

Nortegas Energía Distribución, S.A.U. and Subsidiaries

Consolidated Annual Accounts
31 December 2019

Consolidated Directors' Report
2019

(With Auditor's Report Thereon)

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



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

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

To the Sole Shareholder of Nortegas Energía Distribución, S.A.U.

Opinion

We have audited the consolidated annual accounts of Nortegas Energía Distribución, S.A.U. (the "Company") and subsidiaries (together the "Group"), which comprise the consolidated balance sheet at 31 December 2019, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and consolidated notes.

In our opinion, the accompanying consolidated annual accounts give a true and fair view, in all material respects, of the consolidated equity and consolidated financial position of the Group at 31 December 2019 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU) and other provisions of the financial reporting framework applicable in Spain.

Basis for Opinion

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

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

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



Most Relevant Aspects of the Audit

The most relevant aspects of the audit are those that, in our professional judgement, have been considered as the most significant risks of material misstatement in the audit of the consolidated annual accounts of the current period. These risks were addressed in the context of our audit of the consolidated annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these risks.

Recoverability of non-current assets (see notes 2.c, 3.h, 4, 7 and 8 to the consolidated annual accounts)

The Group's principal activities are related to gas distribution and the marketing of liquefied propane gas through pipelines and, therefore, the balances recognised under intangible assets and property, plant and equipment are highly significant. Furthermore, the consolidated annual accounts include goodwill amounting to Euros 46 million assigned to the Cash Generating Units (CGUs) in accordance with IFRS-EU. IFRS-EU determine the need to carry out an analysis of the recoverable amounts of the assets referred to in the previous paragraph in those cases in which indications of impairment were identified. Goodwill and intangible assets with indefinite useful lives are not amortised, but are instead tested for impairment at least on an annual basis.

The calculation of the recoverable amount of non-current assets indicated in the preceding paragraphs is determined through the use of methodologies based on discounted cash flows, the estimation of which is subject to uncertainty and which therefore requires the use of a high degree of judgement.

Our review procedures included assessing the design and implementation of the key controls relating to the process of determining the value in use of CGUs, assessing the reasonableness of the methodology used to calculate value in use and the main assumptions considered, with the involvement of our specialists, analysing the consistency of the estimated growth in future cash flows with the 2020 budget and the business plans approved by the governing bodies, comparing cash flow forecasts estimated in prior years with the actual cash flows obtained, assessing the sensitivity of certain assumptions to changes that are considered reasonable, and verifying compliance with the disclosure requirements established in IFRS-EU.

Accounting for investments in property, plant and equipment (see notes 7 and 8 to the consolidated annual accounts)

As mentioned above, the Group's principal activity is related to gas distribution and the marketing of liquefied propane gas through pipelines and, therefore, the balances recognised under property, plant and equipment are highly significant. Therefore, given the volume represented by property, plant and equipment over the Group's total assets and due to the high degree of judgement required to assess the nature and amount of expenses to be capitalised as property, plant and equipment, to calculate the amount of interest expenses that should be capitalised in the construction of these assets and to determine the date on which the transfer to operation of installations under construction takes place, we consider the correct recognition of investments in property, plant and equipment to be a relevant aspect of the audit.



Our audit procedures included assessing the design and implementation of the Group's key controls related to the process of capitalisation and acquisition of assets, the analysis and documentary support of a statistically selected sample of additions for the period and assessing the accuracy of their accounting recognition, assessing whether the commencement date of the depreciation of the Group's assets is in accordance with the Group's accounting policy and assessing the adequacy of the accounting policy in this regard. In addition, we assessed whether the disclosures included in the annual accounts meet the requirements of the financial reporting framework applicable to the Group.

Other information: Consolidated Directors' Report

Other information solely comprises the 2019 consolidated directors' report, the preparation of which is the responsibility of the Parent's Directors and which does not form an integral part of the consolidated annual accounts.

Our audit opinion on the consolidated annual accounts does not encompass the consolidated directors' report. Our responsibility for the consolidated directors' report, in accordance with the requirements of prevailing legislation regulating the audit of accounts, consists of assessing and reporting on the consistency of the consolidated directors' report with the consolidated annual accounts, based on knowledge of the Group obtained during the audit of the aforementioned accounts and without including any information other than that obtained as evidence during the audit. It is also our responsibility to assess and report on whether the content and presentation of the consolidated directors' report are in accordance with applicable legislation. If, based on the work we have performed, we conclude that there are material misstatements, we are required to report them.

Based on the work carried out, as described in the preceding paragraph, the information contained in the consolidated directors' report is consistent with that disclosed in the consolidated annual accounts for 2019 and the content and presentation of the report are in accordance with applicable legislation.



Directors' Responsibility and Audit Committee's for the Consolidated Annual Accounts _____

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

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

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

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

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

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

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

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



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

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

From the significant risks communicated to the Directors of Nortegas Energía Distribución, S.A.U., we determine those that were of most significance in the audit of the consolidated annual accounts of the current period and which are therefore the most significant risks.

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

KPMG Auditores, S.L.

On the Spanish Official Register of Auditors ("ROAC") with No. 50702

(Signed on original in Spanish)

David España Martín

On the Spanish Official Register of Auditors ("ROAC") with No. 22,690

20 March 2020

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated balance sheet
for the years ended 31 December 2019 and 2018

(Expressed in thousands of Euros)

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

<u>Assets</u>	<u>Note</u>	<u>31 December 2019</u>	<u>31 December 2018</u>
Property, plant and equipment	7	1,000,698	1,031,365
Goodwill	8	45,910	45,910
Other intangible assets	8	1,475,927	1,501,680
Right-of-use assets		3,594	-
Equity-accounted investees	9	778	745
Other financial assets	11 and 12	585	2,379
Deferred tax assets	13	14,215	19,530
Total non-current assets		2,541,707	2,601,609
Inventories	3 (k)	3,913	4,345
Trade and other accounts receivable	11, 12 and 14	19,261	19,785
Other financial assets	11 and 12	98	37,665
Other current assets	15	1,584	3,775
Cash and cash equivalents	16	366,919	157,068
Total current assets		391,775	222,638
Total assets		2,933,482	2,824,247
		2,933,482	2,824,247
<u>Equity and Liabilities</u>	<u>Note</u>	<u>31 December 2019</u>	<u>31 December 2018</u>
Capital	17	100,000	100,000
Share premium	17	552,080	701,290
Reserves	17	15,367	(79,785)
Other shareholder contributions	17	528,144	324,244
Profit/(loss) for the year	17	56,575	95,152
Total equity		1,252,166	1,140,901
Capital grants	27	449	335
Contract liabilities	28	8,152	4,922
Provisions for liabilities and charges	25	230	5,486
Liabilities from the issue of bonds and other marketable securities	18, 19 and 21	1,293,640	1,292,309
Leases	18, 19 and 20	2,680	-
Other financial liabilities	18, 19 and 20	2,560	2,191
Deferred tax liabilities	13	284,645	290,671
Total non-current liabilities		1,592,356	1,595,914
Liabilities from the issue of bonds and other marketable securities	18, 19 and 21	5,345	5,345
Bank borrowings	18, 19 and 20	50	1,692
Other financial liabilities	18, 19 and 20	4,967	6,947
Leases	18, 19 and 20	983	-
Trade and other accounts payable	18, 19 and 22	60,886	54,969
Income tax liabilities	13	9,293	12,537
Other current liabilities	29	7,436	5,942
Total current liabilities		88,960	87,432
Total equity and liabilities		2,933,482	2,824,247
		2,933,482	2,824,247

The accompanying notes form an integral part of the consolidated annual accounts.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated income statement
for the years ended 31 December 2019 and 2018

(Expressed in thousands of Euros)

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

	Note	31 December 2019	31 December 2018
Revenue	30	222,672	229,687
Other operating income	30	13,732	9,463
Work carried out for the Group's own assets		7,005	6,459
Supplies	30	(18,421)	(21,730)
Personnel expenses	32	(12,323)	(16,763)
Change in trade receivables and contract assets		364	(59)
Other expenses	31	(35,522)	(35,473)
Operating profit before depreciation/amortisation		177,507	171,584
Amortisation and depreciation	7, 8 and 10	(83,346)	(81,863)
Operating profit		94,161	89,721
Finance income	33	224	357
Finance cost	33	(22,545)	(28,612)
Share in profit for the period from investments accounted for using the equity method	9	158	191
Profit/ (loss) before tax from continuing operations		71,998	61,657
Income tax (expense)/income	13	(15,423)	33,495
Profit/ (loss) for the period from continuing operations		56,575	95,152
Profit/(loss) for the period		56,575	95,152
Comprehensive income for the period		56,575	95,152

The accompanying notes form an integral part of the consolidated annual accounts.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

**Statement of changes in equity
for the years ended
31 December 2019 and 2018**

(Expressed in thousands of Euros)

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

	Equity attributable to equity holders of the parent							
	Capital	Share premium	Reserve for merger	Legal reserve	Other reserves	Profit/(loss) for the period	Other shareholder contributions	Total equity
Balance at 31 December 2017	100,000	814,183	(91,773)	-	-	11,988	196,941	1,031,339
Comprehensive income for the period	-	-	-	-	-	95,152	-	95,152
Distribution of profit/(loss)	-	-	-	75	11,913	(11,988)	-	-
Distribution of share premium	-	(112,893)	-	-	-	-	-	(112,893)
Shareholder contributions (note 17)	-	-	-	-	-	-	127,303	127,303
Balance at 31 December 2018	100,000	701,290	(91,773)	75	11,913	95,152	324,244	1,140,901
Comprehensive income for the period	-	-	-	-	-	56,575	-	56,575
Distribution of profit/(loss)	-	-	-	8,145	87,007	(95,152)	-	-
Distribution of share premium	-	(149,210)	-	-	-	-	-	(149,210)
Shareholder contributions (note 17)	-	-	-	-	-	-	203,900	203,900
Balance at 31 December 2019	100,000	552,080	(91,773)	8,220	98,920	56,575	528,144	1,252,166

The accompanying notes form an integral part of the consolidated annual accounts.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated statement of cash flows
for the years ended
31 December 2019 and 2018

(Expressed in thousands of Euros)

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

	<i>Note</i>	<i>31.12.2019</i>	<i>31.12.2018</i>
Cash flows from operating activities			
Profit/(loss) for the period before tax		71,998	61,657
Adjustments for		101,310	113,112
Amortisation and depreciation	Notes 7, 8 and 10	83,346	81,863
Impairment allowances		(364)	59
Change in provisions	Note 25	(3,649)	3,117
Grants recognised in the income statement		(144)	(6)
Proceeds from disposals of fixed assets		(42)	15
Finance income		(224)	(357)
Finance cost		22,545	28,612
Share of profit of equity-accounted investees		(158)	(191)
Changes in operating assets and liabilities		11,956	57,142
Inventories		432	953
Trade and other receivables		2,978	71,935
Other current assets		2,191	(1,018)
Other current liabilities		1,494	(11,859)
Trade and other payables		4,861	(2,869)
Other cash flows from operating activities		(43,580)	(37,290)
Interest paid		(24,140)	(27,015)
Dividends received		124	112
Interest received		470	94
Other amounts received/(paid)		(1,607)	(1,560)
Income tax paid		(18,427)	(8,921)
Cash flows from operating activities		141,684	194,621
Cash flows from investing activities			
Payments for investments		(25,194)	(66,801)
Change in cash due to modification of the consolidation perimeter	Note 4	-	(4,632)
Intangible assets	Note 8	(2,786)	(2,351)
Property, plant and equipment		(22,408)	(22,818)
Other financial assets	Note 11	-	(37,000)
Proceeds from sale of investments		37,274	5,939
Property, plant and equipment		274	416
Other financial assets		37,000	5,523
Cash flows from investing activities		12,080	(60,862)
Cash flows from financing activities			
Proceeds from and payments for equity instruments		203,900	-
Other shareholder contributions		203,900	-
Proceeds from and payments for financial liability instruments		1,397	5,668
Issue		4,117	5,781
Issuance and disposal of debt		-	1,642
Capital grants and other	Notes 27 and 28	3,515	3,985
Other		602	154
Redemption and repayment of		(2,720)	(113)
Repayment of debt		(1,749)	(113)
Leases		(971)	-
Dividends and interest on other equity instruments paid		(149,210)	(112,893)
Distribution of share premium	Note 17	(149,210)	(112,893)
Cash flows from financing activities		56,087	(107,225)
Net increase/decrease in cash and cash equivalents		209,851	26,534
Cash and cash equivalents at start of period		157,068	130,534
Cash and cash equivalents at period end		366,919	157,068

The accompanying notes form an integral part of the consolidated annual accounts.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

1. Nature, Activities and Composition of the Group

Nortegas Energía Distribución, S.A.U. (formerly Naturgas Energía Distribución, S.A.U.) (hereinafter the Parent company) was incorporated with limited liability under Spanish law on 31 December 2003 with the corporate name Naturcorp Redes, S.A.U. In 2005, the company changed its name to Naturgas Energía Distribución, S.A.U.

On 27 July 2017 the sole shareholder approved, among other things, a change in the Company's name from Naturgas Energía Distribución S.A.U. to Nortegas Energía Distribución S.A.U.

Nortegas Energía Distribución, S.A.U. is the Parent of a group of companies whose main activities are as follows:

- a) The distribution of natural gas, including the construction, operation and maintenance of distribution facilities used to transmit natural gas from the transmission networks to consumption points.
- b) The construction, maintenance and operation of secondary transmission network facilities for natural gas, in order to facilitate the transmission of natural gas to distribution networks or to end consumers, where appropriate.
- c) The provision of services linked to or which are considered to be ancillary to the gas distribution business, to natural gas suppliers and end users.
- d) The acquisition, import, storage, bottling, all manner of industrial handling, transport, distribution and supply of liquefied petroleum gas, and the acquisition, manufacture, distribution and supply of all machinery and equipment required to perform this activity, and the provision of technical assistance.
- e) The production, acquisition, intra-EU exchange, import and export of liquefied petroleum gas and light hydrocarbons obtained from oil, natural gas and the storage, mixture, bottling and transportation of liquefied petroleum gas and light hydrocarbons obtained from oil, natural gas or biogas.
- f) The wholesale and retail sale of liquefied petroleum gas, natural gas and biogas, and the supply thereof, bottled or in bulk, including via tanker and the promotion, installation, maintenance and review of facilities required to conduct the above activities, including the construction, modification, operation and closure of LPG bulk storage and distribution facilities, and the pipelines required to supply end consumers from the aforementioned storage facilities.

The Group conducts its statutory activity under the terms and within the scope provided for in the Hydrocarbon Industry Law and related implementing legislation and pursuant to the legislation issued by the autonomous regional governments in accordance with their powers. If, in order to engage in its statutory activity, the Company were required to provide prior authorisations or to meet any requirements, legal, technical or economic-financial conditions or special training requirements, the Company would do so before carrying out its activity.

At 31 December 2019, Nortegas Energía Distribución, S.A.U. is the Parent of a Group comprising the subsidiaries NED España Distribución Gas, S.A.U. and NED Suministro GLP, S.A.U. Similarly, the Group has investments in the associates Tolosa Gasa, S.A. and Inkolan A.I.E. Details of the composition of the Group are provided in Appendix I.

In accordance with article 13.1 of the Revised Spanish Companies Act, the Parent is filed at the Mercantile Registry as a single shareholder company.

On 31 March 2017 Naturbidco S.L., was incorporated through a contribution of Euros 3 thousand and filed at the Mercantile Registry on 6 April 2017. The Company's sole shareholder approved a change to the corporate name on 19 April 2017, altering it to Nature Gasned XXI S.L.U.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

On 27 July 2017, the Parent's shares were acquired by Nature Gasned XXI S.L.U.

Regulatory framework

Details of the basic regulatory framework for the industry applicable to the Group up to 31 December 2021 are as follows:

Hydrocarbon Industry Law 34/1998 of 7 October 1998, amended by Law 12/2007 and by Royal Decree-Law 13/2012, by law 18/2014 and by Law 8/2015, introducing mechanisms to foster competition within the sector and defining a new natural gas market model. This law implements the main system definitions as regards the parties that participate therein and organises the gas system, distinguishing between regulated activities (regasification, transmission, storage and distribution) and unregulated activities (supply and other services). Lastly, this law defines the rights and obligations of the parties that operate in the natural gas market and regulates the distribution of liquefied petroleum gases.

1. Natural gas

In accordance with the above framework, the following principles are established:

a) Gradual liberalisation of the natural gas system:

This law provides for the liberalisation of gas supply activities, gradually enabling different types of customers to select their supplier. Since 1 January 2003, different types of customers have been able to freely select their supplier. The schedule for implementing the last resort supply commenced on 1 July 2008, leading to the elimination of the tariff-based supplies from gas distributors in place up until this point.

Royal Decree 949/2001 of 3 August 2001 regulates third-party access to gas facilities and sets out an integrated economic system for the natural gas sector. This Royal Decree also sets out the model for calculating natural gas tariffs and the payments and fees charged for third-party use of the gas network. Subsequently, Royal Decree 984/2015 of 30 October 2015, in addition to creating the organised gas market, introduces amendments to the access regime of third parties to gas facilities, establishes a centralised system of guarantees and modifies the regime associated with periodic inspections.

Following approval by the Delegate Commission on Economic Affairs, the Ministry for Ecological Transition and Demographic Challenge sets the new prices for last resort tariffs and the tolls and charges for basic third-party access services. The entitlement of direct market consumers and suppliers to use the basic grid and transmission and distribution facilities was also established, and a single nationwide toll was set for the use of these networks. Order TEC/1367/2018, stipulating the tolls and charges for third-party access to gas facilities, among other things, was published on 20 December 2018.

Royal Decree 1434/2002 of 27 December 2002, implementing the Hydrocarbon Industry Law, regulates transmission, distribution, sale and supply activities and the authorisation procedures for gas facilities.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

With respect to distributors, Ministry of Economy Order ECO/301/2002 set out the remuneration for distribution activities for the first time, to be determined as of that date on the basis of an annual revision, taking into account increases in the points of supply, the volume of gas transmitted and price fluctuations. Publication of Royal Decree-Law 8/2014 and Law 18/2014 brought about changes to the remuneration model applicable to distributors from the second half of 2014 onwards, although the annual revision of remuneration will continue to be determined by reference to the variation in demand.

In addition to tolls and charges, the aforementioned Order TEC/1367/2018 also sets the remuneration for regulated activities in 2019.

Similarly, Ministry of Economy Order ECO/2692/2002 of 28 October 2002 defines the settlement procedures for the payment obligations and rights to receivables necessary to remunerate natural gas regasification, transmission, storage and distribution activities and the pertinent, specifically allocated payments and charges, and defines a system for reporting on natural gas billing and use.

In January 2019, Royal Decree-Law 1/2019 of 11 January was published on urgent measures to adapt the powers of the Spanish National Markets and Competition Commission (CNMC) to the requirements arising from Community law, which stipulates that the regulators of domestic natural gas and electricity markets be fully independent. The Royal Decree-Law acknowledges the technical skill and criteria of the CNMC and sets out mechanisms for cooperation that guarantee the smooth running of the entire system. Specifically, the regulation redistributes competences, whereby the CNMC is assigned, with regards the gas sector, the approval of the structure, methodology and the specific toll values granting access to the transmission and distribution networks, and to liquefied natural gas plants. Similarly, the Commission will approve the methodology and remuneration values for gas transmission and distribution activities and liquefied natural gas plants. It will also be in charge of gas system technical manager remuneration. Likewise, it shall be responsible for the methodology and conditions for access and connection to the natural gas transmission and distribution networks. These powers will be enacted through the issuing of Circulars and Resolutions.

Within the scope of its new regulatory powers, the CNMC must take into account the strategic priorities set out by the Government, which are approved by Order TEC/406/2019 of 5 April, establishing the energy policy guidelines for the Spanish National Markets and Competition Commission when preparing Circulars and which cover issues such as supply security, the economic and financial sustainability of the gas system, the fight against climate change, etc.

With regard to remuneration, the Royal Decree-Law stipulates that the CNMC must approve, before 1 January 2020, the Circular containing the methodology for calculating remuneration for natural gas distribution for the 2021-2026 regulatory period. This Circular has not however been approved in accordance with the planned timetable; a first proposal was submitted for public consultation in July 2019 and a second proposal in December 2019. In accordance with this second proposal, submitted to the State Council in January 2020, the CNMC has opted for a methodology that is consistent with the current remuneration framework. Thus, the current activity model is maintained (remuneration based on the number of supply points and structured demand), but it introduces an adjustment to the remuneration base. This adjustment reviews the unit values applicable to distributors' activity in 2000, keeping sufficient incentives to guarantee the operation and maintenance of distribution networks. The methodology for tolls and charges is also pending approval and is currently in the public consultation stage which ends in April 2020.

At the date on which these consolidated annual accounts are prepared, the aforementioned Circular has not been published. Based on our best expectations, the published draft will be approved without significant differences.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

b) Settlements of regulated activities - gas sector:

Basically, as a result of the entry into force of the Spanish Hydrocarbon Industry Law 34/1998 and the corresponding implementing provisions, inter-company settlements have arisen since 2002. These settlements are performed by the Spanish National Markets and Competition Commission (CNMC), which incorporates the defunct National Energy Commission (CNE), and give rise to receipts and payments between companies in the sector in order to redistribute the proceeds obtained from access tolls and charges so that each company receives the remuneration effectively allocated to it for regulated activities. These settlements are currently being carried out by the CNMC, although the responsibility for this process has returned to the Ministry.

c) Financing of the sector deficit:

Law 18/2014 establishes the treatment of the gas sector tariff deficit, i.e. the financing of the deficit between the income and costs of the gas system each year.

Thus, the law determines that the amount of the accumulated deficit at 31 December 2014 will be determined in the final 2014 settlement (settlement 15), and the regulated parties are entitled to recover the annual amounts corresponding to this accumulated deficit in the settlements for the following 15 years, recognising interest at market rates. Deficits subsequent to 2014 will be settled in the 5 following annual amounts, and will also recognise interest at market rates. The amount of the deficit recognised, the corresponding annual amount and the interest rate applied must be approved by the Ministry for Ecological Transition and Demographic Challenge.

Pursuant to Ministerial Order ETU/1977/2016, the accumulated industry deficit at 31 December 2014 amounted to Euros 1,025 million and in 2015 it amounted to Euros 27 million. The portion of these 2014 and 2015 deficits corresponding to Nortegas Energía Distribución, S.A.U. (formerly Naturgas Energía Distribución, S.A.U.) amounted to Euros 55.9 million and Euros 1.7 million, respectively. With regards following years:

- 2016: pursuant to the final settlement for 2016 made by the Spanish National Markets and Competition Commission (CNMC), the deficit for 2016 amounted to Euros 90 million of which Euros 5.3 million corresponded to Nortegas Energía Distribución, S.A.U. (formerly Naturgas Energía Distribución, S.A.U.).
- 2017: The final settlement for 2017 produced a deficit of Euros 24.8 million, whereby Nortegas Group companies had to assume a deficit of Euros 1.6 million.
- 2018: The CNMC has published the surplus for 2018, which amounts to Euros 30.9 million, whereby Euros 0.35 million corresponds to Nortegas Energía Distribución, S.A.U. and Euros 1.53 million to NED España Distribución, S.A.U.
- In 2019 the inbalance between income and gas system costs is expected to be positive (surplus).

On 1 December 2017, under the system of settlements with entitlement to recover annual amounts corresponding to the 2014 deficit, the Company transferred the amount and the interest receivable to a financial institution. This transaction, amounting to Euros 53,036 thousand, means that the payments for the aforementioned items, which according to the periodic settlements drawn by the CNMC, are payable to the company should be paid into the current account and in the name of the new beneficiary. Furthermore, on 21 December 2018 the CNMC was notified of the assignment agreement, of the recognised amount pending collection plus interest corresponding to the temporary imbalance between income and expenses for 2015 and 2016 referred to in Orders ETU/1977/2016 and ETU/1283/2017, which amount to Euros 1,089 thousand and Euros 4,434 thousand, respectively.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

The prior approval of 2018 surplus, which amounts to Euros 30.9 million as a whole, has enabled the early repayment of current debt relating to previous years. The System has therefore cancelled the debt with Nortegas Energía Distribución, S.A.U. for the 2017 deficit (except for two monthly payments that will be settled at the start of 2020 for Euros 53 thousand).

- d) Correct functioning of the system guaranteed through the following measures:

Enagás GTS, S.A.U. carries out system technical manager activities, for which it receives remuneration. As the entity responsible for the technical management of the basic grid and secondary transmission networks, Enagás GTS, S.A.U. must guarantee the continuity and security of supply of natural gas and the correct coordination between access points, storage facilities and transmission facilities under criteria of non-discrimination.

- e) Unbundling of activities:

Activities pertaining to the supply of natural gas by pipeline are conducted by transmission agents, distributors and suppliers. Regasification, strategic storage, transmission and distribution are regulated activities, whilst supply activities are carried out freely and the corresponding economic regime is determined on the basis of the terms and conditions agreed between the parties.

In this regard, trading companies that carry out any of the regulated activities described in the preceding paragraph should have this activity as their sole statutory activity and may not, therefore, carry out any supply activities. Similarly, companies engaged in the supply of natural gas should have this activity as their sole statutory activity and may not carry out any regulated activities.

Natural gas companies that conduct more than one of the regulated activities described above must maintain separate accounts for each of these activities in their internal accounting records, exactly as would be required if these activities were conducted by different companies. Furthermore, the Law defines a number of mandatory unbundling requirements applicable to companies that carry out regulatory activities and belong to a corporate group that also includes companies that carry out supply activities.

2. LPG - Liquefied Petroleum Gas

The Hydrocarbon Law implements the main system definitions regarding the parties involved and organises the activities related to the supply of liquefied petroleum gases (hereinafter LPG), distinguishing between wholesale and retail supply.

Subsequently, Law 8/2015 of 21 May 2015, which amends Hydrocarbon Industry Law 34/1998 of 7 October 1998 and regulates certain tax and non-tax related measures related to exploration, research and operations in the field of hydrocarbons, introduced profound changes into the general framework for the activity. It explicitly defined bulk supply and stipulated that the provisions for the supply of gaseous fuels through mains would also apply to the bulk supply of piped LPG, as long as there were no regulatory developments in this respect.

Royal Decree 1085/1992 of 11 September 1992, which in turn approved the regulation governing the distribution of liquefied petroleum gases, in implementation of Law 15/1992 of 5 June 1992, on urgent measures for the progressive adaptation of the oil sector to the community framework, included the main details for conducting the retail LPG supply activity, i.e. the sale to end consumers or users. It implements, among others, the requirements for parties to carry out the activity, aspects related to the installations, details on supply and contracting, and the regime governing tariffs. This Royal Decree was subsequently amended by Royal Decree 197/2010 of 26 February 2010 adapting certain provisions relating to the hydrocarbon industry to the provisions of Law 25/2009 of 22 December 2009, which amended various laws to adapt them to the Law on unrestricted access to service activities and the provision thereof, for purposes of compliance with Law 34/1998.

- a) Definition of the LPG supply sector:

Liquefied petroleum gases are defined as light hydrocarbon fractions, mainly propane and butane, which are obtained during the extraction of crude oil or natural gas or during refining of petroleum products.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

The activities related to the supply of LPG are as follows: production, acquisition, intra-EU exchange, import and export; storage, mixing and packaging; transportation; wholesale supply; retail supply; installation, maintenance and review of the facilities related to the supply of LPG.

One of the methods by which LPG can be supplied is in bulk. This includes the distribution and/or supply of LPG through mains, the latter being understood as the distribution and supply of LPG from one or more mains tanks which are used to supply users with piped LPG supply contracts with a distribution company.

"Wholesale supply" is defined as that which does not involve the supply to an end consumer or user.

"Retail supply" is defined as the sale to end consumers or users.

b) Requirements and conditions for carrying out the retail distribution of LPG

Article 46 of Hydrocarbon Industry Law 34/1998 defines the role of retail distributor of bulk liquefied petroleum gases. It establishes the requirements for obtaining authorisation to carry out this activity as follows: to have the legal, technical and financial capacity and to comply with the technical and safety conditions established by law at its installations.

In the absence of a regulation to implement article 46, the second transitional provision of Law 34/1998 is applicable. This provision maintains the validity of the regulations applicable to the matters governed by Law 34/1998 until new ones are introduced. In this case, the prevailing regulation is the aforementioned regulation governing the distribution of liquefied petroleum gases (Royal Decree 1085/1992, Official State Gazette of 9 October 1992). Although it does not define the same roles, it stands to reason that the retail distributor of bulk liquefied petroleum gases must fulfil the same conditions as the LPG supply company.

Under this regulation, the requirements for carrying out the activity are:

1. To possess the financial capacity to do so.
2. To possess the technical capacity to do so.
3. To have a guaranteed source of supply.
4. To have a means of storage.
5. To keep minimum security stocks equivalent to thirty days' total sales, or to acquire LPG through a wholesale operator.

c) Economic regime

With regard to the economic regime governing piped LPG, the current wording of article 94 of Law 34/1998 stipulates that the Ministry may make the provisions required to establish the sales prices of piped LPG for end consumers, and the consumer transfer tariffs for distributors of piped gaseous fuels. The difference between both prices provides the supplier's margin on the activity of supplying end customers. This margin carries a fixed margin per consumer and a variable component based on consumption.

The source of the current economic framework is the Order dated 31 July 1997 establishing the system of maximum sales prices before tax for liquefied petroleum gases (B.O.E. of 1 August 1997). This Order has been the subject of successive revisions and updates:

- Order of 16 July 1998 updating the selling costs of the system for the automatic establishment of maximum pre-tax sales prices of liquefied petroleum gases, and liberalising certain supplies.
- Order ITC/3292/2008 of 14 November 2008, modifying the system for the automatic determination of pre-tax sales tariffs of piped liquefied petroleum gases.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

- Order IET/389/2015 of 5 March 2015, updating the system for the automatic determination of maximum pre-tax sales prices of bottled liquefied petroleum gases and modifying the system for the automatic determination of pre-tax sales tariffs for piped liquefied petroleum gases.

The maximum price of piped liquefied petroleum gas (LPG) is established in the Resolution issued by the Directorate-General for Energy Policy and Mining, in accordance with the aforementioned regulations. Among these resolutions, which may be issued monthly, the revision in July of each year is particularly important as it determines the sales margin on the activity. Thus, in 2019 the main Resolution is that of 11 July 2019, by the Directorate-General for Energy Policy and Mining, publishing the new pre-tax sales prices of piped liquefied petroleum gases.

2. Basis of Presentation

The consolidated annual accounts have been prepared on the basis of the accounting records of Nortegas Energía Distribución, S.A.U. and subsidiaries. The consolidated annual accounts for the year ended 31 December 2019 are prepared in accordance with International Financial Reporting Standards (hereinafter, IFRS), as adopted by the European Union in accordance with EC Regulation No. 1606/2002 of the European Parliament and of the Council. The Directors of the Parent consider that these consolidated annual accounts will be approved by the sole shareholder with no changes.

The Nortegas Group's consolidated annual accounts for 2018 were approved by shareholders at their general meeting held on 27 June 2019.

Additionally, the Parent Company forms part of Grupo Nature Investments, S.a.r.l., the parent company of which is Nature Investments, S.a.r.l., with registered address at 19 rue de Bitbourg, Luxembourg. The latter company draws up the consolidated financial statements, the Spanish translation of which will be deposited with the Mercantile Registry of Bizkaia.

(a) Basis of presentation of the annual accounts

These consolidated annual accounts have been prepared on a historical cost basis.

(b) Comparative information

In May 2018 staff from the corporate departments (76 employees) were transferred to the sole shareholder (Nortegas Energía Grupo, S.L.U.). Since then, the sole shareholder renders these services to Group companies (note 34). This fact needs to be taken into consideration when comparing the income statement for both years.

Furthermore, when comparing the 2019 figures included in these Consolidated Annual Accounts with the 2018 figures, the application of IFRS 16 on 1 January 2019 must be taken into account (note 2.d).

(c) Significant accounting estimates and key assumptions and judgements when applying accounting policies

Relevant accounting estimates and judgements and other estimates and assumptions have to be made when applying the Group's accounting principles to prepare the consolidated annual accounts in line with IFRS-EU. A summary of the items requiring a greater degree of judgement or which are more complex, or where the assumptions and estimates made are significant to the preparation of the consolidated annual accounts is as follows:

- Impairment of non-current assets (see note 8)
- As described in notes 3.h and 8, in accordance with applicable accounting regulations, the Group performs annual impairment tests of its cash generating units. It carries out specific tests in the event it detects indications of impairment. These impairment tests imply an estimation of the future evolution of the businesses and of the most appropriate discount rates used in each case.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

The Group believes that its estimates in this regard are adequate and consistent with the current economic situation and that they reflect its investment plans and the best available estimate of its future income and expenses, and considers that its discount rates adequately reflect the risks corresponding to each cash generating unit.

- Useful life of property, plant and equipment and intangible assets (see notes 7 and 8)

The Directors of the Parent company determine the estimated useful lives and corresponding depreciation and amortisation for its property, plant and equipment and intangible assets. This estimate is based on the expected duration of each of the Group's property, plant and equipment and intangible assets and the forecast life cycles of the products it sells. The Directors of the Parent company will modify the depreciation charges for these items when the useful lives are considered to differ from the lives previously estimated and will depreciate or derecognise technically obsolete or non-strategic assets that have been abandoned or sold.

- Income tax (see note 13)

Due to the legal status of the tax regulation applicable to the Group companies, certain calculations are estimates and the ultimate quantification of the tax is uncertain. Tax is calculated based on Management's best estimates according to the current status of the tax legislation and taking into account its foreseeable evolution.

When the ultimate taxable income amount is different to the amounts initially recorded, the effect of these differences is recognised in income tax in the year in which they are determined.

- Provisions for risks and expenses (see note 25)

Despite the fact that these estimates have been made based on the best information available at the close of the year ended 31 December 2019, it is possible that events may take place in the future which will require them to be changed (upwards or downwards) in future years, which would be done on a prospective basis.

- Settlement of regulated activities (see note 1.1b)

At the end of each period, the Group estimates the final settlement for the regulated activities carried out in Spain in that period, determining, where appropriate, the corresponding revenue deficit, as well as the amount that will be subject to future recovery in accordance with the pronouncements of the authorities in this regard and the periods in which said recovery will take place (note 1).

The estimates include the provisional settlements published up to the date of authorisation of the annual accounts, as well as all available sector information.

(d) Standards and interpretations effective as of 1 January 2019

The accounting policies used to prepare these consolidated annual accounts are the same as those used for the year ended 31 December 2018, except for the application of IFRS 16 Leases on 1 January 2019, issued by the IASB (International Accounting Standards Board) and adopted by the European Union.

Transition to IFRS 16

The Group has made the transition to IFRS 16 by means of the modified retrospective approach whereby comparative figures for the period are not re-stated and the effect of initially applying IFRS 16 at 1 January 2019 (date of first application) is recorded so that in the lease agreements in which the Group acts as lessee, the lease liability is measured at the present value of the lease payments remaining, discounted using a discount rate at the date of first application.

From the lessor's standpoint, IFRS 16 does not introduce any relevant changes.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

Right-of-use asset and lease liability

From the point of view of the lessee, IFRS 16 eliminates the previous classification between operating and finance leases based on measuring the transfer of risks and rewards, and stipulates that a lessee must recognise an asset for the right to use a lease (note 10) and a liability for the present value of the obligation to make lease payments during the term of the agreement (note 21.2) in the consolidated balance sheet.

In accordance with the transition approaches provided for in the standard, right-of-use assets at the transition date were calculated at an amount equivalent to the value of future lease payments discounted at the incremental rate. Furthermore, according to the approaches provided for by IFRS 16, the Group has chosen to:

- Not recognise the right-of-use asset and lease liability relating to agreements whose term ended within the twelve months prior to the transition date;
- Exclude the direct costs relating to the agreements from the right-of-use asset;
- Calculate the lease term using the information available at the transition date;
- Not apply the new regulation to leases for intangible assets;

One single contract may contain lease and non-lease components. The Group has chosen not to separate the accounting records relating to the two components and to account for them as a single lease component.

Presentation

In the 2019 consolidated financial statements, the Group has classified the right-of-use asset and the lease liability under the new headings Right-of-use asset, Non-current financial liabilities-Leases and Current financial liabilities-Leases in the consolidated balance sheet, respectively.

Furthermore, the expense relating to these leases, which is recognised in the consolidated annual accounts for the comparative year under Other expenses in the consolidated income statement, is now recognised under Amortisation and depreciation expenses and Finance cost.

Impact on the Group

The Group has analysed whether a contract is or contains a lease at the date of first application in accordance with the definition and conditions set out in IFRS 16.

The effect of applying IFRS 16 at 1 January 2019 recorded by the Group is as follows:

Thousands of Euros	1 January 2019
Right-of-use asset	4,492
NON-CURRENT ASSETS	4,492
TOTAL ASSETS	4,492
Leases	3,524
NON-CURRENT LIABILITIES	3,524
Leases	968
CURRENT LIABILITIES	968
TOTAL EQUITY AND LIABILITIES	4,492

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

The increase in current and non-current liabilities relating to lease contracts corresponds to the following type of asset:

Thousands of Euros	1 January 2019
Buildings and properties	2,354
Fleet of vehicles	553
Other	1,585
Total	4,492

An incremental effective interest rate for financing has been applied to each uniform portfolio of this type of lease, country and term. The average weighted incremental interest rate at the date of initial application fell between 2.75% and 3.25%.

Below is a summary of the impact of applying IFRS 16 on the consolidated income statement at 31 December 2019:

Thousands of Euros	
Increase in the Finance cost heading	129
Increase in the Amortisation and depreciation heading	910
Total	1,039

The expense increase in the foregoing headings of the consolidated income statement at 31 December 2019 is offset by the expense reduction recognised in Other expenses in the consolidated income statement at 31 December 2019 for Euros 971 thousand.

Below is a breakdown of the reconciliation between future minimum payments under non-cancellable operating leases within the scope of current IAS 17 at 31 December 2018 and lease liabilities expected to be recognised at 1 January 2019 in the transition to IFRS 16:

Thousands of Euros	
Future minimum payments under non-cancellable operating leases according to IAS 17	2,320
Change of lease term due to change in standard	2,298
Financial discount difference	(126)
Lease liability at 1 January 2019 under IFRS 16	4,492

Legislation issued and pending application

On the date on which these consolidated annual accounts were prepared, the following standards, amendments and interpretations had been issued, the effective date of which is subsequent to the years started as of 1 January 2020:

Standard		Mandatory application	
		IASB	European Union
Amendments to IFRS 3	Definition of a business	01.01.2020	(*)
Amendments to IFRS 9, IAS 39 and IFRS 7	Reform of interest rate benchmark index	01.01.2020	01.01.2020

(*) Amendments to the definition of a business aim to help identify transactions that should be considered under the scope of IFRS 3.

Amendments to IAS 39, IFRS 9 and IFRS 7 Financial Instruments deal with uncertainty arising from interbank rate reforms (IBORs), preventing the interruption of existing hedging relationships thanks to the

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

temporary exceptions from applying certain specific hedge accounting requirements. This reform will not have an impact on Nortegas' consolidated annual accounts.

When preparing these consolidated annual accounts, the Group has not adopted the early application of any standard, interpretation or amendment that has been published but is not yet applicable.

The Group estimates that the application of IRFS 3 would not entail significant changes to these consolidated annual accounts.

3. Accounting Principles

(a) Subsidiaries

The subsidiaries that the Group holds control over are fully consolidated from the date on which control is obtained.

The Group considers that it holds control over a company when it is exposed to, or has the right to receive, variable yield as a result of its involvement in it, and has the capacity to influence such yield through the power it exercises over the company. For the purposes of preparing these consolidated annual accounts, a controlling interest is considered to be held in those companies in which an interest of over 50% of share capital is held and proof of control can be shown.

Results of subsidiaries acquired or disposed of during the year are taken to the consolidated income statement from the effective date of acquisition or until the effective date of disposal, as appropriate. All balances and transactions between fully consolidated companies are eliminated on consolidation.

At the date of taking control, the assets, liabilities and contingent liabilities of subsidiaries are recognised at fair value. Any excess of the cost of acquisition of the consolidated subsidiaries over the market value of these assets and liabilities is included under the heading goodwill, since these assets cannot be separately identified and measured. Any deficiency of the cost of acquisition below the market value is credited to the consolidated income statement.

When a Group company loses control of a Group company, their assets and liabilities and any minority interest that may be held are written off. The resulting gains or losses are recognised in the consolidated income statement. Shareholdings in subsidiaries for which control is no longer held are measured at fair value on the date on which control was lost. Gains or losses on purchases of minority interests in companies in which a controlling interest is held, as well as sales of shareholdings without loss of control, are charged or credited to reserves.

The subsidiaries' accounting policies have been adapted to Group accounting policies for like transactions and other events in similar circumstances.

The annual accounts of the subsidiaries used in the consolidation process have been prepared as of the same date and for the same period as those of the Parent.

Appendix I contains information about the subsidiaries included in the Group's scope of consolidation.

(b) Business combinations

The Group has applied the exception contemplated in IFRS 1 First-time adoption of International Financial Reporting Standards so that only business combinations undertaken after 1 April 2017, the IFRS-EU transition date, have been accounted for using the acquisition method.

The Group has applied IFRS 3 Business combinations revised in 2008, in transactions made subsequent to 1 April 2017.

The Group applies the acquisition method for business combinations.

The acquisition date is the date on which the Group obtains control of the acquiree.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

The cost of the business combination is calculated as the sum of the acquisition-date fair values of the assets transferred, the liabilities incurred or assumed, the equity instruments issued and any consideration contingent on future events or compliance with certain conditions in exchange for control of the acquiree.

The consideration paid excludes any payments that do not form part of the consideration given in exchange for the acquiree. Acquisition costs are recognised as an expense when incurred.

The Group recognises the assets acquired, the liabilities assumed and any non-controlling interest at their acquisition-date fair value. Liabilities assumed include any contingent liabilities that represent present obligations arising from past events for which the fair value can be reliably measured. The Group also recognises indemnity assets granted by the seller at the same time and following the same measurement standards for the relevant indemnity item within the acquired business, taking into account any risk of insolvency and any contractual limitation to the indemnity amount.

With the exception of lease and insurance contracts, the assets acquired and liabilities assumed are classified and designated for subsequent measurement based on contractual agreements, economic terms, accounting and operating policies and any other conditions existing at the acquisition date.

The excess between the business combination cost, plus the value given to non-controlling interests, and the value of net assets acquired and liabilities assumed, is recognised as goodwill.

(c) Associates

Associates are entities over which the Company, either directly, or indirectly through subsidiaries, exercises significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. The existence of potential voting rights that are exercisable or convertible at the end of each reporting period, including potential voting rights held by the Group or other entities, are considered when assessing whether an entity has significant influence.

Investments in associated entities are recorded using the equity accounting method from the date significant influence is exercised until the date on which the Company can no longer prove this influence exists. However, if at the date of acquisition, all or part of the investment meets the conditions for classification as non-current assets or disposable groups of elements classified as held for sale, these are recorded at their fair value, less costs of retirement or disposal.

Investments in associated entities are initially recorded at cost of acquisition, including any cost directly attributable to the acquisition and any contingent asset or liability consideration that depends on future events or fulfilment of certain conditions.

The excess of the cost of the investment over the Group's share in the fair value of the identifiable net assets is recognised as goodwill which is included in the carrying amount of the investment. Once the cost of the investment is measured and the net assets of the associate are identified and measured, the deficiency is included as income in the determination of the investor's share of the associate's profit or loss in the period in which the investment was acquired.

If the investment results from the loss of control of a subsidiary that did not constitute a business, the cost of the investment is the fair value, net of the earnings written off as a result of the loss of control.

The Group's share of the profit or loss of an associate from the date of acquisition is recognised as an increase or decrease in the value of the investments, with a credit or debit to share of the profit or loss for the year of equity-accounted associates in the consolidated income statement. The Group's share of other comprehensive income of associates from the date of acquisition is recognised as an increase or decrease in investments in associates with a balancing entry, naturally, in other comprehensive income. The distribution of dividends is recognised as a decrease in the value of the investment. The Group's share of profit or loss, including impairment losses recognised by the associates, is calculated based on income and expenses arising from application of the acquisition method.

The Group's share of the profit or loss of an associate and changes in equity is calculated to the extent of the Group's interest in the associate at year end and does not reflect the possible exercise or conversion

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

of potential voting rights. However, the Group's share is calculated taking into account the possible exercise of potential voting rights and other derivative financial instruments which, in substance, currently allow access to the economic benefits associated with the interests held, such as entitlement to a share in future dividends and changes in the value of associates.

The Group's share in the profit or loss of associated entities is recorded after taking into account the effect of dividends, agreed or otherwise, corresponding to cumulative preferential shares recorded in equity.

Losses of an associate attributable to the Group are limited to the extent of its net investment, except where the Group has legal or constructive obligations or when payments have been made on behalf of the associate. For the purposes of recognising impairment losses in associated entities, net investment is the result of adding the amount of any other item that substantially forms part of the investment in associates to the carrying amount resulting from applying the equity accounting method. The surplus of losses over the investment in equity instruments is applied to the remaining entries in inverse order of priority in the settlement. Profits obtained subsequently by those associates in which loss recognition was limited to the value of the investment are recorded if they exceed the previously unrecognised losses.

Unrealised gains and losses arising on transactions between the Group and its associates are only recognised insofar as they correspond to interests held by other non-related investors. This criterion is not applicable to recognition of unrealised losses constituting evidence of impairment of the asset transferred.

However, profits and losses on transactions between Group and associated companies regarding net assets that constitute a business are recognised fully.

Details of equity-accounted investees are included in Appendix I.

Impairment

The Group applies the impairment criteria contained in IAS 39 "Financial Instruments: Recognition and Measurement" to determine whether it is necessary to recognise any additional impairment loss with respect to the net investment in the associate or in any other financial asset held with it as a result of applying the equity method.

Impairment is calculated by comparing the carrying amount of the investment with its recoverable amount. The recoverable amount is the higher of value in use and fair value less costs of retirement or disposal. Value in use is calculated based on the Group's share of the present value of future cash flows expected to be derived from ordinary activities and the amounts that may arise from the final disposal of the associate.

The recoverable amount of the investment in the associate is assessed in relation to each associate, except when it does not constitute a cash generating unit (CGU).

Impairment losses are not allocated to goodwill or other assets implicit in the investment in associates derived from application of the acquisition method. In subsequent years, reversals of impairment of investments are recognised in profit or loss to the extent of any increase in the recoverable amount. Impairment losses are recognised separately from the Group's share of the profit or loss of an associate,

(d) Functional and presentation currency

The figures disclosed in the consolidated annual accounts are expressed in thousands of Euros, the Parent's functional and presentation currency, rounded off to the nearest thousand, unless otherwise stated.

(e) Property, plant and equipment

Initial recognition

Property, plant and equipment are recognised at cost or deemed cost, less accumulated depreciation and any accumulated impairment losses.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

Production costs are capitalised in the consolidated income statement under Work carried out for the Group's own assets. Property, plant and equipment are carried at cost, less any accumulated amortisation and impairment.

Subsequent costs

Subsequent to initial recognition of the asset, only the costs incurred which increase capacity or productivity or which lengthen the useful life of the asset are capitalised. The carrying amount of parts that are replaced is derecognised. Costs of day-to-day servicing are recognised in profit and loss as incurred.

Depreciation

Property, plant and equipment are depreciated by allocating the depreciable amount of an asset on a systematic basis over its useful life. The depreciable amount is the cost of an asset less its residual value.

Property, plant and equipment are depreciated using the following criteria:

	Depreciation method	Estimated years of useful life
Buildings	Straight-line	10 - 50
Technical installations and machinery (gas distribution network)	Straight-line	30 – 35
Technical installations and machinery (regulation and metering stations)	Straight-line	15 - 30
Technical installations and machinery (LNG plants)	Straight-line	12
Other installations, equipment and furniture	Straight-line	5 - 20
Technical installations and machinery (LPG installations)	Straight-line	17.5 - 30
Other property, plant and equipment	Straight-line	4 - 10

The Group reviews residual values, useful lives and depreciation methods at each financial year end. Changes to initially established criteria are accounted for as a change in accounting estimates.

Revaluations permitted by law are depreciated over the remaining useful life of the revalued assets.

Impairment

The Group measures and determines impairment to be recognised or reversed based on the criteria in section (h).

(f) Intangible assets

Goodwill

The excess between the consideration paid, plus the value given to non-controlling interests, plus the fair value of the previous interest in the acquired business and the net value of assets acquired and liabilities assumed.

The cost of the business combination is calculated as the sum of the acquisition-date fair values of the assets transferred, the liabilities incurred or assumed, the equity instruments issued and any consideration contingent on future events or compliance with certain conditions in exchange for control of the acquiree.

The consideration paid excludes any payments that do not form part of the consideration given in exchange for the acquiree. Acquisition costs are recognised as an expense when incurred.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

Goodwill represents the positive difference between the cost of the business combination and the value at the acquisition date of the assets acquired, liabilities and contingent liabilities taken on from the business acquired.

Goodwill is not amortised but is tested for impairment annually or more frequently where events or circumstances indicate that an asset may be impaired. Goodwill arisen in business combinations is allocated to each cash-generating unit (CGU) or groups of CGUs that the Group expects to benefit from the synergies of the combination, applying the criteria mentioned. After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill generated internally is not recognised as an asset.

Patents, licences, trademarks and similar rights

This caption corresponds to the cost of identifiable intangible assets acquired in the business combination and reflects their fair value, subject to the exceptions set forth in the business combinations section.

Separable and identifiable intangible assets correspond to the value assigned to clients / connection points by an independent expert in the process of identifying and allocating the acquisition cost of subsidiaries. As a result of this, these items were recognised separately to goodwill.

Computer software

The licenses for computer software acquired from third parties are capitalized at cost of acquisition plus the costs incurred to prepare them for the use the specific programme.

Maintenance costs on computer software are recorded as an expense in the year in which they are incurred. Costs directly related to the production of unique and identifiable software controlled by the Group and which are likely to generate financial benefits above costs for more than one year are recognised as intangible assets. The direct costs include the costs of the personnel developing the software and an adequate percentage of overhead.

Useful life and amortisation rates

The Group assesses whether the useful life of each intangible asset acquired is finite or indefinite. An intangible asset is regarded by the Group as having an indefinite useful life when there is no foreseeable limit to the period over which the asset will generate net cash inflows.

Intangible assets with indefinite useful lives are not amortised, but are instead tested for impairment on an annual basis or whenever there is an indication that the intangible asset may be impaired.

Intangible assets with finite useful lives are amortised on a straight-line basis by allocating the depreciable amount of an asset on a systematic basis over the following estimated years:

	<u>Amortisation method</u>	<u>Estimated years of useful life</u>
Computer software	Straight-line	4
Patents, licences, trademarks and similar rights	Straight-line	40-60

The depreciable amount is the cost of an asset or deemed cost less its residual value.

The Group reviews the residual value, useful life and amortisation method for intangible assets at each financial year end. Changes to initially established criteria are accounted for as a change in accounting estimates.

Impairment

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

The Group measures and determines impairment to be recognised or reversed based on the criteria in section (h).

(g) Lease contracts

As mentioned in note 2.d, the Group started applying IFRS 16 Leases to its lease contracts on 1 January 2019.

Standards applied in prior years

Prior to 2019 the Group's leases were recognised in accordance with the standards established by IAS 17: Leases and IFRIC 4: Determining whether an arrangement contains a lease. The Group classified leases in which the lessor substantially transferred to the lessee the risks and rewards of ownership of the asset as financial leases. All other leases were classified as operating leases. This classification applied when the Group acted as lessor and as lessee.

Assets acquired under finance leases were recorded under the non-current assets heading relating to their nature and function. These assets were recorded at the lower of the fair value of the leased asset and the present value of future payments under the contract, and they were depreciated over the useful life of each asset in question.

Expenses and income arising from operating leases were recognised in the consolidated income statement over the term of the lease on an accruals basis.

Criteria applied from 1 January 2019 onwards

Leases determine the control to use an identified asset for a period of time in exchange for a consideration.

The right-of-use asset is initially recorded at cost, which includes:

- The amount of the initial measurement of the lease liability;
- Any lease payment made on or prior to the commencement of the lease, less any incentives received;
- Any initial direct costs incurred by the lessee; and
- An estimate of the costs to be incurred by the lessee in dismantling and restoring the asset.

Subsequent to initial recognition, the right-of-use asset is recorded at cost less accumulated depreciation and impairment losses. Depreciation of the right-of-use asset is recognised under Amortisation and provisions in the consolidated income statement on a straight-line basis over the period from the start of the contract to its expiry date, except when ownership of the contract is transferred when the contract term ends or the right-of-use amount includes the exercise of a purchase option, whereby the depreciation period is calculated on the basis of the useful life of the underlying asset. Furthermore the right-of-use asset is subsequently adjusted as a result of certain re-estimates affecting the lease liabilities.

The lease liabilities are measured at the present value of the lease payments to be made subsequent to the start of the contract discounted using the interest rate implicit in the lease or using the incremental rate if the former cannot be readily determined. Generally speaking, future payments are discounted using the incremental interest rate.

Lease payments include:

- Fixed or in-substance fixed payments;
- Variable payments that depend on an index or rate;

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

- The amounts expected to be paid by the lessee under residual value guarantees;
- The price of exercising a purchase option if the lessee is reasonably certain to exercise this option;
- The amounts payable during optional renewal periods, provided that the extension of a lease is considered to be reasonably certain; and
- Payments for terminating the lease early if it is considered reasonably certain that the lease will be terminated early;

Subsequently, lease liabilities are measured at amortised cost using the effective interest rate and they are remeasured when there is a change in the index or rate, in the amounts expected to be paid under residual value guarantees or when there are changes that affect the estimated price of exercising purchase options, or extending or terminating the lease. The financial restatement is recorded under Finance cost in the consolidated income statement (note 33).

Contingent rents subject to the occurrence of a specific event and variable payments that depend on the income from or the use of the underlying asset are recorded when incurred under Other expenses in the consolidated income statement instead of forming part of the lease liability.

(h) Impairment of non-financial assets subject to amortisation or depreciation

The Group evaluates whether there are indications of possible impairment losses on non-financial assets subject to amortisation or depreciation to verify whether the carrying amount of these assets exceeds the recoverable amount.

The Group tests goodwill and intangible assets not yet available for use for impairment at least annually, irrespective of whether there is any indication that the assets may be impaired.

The recoverable amount of assets is the higher of fair value less costs of retirement or disposal and value in use.

Negative differences arising from comparison of carrying amounts of assets with their recoverable amounts are expensed, except in those cases in which the non-current asset is recorded at the revalued amount.

Recoverable amount is determined for each individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit (CGU) to which the asset belongs.

Impairment losses for cash-generating units are allocated first to reduce the carrying amount of goodwill allocated to the unit and then to the other assets of the unit pro rata with their carrying amounts. The carrying amount of each asset may not be reduced below the highest of its fair value less costs of retirement or disposal, its value in use and zero.

At the end of each reporting period the Group assesses whether there is any indication that an impairment loss recognised in prior periods may no longer exist or may have decreased. Impairment losses on goodwill may not be reversed. Impairment losses on assets other than goodwill are reversed if, and only if, there has been a change in the estimates used to calculate the asset's recoverable amount.

A reversal of an impairment loss is recognised in the income statement except when the non-current asset is recorded at its restated amount. The increased carrying amount of an asset attributable to a reversal of an impairment loss may not exceed the carrying amount that would have been determined, net of depreciation or amortisation, had no impairment loss been recognised.

A reversal of an impairment loss for a CGU is allocated to the assets of each unit, except goodwill, pro rata with the carrying amounts of those assets. The carrying amount of an asset may not be increased above the lower of its recoverable amount and the carrying amount that would have been disclosed, net of amortisation or depreciation, had no impairment loss been recognised.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

(i) Financial instruments

The Group classifies and measures its financial assets, both current and non-current, as follows:

1. Assets at amortised cost:

This category includes the financial assets that meet the following conditions:

- The asset is held within the framework of a business model whose purpose is to hold financial assets in order to obtain contractual cash flows, and
- the contractual conditions of the financial asset give rise, on specified dates, to cash flows constituting solely payments of principal plus interest on the outstanding principle.

These assets are initially measured at fair value, plus any transaction costs, and then subsequently at amortised cost. The interest accrued is taken to the consolidated income statement applying the effective interest method. Nonetheless, financial assets falling due one year or less without a contractual interest rate are initially and subsequently measured at their nominal amount, if the effect of upgrading the cash flows is insignificant.

2. Financial assets at fair value through profit and loss

This category contains all other financial assets, including derivative financial instruments that do not meet the hedge accounting criteria in accordance with the requirements set out for this purpose in IFRS 9 Financial Instruments.

Financial assets at fair value through profit or loss are initially recognised at fair value. Transaction costs directly attributable to the acquisition or issue are recognised as an expense in the consolidated income statement when incurred. Changes in fair value are recognised in the consolidated income statement under the headings Finance cost and Finance income, as appropriate.

The Group identifies the most appropriate classification for each asset when it is acquired and this is reviewed at year end.

Impairment of financial assets at amortized cost

The Group recognises value adjustments relating to expected credit losses on financial assets measured at amortised cost and contract assets.

The Group applies the general approach of calculating the expected loss of its financial assets.

The general approach considers expected credit losses for the next twelve months, except when the credit risk of a financial instrument has increased significantly since its initial recognition, in which case the expected credit losses for the entire life of the asset are considered. The Group assumes that the credit risk of a financial instrument has not increased significantly since its initial recognition if the financial instrument has a low credit risk at the closing date,

Impairment losses and reversals of impairment losses on trade receivables and contract assets are recognised under Change in trade receivables and contract assets in the consolidated income statement. Impairment losses and reversals of impairment losses on other financial assets at amortised cost are recognised under Impairment and gains/(losses) on disposals of financial instruments in the consolidated income statement.

Derecognition of financial assets

Financial assets are derecognised when the contractual rights to the cash flows from the financial asset expire or have been transferred and substantially all the risks and rewards of ownership are considered to have been transferred.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

On derecognition of a financial asset, the difference between the carrying amount and the sum of the consideration received, net of transaction costs, including any new asset obtained less any new liability assumed and any cumulative gain or loss deferred in other comprehensive income, is recognised in the consolidated income statement.

In this regard, at the end of 2019, the Group has carried out transactions for which Euros 39.5 million have been derecognised from its assets recorded under Trade and other receivables as the conditions detailed above were met (Euros 50 million in 2018).

Classification and measurement of financial liabilities

The Group classifies all financial liabilities as measured at amortised cost using the effective interest rate method, except derivative financial instruments that do not meet the hedge accounting criteria in accordance with the requirements set out for this purpose in IFRS 9: Financial Instruments, which are recognised at fair value through profit and loss.

Derecognition of financial liabilities

Financial liabilities are derecognised where they are extinguished, i.e., when the obligation deriving from the liability has been discharged or cancelled, or it has expired. When there is an exchange of debt instruments between the Group and the counterparty, provided that they have substantially different conditions, the original financial liability is eliminated, and the new financial liability is recognised. Similarly, any substantial modification to the current conditions affecting a financial liability is recognised.

The difference between the carrying amount of the financial liability, or a portion thereof, which has been eliminated and the consideration paid, including the attributable transaction costs and under which any assigned asset that is different from the assumed asset or liability is recorded, is recognised in the consolidated income statement in the year in which this occurs.

The Group considers the terms to be substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability.

When there is an exchange of debt instruments that do not contain substantially different conditions, the modified flows are discounted at the original effective interest rate and any difference in the prior carrying amount is recognised in the consolidated income statement. Similarly, any costs or fees incurred adjust the carrying amount of the financial liability and are amortised over the remaining term of the modified liability.

Interest and dividends

Interest revenue is recognised based on outstanding principal and taking into consideration the applicable effective interest rate, which matches the carrying value of the asset, discounting expected future cash flows over the estimated useful life of the asset.

Dividend income is recognised when the right to receive payment is established.

Derivative financial instruments

Derivative financial instruments are initially recognised at acquisition cost in the consolidated balance sheet and subsequently all measurement adjustments that are necessary are applied to reflect their fair value at any given moment. Gains and losses arising from these changes are recognised in the consolidated income statement, unless the derivative has been designated as a cash flow hedge, or net foreign investment hedge instrument.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

Embedded derivatives

The derivatives embedded in financial liabilities and transactions whose primary contract lies outside the scope of IFRS 9: Financial instruments are recognised separately when their characteristics and risks are not closely related to those of the host contracts in which they are embedded, provided that the contract taken as a whole is not stated at fair value, recognising changes in the value by applying a charge or credit to the consolidated income statement.

Fair value of derivative financial instruments

The fair value of the various derivative financial instruments is calculated using the following procedures:

- The fair value of derivatives listed on an organised market is their market price at the year-end.
- To measure derivatives not traded on an organised market, the Nortegas Group uses assumptions based on year-end market conditions. Specifically,
 - the fair value of interest rate swaps is calculated as the value adjusted to the market interest rates for the rate spread in the swap agreement;
 - the measurement of this item in futures contracts is calculated by discounting future cash flows determined using the future exchange rates in place at the year-end;
 - finally, the fair value of the acquisition contracts for non-financial items to which IFRS 9 is applicable are calculated based on the best estimate of the future price curves for those non-financial items existing at the date the consolidated annual accounts are closed, using the prices established in future markets to the extent possible.

Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated balance sheet if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis or to realise the assets and settle the liabilities simultaneously.

(j) Distributions to Shareholders

Dividends, whether in cash or in kind, are recognised as a reduction in equity when approved by the sole shareholder.

(k) Inventories

Group inventories consist of LPG held in tanks and are measured at the lower of the weighted average acquisition cost or the sale price.

When the cost of inventories exceeds net realisable value, materials are written down to net realisable value.

(l) Cash and cash equivalents

Cash and cash equivalents include cash on hand and at banks. They also include other short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. An investment normally qualifies as a cash equivalent when it has a maturity of less than three months from the date of acquisition.

In the consolidated statement of cash flows, bank overdrafts which are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents. Bank overdrafts are recognised in the consolidated balance sheet as financial liabilities arising from loans and borrowings.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

(m) Capital grants

This heading includes any non-repayable subsidy granted by the government whose purpose is to finance capital assets, plant and equipment. All capital grants are taken to the heading Other operating income in the consolidated income statement as the subsidised items are depreciated.

(n) Connection and extension rights

Amounts paid by customers on account of connection rights for the installations needed to facilitate new supplies or extend existing ones are recorded under non-current and current Contract liabilities on the consolidated balance sheet, and recognised as income over the useful life of the extended installations they finance or, if appropriate, when the assets are sold or restated due to impairment losses. They are recognised as income under Other operating income in the consolidated income statement as the subsidised facilities are amortised.

(o) Employee benefits

Defined contribution plans

The Group recognises the contributions payable to a defined contribution plan in exchange for a service when an employee has rendered service to the Company. The amount of the contributions accrued is recognised as an employee benefits expense.

Short-term employee benefits

Short-term employee benefits are different from termination benefits that are expected to be settled in full before 12 months after the end of the reporting period in which the employees render the related services.

The Group recognises the expected cost of profit-sharing and bonus plans when it has a present legal or constructive obligation to make such payments as a result of past events and a reliable estimate of the obligation can be made.

Redundancy indemnities

Pursuant to current employment law, in certain circumstances the Group is liable to pay redundancy indemnities to employees whose services are discontinued.

(p) Provisions

General criteria

Provisions are recognised when the Group has a present obligation (legal, or implicit) as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period, taking into account all risks and uncertainties surrounding the amount to be recognised as a provision and, where the time value of money is material, the financial effect of discounting provided that the expenditure to be made each period can be reliably estimated. The discount rate is determined before taxes, taking into consideration the time value of money, as well as the specific risks that have not been included in the future cash flows relating to the provision at each closing date.

Single obligations are measured using the individual most likely outcome.

The financial effect of provisions is recognised as a finance cost in profit or loss.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

The tax effect and gains on the expected disposal of assets are not taken into account in measuring a provision.

If it is not probable that an outflow of resources will be required to settle an obligation, the provision is reversed. The provision is reversed against the income statement caption in which the related expense was recognised, and any surplus is accounted for in other income.

In turn, contingent liabilities are considered as those potential obligations arising from past events that are conditional upon one or more future events that are beyond the control of the Group. These contingent liabilities are not subject to accounting record but are disclosed in the relevant notes.

(q) Recognition of revenue

Revenue from the sale of goods and the rendering of services is recognised at the fair value of the consideration received or receivable.

The Group assesses whether a transaction is comprised of different components, in order to apply the appropriate income recognition criteria to each one.

Revenue from sales

The new regulatory framework for the gas sector in Spain entered into force in February 2002 and governs the settlement procedures for the redistribution between the sector companies of revenues from tolls, charges and tariffs, net of payments for specific purposes, so that each company receives the revenues allocated for its regulated activities.

The Group estimates these settlements accrued at 31 December 2019 and pending settlement by the Spanish National Markets and Competition Commission (CNMC). The final settlement for 2019 had not been published at the date these annual accounts were authorised for issue. However, it is not expected to differ significantly from the estimates, including the deficit estimate.

Royal Decree-Law 8/2014 approving urgent measures for growth, competitiveness and efficiency, enacted by means of Law 18/2014, establishes the principle of economic and financial sustainability of the gas system. Hence, any measure that could lead to an increase in costs or a reduction in income must incorporate an equivalent reduction of other cost items or an equivalent increase in income to ensure the system is balanced. It also limits annual gaps between the system's income and costs in that these cannot exceed 10 percent of the final revenues for the year and the amount of the annual gaps and annual amounts recognised pending settlement cannot exceed 15 percent of this amount.

Revenues received as remuneration for distribution activity each year are set ex ante. The Ministerial Orders published at the end of each year establish the remuneration for the coming year based on expected sales and new customers for that year. As a result, the remuneration amount is subject to change for up to two years, until the definitive data on demand and new customers are available for the year analysed. Order TEC/1259/2019, published on 20 December 2019, adjusted the remuneration for 2019 and 2018 based on the most up-to-date figures on sales and consumers.

The CNMC's resolution of 18 December 2019, established the remuneration for distribution activity for 2020 through application of the parameters established by Law 18/2014 of 15 October 2014 approving urgent measures for growth, competitiveness and efficiency. This law reformed the remuneration for gas activities with a view to eliminating deficits in the settlement system.

Pursuant to the above, this remuneration for distribution activities will be adjusted once the final amounts of this remuneration have been set by the Spanish Ministry for Ecological Transition and Demographic Challenge based on the actual figures for the average increase in consumers and KWh distributed. This authority will be transferred to the CNMC as of 2020. For 2019, the Group does not expect significant differences to arise between the amounts recognised and the final settlements. Nevertheless, any differences will be recognised as a change in accounting estimate in the consolidated income statement when they arise.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

During 2016 the final settlement for Regulated Gas Sector Activities for 2014 and 2015 was received. The amount of the gas sector deficit for 2014, which included the accumulated deficits of prior years, was concluded to be Euros 1,025 million, recoverable by the regulated parties in fifteen consecutive annual amounts from 25 November 2016 to 24 November 2031, at market interest rates. The amount of the deficit corresponding to the Group amounted to Euros 55,921 thousand and it was securitised before 31 December 2017. The deficit amount for 2015 was concluded to be Euros 27 million, recoverable in five annual amounts (from 25 November 2016 to 24 November 2021) at the market interest rate, which was set at 0.836% based on Order TEC/1367/2018. The amount of the deficit corresponding to the Group amounted to Euros 1,737 thousand and it was securitised before 31 December 2018. With regards 2016, pursuant to the final settlement made by the Spanish National Markets and Competition Commission, the deficit amounted to Euros 90 million, of which Euros 5.3 million corresponded to Nortegas Energía Distribución, S.A.U. (formerly Naturgas Energía Distribución, S.A.U.), at an interest rate of 0.716% (Order TEC/1367/2018) and it was securitised before 31 December 2018.

The final 2017 settlement produced a deficit of Euros 24.8 million, whereby Nortegas Group companies had to assume a deficit of Euros 1.6 million, with an applicable interest rate of 0.923% (Order TEC/1367/2018). This amount is recognised as pending collection at 31 December 2018.

In 2019 the system surplus for 2018 was published, amounting to Euros 30.9 million. According to current legislation, the debt that the system had with Nortegas relating to the 2017 deficit was cancelled in the 2019 settlement (except for two monthly payments that will be settled at the start of 2020 for Euros 53 thousand).

Services rendered

Revenue from inspection services rendered and rental of gas meters and others are recognised when the service is rendered.

The Group regularly checks if any service contract is onerous and makes provision where appropriate.

Interest and dividends

Interest is recognised using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of a financial instrument to the net carrying amount of that financial instrument based on the contractual terms of the instrument and not considering future credit losses.

Income from dividends on investments in equity instruments is recognised in profit or loss when the Group's right to receive payment is established.

(r) Income tax

Tax expense and income comprises current tax and deferred tax.

Current tax is the amount of income tax payable or recoverable in respect of the consolidated taxable income or consolidated tax loss for the year. Current tax assets or liabilities are measured at the amount expected to be paid to or recovered from the taxation authorities, using the tax rates and tax laws that have been enacted or are about to be enacted at the reporting date.

Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences, whereas deferred tax assets are the amounts of income taxes recoverable in future periods in respect of deductible temporary differences, the carryforward of unused tax losses, and the carryforward of unused tax credits. Temporary differences are defined as differences between the carrying amount of an asset or liability in the statement of financial position and its tax base.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

Current and deferred tax are recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, directly in equity, or from a business combination.

The Group recognises tax allowances for investments according to the criteria for measuring and recording deferred and current tax assets, unless in the form of a grant. If deductions are in the form of a grant, they are recognised and stated in accordance with the corresponding accounting policy. For these purposes, the Group considers as grants those deductions that are applicable regardless of whether tax is payable and have substantive operating conditions in addition to the making or holding of the investment.

Recognition of deferred tax liabilities

The Group recognises deferred tax liabilities derived from taxable temporary differences in all cases except:

- they arise from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable income;
- they are related to investments in subsidiaries, associates and interests in joint ventures over which the Group is able to control the timing of the reversal of the temporary difference and it is not probable that the temporary difference will reverse in the foreseeable future.

Recognition of deferred tax assets

The Group recognises deferred tax assets provided that:

- it is probable that sufficient taxable income will be available against which they can be utilised or when tax legislation envisages the possibility of converting deferred tax assets into a receivable from public entities in the future. However, assets that arise from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable income are not recognised;
- the temporary differences are related to investments in subsidiaries, associates and joint ventures providing the temporary differences will reverse in the foreseeable future and sufficient taxable income is expected to be generated against which the differences can be offset;

It is considered probable that the Group will generate sufficient taxable profit to recover deferred tax assets when there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which are expected to reverse in the same tax period as the expected reversal of the deductible temporary differences or in periods into which a tax loss arising from a deductible temporary difference can be carried back or forward.

In order to determine future taxable profit the Group takes into account tax planning opportunities, provided it intends or is likely to adopt them.

Measurement of deferred tax assets and liabilities

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the years when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or are about to be enacted. The tax consequences that would follow from the manner in which the Company expects to recover or settle the carrying amount of its assets or liabilities are also reflected in the measurement of deferred tax assets and liabilities.

The Group reviews the carrying amount of deferred tax assets at the reporting date and reduces this amount to the extent that it is not probable that sufficient taxable profit will be available against which to recover them.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

Deferred tax assets that do not meet the aforementioned conditions are not recognised in the consolidated balance sheet. At year end, the Group reassesses whether the conditions for recognising previously unrecognised deferred tax assets have been met.

Offsetting and classification

The Group only offsets current tax assets and liabilities if it has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Tax consolidation

The Parent company filed consolidated tax returns under the Bizkaia provincial regime with its sole shareholder Nortegas Energía Grupo, S.L.U. and NED Suministro GLP, S.A.U. (subsidiary) in the year ended 31 December 2019 and in 2018.

The subsidiary NED España Distribución Gas, S.A.U. files separate taxes.

In addition to the factors to be considered for individual taxation, set out previously, the following factors are taken into account when determining the accrued income tax expense for the companies forming the consolidated tax group:

- Temporary and permanent differences arising from the elimination of profits and losses on transactions between Group companies, derived from the process of determining consolidated taxable income.
- Deductions and credits corresponding to each company forming the consolidated tax group. For these purposes, deductions and credits are allocated to the company that carried out the activity or obtained the profit necessary to obtain the right to the deduction or tax credit.

Temporary differences arising from the elimination of profits and losses on transactions between tax group companies are allocated to the company which recognised the profit/loss and are valued using the tax rate of that company.

A reciprocal credit and debit arises between the companies that contribute tax losses to the tax group and the rest of the companies in the tax group that offset those losses. Where a tax loss cannot be offset by the other companies in the tax group, these tax credits for loss carryforwards are recognised as deferred tax assets using the applicable recognition criteria, considering the tax group as a taxable entity.

(s) Segment reporting

A business segment is a component of the Group that develops business activities that can generate ordinary income and incur expenses, the operating results of which are reviewed regularly by the Group's senior operational decision-making authority, to decide on resources to be allocated to the segment, assess its performance and in relation to which separate financial information is available.

The Group has two operating segments, as described below. These segments are the strategic business units.

The Group comprises the following operating segments:

- Natural gas
- LPG - Liquefied Petroleum Gas

The accounting policies applicable to the segments are those set forth herein in note 5.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

The method of obtaining this financial information by segment is based on assigning each of the companies within the scope of consolidation to an activity, since each company/segment relates to a different activity.

The consolidation process has been carried out strictly in accordance with the principles and standards governing its legal consolidation.

The results of associates are included in the segment of activity they carry out, i.e. distribution of natural gas.

(t) Classification of assets and liabilities as current and non-current

The Group classifies assets and liabilities in the consolidated balance sheet as current and non-current. Current assets and liabilities are determined as follows:

- Assets are classified as current when they are expected to be realised or are intended for sale or consumption in the Group's normal operating cycle, they are held primarily for the purpose of trading, they are expected to be realised within twelve months after the reporting date or are cash or a cash equivalent, unless the assets may not be exchanged or used to settle a liability for at least twelve months after the reporting date.
- Liabilities are classified as current when they are expected to be settled in the Group's normal operating cycle, they are held primarily for the purpose of trading, they are due to be settled within 12 months after the reporting date or the Group does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.
- Financial liabilities are classified as current when they are due to be settled within 12 months after the reporting date, even if the original term was for a period longer than 12 months, and an agreement to refinance or to reschedule payments on a long-term basis is completed after the reporting date and before the consolidated annual accounts are authorised for issue.

(u) Environmental issues

Property, plant and equipment acquired by the Group for long-term use to minimise the environmental impact of its activity and protect and improve the environment, including the reduction and elimination of future pollution from the Group's activities, are recognised as assets applying the measurement, presentation and disclosure criteria described in section (e).

The outcome of the Group's activity on the environment is not significant. Expenses derived from environmental activities are recognised as other operating expenses in the period in which they are incurred.

(v) Transactions between Group companies excluded from the consolidated group

Transactions between Group companies excluded from the consolidated group, except those related to mergers, spin-offs and non-monetary contributions, are recognised at the fair value of the consideration given or received. The difference between this value and the amount agreed is recognised in line with the underlying economic substance of the transaction.

4. Business combinations

The Group has not conducted any business combinations in 2019 or 2018.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

5. Segment information

The table below contains segment information at 31 December 2019 and 2018 for each of the Group's businesses, obtained by applying the criteria described in note 3(s).

31.12.2019	Thousands of Euros		
	Segments		Total
	Natural gas	LPG	
Ordinary revenue	198,488	24,184	222,672
Work carried out for the Group's own assets	6,749	256	7,005
Supplies	(3,666)	(14,755)	(18,421)
Personnel expenses	(12,323)	-	(12,323)
Depreciation of PPE expenses	(76,799)	(6,547)	(83,346)
Change in trade receivables and contract assets	428	(64)	364
Other expenses	(32,111)	(3,411)	(35,522)
Other income	7,349	6,383	13,732
Results from operating activities	88,115	6,046	94,161
Finance income (unallocated)	-	-	224
Finance cost (unallocated)	-	-	(22,545)
Income tax (unallocated)	-	-	(15,423)
Share in profit from investments accounted for using the equity method (unallocated)	-	-	158
Profit/(loss) for the year			56,575
Segment assets	2,797,533	135,949	2,933,482
Segment liabilities	1,557,379	123,937	1,681,316

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

31.12.2018	Thousands of Euros		
	Segments		Total
	Natural gas	LPG	
Ordinary revenue	200,309	29,378	229,687
Work carried out for the Group's own assets	6,270	189	6,459
Supplies	(3,210)	(18,520)	(21,730)
Personnel expenses	(16,763)	-	(16,763)
Depreciation of PPE expenses	(75,414)	(6,449)	(81,863)
Change in trade receivables and contract assets	24	(83)	(59)
Other expenses	(31,284)	(4,189)	(35,473)
Other income	4,523	4,940	9,463
Results from operating activities	84,455	5,266	89,721
Finance income (unallocated)	-	-	357
Finance cost (unallocated)	-	-	(28,612)
Income tax (unallocated)	-	-	33,495
Share in profit from investments accounted for using the equity method (unallocated)	-	-	191
Profit/(loss) for the year			95,152
Segment assets	2,685,573	138,674	2,824,247
Segment liabilities	1,553,885	129,461	1,683,346

6. Subsidiaries

Appendix I contains information about the subsidiaries included in the Group's scope of consolidation at 31 December 2019 and 2018.

There have been no changes to the scope of consolidation during 2019 and 2018.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

7. Property, Plant and Equipment

Details of property, plant and equipment and movement in 2019 and 2018 are as follows:

31.12.2019	Thousands of Euros						Total
	Land	Buildings	Technical installations and machinery	Other installations, equipment and furniture	Under construction and advances	Other property, plant and equipment	
Cost at 31 December 2018	439	5,303	1,726,529	83,494	9,560	7,620	1,832,945
Additions	-	-	396	950	21,998	120	23,464
Disposals	-	(128)	(21)	(3,880)	(99)	3	(4,125)
Transfers	461	409	23,466	529	(24,865)	-	-
Cost at 31 December 2019	900	5,584	1,750,370	81,093	6,594	7,743	1,852,284
Accumulated depreciation at 31 December 2018	-	(2,845)	(726,151)	(66,212)	-	(6,372)	(801,580)
Depreciation	-	(146)	(50,040)	(3,387)	-	(324)	(53,897)
Disposals	-	8	3	3,880	-	-	3,891
Transfers	-	-	-	-	-	-	-
Accumulated depreciation at 31 December 2019	-	(2,983)	(776,188)	(65,719)	-	(6,696)	(851,586)
Carrying amount at 31 December 2019	900	2,601	974,182	15,374	6,594	1,047	1,000,698

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

		Thousands of Euros						
31.12.2018		Land	Buildings	Technical installations and machinery	Other installations, equipment and furniture	Under construction and advances	Other property, plant and equipment	Total
Cost at 31 December	2017	656	5,999	1,699,648	89,565	11,686	7,561	1,815,115
Additions		-	-	2,413	812	16,563	59	19,847
Disposals		(217)	(696)	(141)	(900)	(63)	-	(2,017)
Transfers		-	-	24,609	(5,983)	(18,626)	-	-
Cost at 31 December	2018	439	5,303	1,726,529	83,494	9,560	7,620	1,832,945
Accumulated depreciation	at 31 December 2017	-	(3,395)	(673,004)	(66,836)	-	(6,037)	(749,272)
Depreciation		-	(146)	(49,865)	(3,567)	-	(335)	(53,913)
Disposals		-	696	19	890	-	-	1,604
Transfers		-	-	(3,301)	3,301	-	-	-
Accumulated depreciation	at 31 December 2018	-	(2,845)	(726,151)	(66,212)	-	(6,372)	(801,580)
Carrying amount at 31	December 2018	439	2,458	1,000,378	17,282	9,560	1,248	1,031,365

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

The additions recognised in 2019 under the heading Under construction and advances for Euros 21,998 thousand (Euros 16,563 thousand in 2018), relate mainly to additions for investments in the proprietary network, network extensions in the Basque Country, Asturias and Cantabria and the development of networks in new municipalities.

Insurance

The Group has taken out an insurance policy to cover the risk of damage to its property, plant and equipment. The insured asset value of networks and pipelines, industrial installations, office buildings and electronic equipment amounts to Euros 2,110,846 thousand (Euros 2,012,063 thousand in 2018). In addition, there is automatic insurance coverage for damages of Euros 422,169 thousand (Euros 402,413 thousand in 2018).

Fully depreciated assets

The cost of fully depreciated property, plant and equipment still in use at 31 December 2019 and 2018 is as follows:

	Thousands of Euros	
	31.12.2019	31.12.2018
Buildings	1,466	1,268
Technical installations and machinery	156,418	154,855
Other installations, equipment and furniture	36,812	39,287
Other property, plant and equipment	4,809	4,759
	199,505	200,169

Property, plant and equipment pledged as collateral

At 31 December 2019 and 2018, the Group has not pledged any fixed assets to secure bank loans.

Commitments

At 31 December 2019 and 2018, the Group does not have any significant commitments to acquire assets.

8. Intangible assets

Details of intangible assets and movement during the year ended 31 December 2019 and 2018 are as follows:

31.12.2019	Thousands of Euros			
	Patents, licences, trademarks and similar	Goodwill	Computer software	Total
Cost at 31 December 2018	1,531,498	45,910	21,900	1,599,308
Additions	-	-	2,786	2,786
Cost at 31 December 2019	1,531,498	45,910	24,686	1,602,094
Accumulated amortisation at 31 December 2018	(36,548)	-	(15,170)	(51,718)
Amortisation	(25,798)	-	(2,741)	(28,539)
Accumulated amortisation at 31 December 2019	(62,346)	-	(17,911)	(80,257)
Carrying amount at 31 December 2019	1,469,152	45,910	6,775	1,521,837

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

31.12.2018	Thousands of Euros			
	Patents, licences, trademarks and similar	Goodwill	Computer software	Total
Cost at 31 December 2017	1,531,498	45,910	19,549	1,596,957
Additions	-	-	2,351	2,351
Cost at 31 December 2018	1,531,498	45,910	21,900	1,599,308
Accumulated amortisation at 31 December 2017	(10,775)	-	(12,993)	(23,768)
Amortisation	(25,773)	-	(2,177)	(27,950)
Accumulated amortisation at 31 December 2018	(36,548)	-	(15,170)	(51,718)
Carrying amount at 31 December 2018	1,494,950	45,910	6,730	1,547,590

At 31 December 2019 and 2018 the Group has no commitments to acquire intangible assets.

Goodwill

Goodwill resulting from the business combination undertaken during 2017, amounting to Euros 46 million, mainly comprises future profits on the activity of the Parent Company and of the subsidiaries listed in Appendix I, which do not meet the conditions established to be recognised as a separate asset.

The allocation of goodwill at 31 December 2019 and 2018 by Cash-Generating Unit (CGU) is as follows:

	Thousands of Euros	
	2019	2018
Natural gas distribution in the Basque Country	15,302	15,302
Natural gas distribution in Asturias and Cantabria	30,052	30,052
Distribution and supply of liquefied petroleum gas	556	556
	45,910	45,910

Fully depreciated assets

The cost of fully amortised intangible assets in use at 31 December 2019 and 2018 is as follows:

	Thousands of Euros	
	31.12.2019	31.12.2018
Computer software	12,701	11,674
	12,701	11,674

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

Impairment

The Group has carried out an impairment test using the following main assumptions:

- o Regulated remuneration: the approved remuneration has been used for the years in which it is available, and for subsequent years the best available information up to the date of authorisation of the consolidated annual accounts have been used as well as the mechanisms for updating said remuneration, which have been applied in a manner consistent with the estimated costs of the cash generating unit.
- o Investment: investment plans have been considered that are consistent with the expected growth in customers and demand in the cash generating unit.
- o Operation and maintenance costs: the best available estimate of changes in these costs based on historical Group information.
- o Projections at 14 years with a growth rate from year 14 of between 0% and 0.4%.
- o Before tax discount rate of between 5.54% and 6.75% (between 5.50% and 6.46% in 2018). The discount rate applied to calculate the current values of free cash flows has been determined according to the weighted average cost of capital (WACC). WACC is a type of discount based on the required rates of return of each component of the capital invested (equity and financial debt) and is calculated by weighting the required returns of these components in proportion to the weight of each of these sources of financing in an expected capital structure. In this regard, the following has been taken into account in this calculation:
 - Cost of capital or own resources (Ke):
 - o Risk-free rate (Rf): calculated based on the profitability of the Spanish State Bond.
 - o Market risk premium (Rm-Rf): this has been defined according to the analysis carried out based on empirical studies in long series that analyse the difference between the average historical profitability of the stock exchange and long-term state debt.
 - o Unlevered beta coefficient: represents the risk differential of each business with respect to the average market risk (Rm), referenced using certain listed companies with businesses comparable to the business under analysis.
 - Cost of debt (Kd): we understand that the cost of the debt must reflect the cost at which a company could be financed.
 - Nominal tax rate applicable in each jurisdiction

The recoverable amount calculated in the aforementioned impairment test is a value higher than the carrying amount of the cash generating unit, so no impairment losses have been recognised for intangible assets or property, plant and equipment in the year ended 31 December 2019.

Sensitivity analysis

The Group systematically carried out sensitivity analyses on the results of the impairment tests undertaken using changes in the following assumptions in each cash-generating unit:

- A 1% increase in the discount rate for natural gas distribution and 0.5% for the distribution and supply of LPG.
- A 0.5% reduction in growth of supply points
- A 0.5% slowdown in the growth of demand per supply point
- A 5% reduction in LPG consumption per supply point.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

- A growth rate in perpetuity of 0%.

In these sensitivity analyses carried out for each individually considered assumption, the impairment has been detected in the following cases:

- In natural gas distribution in the Basque Country, the sensitivity analysis has not detected any impairment.
- In natural gas distribution in Asturias and Cantabria, where the value in use is Euros 11 million higher than the carrying amount. Based on the assumption of an increase in the discount rate of 100 basis points, a drop in supply points of 0.5%, a drop in demand of 0.5% per supply point and a growth rate in perpetuity of 0%, the value in use would be reduced by 184 million euros, 42 million euros, 33 million euros and 53 million euros, respectively.
- In LPG distribution and supply, the sensitivity analysis has not detected any impairment.

9. Investments in equity-accounted associates

Below is the information regarding investments in equity-accounted associates at 31 December 2019 and 2018:

Name	Registered office	Activity	Auditor	Group company	% of ownership	Amount of investment
Tolosa Gasa, S.A.	Tolosa (Gipuzkoa)	Natural gas distribution	KPMG Auditores, S.L.	Nortegas Energía Distribución, S.A.U.	40.00	260
Inkolan, A.I.E.	Bilbao (Vizcaya)	Compilation and management of all information relating to the networks installed by each partner in the Basque Country (CAV).	Moore Stephens AMS, S.L.	Nortegas Energía Distribución, S.A.U.	14.29	69
						329

Details of investments in the equity of Group companies and associates in 2019 and 2018 and movement are as follows:

Company	Balance at 31 December 2018	Share in profit	Dividends received	Balance at 31 December 2019
Inkolan, A.I.E.	222	46	-	267
Tolosa Gasa, S.A.	523	112	(124)	511
	745	158	(124)	778

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

Company	Balance at 31 December 2017	Share in profit	Dividends received	Balance at 31 December 2018
Inkolan, A.I.E.	157	65	-	222
Tolosa Gasa, S.A.	509	126	(112)	523
	666	191	(112)	745

Associates have not incurred contingent liabilities.

10. Operating leases and Right-of-use assets

The Group's main lease relates to the offices where it carries out its business.

Operating lease payments recognised as expenses in 2018 amounted to Euros 1,739 thousand.

Movement in right-of-use assets in 2019 arising from contracts in which the Group acts as lessee is as follows:

Thousands of Euros	Balance at 01.01.2019	Application of IFRS 16	Additions	Remeasurement /modification of lease liability	Balance at 31.12.2019
Cost:					
Land	-	133	13	-	146
Buildings	-	2,221	-	(144)	2,077
Fleets	-	553	105	-	658
Other rights-of-use	-	1,585	38	-	1,623
Total cost	-	4,492	156	(144)	4,504
Accumulated depreciation					
Land	-	-	(23)	-	(23)
Buildings	-	-	(559)	-	(559)
Fleets	-	-	(180)	-	(180)
Other rights-of-use	-	-	(148)	-	(148)
Total accumulated depreciation	-	-	(910)	-	(910)
Total net cost	-	4,492	(754)	(144)	3,594

Future minimum payments under non-cancellable operating leases at 31 December 2019 are as follows:

	Thousands of Euros 31.12.2018
Less than one year	802
One to five years	1,131
Over five years	387
	2,320

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

On 20 July 2018 the Parent company granted a loan to its sole shareholder, Nortegas Energía Grupo, S.L.U., amounting to Euros 37,000 thousand at an interest rate of 1.5%, which expired on 19 July 2019. In 2019, Nortegas Energía Grupo, S.L.U. repaid this loan as well as the interest accrued up until it was cancelled.

The book values of trade credits and debits are assumed to approximate their fair value.

The amount of net losses and gains by financial asset category at 31 December 2019 amounts to income of Euros 224 thousand corresponding to accrued interest income (Euros 357 thousand of finance income in 2018) (see note 33).

12. Current and non-current financial assets

Details of current and non-current financial assets at 31 December 2019 and 2018 are as follows:

	Thousands of Euros			
	2019		2018	
	Non-current	Current	Non-current	Current
Security deposits paid	91	43	228	43
Loans to related parties (note 11)	-	1	-	37,280
Loans to unrelated parties	-	53	1,265	318
Deposits given	494	1	886	24
Trade and other receivables (note 14)	-	19,261	-	19,785
Total	585	19,359	2,379	57,450

Non-current and current loans to unrelated parties includes the deficit in the gas sector receivable (see notes 1.1(c) and 3(q)).

The fair values of loans and other receivables do not differ significantly from their carrying amounts.

13. Income tax

The Parent company, Nortegas Energía Distribución, S.A.U., its sole shareholder, Nortegas Energía Grupo, S.L.U., and the Group company NED Suministro GLP, S.A.U are taxed under the special tax consolidation regime, in adherence with Regional Corporation Tax Regulation 11/2013, of 5 December, whereby the parent company of the tax group is Nortegas Energía Distribución, S.A.U.

Without prejudice to this special tax regime, the subsidiary NED España Distribución Gas, S.A.U. files tax returns individually under Corporation Tax Act 27/2014 of 27 November.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

Details of deferred tax assets and liabilities by type of asset and liability at 31 December 2019 and 2018 are as follows:

Thousands of Euros		
31.12.2019		
	Assets	Liabilities
Property, plant and equipment and intangible assets	13,962	278,443
Deferred income	-	6,202
Provisions for termination benefits	-	-
Activation of tax credits	195	-
Other	58	-
	14,215	284,645
Total assets/liabilities		
Thousands of Euros		
31.12.2018		
	Assets	Liabilities
Property, plant and equipment and intangible assets	17,701	284,274
Deferred income	-	6,397
Provisions for termination benefits	708	-
Activation of tax credits	445	-
Other	676	-
	19,530	290,671
Total assets/liabilities		

Details of movement in deferred taxes by type of asset and liabilities which has been recognised in deferred income tax (expense)/income at 31 December 2019 and 2018 are as follows:

Thousands of Euros		
31.12.2019		
	Assets	Liabilities
Property, plant and equipment and intangible assets	(3,739)	(5,831)
Deferred income	-	(195)
Provisions for termination benefits	(708)	-
Tax credits	(250)	-
Other	(618)	-
	(5,315)	(6,026)
Total assets/liabilities		
Thousands of Euros		
31.12.2018		
	Assets	Liabilities
Property, plant and equipment and intangible assets	(5,033)	(56,269)
Deferred income	-	(1,709)
Provisions for termination benefits	(248)	-
Tax credits	(309)	-
Other	429	-
	(5,161)	(57,978)
Total assets/liabilities		

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

Details of income tax expense for the years ended 31 December 2019 and 2018 are as follows:

	Thousands of Euros	
	31.12.2019	31.12.2018
Current tax		
For the period	(17,649)	(18,720)
Prior years' adjustments	1,515	(602)
	(16,134)	(19,322)
Deferred taxes		
Origination and reversal of temporary differences		
Property, plant and equipment and intangible assets	2,092	51,236
Provisions for termination benefits	(708)	(248)
Deferred income	195	1,709
Other	(618)	429
Activation/(application) of tax credits	(250)	(309)
Total deferred tax	711	52,817
	(15,423)	33,495

A reconciliation of current tax with current income tax liabilities for the years ended 31 December 2019 and 2018 is as follows:

	Thousands of Euros	
	2019	2018
Current tax	17,649	18,720
Payments made during the period	(4,195)	(2,972)
Payables to Group companies due to tax effect (note 18)	(4,161)	(3,211)
Current income tax liabilities	9,293	12,537

Payables to Group companies due to tax effect includes the debt arising from the tax consolidation with Nortegas Energía Grupo, S.L.U., the Company's sole shareholder, whose accounts are not included in the scope of consolidation of these consolidated annual accounts.

The relationship between income tax expense and profit from continuing operations for the years ended 31 December 2019 and 2018 is as follows:

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

	Thousands of Euros	
	Profit and loss	Total
31.12.2019		
Income and expenses for the period before tax	71,998	70,552
Tax	(17,514)	(17,163)
Non-deductible expenses	(608)	(608)
Deductions	1,256	1,256
Prior years' adjustments	1,405	1,405
Other	38	38
Income tax (expense)/income		
From continuing operations	(15,423)	(15,072)
	Thousands of Euros	
	Profit and loss	Total
31.12.2018		
Income and expenses for the period before tax	61,657	61,657
Tax	(15,788)	(15,788)
Effect of changes in tax rates	49,081	49,081
Prior years' adjustments	102	102
Other	100	100
Income tax (expense)/income		
From continuing operations	33,495	33,495

Provincial Standard 2/2018 of 21 March was published on 27 March 2018, introducing among other measures, modifications to corporation tax and the general provincial tax regulation for the province of Bizkaia.

Among other measures, the general corporation tax rate was modified from 28% to 26% in 2018 and to 24% from 2019 onwards.

This tax rate change gave rise to a reduction in deferred tax on the consolidated income statement of Euros 49,081 thousand in 2018.

The Parent has the main applicable taxes open to inspection by the Spanish taxation authorities for the years that are not statute barred.

The other Group companies have all years open to inspection that are applicable to each individual company in accordance with current local legislation.

Article 36 of the Provincial Corporation Tax Regulation states that the income obtained from the transfer of property, plant and equipment cannot be included in the tax base, provided that the proceeds from such transfers are reinvested in certain items of property, plant and equipment, intangible assets or investment property within the period from one year prior to and three years after the date of delivery of the transferred item.

During the eight-month period ended 31 December 2017 and 2018 and 2019, the Company obtained income eligible for the reinvestment exemption incentive amounting to Euros 50.9 million, Euros 0.2 million and Euros 0.1 million, respectively. At 31 December 2019, the Company has already complied with the requirement to reinvest the amounts obtained in such sales by inverting in property, plant and equipment (GLP infrastructure and gas distribution network mainly) in 2016, 2017 and 2019. In the previous years

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

(2016 and the four-month period ended 30 April 2017) the Company has obtained benefits eligible for this same incentive, the information requirements of which are set out in the Reports forming part of the Annual Accounts for the financial years in which they were materialized such operations.

14. Trade and other receivables

Details of trade and other receivables at 31 December 2019 and 2018 are as follows:

	Thousands of Euros	
	31.12.2019	31.12.2018
Sole shareholder (note 34)		
Other receivables	1,225	1,067
Associates (note 34)		
Other receivables	33	27
Unrelated parties		
Trade receivables	11,883	13,935
Other receivables	6,420	5,426
Personnel	144	138
Impairment allowances	(444)	(808)
Total	19,261	19,785

The caption Trade receivables -unrelated parties mainly includes the balances outstanding with natural gas suppliers for tolls charged and invoicing of liquefied gas to end customers.

(a) Valuation adjustments

Movement in valuation adjustments due to the uncollectibility of trade and other receivables in the years ended 31 December 2019 and 2018 is as follows:

	Thousands of Euros
	31.12.2019
Balance at 31 December 2018	(808)
Charges	(64)
Reversals	428
Balance at 31 December 2019	<u>(444)</u>

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

	<u>Thousands of Euros</u> <u>31.12.2018</u>
Balance at 31 December 2017	(749)
Charges	(83)
Reversals	24
Balance at 31 December 2018	<u>(808)</u>

15. Other current assets

Details of other current assets are as follows:

	<u>Thousands of Euros</u>	
	<u>2019</u>	<u>2018</u>
Receivables from public entities		
Tax authorities VAT receivable	438	2,163
Adjustments for prepayments	1,146	1,612
Total	<u>1,584</u>	<u>3,775</u>

Adjustments for prepayments

This caption includes an amount of Euros 900 thousand (Euros 1,350 thousand at 31 December 2018) for the prepayment of insurance premiums that Nortegas Energía Distribución, S.A.U. and NED Suministro GLP, S.A.U. have signed with EDP Iberia.

On 20 April 2017, an agreement was signed whereby EDP Iberia guaranteed NED Suministro GLP, S.A.U. a minimum gross margin per supply point acquired from Repsol Butano, S.A. prior to 31 December 2016. This minimum gross margin is equal to at least the margin budgeted by the EDP Group when it performed a valuation of the purchase transaction. Should it fail to meet the agreed minimum gross margin, EDP Iberia must make a cash payment that is equal to the difference between the amount estimated during the valuation of the supply points purchased from Repsol and the actual margin obtained.

This agreement will remain in force until its expiry on 31 December 2021.

On 20 April 2017 a contract was signed whereby EDP Iberia guarantees Nortegas Energía Distribución, S.A.U. compensation in the event of changes in the regulations affecting the remuneration of gas meter rentals with respect to the regulation approved for 2017. This guarantee only covers the effect of a regulatory change relating to this matter in the years 2018 to 2021.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

16. Cash and cash equivalents

Details of cash and cash equivalents are as follows:

	Thousands of Euros	
	31.12.2019	31.12.2018
Cash	7	7
Banks	366,912	157,061
	<u>366,919</u>	<u>157,068</u>

17. Equity

Details of equity and movement during the year are shown in the statement of changes in equity.

Capital

At 31 December 2019 and 2018, the Company's share capital consists of 1,000,000 registered shares with a par value of Euros 100 each, fully subscribed and paid in. All shares bear the same political and financial rights.

These shares are freely transferable.

At 31 December 2019 and 2018 the Company's sole shareholder is Nortegas Energía Grupo, S.L.U. The Company is thus registered at the Mercantile Registry as a single shareholder company (Sociedad Unipersonal).

Transactions with the sole shareholder are detailed in note 34 to the consolidated annual accounts.

Shareholder contributions

On 20 December 2018 the sole shareholder assumed a creditor position in the shareholder loan held by Nature Investments, SARL and thus held a debt claim against the Parent company in the amount of Euros 127,303 thousand. Subsequently, on 21 December 2018, the sole shareholder of the Parent company decided to make a non-cash contribution to the Company's equity in the amount of Euros 127,303 thousand consisting of the contribution of the debt claim held by the sole shareholder against the Company. The aforementioned shareholder loan to the Company was completely extinguished by this contribution due to the fact that the Company holds the creditor and debtor rights, by virtue of the provisions of Article 1192 of the Civil Code.

Furthermore, on 12 March 2019, the sole shareholder made a shareholder contribution of Euros 163 million.

Lastly, in June 2019 the sole shareholder made an additional shareholder contribution of Euros 40.9 million to strengthen the Group's financial position.

Financial management

The Group's objectives in managing capital are to safeguard its ability to operate as a going concern so that it can continue to perform its core natural gas distribution activities as a regulated company, keeping a solvent, reasonable and optimum capital structure, reducing the cost of capital and also ensuring the sustainability of its activities in the long term. At the same time generating profits for shareholders and benefiting the rest of the stakeholders with whom the Group interacts.

In order to maintain and adjust the capital structure, the Group can adjust the amount of the dividends payable to shareholders, refund capital, issue shares or sell assets to reduce debt.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

The main mechanism used by the Group to control and ensure long-term financial solvency is the attainment and maintenance of a minimum investment grade rating of BBB- (in the case of S&P) (note 21).

Net Financial Debt/EBITDA ratio is one of the metrics that the Group overseas to evaluate its capital structure. EBITDA is determined as the operating income plus depreciation and amortisation and impairment for the period. Net financial debt is determined as the sum of the financial debts less cash and cash equivalents.

The Net Financial Debt/EBITDA ratio in 2019 and 2018 is determined as follows:

	Thousands of Euros	
	2019	2018 (*)
Liabilities from the issue of bonds and other marketable securities (current and non-current) (note 18)	1,298,985	1,297,654
Security deposits (current and non-current) (note 18)	1,203	1,205
Other financial liabilities (current and non-current) (note 18)	1,557	1,192
Debts with associates (note 18)	607	454
Debts with Group companies (note 18)	4,161	6,287
Loans and borrowings (note 18)	50	1,692
Leases (note 18)	3,663	-
Total financial debt	1,310,226	1,308,484
Less: Cash and cash equivalents	(366,919)	(157,068)
Net financial debt	943,307	1,151,416
EBITDA	177,507	171,584
Net financial debt/EBITDA ratio	5.31	6.71

(*) 2018 does not include the effect of IFRS 16 on the ratio calculation. Its inclusion would result in increased financial debt of Euros 4,492 thousand, increased EBITDA of Euros 802 thousand and therefore the Net Financial Debt/EBITDA ratio would increase to 6.71.

Share premium

The revised Spanish Companies Act expressly allows for the use of the share premium balance for capital increases and does not establish any specific restrictions regarding the availability thereof. The share premium resulted from the capital increase carried out by Nature Gasned XXI S.L.U. on 25 July 2017.

However, at 31 December 2019 a non-distributable amount of Euros 22,016 thousand is included therein (Euros 23,610 thousand at 31 December 2018), attributable to the legal revaluations of assets of the Group.

This balance shall remain non-distributable until it has been inspected and approved by the tax authorities. That verification must take place within three years following the date on which the return reporting the restatement is filed. For these purposes, the balance of the share premium account will be understood not to have been used in the following cases:

- a) When the partner or shareholder exercises their right to leave the company.
- b) When the balance of the account is used, in full or in part, as a result of transactions eligible for the special regime for mergers, divisions, transfers of assets, exchanges of shares and change of registered address of a European Company or European Cooperative Company from one EU member state to another, pursuant to chapter X, title VIII of Provincial Corporation Tax Regulation 3/1996 of 26 June.
- c) When the company needs to apply the balance of the account due to a legal obligation.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

Once the revaluation has been agreed with the tax authorities or after the inspection period has expired, the balance of the reserve may be applied to offset prior years' losses, to increase share capital or to increase distributable reserves after ten years have elapsed from the closing date of the balance sheet in which the revaluations were recorded. However, this balance may only be directly or indirectly distributed when the restated assets have been fully depreciated, sold or written-off from the balance sheet.

The Company's sole shareholder agreed a share premium distribution of Euros 78 million, Euros 3.2 million and Euros 68 million on 1 July 2019, 25 November 2019 and 10 December 2019, respectively.

Other reserves

These reserves are freely available.

Profit/(loss) for the period

The contribution of each company included in the consolidated group to consolidated profit/(loss), indicating the portion relating to non-controlling interests in the years ended 31 December 2019 and 2018, is as follows:

Company	Thousands of Euros	
	Consolidated Profit/ (loss)	
	31.12.2019	31.12.2018
Fully consolidated companies		
Nortegas Energía Distribución, S.A.U.	36,142	74,639
NED España Distribución Gas, S.A.U.	17,535	18,261
NED Suministro GLP, S.A.U.	2,740	2,061
	56,417	94,961
Equity-consolidated companies:		
Inkolan, A.I.E.	46	65
Tolosa Gasa, S.A.	112	126
 Total	 56,575	 95,152

Distribution of the Parent Company's profit/loss

The proposed distribution of the Parent Company's profit for the years ended 31 December 2019 and 2018 to be submitted to the sole shareholder for approval is as follows:

	2019
Basis of allocation	
Profit for the year	34,779,229.42
Distribution	
Legal reserve	3,477,922.94
Voluntary reserves	31,301,306.48
	34,779,229.42

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

	<u>2018</u>
Basis of allocation	
Profit for the year	<u>81,450,884.88</u>
Distribution	
Legal reserve	8,145,088.49
Voluntary reserves	<u>73,305,796.39</u>
	<u>81,450,884.88</u>

18. Financial Liabilities by Category

Classification of financial liabilities by category

The classification of financial liabilities by category and class at 31 December 2019 and 2018 is as follows:

	Thousands of Euros				
	Non-current			Current	
	At amortised cost or cost			At amortised cost or cost	Total
	Carrying amount	Fair value	Total	Carrying amount	Total
31.12.2019					
<i>Debts and payables</i>					
Bonds and other marketable securities (note 21)					
Fixed rate	1,293,640	1,356,065	1,293,640	5,345	5,345
Loans and borrowings	-	-	-	50	50
Group companies (note 34)	-	-	-	4,161	4,161
Associates (note 34)	-	-	-	607	607
Security deposits	1,084	1,084	1,084	119	119
Leases	2,680	2,680	2,680	983	983
Other financial liabilities	1,476	1,476	1,476	81	81
Trade and other payables					
Suppliers	-	-	-	2,408	2,408
Creditors	-	-	-	52,204	52,204
Payables on fixed assets	-	-	-	5,499	5,499
Other payables	-	-	-	774	774
Total financial liabilities	<u>1,298,880</u>	<u>1,361,305</u>	<u>1,298,880</u>	<u>72,231</u>	<u>72,231</u>

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

	Thousands of Euros				
	Non-current			Current	
	At amortised cost or cost			At amortised cost or cost	
	Carrying amount	Fair value	Total	Carrying amount	Total
31.12.2018					
<i>Debts and payables</i>					
Bonds and other marketable securities (note 21)					
Fixed rate	1,292,309	1,276,610	1,292,309	5,345	5,345
Loans and borrowings	-	-	-	1,692	1,692
Group companies (note 34)	-	-	-	6,287	6,287
Associates (note 34)	-	-	-	454	454
Security deposits	1,086	1,086	1,086	119	119
Other financial liabilities	1,105	1,105	1,105	81	81
Trade and other payables					
Suppliers	-	-	-	2,638	2,638
Creditors	-	-	-	47,259	47,259
Payables on fixed assets	-	-	-	4,443	4,443
Other payables	-	-	-	629	629
Total financial liabilities	1,294,500	1,278,801	1,294,500	68,953	68,953

At 31 December 2019 current debts with Group companies includes the debt with the sole shareholder due to current tax arising from the consolidated tax regime amounting to Euros 4,161 thousand (Euros 3,211 thousand at 31 December 2018) (notes 13 and 34).

Net losses and gains by financial liability category

Net losses and gains by financial liability category for the years ended 31 December 2019 and 2018 are as follows:

	Thousands of Euros			
	2019		2018	
	Debts and accounts payable	Total	Debts and payables	Total
Finance cost measured at amortised cost (note 33)	20,904	20,904	27,071	27,071
Other (note 33)	1,641	1,641	1,541	1,541
Net gains/(losses) in profit and loss	22,545	22,545	28,612	28,612
Total	22,545	22,545	28,612	28,612

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

19. Current and non-current financial liabilities

Details of current and non-current financial liabilities at 31 December 2019 and 2018 are as follows:

	Thousands of Euros			
	2019		2018	
	Non-current	Current	Non-current	Current
Bonds and other marketable securities (note 21)	1,293,640	5,345	1,292,309	5,345
Loans and borrowings	-	50	-	1,692
Debt with Group companies and associates (note 20)	-	4,768	-	6,741
Security deposits received (note 20)	1,084	119	1,086	119
Other financial liabilities (note 20)	1,476	81	1,105	87
Leases (note 21.2)	2,680	983	-	-
Trade and other payables (note 22)	-	60,886	-	54,969
Total	1,298,880	72,231	1,294,500	68,953

20. Financial Liabilities by debt

Details of financial liabilities by debt are as follows:

	Thousands of Euros			
	2019		2018	
	Non-current	Current	Non-current	Current
Related parties				
Debt	-	4,768	-	6,741
Unrelated parties				
Loans and borrowings	-	50	-	1,692
Other debt	1,476	81	1,105	87
Leases	2,680	983	-	-
Security and other deposits received	1,084	119	1,086	119
Total	5,240	6,001	2,191	8,639

At 31 December 2019, Debts with related parties mainly includes the debt with the sole shareholder due to current tax arising from the consolidated tax regime amounting to Euros 4,161 thousand (Euros 3,211 thousand at 31 December 2018) (notes 13, 34 and 18). At 31 December 2018, this heading also included outstanding interest at this date of Euros 3,076 thousand, which was paid at the start of 2019, relating to the subordinate loan that Nature Investments SARL had granted to the Parent company in 2017 and which matured at the end of 2018 (note 17).

The lending entities have not called for any form of guarantee on the aforementioned loans.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

Credit facilities and other financing

The Group has a credit facility with a limit of Euros 100 million. At 31 December 2019, no amount was drawn down by the Group.

21. Financial liabilities by category

21.1 Issue of bonds and other marketable securities

On 13 September 2017, Nortegas Energía Distribución, S.A.U. obtained a credit rating of BBB- from the international credit rating agency Standard & Poors (S&P), which corresponds to an investment grade, both for the company and for the Euro Medium Term Note Programme (EMTN). On 17 February 2020 S&P issued a new credit report on Nortegas Energía Distribución maintaining the investment grade credit rating (BBB-).

On 28 September 2017 the Group carried out two bond issues within the framework of the Euro Medium Term Note Programme (EMTN) and these also obtained the S&P rating of BBB-. The first is an issue of Euros 550 million, which matures on 28 September 2022. The issue price was 100% and the annual interest rate is 0.918% payable annually on 28 September.

The second is a bond issue for Euros 750 million. This issue matures on 28 September 2027. The issue price was 100% and the annual interest rate is 2.065% payable annually on 28 September.

The average interest rate of these two bond issues is 1.58%. On 31 December 2019 accrued interest payable amounts to Euros 5,345 thousand (Euros 5,345 thousand in 2018) and is classified in the consolidated balance sheet caption Current liabilities from the issue of bonds and other marketable securities.

21.2 Leases

The Group enters lease agreements in which it acts as lessee mainly in relation to buildings, vehicles and land. Movement in lease liabilities in 2019 is as follows:

Thousands of Euros	2019
Balance at 01.01.2019	-
Initial application of IFRS 16 (note 2.a)	4,492
New lease contracts	157
Interest expense	129
Principal paid	(971)
Remeasurement /modification of lease liability	(144)
Balance at 31.12.2019	3,663

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

Details of lease liabilities by maturity at 31 December 2019 are as follows:

Thousands of Euros	31.12.2019
2020	994
2021	750
2022	687
2023	297
2024	178
From 2025 onwards	1,194
Total	4,100
Finance cost	437
Present value of payments	3,663
Total	4,100

21.3 Statement of cash flows

Movement in liabilities classified as financing activities in the statement of cash flows, excluded from the equity headings, for the years ended 31 December 2019 and 2018, is as follows:

Cash flows								
Thousands of Euros (2019)	Balance at 31.12.2018	Application of IFRS 16	Issue	Reimburse- ments	Interest paid	Accrued interest	Non- redeemable expenses and other	Balance at 31.12.2019
Bonds	1,292,309	-	-	-	-	1,331	-	1,293,640
Loans and borrowings	1,642	-	-	(1,642)	-	-	-	-
Debt with Group companies and associates	3,664	-	153	-	-	-	950	4,768
Other financing operations	2,397	-	449	(107)	-	21	-	2,768
Leases	-	4,492	-	(971)	-	129	13	3,663
Accrued interest payable	8,472	-	-	-	(24,141)	21,064	-	5,395
Total financial debt-loans and other	1,308,484	4,492	602	(2,720)	(24,141)	22,545	963	1,310,226

Cash flows							
Thousands of Euros (2018)	Balance at 31.12.2017	Issue	Reimburse- ments	Interest paid	Accrued interest	Non- redeemable expenses and other	Balance at 31.12.2018
Bonds	1,291,899	-	-	-	1,365	(955)	1,292,309
Loans and borrowings	-	1,642	-	-	-	-	-
Debt with Group companies and associates	127,689	68	-	-	-	(124,093)	3,664
Other financing operations	2,400	87	(113)	-	24	(1)	2,397
Accrued interest payable	8,263	-	-	(27,015)	27,223	-	8,472
Total financial debt-loans and other	1,430,251	1,797	(113)	(27,015)	28,612	(125,049)	1,308,484

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

22. Trade and other payables

Details of trade and other payables at 31 December are as follows:

	Thousands of Euros	
	Current	
	31.12.2019	31.12.2018
Related parties (note 34)		
Payables	2,393	1,726
Unrelated parties		
Suppliers	2,408	2,638
Creditors	49,812	45,533
Suppliers of fixed assets	5,499	4,443
Personnel	774	629
	60,886	54,969
Total		

The fair values of trade and other payables do not differ significantly from their carrying amounts.

Unrelated parties include Euros 43,010 thousand for gas sector inter-company settlements, reflecting the estimate at 31 December 2019 (Euros 34,813 in 2018), which, based on authorised costs for the distribution activity, are allocated to the Group in the corresponding settlement period to adjust the settlements to the remuneration calculated by the Ministry, pursuant to the legislation applicable to the gas sector.

The Group has estimated its settlement for 2019 based on a comparison between the sales made in each year, less other related costs, and the Company's accrued authorised costs at 31 December 2019, calculated based on the distribution of total authorised fixed remuneration for 2019, distributed proportionally.

23. Late Payments to Suppliers. "Reporting Requirement". Third Additional Provision of Law 15/2010 of 5 July 2010

Information on late payments to suppliers during the years ended 31 December 2019 and 2018 is as follows:

	Days	
	31.12.2019	31.12.2018
	Average supplier payment period	26.74
Transactions paid ratio	27.30	30.63
Transactions payable ratio	23.30	13.59
	Amount in Euros	
	31.12.2019	31.12.2018
	Total payments made	62,384,020
Total payments outstanding	10,149,624	8,719,240

24. Risk management policy

Financial risk factors

The Group's activity consists of gas distribution in Spain, thus it is not subject to currency risk, country risk, etc. Furthermore, the Group does not have any financial derivatives of any kind. The Group has not carried out significant transactions with end customers, only with gas suppliers and other agents in the gas system.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

The Group's activities are exposed to various financial risks: credit risk, liquidity risk and cash flow interest rate risk. The Group's global risk management programme focuses on uncertainty in the financial markets and aims to minimise potential adverse effects on the Group's profits.

Adaptation of the systems to the Group's risk profile is managed individually by specifically analysing each risk and the related factors, taking into consideration its nature, source, possibility and probability of occurrence and the significance of the associated impact. Management measures (hedges, mitigation, opportunity, etc.) that are viable for each risk are also considered.

Controls are based on the approval of management policies and include mechanisms to set and control operational limits, as well as authorisation and supervision processes, together with operational procedures.

(i) Interest rate risk

As the Group does not have a considerable amount of remunerated assets, income and cash flows from operating activities are not significantly affected by fluctuations in market interest rates.

Interest rate risk arises from non-current borrowings. Fixed interest loans expose the Company to fair value interest rate risks.

(ii) Credit risk

The Group is not exposed to significant credit risk, due to the regulated nature of its principal activities.

The accompanying table shows an age analysis of financial assets at 31 December 2019 and 2018:

	31.12.2019				Total
	Thousands of Euros				
	Less than 3 months	More than 3 months and less than 6 months	More than 6 months and less than 1 year	More than 1 year	
Trade and other receivables at fixed rate	19,236	3	4	18	19,261
Other financial assets	1	-	44	53	98
Total assets	19,237	3	48	71	19,359

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

	31.12.2018				
	Thousands of Euros				
	Less than 3 months	More than 3 months and less than 6 months	More than 6 months and less than 1 year	More than 1 year	Total
Trade and other receivables at fixed rate	19,682	37	66	-	19,785
Other financial assets	485	37,113	67	-	37,665
Total assets	20,167	37,150	133	-	57,450

(iii) Liquidity Risk

At 31 December 2019, the Group has positive working capital of Euros 302,815 thousand (Euros 135,206 thousand in 2018). The Group generates sufficient cash on an annual basis to meet its requirements.

The liquidity policy adopted ensures that payment obligations are met through the arrangement of sufficient credit facilities.

The table below shows the Group's exposure to liquidity risk at 31 December 2019 and 2018. The tables below reflect the analysis of financial liabilities by contracted maturity.

	31.12.2019				
	Thousands of Euros				
	Less than 3 months	More than 3 months and less than 6 months	More than 6 months and less than 1 year	More than 1 year	Total
Bank borrowings					
Variable rate Interest	50	-	-	-	50
Trade and other payables	59,613	888	385	-	60,886
Liabilities from the issue of bonds and other marketable securities					
Principal	-	-	-	1,293,640	1,293,640
Interest	-	-	5,345	-	5,345
Total liabilities	59,663	888	5,730	1,293,640	1,359,921

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

	31.12.2018				
	Thousands of Euros				
	Less than 3 months	More than 3 months and less than 6 months	More than 6 months and less than 1 year	More than 1 year	Total
Bank borrowings					
Variable rate					
Principal	1,642	-	-	-	1,642
Interest	50	-	-	-	50
Trade and other payables	46,845	7,773	351	-	54,969
Liabilities from the issue of bonds and other marketable securities					
Principal	-	-	-	1,292,309	1,292,309
Interest	-	-	5,345	-	5,345
Total liabilities	48,537	7,773	5,696	1,292,309	1,354,315

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

25. Provisions

The classification of current and non-current provisions is as follows:

	Thousands of Euros	
	Non-current	
	31.12.2019	31.12.2018
Provision for voluntary redundancy costs	-	2,934
Other personnel provisions	211	330
Other liabilities	19	2,222
Total	230	5,486

Movement in provisions for the years ended 31 December 2019 and 2018 is as follows:

	Thousands of Euros			
	Voluntary redundancy costs (note 32)	Other personnel provisions	Other liabilities	Total
At 31 December 2018	2,934	330	2,222	5,486
Charges	-	-	19	19
Reversals	(1,327)	(119)	(2,222)	(3,668)
Use	(1,607)	-	-	(1,607)
At 31 December 2019	-	211	19	230

	Thousands of Euros			
	Voluntary redundancy costs (note 32)	Other personnel provisions	Other liabilities	Total
At 31 December 2017	3,587	330	12	3,929
Charges	900	-	2,222	3,122
Reversals	-	-	(5)	(5)
Use	(1,553)	-	(7)	(1,560)
At 31 December 2018	2,934	330	2,222	5,486

Commitments with personnel

At 31 December 2018, the provision mainly relates to the liability registered to cover the voluntary redundancy commitment agreed with several employees at 31 December 2018 for a total amount of 2,9 million euros, which has been applied in 2019.

Other liabilities

The provision covers the potential outcomes of litigious processes relating to the Group. According to the Directors, following the relevant legal advice given, the outcome of such processes is not expected to differ significantly from provisions made at 31 December 2019.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts
for the year ended 31 December 2019

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

Contingent liabilities

As per publicly available information, the CNMC issued decisions in February 2018 and May 2018, which related to the CNMC requiring the Parent company and its subsidiary NED España Distribución Gas, S.A.U. to meet the conditions imposed according to the explanatory plan filed by the company with the CNMC in April 2017.

In this regard, on 21 March 2019, the CNMC issued its resolution considering the conditions set out in the aforementioned explanatory plan fulfilled, once the Parent company's sole shareholder made the previously described contributions in December 2018 and March 2019, thus eliminating the contingent liability.

Guarantees

The total amount of guarantees extended to third parties (councils and other public entities) at 31 December 2019 amounts to Euros 6,075 thousand (Euros 5,561 thousand in 2018), whilst guarantees received from suppliers amount to Euros 4,384 thousand (Euros 4,374 thousand in 2018).

The guarantees made to city councils and other public entities are for occupying and guaranteeing to replace public assets affected by the construction of pipelines and supply networks. No losses are expected in relation to these guarantees.

26. Environmental Information

The very nature of the Group's activity, the distribution of natural gas as a substitute for oil and coal derivatives, which are more polluting due to the effects of combustion, helps to improve the environment and provides greater thermal efficiency that promotes energy efficiency and therefore savings.

Natural gas contributes to improving the environment as it reduces the emission of greenhouse gases (90% methane) as it generates less CO₂ during combustion. Natural gas is one of the least contaminating fossil fuels, as it contains practically no sulphur.

Throughout 2019, work has continued on the environmental monitoring of gas distribution works, including regular visits. Furthermore, in accordance with the environmental procedures of the integrated management system, noise levels are measured at the distribution facilities, the location of which makes them susceptible to exceeding the permitted limits. In 2019, measurements were taken at 12 facilities and all the results fell within the ranges set out in current legislation.

In order to have available a more complete and ambitious risk map than that required by the Environmental Liability Law, in 2019 an environmental risk analysis was voluntarily carried out at natural gas storage facilities with satisfactory results.

The Group received no environmental grants or income from activities related to the environment in the year ended 31 December 2019.

As a result of the aforementioned actions undertaken by the Group, the directors consider that any contingencies that could arise from environmental issues, which are very unlikely, are sufficiently covered by their civil liability insurance policies.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

27. Capital grants

Movement in deferred income is as follows:

	Thousands of Euros
	31.12.2019
Opening balance	335
Additions	117
Amounts transferred to the income statement	<u>(3)</u>
Closing balance	<u>449</u>

	Thousands of Euros
	31.12.2018
Opening balance	-
Additions	339
Amounts transferred to the income statement	<u>(4)</u>
Closing balance	<u>335</u>

28. Contract liabilities

Movement in contract liabilities is as follows:

	Thousands of Euros	
	31.12.2019	31.12.2018
Opening balance	4,922	1,242
Additions	3,398	3,646
Disposals	(19)	-
Amounts transferred to the income statement	(149)	(12)
Other movement	<u>-</u>	<u>46</u>
Closing balance	<u>8,152</u>	<u>4,922</u>

Contract liabilities include connection and extension activities.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

29. Other current liabilities

Details of other current liabilities are as follows:

	Thousands of Euros	
	31.12.2019	31.12.2018
Public entities, other		
tax authorities Withholdings payable to	2,032	1,570
Social Security contributions	215	225
Public charges, taxes and councils	4,237	4,147
Other	952	-
	7,436	5,942
Total	7,436	5,942

Public charges, taxes and councils includes the amount relating to charges for subsoil use, which has not been included under the scope of IFRS 16 due to its consideration as a variable cost. Amounts paid in 2019 and 2018 for this item amount to Euros 4.1 million and Euros 4.1 million, respectively. It is likely that a similar amount will be paid in coming years.

30. Revenue and supplies

Details of revenue by category are as follows:

	Thousands of Euros	
	Domestic	
	2019	2018
Revenue from the sale of propane gas	22,142	27,214
Revenue from regulated activities	177,775	179,916
Revenue from services rendered and other	22,755	22,557
	222,672	229,687

Regulated activity revenue mainly relates to the amount accrued for regulated remuneration to gas distributors.

Details of supplies are as follows:

	Thousands of Euros	
	2019	2018
Merchandise used		
Purchases	13,827	17,036
Change in inventories	432	882
	14,259	17,918
Other purchases and external expenses		
Subcontracted work	3,246	2,895
Other	916	917
	4,162	3,812
	18,421	21,730

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

Subcontracted work at 31 December 2019 and 2018 relates mainly to the periodic inspections outsourced to third parties.

Other revenue relates to an amount of Euros 3,985 thousand recognised in 2019 (Euros 3,985 thousand in 2018) based on the agreement signed by Nortegas Energía Distribución, S.A.U and EDP Iberia whereby compensation in the event of changes in the regulations affecting the remuneration of gas meter rentals is guaranteed (see note 15).

In addition, this heading includes revenue recognised based on the agreement signed with EDP Iberia whereby the Group company NED Suministro GLP, S.A.U. is guaranteed a minimum gross margin per supply point acquired from Repsol Butano, S.A. prior to 31 December 2016.

31. Other expenses

Details of other expenses are as follows:

	Thousands of Euros	
	2019	2018
Operating lease expenses (note 10)	210	1,739
Repairs and maintenance	3,084	3,752
Independent professional services	940	2,324
Services rendered to Group companies (note 34)	13,891	6,856
Insurance premiums	629	590
Utilities	278	228
Other services	7,153	10,753
Taxes	5,731	5,709
Other expenses	3,606	3,522
	35,522	35,473

32. Personnel expenses

Details of personnel expenses are as follows:

	Thousands of Euros	
	2019	2018
Salaries and wages	10,415	12,168
Other employee benefit expenses and taxes	2,861	3,184
Allocation to personnel provisions (note 25)	(1,327)	900
Contributions to other long-term benefits	374	511
	12,323	16,763

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

33. Financial income and expenses

Details of financial income and expense are as follows:

	Thousands of Euros	
	2019	2018
Finance income on loans to Group companies (notes 11 and 34)	109	254
Finance income (see note 11)	115	103
Interest expense on debts, Group companies (notes 18 and 34)	-	(6,277)
Interest expense on debts, Banks (note 18)	(367)	(332)
Interest expense on debts, bond issuance (note 18)	(20,537)	(20,462)
Other financial costs (note 18)	(1,641)	(1,541)
	(22,321)	(28,255)
Net finance cost	(22,321)	(28,255)

34. Related party balances and transactions

Details of balances receivable from and payable to related parties by category and the main characteristics thereof are chiefly disclosed in notes 9, 11, 14, 20 and 22.

Details of balances by category at 31 December 2019 and 2018 are as follows:

	Thousands of Euros			
	Sole Shareholder	Group companies	Associates	Total
31.12.2019				
Non-current investments in Group companies and associates				
Equity-accounted investees (note 9)	-	-	778	778
Total non-current assets	-	-	778	778
Current investments in Group companies and associates				
Loans to companies (note 11)	1	-	-	1
Trade and other receivables				
Other receivables (note 14)	1,225	-	33	1,258
Total current assets	1,226	-	33	1,259
Total assets	1,226	-	811	2,037
Current debt				
Other financial liabilities (note 20)	4,161	-	607	4,768
Payables, Group companies and associates (note 22)	2,393	-	-	2,393
Total current liabilities	6,554	-	607	7,161
Total liabilities	6,554	-	607	7,161

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

31.12.2018	Thousands of Euros			
	Sole Shareholder	Group companies	Associates	Total
Non-current investments in Group companies and associates				
Equity-accounted investees (note 9)	-	-	745	745
Total non-current assets	-	-	745	745
Current investments in Group companies and associates				
Loans to companies (note 11)	37,280	-	-	37,280
Trade and other receivables				
Other receivables (note 14)	1,067	-	27	1,094
Total current assets	38,347	-	27	38,374
Total assets	38,347	-	772	39,119
Current debts				
Other financial liabilities (note 20)	3,211	3,076	454	6,741
Payables, Group companies and associates (note 22)	1,726	-	-	1,726
Total current liabilities	4,937	3,076	454	8,467
Total liabilities	4,937	3,076	454	8,467

Group transactions with related parties

Group transactions with related parties at 31 December 2019 and 2018 are as follows:

31.12.2019	Thousands of Euros			
	Sole Shareholder	Group companies	Associates	Total
Income				
Other services rendered	-	-	302	302
Other operating income	63	-	-	63
Financial instruments				
Finance income (note 33)	109	-	-	109
Equity-accounted investees (note 9)	-	-	158	158
Total income	172	-	460	632
Expenses				
Other expenses (note 31)	13,891	-	-	13,891
Total expenses	13,891	-	-	13,891

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

31.12.2018	Thousands of Euros			
	Sole Shareholder	Group companies	Associates	Total
Income				
Other services rendered	-	-	291	291
Other operating income	66	-	-	66
Financial instruments				
Finance income (note 33)	254	-	-	254
Equity-accounted investees (note 9)	-	-	191	191
Total income	320	-	482	802
Expenses				
Other expenses (note 31)	6,856	-	-	6,856
Financial instruments				
Finance costs (note 33)	-	6,277	-	6,277
Total expenses	6,856	6,277	-	13,133

Information on the Parent's directors and the Group's senior management personnel

In the year ended 31 December 2019, the Directors and members of the Company's senior management have received remuneration amounting to Euros 58 thousand and Euros 859 thousand, respectively (Euros 642 thousand and Euros 1,063 thousand, respectively, in 2018). Furthermore, members of senior management have an outstanding repayable amount on loans of Euros 7 thousand (Euros 26 thousand in 2018). The Parent company has no pension or life insurance obligations with its former or current directors.

The civil liability insurance premium for the year for the position of director amounted to Euros 25 thousand in 2019 (Euros 25 thousand in 2018).

Transactions other than ordinary business or under terms differing from market conditions carried out by the Directors and members of the Supervisory Board of the Parent company

In the years ended 31 December 2019 and 2018, the Directors of the Company have not carried out any transactions other than ordinary business or applying terms that differ from market conditions with the Company of any other Group company.

Conflicts of interest concerning the Directors of the Parent company

The directors of the Company and their related parties have had no conflicts of interest requiring disclosure in accordance with article 229 of the Revised Spanish Companies Act, other than Mr Conrado Navarro who has 6,000 shares in Enagas S.A., but does not hold any position whatsoever in this Company.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

35. Employee Information

The average number of Group employees in the years ended 31 December 2019 and 2018 is as follows:

	Average number of employees	
	31.12.2019	31.12.2018
Directors	8	10
Managers	26	34
Other	126	143
	160	187

At 31 December 2019, the Group has one employee with a disability rating of 33% or higher (or equivalent local rating) (one at 31 December 2018).

Royal Legislative Decree 1/2013 of 29 November, which approves the revised General Act on the rights of persons with disabilities and their social inclusion, requires that public and private companies employing 50 or more staff must reserve at least 2% of their jobs for persons with disabilities.

Since the Company has not met this condition, it has applied a series of alternative measures established by Royal Decree 364/2005 of 8 April, which governs such exceptions. The alternative measures available to companies failing to reserve the required 2% of its posts for persons with disabilities largely consist of maintaining service contracts with at least two suppliers that are certified as "special centres".

At 31 December 2019 and 2018 the distribution by gender of Group personnel and the directors is as follows:

	Number			
	2019		2018	
	Women	Male	Female	Male
Board members	-	4	-	3
Directors	-	8	-	7
Managers	9	17	9	18
Other	28	98	29	98
	37	127	38	126

36. Audit Fees

KPMG Auditores, S.L., the auditor of the Group's annual accounts, and other affiliates of KPMG International invoiced the following fees for professional services during the years ended 31 December 2019 and 2018:

	Thousands of Euros	
	31.12.2019	31.12.2018
Audit services, consolidated annual accounts	54	54
Audit services, individual annual accounts for the Company	41	41
Audit services, annual accounts for subsidiaries	55	59
	150	154

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Notes to the Consolidated Annual Accounts

In the year ended 31 December 2019, other firms affiliated with KPMG International invoiced the Group for professional service fees totalling Euros 203 thousand (Euros 545 thousand in 2018).

37. Events after the Reporting Period

No significant event of note that could have an effect on the accompanying consolidated annual accounts and which is not disclosed herein has taken place after the year ended 31 December 2019.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Details of subsidiaries

31 December 2019

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

Name	Registered address	Activity	Auditor	Company holding investment	% of ownership	% of voting rights	Consolidation based on
NED España Distribución Gas, S.A.U.	Oviedo (Asturias)	Natural gas distribution	KPMG Auditores, S.L.	Nortegas Energía Distribución, S.A.U.	100%	100%	Fully consolidated
NED Suministro GLP, S.A.U.	Bilbao (Vizcaya)	Distribution and sale of liquefied petroleum gas	KPMG Auditores, S.L.	Nortegas Energía Distribución, S.A.U.	100%	100%	Fully consolidated
Tolosa Gasa, S.A.	Tolosa (Guipuzkoa)	Natural gas distribution	KPMG Auditores, S.L.	Nortegas Energía Distribución, S.A.U.	40.00%	40.00%	Equity method
Inkolan, A.I.E.	Bilbao (Vizcaya)	Compilation and management of all information relating to the networks installed by each partner in the Basque Country (CAV).	Moore Stephens AMS, S.L.	Nortegas Energía Distribución, S.A.U.	14.29%	14.29%	Equity method

This appendix forms an integral part of note 6 to the consolidated annual accounts.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Details of subsidiaries

31 December 2018

Name	Registered address	Activity	Auditor	Company holding investment	% of Ownership	% of voting rights	Consolidation based on
NED España Distribución Gas, S.A.U.	Oviedo (Asturias)	Natural gas distribution	KPMG Auditores, S.L.	Nortegas Energía Distribución, S.A.U.	100%	100%	Fully consolidated
NED Suministro GLP, S.A.U.	Bilbao (Vizcaya)	Distribution and sale of liquefied petroleum gas	KPMG Auditores, S.L.	Nortegas Energía Distribución, S.A.U.	100%	100%	Fully consolidated
Tolosa Gasa, S.A.	Tolosa (Guipuzkoa)	Natural gas distribution	KPMG Auditores, S.L.	Nortegas Energía Distribución, S.A.U.	40.00%	40.00%	Equity method
Inkolan, A.I.E.	Bilbao (Vizcaya)	Compilation and management of all information relating to the networks installed by each partner in the Basque Country(CAV).	Moore Stephens AMS, S.L.	Nortegas Energía Distribución, S.A.U.	14.29%	14.29%	Equity method

This appendix forms an integral part of note 6 to the consolidated annual accounts.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Directors' Report

31 December 2019

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

1. Most significant milestones in 2019

2019 has been a challenging year in which Nortegas (the Group) has been able to quickly adapt to and meet the development and growth targets set for 2019 in all of its business areas.

2019 has been the first year of implementation of the Company's new Expansion Plan and of the definition of an Operational Efficiency Plan. Work has also been carried out to define a new Strategic Plan in order to continue improving the natural gas distribution business with a view to continuing to use clean, efficient and sustainable energy.

In terms of legislation, the challenge facing Nortegas has centred on defending and encouraging regulatory stability to develop the distribution business, emphasising the use of gas, both conventional and renewable, as an energy player in the future low-carbon economy.

As a result, Nortegas is the second largest gas distributor in Spain and the primary distributor in the north of the country. It has more than one million supply points and 8,241 km of gas pipelines distributed throughout the Basque Country, Asturias and Cantabria. It employs 160 professionals at 31 December 2019 and its corporate headquarters is in Bilbao.

2. Operational data and milestones

Most of the activities carried out by Nortegas are regulated and at the end of 2019 it has more than 1 million natural gas and LPG supply points, is present in 383 municipalities, of which 225 are supplied with natural gas and the rest with LPG. The average penetration rate in Asturias, Cantabria and the Basque Country is 68%.

Operational data	2019	2018	2017	CAGR (2017- 2019) ⁽¹⁾
Connection points	1,035,062	1,025,525	1,016,530	1%
Natural gas (NG)<4 bar	951,595	942,305	932,578	
Natural gas (NG)>4 bar	668	672	685	
LPG	82,799	82,548	83,267	
Energy distributed NG+LPG (GWh)	31,967	31,710	29,728	4%
Energy distributed (NG) (GWh)	31,588	31,287	29,339	
Energy distributed (LPG) (GWh)	379	423	389	
Network length (NG+LPG) (Km)	8,241	8,207	8,194	0%
Km NG	7,861	7,831	7,803	
Km LPG	380	376	391	

Note 1: Compound annual growth rate from 2017 to 2019

3. Analysis of 2019 results

The execution of the Growth Plan in 2019, defined the previous year, has meant that consolidated EBITDA (revenue before depreciation and amortisation) recognised by Nortegas in 2019 amounts to Euros 177.5 million, compared to Euros 171.6 million in 2018, up 3.4% on the previous year.

The Group's revenues in 2019 totalled Euros 222.7 million compared to Euros 229.7 million in 2018.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Directors' Report

31 December 2019

Finally, Nortegas and its subsidiaries obtained a profit of Euros 56.7 million in 2019.

Details by business segment of the investments made by Nortegas are broken down below. In 2019 there has been an increase of 18% compared to 2018.

Investments (millions of Euros)	Jan-Dec 2019	Jan-Dec 2018	Jan-Dec 2017
Distribution	24.7	21.5	24.9
LPG	1.6	0.7	0.5
TOTAL	26.3	22.2	25.4

4. Most significant events in 2019

The Group has continued with its standard business as a regulated natural gas and LPG sector enterprise. This activity consists of the management of the regulated distribution assets, including promoting, developing and building new infrastructure, as well as network operation, maintenance and optimisation services.

The Group is also present in the liquefied petroleum gas market, where it is in charge of supplying the fuel in addition to the activities mentioned above.

The Nortegas Group has continued to expand its network in its areas of influence. Some of the key projects are indicated below:

- ✓ Work to extend the network in Selaya (Cantabria), where 3.8 kilometres have been executed and 100 connections made from the Villacarriedo LPG plant.
- ✓ Network extension relating to the Maoño-Escobedo Phase I municipality project (Cantabria) measuring 4,851 metres with 7 connections completed.
- ✓ Commissioning of the Eskuzaitzeta industrial estate network (Donostia-Gipuzkoa) with 2,415 metres and 3 connections. In addition to the industrial estate, a link has been established with the Lasarte network, improving the safety of the area's supply as set out in the Operating Plan for the area.
- ✓ Relaunch of the network expansion at the BOBES (Siero-Asturias) industrial estate, which involves 5,525 metres of network and 56 new connections.
- ✓ Authorisation obtained to supply LPG to the municipalities of Cudillero and Campomanes in Asturias with investments of Euros 473 thousand and Euros 185 thousand, respectively.
- ✓ Projects to replace metal gas pipes continue, as do improvements to networks and equipment.

Other significant milestones were reached as well:

- ✓ Within the context of the gasification agreement with the Principality of Asturias, the 2019 gasification agreement between Nortegas and the Principality of Asturias has been signed, authorising a grant of Euros 117 thousand to supply gas to the Santianes industrial estate (Sariego-Asturias).
- ✓ Update of the Cantabria Network Operating Plan.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Directors' Report

31 December 2019

- ✓ Approval of the "Technological solutions for the hydrogen economy" project by the Board of Directors of the Centre for Industrial Technological Development (CDTI), which Nortegas is taking part in together with other partners, such as ENAGAS. Nortegas is involved in the part of the project to design, develop and validate a system for upgrading / downgrading H2 in natural gas networks using membranes for H2 purification, with a budget of Euros 761 thousand.
- ✓ On 22 July 2019, Ente Vasco de la Energía and Nortegas signed a Memorandum of Understanding to drive the use of renewable gas and promote smart gas networks in the Basque Country. This memorandum is signed within the framework of their commitment to drive greater use of renewable energy resources by identifying and analysing projects that could be developed to:
 1. Promote the use of biomethane from domestic organic waste, agricultural waste, waste from water treatment plants, food and agriculture industry waste, etc., in the industrial, tertiary and transport sectors. This adds further impetus to the work carried out by Ente Vasco de la Energía in the field of renewable energy sources for over two decades.
 2. Promote smart networks to analyse interest in equipping gas distribution networks with electronic telecommunications elements, such as smart meters that provide information to distribution companies and users, making it possible to manage energy use more efficiently and safely, leading to improved supply and service quality.

Within this context, the following projects are launched:

1. Technical studies alongside Ente Vasco de la Energía on rubbish tips in the Basque Country to analyse the potential use of renewable gas.
 2. The launch of the BIDE GAS project by Nortegas and Ente Vasco de la Energía to digitalise gas networks in the Basque Country with steps taken to start installing 1,000 smart meters in UGAO-MIRABALLES, which will allow account holders to permanently control their energy consumption whilst enabling the real-time monitoring of customer installation safety.
- ✓ A change of preventive modality by arranging the 4 preventive specialities with an external prevention service
 - ✓ Satisfactory external annual audits of the OSHAS 18001:2007 certification, ISO 14001:2015 and ISO 9001:2015.
 - ✓ Investments to extend the natural gas distribution network to a total of 7,861 km at 31 December 2019, which represents a 9% share of the industry in Spain.
 - ✓ Investments in new natural gas networks and the increase in the saturation of supply points in existing natural gas networks allowed the number of supply points to increase to 952,263. The networks distributed 31,588 GWh of energy.
 - ✓ The LPG business at 31 December 2019 totalled 82,799 supply points and 380 km of LPG lines.

Operating profits amounted to Euros 94.2 million in 2019, after amortisation and depreciation totalling Euros 83.3 million. Finance income/cost and other results, together with corporate income tax, gave rise to a net profit of Euros 56.6 million.

The regulatory scenario in 2019 included the following milestones:

- ✓ Approval of Order TEC/1367/2018 (20 December), which establishes the tolls and royalties associated with third party access to gas facilities and remuneration for regulated activities in

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Directors' Report

31 December 2019

2019. Publication of Royal Decree-Law 1/2019 of 11 January on urgent measures to adapt the powers of the Spanish National Markets and Competition Commission to the requirements arising from Community law in relation to Directives 2009/72/EC and 2009/73/EC of the European Parliament and of the Council of 13 July 2009, concerning common standards for the domestic electricity and natural gas market.

- ✓ Approval of Order TEC/406/2019 of 5 April, which establishes energy policy guidance for the Spanish National Markets and Competition Commission.
- ✓ Publication in the BOE (official state gazette) of Communication 1/2019 of 23 October by the Spanish National Markets and Competition Commission, on the definition of ratios for assessing the level of borrowings and the economic and financial capacity of companies that carry out regulated activities, and on recommended value ranges thereof.
- ✓ Publication of Circular 2/2019 of 12 November by the Spanish National Markets and Competition Commission, which establishes the methodology for calculating the financial remuneration rate of electricity distribution and transport, and the regasification, transport and distribution of natural gas activities.
- ✓ Receipt on 29 November of the final settlement for 2018, which shows a system surplus totalling Euros 30.9 million. The impact of the surplus on Nortegas Group companies totals Euros 1.9 million, settled in December 2019.
- ✓ Publication of Circular 8/2019 of 12 December, which establishes the methodology and conditions for accessing and allocating capacity in the natural gas system.
- ✓ Publication of Order TEC/1259/2019 (20 December), which establishes remuneration for basic underground storage and tolls and royalties associated with third party access to gas facilities for 2020, correcting the estimated remuneration for 2018 and 2019.
- ✓ Publication in the BOE (official state gazette) of the Resolution of 18 December 2019 by the Spanish National Markets and Competition Commission, which establishes remuneration for 2020 for companies undertaking regulated liquefied natural gas plant, transport and distribution activities.
- ✓ Publication of Royal Decree-Law 1/2019, which stipulates that the CNMC must approve, before 1 January 2020, the Circular containing the methodology for calculating remuneration for natural gas distribution for the 2021-2026 regulatory period. This Circular has not however been approved in accordance with the planned timetable; a first proposal was submitted for public consultation in July 2019 and a second proposal in December 2019 (note 1).

The payment policy for Group suppliers establishes a payment period that falls within the limits established by law.

5. Treasury shares

At 31 December 2019 and 2018 there are no treasury shares and none have been acquired during the year.

6. Derivative financial instruments

At 31 December 2019 the Group does not have any financial instruments.

7. Risks

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Directors' Report

31 December 2019

The Group has analysed the risks and uncertainties to which its business is subject, and the Board of Directors understands that the identified risks do not require any urgent or immediate additional or specific actions to be adopted beyond the mitigation measures already in existence that have been evaluated by an external expert.

In 2018 the Company defined its strategic positioning with regards the various risk categories, as well as the tolerance thresholds that allowed it to measure its actual exposure to uncertainty and their development. The positioning and tolerance thresholds have been updated in 2019.

Note 24 of the notes to the accompanying consolidated accounts describes these policies and risk management measures.

8. Research and development activity

During the period the Group has continued with its efforts to develop strategic research projects that are aligned with its priority research and development activities backed by the European gas industry, among which the following are notable:

- ✓ European HYGRID Project: "Flexible Hybrid separation system for H2 recovery from Natural Gas Grids", financed by the EU H2020 programme. The consortium requested an extension for presenting the results and it has been approved by the Commission following delays in building the purification prototype.
- ✓ The CIEN SMART GREEN GAS project: Final achievement of the CDTI certificate for the SMARTGREENGAS project.
- ✓ SINATRAH Project - Development of advanced solutions for the transport and use of hydrogen, a project subsidised by the Basque Government's HAZITEK programme in collaboration with TECNALIA and SIEMENS ENGINES.
- ✓ DINEGAS Project- Intelligent device for natural gas energy evaluation, a project subsidised by the Basque Government's HAZITEK programme in collaboration with CEIT IK4 and IOT WATER.
- ✓ NGV Innovation project: Tests carried out over two months with SEAT at the Ertzaintza de Erandio complex.

Similarly, an active presence has been maintained in leading edge innovation forums in which Nortegas participates:

- ✓ European Gas Research Group (GERG): Attending several board meetings in Brussels and the Netherlands.
- ✓ IGU R&D Committee - attending and actively taking part in Study Group 3, Cross Cutting Technology held in Groningen.
- ✓ IGU Utilization Committee - taking part in Study Group 3, Gas for Transport.
- ✓ Alternative Energy Cooperative Investigation Centre Foundation "CIC energiGUNE": Member of the Board of Trustees.
- ✓ Meetings of the BIOGAS working Group within the SEDIGAS context regarding the injection of bio-methane into gas networks, as part of the Technology and Training Committee within the PROGAS Committee.
- ✓ Actively taking part at UNE as members of the CTN GET-25 work group to develop technical specifications for renewable energy certificates of origin.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Directors' Report

31 December 2019

- ✓ Actively taking part at UNE as members of the CTN-181 work group on hydrogen technologies.
- ✓ AULA DE NORTEGAS: final presentation of the four projects carried out at the Engineering School in Bilbao in 2018-2019.
 - Project no. 1 - A study of supply alternatives to satellite liquefied natural gas plants.
 - Project no. 2 - Adapting a regulation and metering station for injecting renewable gas.
 - Project no. 3 - Designing a mobile compressed natural gas unit.
 - Project no. 4 - A study of technologies for manufacturing methane from biomass and non-vegetable waste.

In addition, four new projects for 2019-2020 have been developed:

- Project no. 1 - Feasibility study for a biomethane liquefaction plant.
 - Project no. 2 - Alternative uses of CO₂ in the process to upgrade biomethane.
 - Project no. 3 - Operational pilot project - natural gas distribution network at the UPV campus in Leioa with 10% H₂ injection.
 - Project no. 4 - Gas station.
- ✓ Taking part in meetings and events at the CIC Venture Café Biscay Start Up Bay.
 - ✓ Signing an agreement with the Ente Vasco de la Energía to drive the use of renewable gas and promote smart gas networks in the Basque Country.

9. Future development

The Company's future development is based on the following pillars:

- ✓ Continue investing in the construction of new distribution networks in new population centres and the extension of current distribution networks to saturate the zones of influence. To do so, in 2019 an ambitious Expansion Plan has continued to be followed as a road map for the coming years
- ✓ Developing new areas of business that are committed to new development paths and new uses of natural gas as well as new businesses that enable the Group to move forward towards clean, efficient and sustainable energy.
- ✓ Continue with the ongoing improvement of supply quality and safety. Achieve an extremely efficient and highly responsible operating system, reflecting excellent operations, inspections and maintenance.
- ✓ Anticipate risks and efficiently manage regulatory requirements, which are essential given the nature of the business.
- ✓ Develop increasingly more demanding health, safety and environmental standards.
- ✓ Continue developing LPG activities throughout the entire network, maximising asset value and customer relationships.
- ✓ Continue investing in R&D+I to guarantee a sustainable future for the company in the long-term.

NORTEGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Directors' Report

31 December 2019

10. Events after the reporting period

Since 31 December 2019, no additional significant events have taken place other than those disclosed in note 37.

AUTHORISATION FOR ISSUE OF THE ANNUAL ACCOUNTS

2019

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

*Signed on original
in Spanish*

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in Spanish*

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Nortegas Energía Grupo, S.L.U.,
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