



REE

RED ELECTRICA

Annual Report 1997



RED ELECTRICA DE ESPAÑA,S.A.

RED ELECTRICA is a company which specialises in the transmission of electric power. Its transmission network, with more than 18,500 kilometres of high voltage power lines and 127 substations, including interconnections with France, Portugal, Morocco and Andorra, guarantees the transmission of electric power between the sources of generation and the consumer markets.

This central position is reinforced by its responsibility as the power system operator. RED ELECTRICA is responsible for ensuring a constant balance between the production and the consumption of electricity; for programming and dispatching the power plants in accordance with the order of economic precedence governed by the Market Operator and the system's technical restrictions; for managing the complementary services market which is needed to guarantee the stability and safety of the system; and for developing and operating the power transmission network.

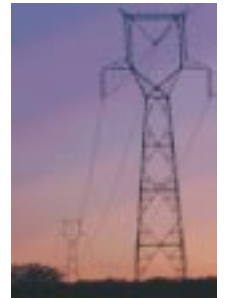
RED ELECTRICA has a team of more than 1,000 people who are experts in the necessary technologies and who have a wide and varied experience in managing power systems and in planning, design, construction, operation and maintenance of power transmission networks. Our goal is to put these capabilities at the disposal of the electric power markets.

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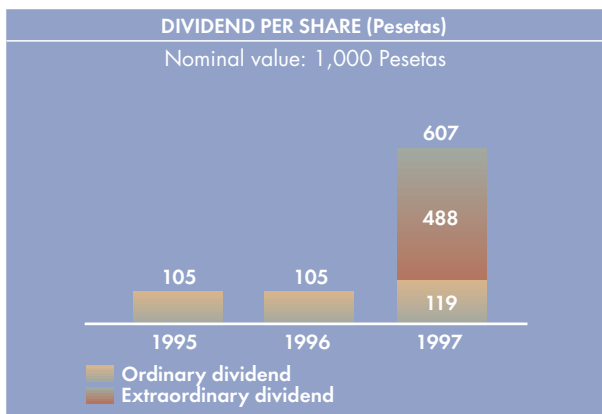
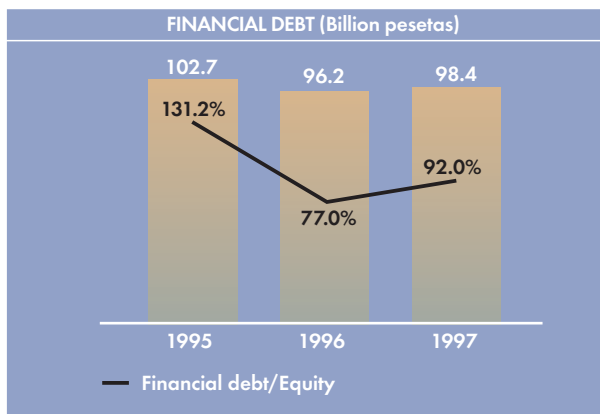
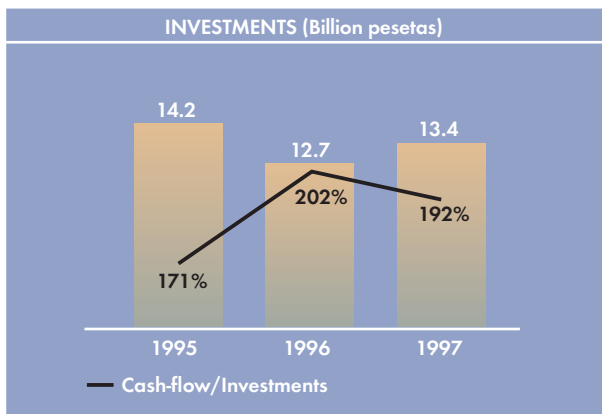
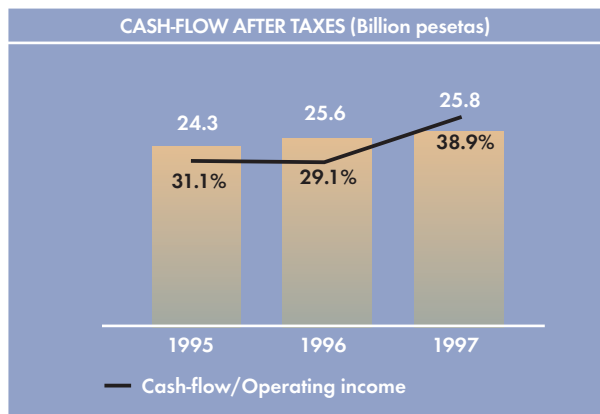
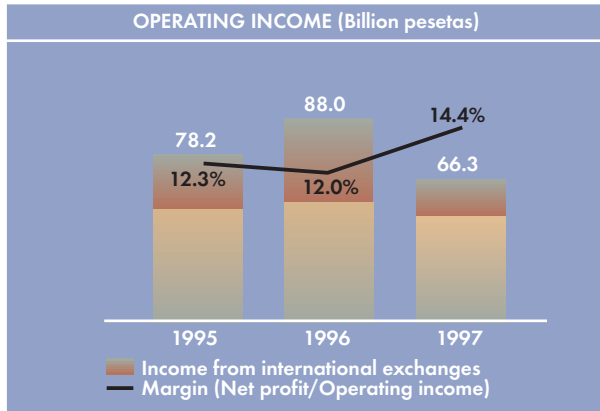


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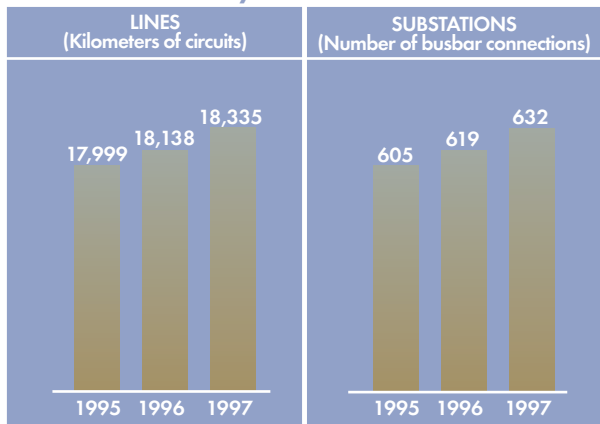
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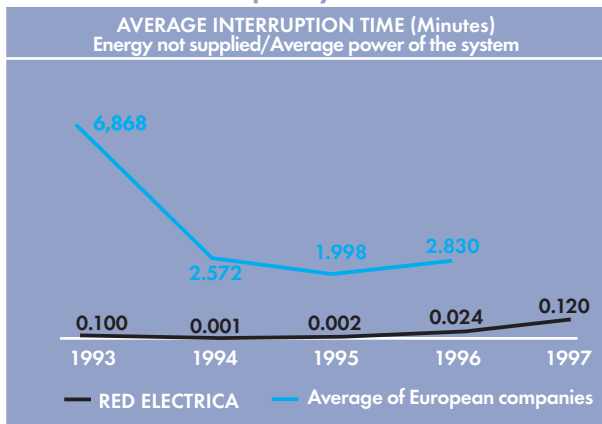
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The chairman's report

To the shareholders:

For RED ELECTRICA, 1997 has been a remarkable year. The past year saw the start of an unprecedented process of change in the electricity sector which is opening the doors to developments whose consequences are still difficult to foresee but which are certainly of great significance. These developments will define the future of the sector and, especially, of RED ELECTRICA. I will refer to these later.

RED ELECTRICA's management has therefore focussed not only on consolidating its business and financial figures but also on adapting to the new legislative framework in order to assume the role which has been defined for it by the Electricity Act, and on facing new responsibilities.

Economic performance was characterised by an improvement in results compared to the figures projected at the beginning of the year. Profit before tax was 14,003 million pesetas which, although 3% less than 1996, was 27.4% higher than the forecast at the start of the year. The efforts to generate new income and a strict policy of cost control have almost compensated the reduction in income, with respect to 1996, which was imposed by the 1997 tariff and the increase in depreciation which resulted from the revaluation of the RED ELECTRICA balance sheet at December 31st, 1996.

Cash-flow before tax came to 30,240 million pesetas, which was 2.6% greater than the previous year and represented 44% of RED ELECTRICA's gross income. This was sufficient to finance the company's investment program, which came to 13,423 million pesetas, and put the ratio of net self-financing of investments at 153%.

During the past year an extraordinary dividend of 22,000 million pesetas was paid from the distributable voluntary reserves in addition to an interim dividend of 3,000 million pesetas paid against the year's results.



Pedro Mielgo Álvarez
Chairman of RED ELECTRICA

In June 1997 the Board of Directors of the company agreed the early retirement of debt arising at incorporation from the acquisition of fixed assets and owed to the utility companies. This amount of 26,834 million pesetas was repaid in two instalments, the last on February 2nd, 1998.

The income generated from the ordinary operations of RED ELECTRICA and from the contract covering leasing of excess capacity of the fibre-optic telecommunications network helped to finance the extraordinary dividend. The reduction in equity required an increase in financial leveraging of the company which, however, still maintains an acceptable ratio. The retirement of the debt created at incorporation with the utility companies meant that this had to be replaced by money market funds and has resulted in an increase in the average cost of funding. However, the total cost of RED ELECTRICA's borrowing is expected to fall in 1998 due to the continued reduction in interest rates which has been noted during the last two years and an expected reduction in indebtedness.

In 1997 income from RED ELECTRICA's ordinary activities reached 67,000 million pesetas of which 49,624 million pesetas was income from transmission activities and from operation of the power system. Total expenses before tax came to 54,774 million pesetas which was 1.7% less than the preceding year if expenses related to the contract with EDF for the import of electric power are taken out of both years.

Additions to fixed assets in use, which came to more than 13,000 million pesetas, reflected the completion of 34 km of overhead power lines and 15 km of submarine and underground cable, two transformers, two busbar connections and 717 km of fibre-optic cable.

The most significant new facility is, without doubt, the underwater power interconnection with Morocco across the Strait of Gibraltar. Its construction was finished in June 1997 and electrical trials were satisfactorily completed on November 3rd. At the current time, preparations are being completed for the provisional acceptance of the facility which will allow it to be commissioned and mean the start of the power supply contract with the Moroccan national power company.

Moreover, the new Electricity Control Centre was inaugurated in May. It is one of RED ELECTRICA's most outstanding facilities and its control system, which is also installed at the Regional Centres, is based on the most advanced technologies in the fields of information technology and telecommunications for real-time management of power systems.

RED ELECTRICA's commitment to the preservation of the environment in which it carries out its activities included the following significant projects in 1997: studies of the environmental impact of the new installations in Catalonia, Galicia and Navarre and the completion of a study on the effects of electromagnetic fields on cellular and molecular mechanisms which was carried out by the Medical Faculty of the Valladolid University.

The average workforce in 1997 was 1,102 persons. This figure is similar to previous years and indicates the stability of human resources after the period of growth which ended in 1994. The objectives of the training policy include the constant updating of technical skills and abilities of the workforce in order to handle new transmission technologies and to match the demands of the services which are provided by RED ELECTRICA.

The legislative changes to which I referred at the beginning of this report are part of a deregulating process which started in a determined way with the signing of the Electric Power Protocol at the end of 1996. This protocol was confirmed by the new Electricity Act which was approved in November as Law 54/1997. Subsequently, the Government has published the corresponding regulations marking the start of its application.

The foregoing defines the legal framework under which the power generation market commenced operation on January 1st, 1998. The creation of this power market is generally perceived as a notable success. In a very short space of time a competitive market –without precedent in our country and practically without any references in the rest of the world– was put into operation.

RED ELECTRICA contributed to this success in a notable way. By express legal mandate it had the task and responsibility of creating the Compañía Operadora del Mercado Español de la Electricidad, S.A. (Spanish Power Market Operating Company) and equipping it with the human, technical and financial resources needed to ensure its operation. The contribution of RED ELECTRICA's professional staff and its co-operation with the rest of the utility companies, the Administration and the CNSE, was decisive in the development of the information, reconciliation and payment systems needed to guarantee the functioning of the market, the operational feasibility and the transparency of the transactions between the different agents of the new power market.

In addition, RED ELECTRICA –as the entity responsible for technical control of the power system– has developed the procedures and computer systems needed to ensure that the procedures for generation scheduling and real-time operation will respond to market criteria and, at the same time, to guarantee the safety and reliability of the power system.

One of the concrete provisions of the Electricity Act which clearly affects RED ELECTRICA refers to the need to make its share capital available to new shareholders. With regard to this requirement, the Law establishes that any holding in RED ELECTRICA is limited to a maximum of 10% except in the case of the Sociedad Estatal de Participaciones Industriales (the State Investment Company) which will own at least 25% until the year 2003. The Law allows a period of six months for the adjustment of holdings in the way defined. In October, an operation took place involving the sale of shares of the ENDESA group to SEPI and, as a consequence, the latter is now the majority shareholder in the company. The Law also fixes a limitation of 40% on the total holdings of all entities related to the power sector.

SEPI has stated its interest in placing part of its holding in RED ELECTRICA on the stock market in the near future. The ability of the current shareholders to realise potential capital gains on their holdings in RED ELECTRICA and the need to offer the new shareholders an attractive value, provides RED ELECTRICA with a clear opportunity to put its infrastructure, financial resources and technical capabilities to the test.

The recognition of the incentives related to the efficient cost management of those technical restrictions and complementary services which increase the price of electricity; the possibility of connecting new generation and consumer facilities to the transmission network, encouraged by the new competitive market and the freedom of access to the grid; and the restructuring of power systems all over the world, which creates a growing demand for technology, management and capital in the field of electric power transmission, constitute opportunities for growth of RED ELECTRICA which are additional to its current activities in the fields of transmission and management of the system.

The priorities of RED ELECTRICA's management in 1998 and subsequent years will be the ability to respond with efficiency, flexibility and competitively to the new challenges which the new power market poses and the creation of shareholder value, taking into consideration the future listing of the shares on the stock exchange.

The Board of Directors and Management

Board of Directors

The composition of the Board of Directors at December 31st, 1997, was as follows:

CHAIRMAN

Pedro Mielgo Álvarez

BOARD MEMBERS

Jaime Carrasco Belmonte
Pedro Rivero Torre
Rafael Miranda Robredo
Carlos Vázquez Fernández-Victorio
Ricardo Rueda Fornies
Francisco García Sánchez
María Luisa Huidobro y Arreba
Victoriano Reinoso Reino
Luis Felipe Castresana Sánchez
Luis Daniel Sanz Suárez
Enrique García Álvarez
Javier Herrero Sorriqueta
Miguel Vila Despujol
Rufino Parra Terrón
José Damián Bogas Gálvez
Carmen Becerril Martínez
Francisco Javier Pinedo Cabezudo
Antonio Tuñón Álvarez

SECRETARY OF THE BOARD OF DIRECTORS (NON-BOARD MEMBER) AND LEGAL ADVISOR

Rafael García de Diego Barber

During 1998 Jaime Carrasco Belmonte, Carlos Vázquez Fernández-Victorio and Ricardo Rueda Fornies resigned as board members. These vacancies were filled at the General Shareholders Meeting with the appointment of Antonio Gomis Sáez, Juan Gurbindo Gutierrez and Miquel Nadal Segalà.

Management

CHIEF EXECUTIVE

Pedro Mielgo Álvarez

GENERAL MANAGERS

Agustín Fernández Herrero
Administration and Finance

Victoriano Casajús Díaz
Transmission

Ángel Landa López de Ocáriz
System Operation