

In 2006, the R+D+i carried out by RED ELÉCTRICA GROUP carried out approximately 60 projects valued at 3.7 million euros. From a technological point of view, the most notable research work focused on the incorporation of renewable energies into the electrical system and the application of demand management mechanisms to foster energy efficiency. Other relevant projects included those related to the installation of high temperature conductors of the acoustical insulation of substations.

2006 was also a year of consolidation of RED ELÉCTRICA GROUP in European research projects, one of the most notable of which was the WIND ON THE GRID project which represents a commitment to the large-scale integration of wind energy in the European market and the IS-POWER project relative to the problems of operating isolated systems, a project on which RED ELÉCTRICA is the coordinator. Furthermore, RED ELÉCTRICA has participated in different technological platforms, including the Spanish Electrical Market Platform (FUTURED), in which it acts as the Vice President.

## QUALITY

The business excellence of RED ELÉCTRICA GROUP is attested to by the external certifications and accreditations of its business management systems.

In 2006, RED ELÉCTRICA received accreditation for the calibration of measuring equipment by the National Accreditation Entity (ENAC) of the Calibration and Test Laboratory. This accreditation is in addition to the one received in 2005 for the inspection of electrical measurements.

The Group has maintained its AENOR certifications in the areas of quality (UNE EN ISO 9001), the environment (UNE EN ISO 14001) and occupational health and safety (OHSAS 18001), after passing the follow-up audits. Furthermore, since 2005, the company has been certified in Social Accountability (SA8000) in recognition of its commitment to the respect for human rights and employees' rights and the ethical treatment of people.

## RISK MANAGEMENT

The GROUP has established a Risk Control System that covers all of its activities and is adapted to its risk profile. The Risk Policy and the General Comprehensive Risk Management and Control Procedure are based on the integrated business management framework contained in the COSO II Report (COMMITTEE OF SPONSORING ORGANIZATIONS).

The principal risks identified for the achievement of the Group's strategic objective are: regulatory, since the GROUP's core business is subject to regulation; operational, associated primarily with the activities for the service of the electrical system; financial (market, credit or counterparty and liquidity), as described in the notes to the consolidated financial statements, and environmental. In the year 2006, no relevant risks materialised.

## ECONOMIC RESULTS AND STOCK MARKET EVOLUTION

### Economic results

In 2006, the after-tax profits of RED ELÉCTRICA GROUP were 200.2 million euros, which represents an increase of 23.2% over the year 2005. The return on equity (ROE) was 19.6%.

The earnings before interest, taxes, depreciation and amortisation (EBITDA) were 651.7 million euros compared to 591.1 million euros in 2005:

- The consolidated turnover was 949.3 million euros compared to 860.2 million euros in 2005. The main factors responsible for the increase in turnover in 2006 were an increase in the remuneration associated with the transmission business, primarily as a consequence of the installations commissioned in 2005, and the remuneration of the transmission assets of INALTA and an increase in the work done for third parties, primarily network modifications.
- Operating costs, net of energy purchases, totalled 302.4 million euros compared to 274.6 million euros in 2005. Among the most relevant operating costs in 2005 were the maintenance expenses associated with renovation and enhancement programmes to increase the quality of the acquired assets. Personnel costs totalled 84.9 million euros which represents an increase of 8.7% over 2005, basically as a consequence of staff increases, with an average of 1,426 employees or 5.2% more than in 2005. This increase in staff was due primarily to the new personnel hired for the integration of the transmission assets acquired.

The net financial debt at the end of 2006 was 2,612.2 million euros and the leveraging ratio was 71.9 %. The financial structure maintains a very low risk profile, with reduced exposure to interest rate variations. The credit rating agencies, Standard and Poor's y Moody's, maintained their credit ratings of AA- y A2, respectively.

The net financial expenses were 99.3 million euros compared to 104.1 million euros in 2005. The increase

in both the average balances carried and interest rates did not compensate the impact of cancelling and subsequently refinancing INALTA's debt during the previous fiscal year.

The net results due to the deterioration of the value of assets resulted in losses of 31.9 million euros due primarily to the adjustment of the value of the Group's international investments and the correction of the value of the electrical installations whose construction has been put on hold for reasons beyond the Group's control.

Furthermore, the tax effects of the adjustment of corporate income tax rates starting in 2007 resulted in net book revenues for the Group of 15.6 million euros.

Group investments in tangible and intangible fixed assets were 529.6 million euros and allocated almost in their entirety to the development of transmission networks.

### Stock Market Evolution and Shareholders Profitability

At the end of 2006, the Group's stock market capitalisation was 4,395 million euros. RED ELÉCTRICA shares performed positively in 2006, ending the year at 32.49 euros/share, which represents an appreciation of 24.2% over the year before, exceeding the rates of most stock market indexes. Despite the fact that the final days of the financial year were marked by the announcement of a possible revision of the regulatory framework affecting the energy transmission sector, which causes a sudden drop in the share price, the Group's shares bounced back in the early months of 2007.

Furthermore, RED ELÉCTRICA GROUP has kept its promise to maximise value for its shareholders, offering a high dividend profitability rate in 2006.



## TREASURY STOCK

The General Meeting of Shareholders, at its session held on 26 May 2006, authorised the Board of Directors to purchase stock pursuant to the terms of the Public Limited Companies Act.

In order to afford investors the proper level of depth and liquidity, in 2006 the Group acquired 5,760,654 shares for a total nominal price of 12 million euros and a cash amount of 168 million euros. At the same time, the number of shares disposed of was 4,276,453 for a total nominal price of 9 million euros and a cash amount of 119 million euros.

As of 31 December 2006, parent company held a total 1,645,183 shares of treasury stock, which represents 1.22 % of the share capital. The total nominal value of those shares is 3.3 million euros while the market value is 53 million euros.

The parent company has complied with its obligations under article 75.2 and the Second Additional Provision of the Public Limited Companies Act which establishes, in relation to the stock which trades on secondary markets, that the par value of the shares acquired, when added to those already in the possession of the parent company and its subsidiaries, may not exceed 5% of the share capital. The subsidiaries do not hold treasury stock or shares in the parent company.

## RELEVANT EVENTS SUBSEQUENT TO 31 DECEMBER 2006

In March 2007 Red Eléctrica de España, S.A. and Energías de Portugal, S.A. (EDP) entered into an agreement, effective, as from that time, whereby Red Eléctrica de España acquires 5% of Redes Energéticas Nacionais, SGPS, S.A. (REN), the holding company which comprises the operation and use of the electricity transmission assets and various gas infrastructures in Portugal.

## OUTLOOK

In the years to come, RED ELÉCTRICA GROUP, through RED ELÉCTRICA, will adhere to the current strategy of being a Spanish TSO dedicated to the quality of service in order to maintain its position of leadership in terms of the reliability and safety of the Spanish electricity sector.

RED ELÉCTRICA GROUP will ensure that the necessary investments are made in the future to absorb future increases in the demand for electricity, developing an ambitious investment plan for the transmission network focused primarily on facilitating the evacuation of wind energy and combined cycles, supporting the expansion of the high speed train network, consolidating international interconnections and reinforcing system reliability. To foster the development of these new infrastructures, the parent company, RED ELÉCTRICA, will continue to reinforce its role in the Spanish electricity sector to favour a regulatory environment which is clear and consistent with this growth.

The expected progress of operating margins as a result of the increased efficiency which will be achieved by the full integration of the assets acquired and the economies of scale created, along with the commitment to maintain an efficient capital structure in line with the best practices in the sector, will enable RED ELÉCTRICA GROUP to continue offering its shareholders high yields and strong growth with low risk in the years to come.

But beyond the obtainment of economic results, it is the understanding of RED ELÉCTRICA GROUP that our responsibility to society is one of the differentiating elements of our management and one of our essential leadership values. By assuming these commitments, we are creating long term value which will make a significant contribution to a long-lasting competitive advantage. In short, it will improve our corporate reputation and enable us to provide society with the best possible service.

# Individual financial statements

Red Eléctrica de España S.A.

Balance at 31 december 2006 (in thousands of euros)

ASSETS	2006	2005
<b>INTANGIBLE ASSETS</b>	<b>5,182</b>	<b>8,246</b>
Research and development expenses and software	36,403	36,842
Amortisation	(31,221)	(28,596)
<b>TANGIBLE ASSETS</b>	<b>4,331,303</b>	<b>3,067,235</b>
Land and buildings	59,959	59,646
Plant and machinery	5,899,480	4,328,191
Other installations, equipment and furniture	95,254	87,887
Plant and machinery under construction	455,793	347,355
Advances and tangible assets under construction	7,131	20,625
Provisions	(42,606)	(29,261)
Depreciation of plant and machinery	(2,066,151)	(1,680,431)
Other depreciation	(77,557)	(66,777)
<b>INVESTMENTS</b>	<b>79,004</b>	<b>755,376</b>
Investments in group companies	62,000	267,518
Loans to associated companies	-	480,375
Other loans	1,258	1,719
Long-term guarantee deposits	434	323
Logn-term balances recoverable from public entitie	19,795	21,572
Provisions	(4,483)	(16,131)
<b>OWN SHARES</b>	<b>12,710</b>	<b>1,133</b>
<b>TOTAL FIXED ASSETS</b>	<b>4,428,199</b>	<b>3,831,990</b>
<b>DEFERRED EXPENSES</b>	<b>10,506</b>	<b>17,880</b>
<b>STOCKS</b>	<b>28,378</b>	<b>35,571</b>
Raw materials and other supplies	33,978	39,735
Provisions	(5,600)	(4,164)
<b>DEBTORS</b>	<b>266,165</b>	<b>277,808</b>
Trade debtors	4,154	14,261
Group companies	272	5,405
Associated companies	68	70
Sundry debtors	252,676	254,505
Personnel	587	811
Public entities	8,477	2,814
Provisions	(69)	(58)
<b>SHORT-TERM INVESTORS</b>	<b>5,876</b>	<b>253,607</b>
Loans to group companies	-	247,830
Other loans	5,570	5,541
Short-term guarantee and deposits	306	236
<b>CASH AND BANKS</b>	<b>4,619</b>	<b>4,861</b>
<b>PREPAID EXPENSES</b>	<b>3,506</b>	<b>21,652</b>
<b>TOTAL CURRENT ASSETS</b>	<b>308,544</b>	<b>593,499</b>
<b>TOTAL ASSETS</b>	<b>4,747,249</b>	<b>4,443,369</b>

SHAREHOLDERS' EQUITY AND LIABILITIES	2006	2005
SHARE CAPITAL	270,540	270,540
REVALUATION RESERVE	247,022	247,022
RESERVES	335,109	325,572
PROFIT FOR THE YEAR	198,676	145,800
INTERIM DIVIDEND	(43,428)	(36,588)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>1,007,919</b>	<b>952,346</b>
Capital grants	81,898	84,116
Exchange gains	213	233
Other deferred income	249,691	181,225
<b>TOTAL DEFERRED INCOME</b>	<b>331,802</b>	<b>265,574</b>
Provisions for the pensions and other liabilities	36,250	28,716
Provisions for taxes	171	327
Other provisions	18,995	34,291
<b>TOTAL PROVISIONS FOR LIABILITIES AND CHARGE</b>	<b>55,416</b>	<b>63,334</b>
BONDS	1,222,546	1,218,387
LOANS	1,261,862	1,261,862
OTHER CREDITORS	117,299	50,625
<b>LONG-TERM CREDITORS</b>	<b>2,601,707</b>	<b>2,530,874</b>
BONDS AND OTHER MARKETABLE SECURITIES	127,785	279,907
Non-convertible bonds	117,263	269,419
Interest payable	10,522	10,488
LOANS	22,391	22,624
Loans and other debt	22,391	22,624
TRADE CREDITORS	117,550	89,164
For purchases and services received	67,906	57,348
Bill payable	49,644	31,816
OTHER CREDITORS	459,308	217,319
Public entities	39,925	29,721
Other	418,045	186,283
Short-term guarantee deposits received	1,338	1,315
ACCRUALS	23,371	22,227
<b>SHORT-TERM CREDITORS</b>	<b>750,405</b>	<b>631,241</b>
<b>TOTAL SHAREHOLDRES' EQUITY AND LIABILITIES</b>	<b>4,747,249</b>	<b>4,443,369</b>

**Red Eléctrica de España S.A.**  
**Profit and loss accounts for the year 2006 (in thousands of euros)**

DEBIT	2006	2005
<b>EXPENSES</b>		
MATERIALS CONSUMED	185,443	214,435
Purchases of energy and power	149,387	182,698
Maintenance and repair materials	36,056	31,737
PERSONNEL EXPENSES	80,934	75,118
Wages and salaries	60,350	57,152
Social security	13,222	12,462
Pensions and similar obligations	1,035	942
Other social charges	6,327	4,562
AMORTISATION AND DEPRECIATION	249,826	182,413
CHANGES IN TRADE PROVISIONS AND BAD DEBTS WRITTEN OFF	1,447	(959)
Change in provisions for stocks	1,436	(951)
Change in provision for bad debts	11	(8)
OTHER OPERATING EXPENSES	190,752	161,849
External services	177,854	154,682
Local taxes	2,969	3,361
Other operating expenses	1,337	1,134
Provision for liabilities and charges	8,592	2,672
<b>TOTAL OPERATING EXPENSES</b>	<b>708,402</b>	<b>632,856</b>
<b>OPERATING PROFIT</b>	<b>392,544</b>	<b>313,802</b>
FINANCIAL AND SIMILAR EXPENSES	107,341	89,736
On debt with group companies	62,269	46,397
On debt with third parties	45,072	43,339
EXCHANGE LOSSES	10	2
<b>TOTAL FINANCIAL EXPENSES</b>	<b>107,351</b>	<b>89,738</b>
<b>PROFIT ON ORDINARY ACTIVITIES</b>	<b>288,069</b>	<b>244,776</b>
CHANGES IN PROVISIONS FOR FIXED ASSETS	18,408	24,118
LOSSES ON TANGIBLE ASSETS	-	26,421
LOSSES ON OWN SHARE OPERATIONS	121	105
EXTRAORDINARY EXPENSES	612	8,633
PRIOR YEARS' EXPENSES AND LOSSES	825	167
<b>TOTAL EXTRAORDINARY EXPENSES</b>	<b>19,966</b>	<b>59,444</b>
<b>PROFIT BEFORE INCOME TAX</b>	<b>281,751</b>	<b>222,163</b>
INCOME TAX	82,956	76,246
TAXES OTHER THAN INCOME	119	117
<b>PROFIT FOR THE YEAR</b>	<b>198,676</b>	<b>145,800</b>

CREDIT	2006	2005
<b>INCOME</b>		
NET SALES	1,078,044	926,094
Services rendered (Transmission and system operation)	893,005	708,915
Sales of energy and power	153,115	188,403
Other service income	31,924	28,776
SELF-CONSTRUCTED ASSETS	17,578	14,714
OTHER OPERATING INCOME	5,324	5,850
Other income	2,941	5,047
Grants	300	258
Surplus provision for liabilities	2,083	545
<b>TOTAL OPERATING INCOME</b>	<b>1,100,946</b>	<b>946,658</b>
INVESTMENTS INCOME	653	519
Group companies	653	519
REVENUES FROM OTHER MARKETABLE SECURITIES AND NON-CURRENT LOANS	-	8,772
Group and associated companies	-	8,772
OTHER INTEREST AND SIMILAR INCOME	2,121	11,336
Group companies	-	7,746
Other interest	2,121	3,590
EXCHANGE GAINS	102	85
<b>TOTAL FINANCIAL INCOME</b>	<b>2,876</b>	<b>20,712</b>
<b>NET FINANCIAL EXPENSES</b>	<b>104,475</b>	<b>69,026</b>
PROFIT ON DISPOSAL OF TANGIBLE FIXD ASSETS	173	23,565
PROFIT ON OWN SHARE OPERATION	1,732	2,127
CAPITAL GRANTS TAKEN TO INCOME	3,296	3,935
EXTRAORDINARY INCOME	2,617	4,579
PRIOR YEARS' PROFIT AND INCOME	5,830	2,625
<b>TOTAL EXTRAORDINARY INCOME</b>	<b>13,648</b>	<b>36,831</b>
<b>NET EXTRAORDINARY LOSS</b>	<b>6,318</b>	<b>22,613</b>



## Proposed profits distribution

Red Eléctrica de España, S.A.

Proposed profits distribution

Year 2006

The year 2006 profit reached Euros 198,676,266.93. The distribution of this profit, as proposed by the Board of Directors to the Annual General Meeting of Shareholders, provides for a gross dividend of Euros 0.8984 per share payable to those entitled to a dividend. Accordingly, an interim dividend of Euros 0.3250 per share has already been paid out. The balance, after the said dividends have been paid, will be transferred to Voluntary Reserves.

	Amounts in euros
VOLUNTARY RESERVES	77,684,383.41
DIVIDEND:	
INTERIM DIVIDEND	43,428,065.52
EXTRA DIVIDEND	77,563,818.00
(computed on the total number of shares)	
<b>Total</b>	<b>198,676,266.93</b>





## Certificate

Rafael García de Diego Barber, Secretary to the Board of Directors of Red Eléctrica de España, S.A., as established in Article 109 of the Trade and Companies Register Regulations,

Certifies Hereby,

That the Annual Accounts and Directors Report of the consolidated Red Eléctrica Group, as well as the Balance Sheet, Profit and Loss Statement and Proposed Profit Distribution of Red Eléctrica de España, S.A., as stated in the present document, are a true and accurate copy of those which were inspected and approved during the meeting held by the Board of Directors of Red Eléctrica de España, S.A., on March 22rd, 2007. A copy of each of these documents, signed by all the Directors, as required by Article 171,2 of the Reviewed Companies Act, is available at the Board Secretary's Office.

And as evidence thereof, I hereby issue this certificate in Madrid, on the 26th of March of the year 2007.

A handwritten signature in black ink, appearing to be 'R. García de Diego Barber', written over a horizontal line.



Co-ordination:

Department of Communications and Institutional Relations of Red Eléctrica

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Red Eléctrica photographic archives

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DE ESPAÑA

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