## ENCE ENERGÍA Y CELULOSA, S.A.

Independent Auditor's Report on Consolidated Annual Accounts at 31 December 2016





## INDEPENDENT AUDITOR'S REPORT ON CONSOLIDATED ANNUAL ACCOUNTS

This version of our report is a free translation from the original, which was prepared in Spanish. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation

To the shareholders of ENCE Energía y Celulosa, S.A.:

## Report on the Consolidated Annual Accounts

We have audited the accompanying consolidated annual accounts of ENCE Energía y Celulosa, S.A. and its subsidiaries (the "Group" hereinafter), which comprise the consolidated statement of financial position as at December 31, 2016, and the consolidated income statement, statement of other comprehensive income, statement of changes in equity, cash flow statement and related notes for the year then ended.

Directors' Responsibility for the Consolidated Annual Accounts

The parent company's directors are responsible for the preparation of these consolidated annual accounts, so that they present fairly the consolidated equity, financial position and financial performance of ENCE Energía y Celulosa, S.A. and its subsidiaries, in accordance with International Financial Reporting Standards, as adopted by the European Union, and other provisions of the financial reporting framework applicable to the Group in Spain and for such internal control as directors determine is necessary to enable the preparation of consolidated annual accounts that are free from material misstatement, whether due to fraud or error.

#### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated annual accounts based on our audit. We conducted our audit in accordance with legislation governing the audit practice in Spain. This legislation requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated annual accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated annual accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the parent company's directors' preparation of the consolidated annual accounts 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the presentation of the consolidated annual accounts taken as a whole.

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





## Opinion

In our opinion, the accompanying consolidated annual accounts present fairly, in all material respects, the consolidated equity and financial position of ENCE Energia y Celulosa, S.A. and its subsidiaries as at December 31, 2016, and 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, and other provisions of the financial reporting framework applicable in Spain.

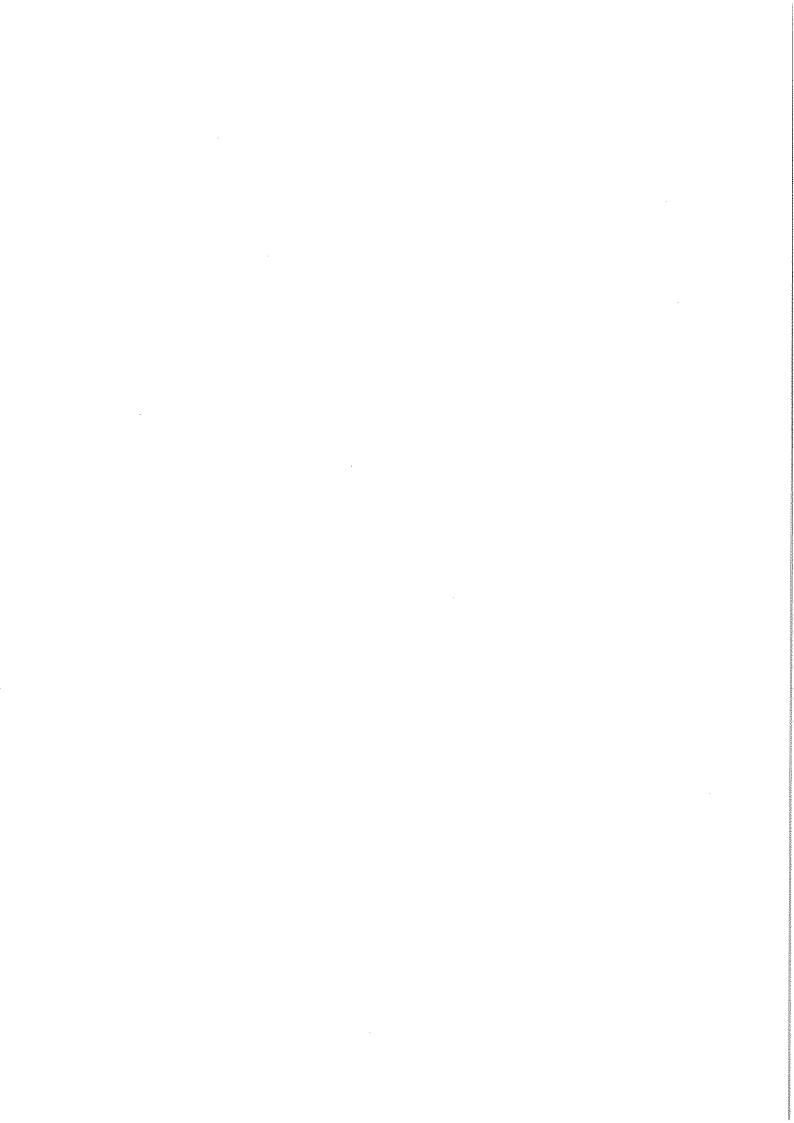
## Report on Other Legal and Regulatory Requirements

The accompanying consolidated directors' Report for 2016 contains the explanations which the parent company's directors consider appropriate regarding ENCE Energia y Celulosa, S.A. and its subsidiaries' situation, the development of their business and other matters and does not form an integral part of the consolidated annual accounts. We have verified that the accounting information contained in the directors' Report is in agreement with that of the consolidated annual accounts for 2016. Our work as auditors is limited to checking the directors' Report in accordance with the scope mentioned in this paragraph and does not include a review of information other than that obtained from ENCE Energia y Celulosa, S.A. and its subsidiaries' accounting records.

PricewaterhouseCoopers Auditores, S.L.

Mar Gallardo

27 February 2017





# ENCE Energía y Celulosa, S.A. and subsidiaries

Consolidated financial statements for 2016 prepared under the International Financial Reporting Standards adopted by the European Union, the Group Management Report and the Audit Report

# **Consolidated financial statements for 2016**



## ENCE ENERGÍA Y CELULOSA, S.A. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 December 2016 AND 2015

Thousands of euros	Note	Year-end 2016	Year-end 2015
NON-CURRENT ASSETS:			
Intangible assets		6.007	
Goodwill	2	2,697	42.64
Other Intangible assets	17	15,242	12,615 641,930
Property, plant and equipment	15 16	686,299 83,411	87,893
Biological assets	25	11,694	3,027
Other financial assets		68,456	70,831
Deferred tax assets	28	867,739	816,29
CURRENT ASSETS:			
Non-current assets held for sale	17	6,883	50,998
Inventories	18	43,607	40,21
Trade and other receivables	19	80,221	121,969
Tax receivables	28	8,811	9,035
Income tax receivable	28	1,459	959
Current financial assets:			
Hedging derivatives	27	-	245
Other financial assets	25	9,580	8,699
Cash and cash equivalents	24	209,864	159,565
Other current assets		3,570	472
		363,995	391,497
TOTAL ASSETS		1,231,734	1,207,791
EQUITY:	21	225,245	225,245
ssued capital	21	170,776	170,776
Share premium	21	161,269	195,096
Parent company reserves	21	(109,117)	(109,117)
Parent company retained earnings (prior-year losses)	21	57,561	60,510
Reserves in fully-consolidated companies	X.L	(7,825)	(10,951)
nterim dividend		(7,625) 86	(1,116)
Translation differences	21	(11,963)	(3,108)
Own shares - parent company shares	21	29,071	51,028
/aluation adjustments	21	517	21,020
Other equity instruments - shareholder remuneration plan		38,711	49,855
Consolidated profit for the year	-	554,331	568,218
Squity attributable to owners of the parent Non-controlling interests	7	7,234	200,210
TOTAL EQUITY		561,565	568,218
NON-CURRENT LIABILITIES: Bonds and other marketable securities	24	243,631	243,108
Bank borrowings	24	132,932	143,527
rank porrowings Grants	22	9,671	11,254
ledging derivatives	27	11,748	7,647
Other financial liabilities	25	39,419	6,687
Deferred tax liabilities	28	20,512	20,560
ion-current provisions	28	6,167	9,260
	252 Z#	454,080	442,049
ZURRENT LIABILITIES:			
Bank borrowings	24	20,476	14,813
ledging derivatives	27	14,741	5,923
	25	1,305	1,356
Other financial liabilities	20	154,169	162,073
rade and other payables	222	117	57
rade and other payables ncome tax payable	28	#A CEE	7 000
rade and other payables ncome tax payable axes payable	28	10,655	7,002
rade and other payables ncome tax payable		10,655 4,626 206,089	7,002 6,306 197,530

The accompanying notes 1 to 32 are an integral part of the consolidated statement of financial position at 31 December 2016



## ENCE ENERGÍA Y CELULOSA, S.A. AND SUBSIDIARIES

## CONSOLIDATED INCOME STATEMENT FOR YEAR-ENDS 2016 AND 2015

Thousands of euros	Note	Year-end 2016	Year-end 2015
Continuing operations:		•	
Revenue	8	605,448	663,912
Gain/(loss) on hedging transactions	27	971	(1,630)
Changes in Inventory of finished goods and work in progress		1,107	4,800
Cost of sales	9	(268,251)	(272,984)
GROSS PROFIT	No.	339,275	394,098
Own work capitalised	14 & 16	6,541	9,526
Other operating Income		5,212	5,995
Grants taken to Income	22	2,435	2,606
Employee benefits expense	10	(68,428)	(62,526)
Depreciation and amortisation charges	14 & 15	(69,728)	(58,980)
Depletion of forest reserve	16 & 17	(7,151)	(8,182)
Impairment of and gains/(losses) on disposals of Intangible assets and PP&E	15, 16, 17 & 23	24,034	8,612
Other operating expenses	11	(159,467)	(157,914)
OPERATING PROFIT/(LOSS)		72,723	133,235
FinanceIncome		285	344
Change In fair value of financial Instruments	27	(100)	(13,990)
Other finance costs	12	(20,364)	(53,921)
Net exchange gains/(losses)		(1,446)	1,370
NET FINANCE COST		(21,625)	(66,197)
PROFIT/(LOSS) BEFORE TAX	-	51,098	67,038
Income tax	28	(12,387)	(17,183
		· · · · · · · · · · · · · · · · · · ·	******
PROFIT/(LOSS) FOR YEAR FROM CONTINUING OPERATIONS Discontinued operations:	times.	38,711	49,855
Profit/(loss) after tax for the period from discontinued operations		g.	
CONSOLIDATED PROFIT FOR THE YEAR		38,711	49,855
Profit/(loss) attributable to non-controlling interests	2		
PROFIT/(LOSS) FOR THE YEAR ATTRIBUTABLE TO OWNERS OF THE PARENT		38,711	49,855
Earnings/(loss) per share attributable to owners of the parent			
Basic	21	0.15	0.20
Diluted	21	0.15	0.20

The accompanying notes 1 to 32 are an integral part of the consolidated 2016 income statement



## ENCE ENERGÍA Y CELULOSA, S.A. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR YEAR-ENDS 2016 AND 2015

Thousands of euros	Note	Year-end 2016	Year-end 2015
CONSOLIDATED PROFIT/(LOSS) FOR THE PERIOD (I)	21	38,711	49,855
Income and expense recognised directly in equity:			
- Cash-flow hedges (*)		(15,444)	(5,555)
- Translation differences (*)		999	(39)
- Tax effect	_	3,861	1,389
TOTAL INCOME AND EXPENSE RECOGNISED DIRECTLY IN CONSOLIDATED EQUITY (II)	21	(10,584)	(4,205
Amounts transferred to the consolidated income statement			
- Cash-flow hedges (*)		(1,031)	15,400
-Tax effect		258	(3,850)
TOTAL AMOUNTS TRANSFERRED TO PROFIT OR LOSS (III)	21	(773)	11,550
TOTAL COMPREHENSIVE INCOME/(EXPENSE) (H-HHII)		27,354	57,200
Attributable to:			
Parent company		27,354	57,200
Non-controlling interests		4	

(\*) Items that may be subsequently be reclassified to profit or loss

The accompanying notes 1 to 32 are an integral part of the consolidated 2016 statement of comprehensive income



## ENCE ENERGÍA Y CELULOSA, S.A. AND SUBSIDIARIES CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR YEAR-ENDS 2016 AND 2015

2016 (thousands of euros)	Balance at 1/1/2016	Total recognised income/ (expense)	Appropriation of prior-year profit/(loss)	Dividends	Trading In	Other movements (note 4.15)	Balance at 31/12/2016
Issued capital	225,245	À	¥	14.		-	225,245
Share premium ·	170,776	*	-				170,776
Legal reserve Other reserves/Parent company retained earnings (prior-	45,050	7		7	38	2	45,050
period losses)	(19,071)	-	51,251	(24,886)	(192)		7,102
Reserves in fully-consolidated companies	60,510	9,600	(12,347)		2	(203)	57,561
Interim dividend	(10,951)		10,951	(7,825)	-	,,	(7,825)
Translation differences	(1,116)	999	4	-4	o <b>=</b> s	203	86
Own shares	(3,108)	1.4		14	(8,855)	*	(11,963)
Valuation adjustments	51,028	(21,957)	4		*	_	29,071
Other equity instruments - shareholder remuneration plan	,	Tie	-	-	-	517	517
Consolidated profit/(loss) for the period	49,855	38,711	(49,855)		-	-	38,711
Total equity attributable to owners of the parent	568,218	27,354	*	(32,711)	(9,047)	517	554,331
Non-controlling interests				*	(8.)	7,234	7,234
Total equity	568,218	27,354		(32,711)	(9,047)	7,751	561,565

	Balance at	Total recognised income/	Appropriation of prior-year		Trading In	Distribution of	Balance at
2015 (thousands of euros)	1/1/2015	(expense)	profit/(loss)	Dividends	own shares	own shares	31/12/2015
Issued capital	225,245	4	3	-	ş	÷	225,245
Share premium	195,665	*		(24,889)			170,776
Legal reserve	45,050		,	-		*	45,050
Other reserves/Parent company retained earnings (prior-							
period losses)	54,915	-	(109,118)	7 <u>~</u>	1,294	33,838	(19,071)
Reserves in fully-consolidated companies	123,282	6,725	(35,658)	4		(33,838)	60,510
Interim dividend			A.	(10,951)	-		(10,951)
Translation differences	(1,077)	(39)	¥.	-		1.2 %	(1,116)
Own shares	(5,744)	4		-	2,636	4	(3,108)
Valuation adjustments	46,501	660	3,867	-	*	· ·	51,028
Consolidated profit/(loss) for the period	(140,909)	49,855	140,909	-			49,855
Total equity attributable to owners of the parent	542,928	57,200	-	(35,840)	3,930	4.7	568,218
Non-controlling interests			- 15		=	y.ª	
Total equity	542,928	57,200		(35,840)	3,930		568,218

The accompanying notes 1 to 32 are an integral part of the consolidated 2016 statement of changes in equity



## ENCE ENERGÍA Y CELULOSA, S.A. AND SUBSIDIARIES CONSOLIDATED STATEMENT OF CASH FLOWS FOR YEAR-ENDS 2016 AND 2015

Thousands of euros	Note	Year-end 2016	Year-end 2015
CASH FLOWS FROM OPERATING ACTIVITIES:			
Consolidated profit/(loss) for the parlod before tax		51,098	67,03
Adjustments for:			
Depreciation		67,206	57,16
Depletion of forest reserve		7,151	8,18
Amortisation		2,522	1,81
Changes in provisions and other deferred expense (net)		5,742	2,79
Impairment of and gains/(losses) on disposals Intangible assets and PP&E		(24,034)	(8,990
Finance Income		(285)	(344
Finance costs		21,637	66,91
Grants taken to Income		(1,701)	{1,982
- market and a second a second and a second		78,458	125,55
Changes in working capital:	18	807	(4,095
nventories	525		(22,070
Frade and other receivables	19	87,065	
inancial and other current assets	25	(881)	(164
Trade payables, other payables and other liabilities	20	(11,436) 25,555	(9,212 (35,541
Other cash flows from operating activities:	-		
- Interest paid	12 & 24	(22,193)	(47,517)
- Interest received		285	344
- Income tax received (paid)	28	(8,313)	744
- Other receipts / (payments)		(2,064)	
September Control Security (September 2) and Control September 2) and C		(32,285)	(46,429)
Net cash from operating activities (I)		122,806	110,621
ASH FLOWS FROM INVESTING ACTIVITIES:			
investments:			
Property, plant and equipment and biological assets	15 & 16	(61,039)	(53,974)
ntangible ussats	14	(6,454)	(5,192)
Business combination		(22,505)	
Other financial assets	2 & 25	(7,590)	(71)
	-	(97,588)	(59,237)
Proceeds:	. was	Security State	
Property, plant and equipment and blological assets	17	38,683 38,683	32,266 32,266
1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1		(58,905)	(26,971)
let cash used in investing activities (ii)		(30,503)	(LUDI'Z)
CASH FLOWS FROM FINANCING ACTIVITIES;			
roceeds from and psyments for aquity instruments	**.	******	
Buyback of own equity instruments	181	(39,387)	(1,093)
Disposal of own equity instruments	21.7	80,340	5,023
		(9,047)	9,930
roceeds from and repayments of financial liabilities:	24	(369)	(7,032)
	24		44,639
Proceeds from Issuance of bonds and other marketable securities, net of issuance costs increase/(decrease) in bank borrowings, net of Issuance costs	24	27,222	
Proceeds from Issuance of bonds and other marketable securities, net of issuance costs increase/(decrease) in bank borrowings, net of Issuance costs	-	27,222	(5,293)
Proceeds from Issuance of bonds and other marketable securities, net of issuance costs Increase/(decrease) in bank borrowings, net of Issuance costs Repayment of other borrowings and cancellation of derivatives	24	(416)	2,011
Repayment of other borrowings and cancellation of derivatives Grants received	24	- 19	2,011
Proceeds from Issuance of bonds and other marketable securities, net of issuance costs Increase/(decrease) in bank borrowings, net of Issuance costs Repayment of other borrowings and cancellation of derivatives Grants received  Dividends and payments on other equity instruments	24 24 22	(416) 25,437	2,011 84,925
Proceeds from Issuance of bonds and other marketable securities, net of issuance costs Increase/(decrease) in bank borrowings, net of Issuance costs Repayment of other borrowings and cancellation of derivatives Grants received  Dividends and payments on other equity instruments	24	(416) 25,437 (32,711)	2,011 84,325 (85,840)
Proceeds from Issuance of bonds and other marketable securities, net of issuance costs Increase/(decrease) in bank borrowings, net of Issuance costs Repayment of other borrowings and cancellation of derivatives Grants received Dividends and payments on other equity instruments	24 24 22	(416) 25,437	2,011 24,325 (85,840) (35,840)
Proceeds from Issuance of bonds and other marketable securities, net of issuance costs Increase/(decrease) in bank borrowings, net of Issuance costs Repayment of other borrowings and cancellation of derivatives Grants received Dividends and payments on other equity instruments Dividends Fransistion differences	24 24 22	(416) 25,437 (32,711) (32,711)	2,011 84,325 (85,840) (35,840)
Proceeds from Issuance of bonds and other marketable securities, net of issuance costs Increase/(decrease) in bank borrowings, net of Issuance costs Repayment of other borrowings and cancellation of derivatives Grants received Ovidends and payments on other equity instruments Ovidends Fransistion differences Vet cash used in/from financing activities (III)	24 24 22	(416) 26,437 (32,711) (32,711) (15,321)	94,925 (85,840) (35,840) 72 2,487
Proceeds from Issuance of bonds and other marketable securities, net of issuance costs Increase/(decrease) in bank borrowings, net of Issuance costs Repayment of other borrowings and cancellation of derivatives Grants received Dividends and payments on other equity instruments Dividends Fransistion differences	24 24 22	(416) 25,437 (32,711) (32,711)	2,011 54,325 (85,840) (35,840)
Proceeds from Issuance of bonds and other marketable securities, net of issuance costs Increase/decrease) in bank borrowings, net of Issuance costs Repayment of other borrowings and cancellation of derivatives Grants received Ovidends and payments on other equity instruments Ovidends Fransistion differences Let cash used in/from financing activities (III)	24 24 24 22 22 22 21.5 2	(416) 26,437 (32,711) (32,711) (15,321) 48,580 159,565	2,011 54,325 (85,840) (35,840) 72 2,487
Proceeds from Issuance of bonds and other marketable securities, net of issuance costs Increase/decrease) in bank borrowings, net of Issuance costs Repayment of other borrowings and cancellation of derivatives Grants received  Ovidends and payments on other equity instruments Ovidends  Fransistion differences Let cash used in/from financing activities (III)  NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS (IHI+BI)	24 24 22	(416) 26,437 (32,711) (32,711) (15,321) 48,580	2,011 84,925 (85,840) (35,840) 72 2,487 86,137

The accompanying notes 1 to 32 are an integral part of the consolidated 2016 statement of cash flows

Notes to the 2016 consolidated financial statements



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## ENCE Energía y Celulosa, S.A. and subsidiaries

Notes to the 2016 consolidated financial statements



## 1. Group business and other information

## 1.1 Business activity

Ence Energía y Celulosa, S.A. (hereinafter "Ence", the "Company" or the "Parent") was incorporated in 1968. Its registered office is located at Calle Beatriz de Bobadilla, 14 in Madrid. It formerly went by the name of Empresa Nacional de Celulosas, S.A. until 1999 and Grupo Empresarial ENCE, S.A. until 2012.

Its corporate purpose, as per its bylaws, consists of:

- a) The manufacture of cellulose pulp and derivatives thereof, the obtainment of the products and other elements necessary to this end and the use of the sub-products of both;
- b) The production by any means, sale and use of electric energy and other sources of energy and of the materials and primary energies needed for its generation, as permitted under prevailing legislation; and the marketing, sale-purchase and supply thereof under any of the formulae permitted under law.
- c) The cultivation, exploitation and use of forests and forest land, afforestation work and the provision of expert forestry-related services and works. The preparation and transformation of forestry products. The use and exploitation for commercial and business purposes of all manner of forestry products (including biomass and forest energy products), their derivatives and their sub-products. Forestry studies and projects;
- d) The planning, development, construction, operation and maintenance of the facilities referred to in sections a), b) and c) above.

The Group has structured its activities around two business lines:

## The Pulp Business-

Includes the production of bleached eucalyptus kraft pulp (BEKP) by means of elementary chlorine free (ECF) and totally chlorine free (TCF) bleaching sequences.

To carry out this activity, the Group has two factories in Spain (located in Asturias and Pontevedra) with combined nominal capacity of approximately 1,070,000 tonnes per annum.

These mills use the kraft process to produce pulp. This productive process includes the co-generation of electric power fuelled by the parts of timber that cannot be transformed into pulp: lignin or biomass. The Group's aggregate nominal installed electric generation capacity (Integrated within the Asturias and Pontevedra factories) is approximately 112 megawatts (MW).

In order to facilitate procurement of the timber supplies needed for the pulp manufacturing process, the Group manages 67,752 hectares of forested land in Spain and Portugal, 44,794 hectares of which it owns.



#### **Energy Business-**

Ence has developed and acquired several power generation facilities that are fuelled by forestry and agricultural biomass; these plants operate on a standalone basis, separately to the pulp business. Their aggregate power-generating capacity is 143 MW, broken down as follows:

Location	Capacity MW	Regulatory useful life
Huelva	50	2037
Huelva	41.	2028
Merida	20	2039
Jaen	16	2027
Ciudad Real	16	2027



All of the Company's shares are represented by book entries and are officially listed on the Spanish stock exchanges and traded on the continuous market (SIBE for its acronym in Spanish).

## 1.2 Proposed appropriation of the Parent's profit

The Company's directors have resolved to submit the following appropriation of the Parent's 2016 profit of €37,957 thousand for shareholder approval at the upcoming Annual General Meeting:

	Thousands of euros
Basis of appropriation:	
Profit for the year	37,957
Appropriation:	
Interim dividend - paid out in December 2016	7,825
Complementary dividend	11,603
To the capitalisation reserve	1,848
To compensate prior-year losses	16,681

At a meeting held on 22 November 2016, the Board of Directors of the Parent resolved to pay an interim dividend from 2016 profits of €0.03196 per share (before withholdings), in cash. This dividend entailed the payment of €7,825 thousand and was paid out on 1 December 2016.

The table below sets out the related forecast liquidity position, as required under article 277 of the Consolidated Text of the Corporate Enterprises Act, evidencing the existence of sufficient liquidity to justify payment of the above interim dividend:



	Thousands of euros
Available liquidity as of 31 October 2016:	
Cash	49,419
	49,419
Interim dividend payment (maximum amount)	(7,999)
Forecast net cash flows until date of approval of interim dividend	(.,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,
Forecast liquidity as of date of approval of interim dividend	41,420
Forecast cash receipts until 31 October 2017	
Operating and investing activities	27,474
Financing activities	22,000
Forecast cash outflows until 31 October 2017	
Operating and investing activities	(28,697)
Financing activities	(40,468)
Forecast liquidity as of 31 October 2017	21,729

## 2. Scope of consolidation and business combinations

#### 2.1 Business combinations

On 29 December 2016, Ence Energía, S.L.U., a 100%-owned subsidiary of Ence Energía y Celuiosa, S.A. and the holding company for the Group's Energy business, acquired 64.07% of the share capital of Energía La Loma, S.A. and 68.42% of that of Energías de la Mancha ENEMAN, S.A. from the Enel Group for €22.5 million. Both of the companies acquired generate power from agricultural biomass, mainly derived from olive waste. The €22.5 million purchase price has already been pald and is subject to certain price adjustments related to the new investees' financial situation at year-end 2016 that are currently being calculated. This transaction has given the Group control over both of these companies.

In keeping with the accounting standards applicable to business combinations (note 4.3), in order to consolidate these investments within the Group's financial statements, the acquisition price was allocated to the assets acquired and the liabilities assumed based on their estimated fair values as of the acquisition date.

As a result of the price allocation process, the value of the productive assets included in non-current assets on the balance sheets of the companies acquired has been written up by €10,789 thousand euros. This amount will be depreciated over the plants' remaining useful lives for regulatory purposes. Ence has conducted an internal valuation analysis to review the fair values ascribed to these productive assets. There is no contingent consideration.

This business combination has been accounted for provisionally as the prescribed 12-month period - starting on the acquisition date - has yet to elapse; although the accounting treatment will be revised if necessary, no significant additional adjustments are anticipated.

The breakdown of the net assets acquired is as follows:



Thousands of euros	Note	Fair value	Carrying amount in target's financial statements
Goodwill	2	2,697	
Property, plant and equipment	15	24,056	13,267
Non-current financial assets		1,377	1,377
Deferred tax assets	28	587	587
Cash and cash equivalents		1,719	1,719
Other current assets		8,984	8,984
Total assets		39,420	25,934
Deferred tax liabilities	28	2,998	300
Other current liabilities		4,308	4,309
Total liabilitles		7,306	4,609
NET ASSETS ACQUIRED		32,114	21,325

<sup>(\*)</sup> Data corresponding to 100% of the acquirees' net assets

The significant costs associated with this transaction totalled €0.3 million and are expensed in the accompanying 2016 consolidated income statement.

The difference between the fair value and tax basis of the assets acquired triggered the recognition of a deferred tax liability in the amount of €2.7 million (note 28).

## 2.1 Consolidation scope

The following subsidiaries, effectively controlled by the Parent, are fully consolidated in the accompanying 2016 consolidated financial statements:





2016

				NIII I		
				sval	Investee equity	2
				YALII	ישובה בלחור	
				Capital and		Profit
				other owner	Share	(loss) for
Company	Registered office	Business activity	Ownership interest (%)	contributions	premium &	the year
	11000				reserves	
Pulp Business-						
Celulosas de Asturias, S.A.U. (a)	Armental s/n Navia (Asturias)	Pula production and power generation			į	
Silvasur Agroforestal S.A.II (a)	Dontring of Charles 11 / 1 / 1 / 1 / 1 / 1 / 1 / 1 / 1 / 1	Lead of the second and bower generation	3	37,863	96,845	18,531
Therefore 6 A 11 (-1	Beau is the Bobacilla, 14 (Magrid)	Forest land management	100	19,800	723	20,790
ibersilva, s.A.U. (a)	Ctra A-5000 Km. 7.5 (Huelva)	Forestry services	100	280	(89)	(25)
Norte Forestal, S.A.U. (a)		Forest land management	100	2.464	12.137	(2 412)
Ence investigación v Desarrollo, S.A.U. (a)	Marisma do Lourizán c/n	Bocograft into and aloughant at a factor	0		1	(27-17-7)
		materials, products and processes	100	6,208	(3,820)	33
Iberflorestal, S.A.U. (a)	lishon (Portugal)	District of the Comment	,		1000	
(5)		ruiciase sale of wood	100	4,055	(3,989)	(779)
Energy Business-						
Celulosa Energía, S.A.U. (a)	Beatriz de Bobadilla, 14 (Madrid)	Generation and sale of electric energy	5	2756	5	1
Fince Energia C.1.11 (a)	Dontrie de Debadille 44 (Nantala		3	00/10	14,839	2,060
Frank Francis Health College	beduiz de bobadilla, 14 (Madrid)	Generation and sale of electric energy	100	116,136	39,907	(3.358)
Elice Elicigia Fluctiva, S.L.O. (a)	Beatriz de Bobadilla, 14 (Madrid)	Generation and sale of electric energy	100	25,757	7.226	8 584
Ence Energia Extremadura, S.L.U. (a)	Beatriz de Bobadilla, 14 (Madrid)	Generation and sale of electric energy	100	20.05	2 447	.00.
Energía de la Loma, S.A. (b)	Villanueva del Arzobispo (Jaen)	Generation and sale of electric energy	20 03	1	/ht/2	7007
Energias de la Mancha Eneman S A (h)	Villanta do Can trans (Citadad and Charles	Consideration and selection of the control of the c	0.4	4,10/	4,214	3,090
מבוכו לכן יעיכ יום ואימוימום דויבווומווי כיטי (ס) אווומו	Villai la ue Sali Juali (Ciudad Real)	Generation and sale of electric energy	68.42	280	7 878	1746

(a) Annual financial statements audited
(b) Financial statements reviewed for consolidation purposes



2015

				Thouse	Thousands of euros	"
				Inve	Investee equity	
			Ownership	Capital and	Profi	Profit (loss)
			interest (%)	other owner Sh	Share for the	for the year
Company	Registered office	Business activity		contributions prei	premium &	
finding.	ò			res	reserves	
Pulp Business-						
Celulosas de Asturias, S.A.U. (a)	Armental s/n Navia (Asturias)	Generation and sale of pulp and electric energy	100	37,863	86,049	40,796
Silvasur Agroforestal, S.A.U. (a)	Beatriz de Bobadilla, 14 (Madrid)	Forest land management	100	3,960	4,204	12,359
Ibersilva, S.A.U. (a)	Ctra A-5000 Km. 7.5 (Huelva)	Forestry services	100	280	(404)	369
Norte Forestal, S.A.U. (a)	Beatriz de Bobadilla, 14 (Madrid)	Forest land management	100	2,464	17,758	(5,621)
Ence Investigación y Desarrollo, S.A.U. (a)	Pontecaldelas (Pontevedra)	Research into and development of new	100	6,208	(3,788)	(32)
(berflorestal Comércio e Servicos	Lisbon (Portugal)	materials, products and processes Purchase-sale of wood	100			
Florestais, S.A.U. (a)	· ·			4,055	260	(4,248)
Energy Business- Celulosa Energía, S.A.U. (a)	Beatriz de Bobadilla, 14 (Madrid)	Generation and sale of electric energy	100	3,756	28,246	6,613
Ence Energía, S.L.U. (a)		Generation and sale of electric energy	100	110,524	20,171	(2,709)
Ence Energía Huelva, S.L.U. (a)	Beatriz de Bobadilla, 14 (Madrid)	Generation and sale of electric energy	100	25,757	5,452	1,774
Ence Energía Extremadura, S.L.U. (a)	Beatriz de Bobadilla, 14 (Madrid)	Generation and sale of electric energy	100	20,054	4,565	(2,118)

(a) Annual financial statements audited

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



In addition, the Group comprises the following dormant companies that are wholly-owned by the Parent: Sierras Calmas, S.A., Maderas Aserradas del Litoral, S.A., Las Pléyades, S.A. (SAFI), Las Pléyades Argentina, S.A. and Las Pléyades Uruguay, S.A.

The Group also has non-controlling interests in certain companies that have not been consolidated on account of their scant materiality: Imacel, A.E.I.E., a dormant company that is 50%-owned by the Parent, and Electroquímica de Hernani, S.A., in which it owns a 5% shareholding, among others.

## 2.3 Other changes in the scope of consolidation

in 2015, the Parent contributed Celulosa Energía, S.A.U. to its subsidiary, Ence Energía, S.L.U. Also in 2015, the dormant Uruguayan companies, Uruguay Celulosas de M'Bopicuá, S.A. and Zona Franca M'Bopicuá, S.A., were unwound.

## 3. Basis of preparation and consolidation

### 3.1 Basis of preparation

Ence Energía y Celulosa, S.A.'s 2016 consolidated annual financial statements were prepared from its accounting records and annual financial statements and those of its Group companies. They were prepared in accordance with the prevailing financial reporting framework, specifically the international Financial Reporting Standards (IFRS) adopted by the European Union, as provided for in Regulation (EC) No. 1606/2002 of the European Parliament, and Spanish Law 62/2003 (30 December 2003) on tax, administrative and corporate measures, to give a true and fair view of the Group's financial position at 31 December 2016 and of its financial performance and cash flows for the year then ended.

Note 4 summarises the most significant mandatory accounting policies and measurement criteria applied.

The Group's consolidated financial statements for 2016, which have been authorised for issue by the Parent's directors, will be submitted for shareholder approval at the Annual General Meeting at which they are expected to be ratified without modification.

The Group's consolidated financial statements for 2015 were ratified at the Annual General Meeting held by the Parent on 15 March 2016.

The Group's functional currency is the euro and the consolidated financial statements are accordingly presented in euros.

#### 3.2 Basis of consolidation

#### **Subsidiaries**

The financial statements of the subsidiaries are consolidated with those of the Parent using the full consolidation method. 'Subsidiaries' are investees over which the Parent has the power to exercise effective control; this power is presumed to exist, in general albeit not exclusively, when it owns, either directly or indirectly, at least 50% of the voting rights of the investee or, even if this percentage is lower, there are agreements with other investee shareholders that grant it control. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

All of the Group subsidiaries' report as of 31 December.



All material inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated on consolidation.

The share of non-controlling interests in the fully-consolidated subsidiaries' equity and earnings is presented in 'Non-controlling interests' within equity on the accompanying consolidated statement of financial position and in 'Profit (loss) attributable to non-controlling interests' in the accompanying consolidated income statement, respectively.

In the accompanying consolidated financial statements for 2016 and 2015, all the companies comprising the consolidation scope Itemised in note 2 are accounted for using the full consolidation method.

#### **Associates**

Associates are all entities over which the Parent has significant influence but not control or joint control. The power to exercise significant influence is usually associated with interests (held directly or indirectly) of 20% or more of an investee's voting rights.

Associates are accounted for using the equity method, i.e., at the carrying amount of the Group's share of the associate's equity, restated for any dividends received and other adjustments to equity.

## Adjustments to conform with the Group's accounting policies

The consolidation of the entities comprising the consolidation scope was carried out on the basis of their respective separate financial statements, which are prepared under the Spanish General Accounting Plan for companies resident in Spain and local accounting standards for the foreign subsidiaries. The directors have made all the material adjustments needed to adapt these separate financial statements to IFRS and/or to align them with the Group's accounting policies as part of the consolidation process.

## Financial statement translation

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into euros as follows: assets and liabilities are translated at the closing rate at each reporting date; equity items are translated at historical rates; and income and expenses are translated at average rates for the period in which they accrued. The resulting exchange differences are recognised in equity and are reclassified to profit or loss in the period in which the foreign operation is disposed of.

## 3.3 Comparison of Information and transaction seasonality

The information provided in these financial statements in respect of 2015 is presented to enable a reader comparison with the equivalent 2016 disclosures. In this respect, the reader needs to consider the changes in the scope of consolidation outlined in note 2.

Given the nature of the Group companies' business operations, its transactions are not cyclical or seasonal in nature. Specific seasonality disclosures are accordingly not provided in these financial statements. Note, however, that the production of pulp and energy requires annual stoppages of between 10 and 15 days for maintenance purposes. The Group carried out these annual stoppages during the first halves of 2016 and 2015.



## 3.4 Key IFRS-related decisions



In presenting the consolidated financial statements and accompanying notes, the Group took the following decisions:

- a. The presentation of the consolidated statement of financial position distinguishes between current and non-current amounts. The consolidated income statement is presented using the nature-of-expense method.
- b. The Group has chosen to present its consolidated statement of cash flows using the indirect method.

## 3.5 Changes in accounting estimates and policies and correction of fundamental errors

The impact of any change in accounting estimates is accounted for prospectively in the same income statement heading in which the previously estimated item of expense or income is recognised.

Meanwhile, changes in accounting policies and the correction of fundamental errors are accounted for as follows insofar as material: the accumulated impact at the beginning of the year is adjusted in reserves and the impact in the year of the restatement is recognised in profit or loss for the year. In these instances, the financial information for the comparative year presented alongside that corresponding to the reporting period is restated.

No significant changes in accounting estimates or policies or corrections of errors affect either the 2016 or the 2015 financial statements.

## 3.6 New and amended standards taking effect during the reporting period

The Group has applied the following new accounting standards and interpretations for the first time in its 2016 consolidated financial statements, the reporting period in which they became effective. Note that their first-time application has not had a significant impact on the consolidated financial statements:



Cham Jana	Contents
Standard  Amendments to IAS 16 / IAS 38 - Acceptable methods of depreciation and amortisation	These amendments clarify which depreciation and amortisation methods are acceptable, stating that revenue-based depreciation methods are not permitted.
Amendments to IFRS 11 - Accounting for acquisitions of interests in joint operations	These amendments specify how to account for the acquisition of an interest in a joint operation whose activity constitutes a business.
Amendments to IAS 16 and IAS 41 - Bearer plants	As amended, bearer plants will have to be carried at cost instead of fair value.
Amendments to IAS 27 - Equity method in separate financial statements	These amendments will reinstate the use of the equity method to measure investments in an investor's separate financial statements.
Amendments to IAS 1: Disclosure initiative	Multiple clarifications with respect to disclosure requirements (materiality, aggregation, note order, etc.).
Amendments to IAS 19 - Employee contribution to defined benefit plans	These amendments will allow for the deduction of these contributions from service cost in the same reporting period as they are paid for, subject to delivery of certain requirements.
Amendments to IFRS 10, IFRS 12 and IAS 28	Introduction of clarifications regarding application of the consolidation exception to investment entitles.
Annual Improvements to IFRSs, 2010-2012 Cycle	Minor amendments to IFRS 2 (definition of 'vesting condition'), IFRS 3 (accounting for contingent consideration in a business combination), IFRS 8 (aggregation of operating segments), IFRS 13 (short-term receivables and payables), IAS 16 (revaluation method – proportionate restatement of accumulated depreciation) and IAS 24 (key management personnel).
Annual Improvements to IFRSs, 2012-2014 Cycle	Minor amendments to IFRS 5 (changes in method of disposal), IFRS 7 (serving contracts and applicability of the amendments to IFRS 7 to condensed interim financial statements), IAS 19 (regional market issue) and IAS 34 (disclosure of information 'elsewhere in the interim financial report').

## 3.7 Standards and interpretations issued but not yet effective

At the date of authorising the accompanying consolidated financial statements for issue, the most significant standards and interpretations published by the International Accounting Standard Board (IASB) but not yet effective, either because they have yet to be adopted by the European Union or because their date of effectiveness is subsequent to that of authorisation of the accompanying statements, are the following:



Standard	Contents	Applicable
Amendments to IAS 7 - Disclosure Initiative	These amendments introduce additional disclosure requirements with the aim of enhancing the information provided to financial statement users.	from January 01, 2017
Amendments to IAS 12 -	Recognition of deferred tax assets for unrealised losses.	January 01, 2017
IFRS 15 - Revenue from contracts with customers and related clarifications.	Replaces prevalling IAS 18 and IAS 11 as well as the current revenue recognition interpretations. The new standard is based on the principle that revenue should be recognised when control of a good or service is transferred to the customer.	January 01, 2018
IFRS 9 - Financial Instruments	Replaces the financial asset and financial liability classification, measurement, recognition and derecognition requirements and the hedge accounting and impairment prescriptions of IAS -39.	January 01, 2018
Amendments to IFRS 2 - Share-based payments	Amendments designed to clarify specific issues such as the effects of vesting conditions on the measurement of a cash-settled share-based payment.	January 01, 2018
Amendments to IFRS 4 - Insurance contracts	Gives entities falling under the scope of IFRS 4 the choice of applying a temporary exemption from application of IFRS 9.	January 01, 2018
Amendments to IAS 40 - Transfers of nvestment property	These amendments clarify that an investment may only be reclassified in or out of investment property if there is an evident change of use.	January 01, 2018
Annual Improvements to IFRSs, 2014- 2016 Cycle	Minor amendments to a series of standards	January 01, 2018
FRIC 22- Foreign currency ransactions and advanced onsideration	This interpretation prescribes how to determine the date of the transaction which in turn determines the exchange rate to be used to account for advances received or paid for in foreign currency.	January 01,2018
mendments to IFRS 10 and IAS 28 - ales or contributions of assets etween and investor and its ssociate or joint venture	Clarification regarding how to account for the gain or loss on these transactions depending on whether the assets constitute a business	No set date
RS 16 - Leases	Replaces IAS 17 and associated interpretations. The new standard puts forward a single accounting model for all leases (with limited exemptions), which will be recognised on the balance sheet in a manner similar to how finance leases are currently treated.	January 01, 2019



The Group is in the process of analysing what impact these new and amended standards could have on its consolidated financial statements if adopted. The specific analysis performed to date has not revealed any significant impacts in relation to application of IFRS 15 — Revenue from contracts with customers. Only the following standards are expected to have a more substantial impact:

#### IFRS 9 - Financial instruments

The most significant differences between the current model for recognising and measuring financial instruments and the new model are:

• IFRS 9 is more flexible about the classes of transactions eligible for hedge accounting, broadening the items that meet the criteria for classification as hedging instruments and the classes of risk components eligible for hedge accounting to include non-financial items. The hedge effectiveness test has also been revised and replaced by the "economic relationship" test (it will no longer be necessary to test hedges retroactively).

IFRS 9 amends the accounting treatment of the time value of options in hedging arrangements; the change in these instruments' fair value under certain circumstances may now be temporarily deferred as a hedging cost to be initially recognised in other comprehensive income within equity and later reclassified to profit and loss using the systematic methods contemplated in the standard.

An Initial assessment of Ence's existing hedging arrangements suggests that they will continue to qualify as effective hedges under IFRS 9.

As for the impairment of financial assets, IFRS 9 requires the application of an expected loss model, in contrast to the incurred loss model prescribed under IAS 39. Under this new model, the Group will have to account for expected losses without waiting for an impairment event to occur.

The Group's financial assets at amortised cost and its outstanding trade and other accounts receivable are subject to IFRS 9 as far as impairment is concerned. Management expects to apply the simplified approach to recognise the lifetime expected credit loss on these financial assets, which is expected to be scantly material insofar as the credit risk implicit in most of the Group's pulp sales is outsourced by means of credit surety arrangements, while the revenue generated by the energy business is due from the Spanish government.

The Group intends to apply this standard early, namely from 1 January 2017.

## IFRS 16 - Leases.

Management has estimated the approximate potential impact application of this new standard (which takes effect on 1 January 2019) will have in the future by using the data and terms of the operating leases currently in effect, assuming they will all be affected by introduction of this new accounting standard and applying a discount rate of 6% and inflation rate of 2% (except for the government concession). This analysis yields the following results:



Millions of euros	Assets Non-current	Financial liabilities
Concession arrangements	25	25
Forest leases	10	10
Other leases	5	5

The estimated impact on the income statement the year after first-time application is as follows: the operating lease expense which under the current standard would amount to €5.2 million would be replaced by higher depreciation and finance charges of €4.1 million and €2.7 million, respectively.

Management does not expect these changes to have a significant impact on performance of the obligations and compliance with the financial ratios covenanted in the agreements with the Group's current lenders.

## 4. Accounting policies

The main accounting policies used to prepare the Group's consolidated financial statements, as provided in the International Financial Reporting Standards adopted by the European Union, are summarised below:

## 4.1 Intangible assets

Intangible assets, mainly software and capitalised development costs, are initially recognised at acquisition or production cost. Subsequent to initial recognition, they are measured at acquisition cost less accumulated amortisation and any impairment losses.

The Group's intangible assets have finite useful lives and are accordingly amortised on a straight-line basis over the best estimate of such useful life.

## R&D expenditure-

Research expenditure is recognised as an expense in the year it is incurred.

Development costs are capitalised when their cost is identifiable, the technical feasibility of the project can be demonstrated and the Group has the Intention and ability to use or sell the asset. Development costs that do not meet these criteria are recognised as an expense in the year in which they are incurred.

To the extent capitalised, these costs are amortised on a straight-line basis over 5 years or over the period of time for which they are expected to generate revenue, up to a limit of 10 years.

#### Computer software-

The Group recognises the costs incurred to acquire software and the associated user rights under this heading. Software maintenance costs are expensed currently.

Costs that are directly associated with the internal development of software are recognised as intangible assets insofar as their cost is clearly identifiable and it is deemed probable that the developments will generate economic benefits beyond one year.

Software is amortised using the straight-line method over a five-year period.



## 4.2 Property, plant and equipment

These assets are measured initially at acquisition or production cost, net of any income generated during the testing phase that is directly attributable to their construction until they are ready for use, and are subsequently carried net of accumulated depreciation and any impairment losses, applying the impairment criteria outlined later on in this note.

Asset extension, upgrade or improvement costs that represent an increase in productivity, capacity or efficiency or an extension of the useful life of assets are capitalised as an increase in the cost of the corresponding assets.

Preservation and maintenance expenses incurred during the year are recognised in the income statement. In addition, certain facilities require periodic inspections. In this respect, the parts requiring replacement at regular intervals that meet the criteria for recognition are recognised specifically and depreciated during the time remaining until the next repair inspection.

Capitalised costs for items of property, plant and equipment which require more than one year to ready for use – qualifying assets – include borrowing costs accrued prior to readying the assets for use when such expenses have been involced by the supplier or correspond to specific or generic borrowings or other external financing directly attributable to the acquisition or production of the asset, including the settlement of financial derivatives arranged as cash flow hedges to mitigate the interest rate risk associated with such financing. The interest rate used for this purpose is either that corresponding to the specific borrowings financing the asset or, if there is no such funding, the Group's average borrowing cost (note 24).

Own work performed by the Group on property, plant and equipment is recognised at production cost, which is external costs plus internal costs incurred in their development, mainly labour and other operating costs.

Other than land, which is deemed to have an Indefinite useful life and is therefore not depreciated, the Group companies depreciate their property, plant and equipment using the straight-line method, distributing the cost of the assets over the following years of estimated useful life:

	Estimated years of useful life
Buildings	25-60
Plant and machinery	8-25
Other fixtures, tools and furniture	5-12
Other Items of PP&E	5-10

Land is recognised separately from the buildings or facilities that may reside on it and is deemed to have an indefinite useful life; accordingly it is not depreciated.

Investment in buildings built on land used under a concession arrangement is recognised under "Buildings". This cost, coupled with that corresponding to the rest of the permanent facilities located on the land held under concession, is depreciated over the shorter of the building's remaining useful life and the term of the concession agreement. The same treatment is applied to investments in remunerated power generation facilities, in this case the limit being the useful life assigned for regulatory remuneration purposes.

Similarly, investments in plant and equipment located on land owned by third parties may include the initially estimated costs of dismantling such assets and rehabilitating the asset sites, to the extent that the Group has



Incurred obligations in this respect subject to specific terms and conditions. Any such costs are recognised and measured in keeping with the rules for measuring provisions (note 4.11). Any subsequent changes in estimated dismantling costs as a result of changes in estimated cash flows and/or the discount rate applied increase or decreases the carrying amount of the corresponding asset in the year in which they arise, unless the correction in the liability exceeds such carrying amount, in which case the surplus is recognised as a gain in the income statement.

In light of the terms and conditions under which the concession for the use of the land on which the Pontevedra factory is located was granted and the length of the term for which the concession has been extended, management's estimates point to scantly material costs in this respect.

## **Impairment of non-current assets**

The Group reviews the carrying amounts of its property, plant and equipment, biological assets and intangible assets for indications of impairment every year.

Whenever it identifies indications of impairment, the Group proceeds to test its assets for impairment, restating them to their recoverable amount if this is determined to be below their carrying amount. The recoverable amount is the higher of fair value less costs to sell and value in use.

In testing its assets for potential impairment, management analyses macroeconomic variables and the outlook for the sector, as gleaned from forecasts for supply and demand, prevailing regulations and regulatory developments, costs and the availability of the key raw materials, etc.

The procedure used by the Company's directors to test for impairment is as follows:

They calculate each cash-generating unit's recoverable amount, the cash-generating units (CGUs) being the Group's various pulp factories and power plants.

Each year, the Group prepares a business plan for each CGU which generally covers a projection period of between three and five years. The business plan materialises in financial projections that are prepared using the best available estimates with respect to macroeconomic variables, planned capacity increases associated with new investments, expected changes in sales prices and the cost of the main raw materials, all of which underpinned by consensus market estimates, working capital trends and discount rates. Sensitivity analyses are conducted to determine the impact of changes in all the key inputs that could have a significant impact on asset valuations.

With the exception of projects financed on a non-recourse basis and biological assets, terminal value is calculated as a function of 'normalised' cash flow in the last year of the projection period, extrapolated at a rate of growth in perpetuity that ranges between 1% and 2%. The cash flows used to calculate the terminal value factor in the maintenance capital expenditure required to ensure the business's continuity.

In the case of assets associated with projects funded on a non-recourse basis, for which cash flows during the construction and operating phases can be estimated with a certain amount of precision, the recoverable amount is calculated using estimated cash flows projected until the end of the asset's life. Accordingly, no terminal value is factored in. And for biological assets, projected cash flows encompass a productive cycle of up to 40 years and, again, no terminal value is factored in.

To calculate value in use, the cash flows so estimated are discounted to present value using a rate that factors in the time value of money and the risks associated with each cash-generating unit. The discount rates applied in the pulp business range between 6% and 8%; in the power generation segment a discount rate equivalent to the yield on 10-year Spanish government bonds plus 300 basis points is used as the after-tax rate.



If the estimated recoverable amount of an asset is lower than its carrying amount, the latter is written down to the former by recognising the corresponding impairment loss in "Impairment of and gains/(losses) on disposals of intangible assets and PP&E" in the income statement. After an impairment loss has been recognised, depreciation charges are calculated prospectively on the basis of the reduced carrying amount of the impaired asset.

When an impairment loss subsequently reverts, the carrying amount of the CGU is written up to its recoverable amount, so long as the restated carrying amount does not exceed the carrying amount that would have been recognised had no impairment loss been recognised in prior years. The reversal of an impairment loss is recognised in "impairment of and gains/(losses) on disposals of intangible assets and PP&E" in the income statement.

#### 4.3 Business combinations

Business combinations in which the Group acquires control of one or more businesses by acquiring all of the assets and liabilities of a company or part of a company that qualifies as a business or several businesses, or by merging or spinning off several companies, are accounted for using the acquisition method, in keeping with the provisions of IFRS 3 - Business combinations.

The acquisition method implies, other than the recognition and measurement exceptions provided for in IFRS 3, recognising the acquisition-date fair values of the identifiable assets acquired and liabilities assumed, so long as their fair value can be reliably determined.

Within the liabilities assumed in business combinations, the Group also recognises the acquisition-date fair value of any contingent consideration identified, even if it does not have to be recognised in keeping with the general criteria for recognising provisions as the likelihood of an outflow of economic benefits is not considered likely, so long as it corresponds to a present obligation arising from prior events and its fair value can be reliably determined. Acquisition-related costs are recognised in profit or loss.

## 4.4 Biological assets

The Group grows several species of trees, mainly eucalyptus, which are used as the raw material for producing pulp and energy. Against this backdrop, the trees in a forest plantation - or forest cover - are considered a biological asset. Forest land is measured in keeping with IAS 16, Property, plant and equipment and is recognised within "Property, plant and equipment" in the statement of financial position (note 4.2).

The Group has been valuing its biological assets at their historical cost (cost less accumulated depreciation less any accumulated impairment losses) in light of the difficulty in identifying active markets for these species in Spain. However, it has been able to verify the validity of these values as a reasonably reliable proxy for fair value and has also carried out discounted cash flow analysis; the results of these cross-checks do not differ materially from the amounts recognised in the accompanying consolidated financial statements.

Investment in forest assets is measured by capitalising all the costs incurred directly in acquiring and developing them, including land rents, site cleaning and preparation costs, plantation costs, fertilisers and forest care and preservation expenses. In addition, because these assets take more than one year to ready for use, borrowing costs accrued until the time the trees are felled are capitalised in respect of the portion of the investment funded with debt (currently not very material). The interest rate used is the Group's average borrowing cost (note 24).

When the plantations are harvested, the value of the asset cover is reduced with a charge to "Biological assets – Depletion of forest reserve" along with the recognition of a corresponding expense under "Depletion of forest



reserve" in the income statement at incurred production costs. The criteria for allocating costs to trees felled takes into consideration total costs incurred as of the date the wood is cut and the residual value of the plantation.

In addition, when forest cover comes to the end of its productive cycle, the amount of recognised forest cover net of accumulated depreclation/depletion is derecognised.

## 4.5 Leases

The Group holds certain assets under lease. All of the lease arrangements entered into by the Group have been classified as operating leases; based on the substance of the leases, none of the agreements transfers ownership of the leased assets nor the risks and rewards incidental to ownership.

Payments on operating leases are expensed in the income statement in the year in which they accrue.

### 4.6 Financial instruments

### Financial assets

The Group's financial assets are classified into the following categories:

- Loans and receivables: trade credit and loans with fixed or determinable payments deriving from noncommercial transactions
- Available-for-sale financial assets: this category mainly includes equity interests in other companies and other financial assets that have not been classified within loans and receivables

No financial assets were reclassified between the above financial asset categories in either 2016 or 2015.

Initial recognition-

Financial assets are initially recognised at the fair value of the consideration delivered plus directly attributable transaction costs.

Subsequent measurement-

Loans and receivables are measured at amortised cost; interest accrued is recognised in the income statement using the corresponding effective interest rate.

The Group recognises Impairment losses in the income statement when it believes there is a risk of non-payment on the basis of the age of the debts. This risk is evidenced primarily when the counterparty declares bankruptcy, the Group has taken legal action to seek payment or the counterparty is in arrears by more than six months.

Available-for-sale financial assets are measured at fair value. Gains and losses arising from changes in the fair value of these assets are recognised directly in equity until the asset is derecognised or considered structurally or permanently impaired, a development that triggers the reclassification of the cumulative gains or losses that had been recognised directly in equity to profit or loss.

Derecognition of financial assets -

Financial assets are derecognised when the contractual rights to the related cash flows have expired or when the risks and rewards incidental to ownership of the asset have been substantially transferred.

Against this backdrop, the Group derecognises discounted trade and other receivables insofar as all of the risks and rewards associated with these assets have been substantially transferred.



In contrast, the Group does not derecognise financial asset transfers in which it retains substantially all the risks and rewards of ownership, recognising instead a financial liability in the amount of any consideration received.

#### Cash and cash equivalents

Cash includes cash on hand and deposits held at call with banks. "Other cash equivalents" include short-term, highly-liquid investments readily convertible into cash within a maximum of three months, the value of which is not subject to significant risks.

### Financial Ilabilities

Financial liabilities are trade and other accounts payable by the Group deriving from the purchase of goods and services in its ordinary course of business and other liabilities that are not commercial in origin and that cannot be considered derivatives (bank borrowings, issued bonds, etc.).

Debts and payables are recognised initially at the amount of cash received, net of any transaction costs incurred. They are subsequently measured at amortised cost. Bank borrowings, therefore, are recognised at the amount received net of direct issuance costs, which are considered an upfront payment for the provision of liquidity.

Trade and other current accounts payable are financial liabilities that do not explicitly accrue interest. They are carried at their face value insofar as the effect of not discounting them is not material.

Finance costs are recognised on an accrual basis in the income statement using the effective interest rate method. The cost of issuing these liabilities is recognised as finance cost applying the same effective interest rate method and is added to the carrying amount of the financial liability to the extent that they are not settled.

The Group derecognises financial liabilities when the related obligation is discharged or cancelled or expires.

## Hedging instruments and derivatives

The Group's activities expose it to financial and market risks deriving from variability in the dollar/euro exchange rate (which affects its revenue as benchmark pulp prices are quoted internationally in dollars), other exchange rate fluctuations insofar as they affect currency-denominated sales and changes in the prices of pulp, fuel-oil, gas and electricity, whether bought or sold. The Group's financial liabilities also expose it to the risk of changes in interest rates. The Group uses derivative financial instruments to hedge these exposures.

They are recognised under "Hedging derivatives" on the liability side of the consolidated statement of financial position if they present a negative balance and similarly under "Hedging derivatives" within current assets on the asset side if they present a positive balance. The fair value of the various derivative financial instruments is calculated in keeping with the criteria outlined in note 4.7 – Fair value estimation.

Gains and losses resulting from fair value changes are recognised as finance income or cost in the income statement, unless the derivative, or a portion thereof, has been designated as a hedging instrument that is deemed highly effective, in which case they are recognised as follows:

- Fair value hedges: the hedged item is measured at fair value, as is the hedging instrument, and the changes in the fair value of both the hedged item and the hedging instruments are recognised, net, in the same income statement heading.
- Cash flow hedges: gains and losses arising on changes in the fair value of these derivatives are recognised in "Equity – Valuation adjustments". The cumulative net gain or loss deferred in this heading



is recycled to profit or loss in conjunction with recognition in the income statement of the underlying hedged item, so that both effects set each other off.

For these instruments to qualify for hedge accounting they are designated as hedges from the outset and the hedging relationship is documented in detail. In addition, the Group tests the effectiveness of its hedges from inception to derecognition/discontinuation. Hedges are deemed effective if it is expected, prospectively, that the changes in the fair value or in the cash flows from the hedged item (attributable to the hedged risk) will be almost entirely offset by the changes in the fair value/cash flows of the hedging instrument and that, retrospectively, the gains or losses on the hedge have fluctuated within a range of 80% to 125% of gains or losses on the hedged item.

In addition, gains or losses on the portion of the hedging instrument deemed ineffective and/or on the portion of a financial instrument used but not designated as a hedge (e.g., time value) are recognised immediately in "Change in the fair value of financial instruments" in the income statement.

Hedge accounting is discontinued when a hedge ceases to be highly efficient. If hedge accounting is discontinued, the cumulative gain or loss on the hedging instrument that has been recognised directly in equity is retained in equity until the commitment or forecast transaction materialises, at which time it is reclassified to profit or loss. When a hedged commitment or forecast transaction is no longer expected to materialise, any net cumulative gain or loss that was recognised in equity is immediately reclassified to profit or loss.

## Equity instruments and own shares held as treasury stock

An equity instrument is a contract that evidences a residual interest in the Parent's assets after deducting all of its liabilities.

The equity instruments issued by the Parent are recognised in equity at the amount received net of any issuance costs.

Own shares acquired by the Parent are recognised at their acquisition and are presented as a deduction from equity. The gains and losses resulting from the purchase, sale, issuance or cancellation of own equity instruments are recognised directly in equity and are not reclassified to profit or loss under any circumstances.

## Distinction between current and non-current

In the accompanying statement of financial position, assets and liabilities are classified by maturity, i.e. as current if they mature within 12 months of the reporting date and as non-current if they mature in more than 12 months.

#### 4.7 Fair value estimation

The fair value of financial instruments traded on active markets is based on market prices at each reporting date. A market in which transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis is an active market.

The fair value of financial instruments that are not traded on an active market is determined using a range of valuation techniques and assumptions that are based on the market conditions prevailing at each reporting date.

The valuation techniques used vary by instrument type. Management uses discounted cash flow analysis to value interest and exchange rate derivatives, the Monte Carlo model for the quanto basket stock options



contained in certain remuneration schemes and the Barone-Adesi and Whaley model to value American options in stock option plans.

Fair value is determined for the main financial instruments used as follows:

- Interest-rate swaps are valued by discounting future payments in respect of the differences between the fixed and floating legs using implied interest rates gleaned from short-term rate curves and long-term swap rates.
- Forward currency contracts and tunnels are valued using spot exchange rates and forward interest rate curves for the currency being hedged.
- Commodity derivatives written over the price of electricity (electricity futures market OMIP) are measured
  in a similar manner, the inputs being futures prices for the underlying being hedged and the implied
  volatility of the options written.

As prescribed by IFRS 13, it is necessary to include own credit risk when measuring financial liabilities at fair value; the Group's only financial liabilities at fair value are derivatives. Application of this standard has had the effect of decreasing the value of the liability balance of Interest-rate hedges by €910 thousand at 31 December 2016 (by €663 thousand at year-end 2015).

The fair value of the various derivative financial instruments is obtained using level 1 inputs in the case of electricity price commodity contracts, as these are referenced to quoted prices, and level 2 inputs according to the fair value hierarchy stipulated in IFRS 13 in all other instances, as they are benchmarked to observable variables other than quoted prices. There were no transfers between level 1 and level 2 valuations in either 2016 or 2015.

### 4.8 Inventories

Inventories of raw materials, finished products and work in progress are measured at acquisition cost, measuring using the weighted average price, or production cost.

Production cost includes the cost of direct materials, the cost of any direct labour and general manufacturing overhead.

The Group values its inventories using the weighted average cost method.

The Group recognises impairment losses on its inventories in its income statement when their net realisable value falls below their carrying amount. Net realisable value is the estimated selling price less estimated costs of completion and the estimated costs necessary to market, distribute and sell the goods. These estimates also factor in the age of the inventories and turnover ratios. Inventory impairment charges are reversed whenever the originating circumstances dissipate.

## Greenhouse gas emission allowances for own use-

Emission allowances acquired are recognised as inventories, initially at the lower of their acquisition cost, calculated using the weighted average cost method, or net realisable value.

Emission allowances received free of charge under the emission allowance trading scheme in effect for 2013-2020 are recognised at their market value at the start of the year for which they are allocated (deemed cost), recognising deferred income in the form of a grant in the same amount as the balancing entry. As the corresponding tonnes of carbon are consumed, the deferred income is reclassified to profit or loss.



In determining the net realisable value of emission allowances, no impairment provision is recognised for allowances used in production if the finished products in which they are incorporated are sold above cost. The allowances acquired for the purpose of generating a profit as a result of changes in their market value are recognised at their fair value and any changes therein are recognised in profit and loss. The market value of emission allowances is calculated with reference to the price of the benchmark contract provided by the European Climate Exchange (ECX).

An expenditure is recognised under "Other operating expenses" in the income statement for emissions made during the year by means of a provision whose amount is calculated as a function of the tonnes of carbon emitted, valued at: (i) their carrying amount in respect of allowances held at year-end; and (ii) the year-end trading price in respect of allowances not held at year-end.

When trading allowances are delivered to the authorities for the tonnage of carbon emitted, both the inventories and the corresponding provision are derecognised, with no impact on profit or loss.

#### 4.9 Current and deferred income tax

income tax expense for the year comprises current and deferred tax.

The Parent and the rest of the Group subsidiarles with tax domicile in Spain in which the Parent holds an equity interest of 75% or more file their income tax returns under the consolidated tax regime provided for in Chapter VII of Title VIII of the Consolidated Text of the Spanish Corporate Income Tax Act.

Current tax is calculated by applying the tax laws enacted at each reporting date in the countries in which the Group companies operate to their profit before tax.

Deferred tax assets and liabilities arise due to differences between the carrying amounts of the assets and liabilities in the financial statements and their tax bases. They are recognised using the tax rates expected to apply when they are recovered or settled.

Income tax and changes in deferred tax assets and deferred tax liabilities that do not arise on business combinations are recognised in the income statement or in equity in the statement of financial position depending on where the gains or losses giving rise to their recognition were initially recognised. Variations in deferred taxes arising on business combinations that are not recognised upon change of control due to the lack of sufficient certainty as to their utilisation are recognised by reducing the carrying amount of any goodwill recognised in accounting for the business combination or following the above criterion if there is no goodwill.

Deferred tax assets are recognised for temporary differences, unused tax losses and unused tax credits only to the extent that it is probable that the consolidated entities will generate sufficient taxable profit in the future against which these assets can be utilised.

The deferred tax assets and liabilities recognised are reassessed at each reporting date in order to check that they still qualify for recognition and the appropriate adjustments are made on the basis of the outcome of the analyses performed.

## 4.10 Income and expense recognition

Revenue is measured at the fair value of the consideration received or receivable in exchange for the goods delivered and services rendered in the ordinary course of the Group's activities, less discounts and amounts received but due to third parties, such as value added tax.



Revenue from the sale of goods is recognised when the goods have been delivered, the customer has accepted the sale and the risks and rewards of ownership of the goods have been transferred to the buyer. Revenue from the rendering of services is recognised by reference to the stage of completion of the transaction at the reporting date, whenever the outcome of the transaction can be estimated reliably. Interest income is recognised using financial criteria with reference to the principal outstanding, the remaining term to maturity and the applicable effective interest rate. Dividend income from equity investments is recognised when the shareholder's right to receive payment is established.

In the power generation business, prevailing regulations stipulate that any deviations between the costs estimated to calculate tariffs in a given year and those ultimately incurred will be compensated for in the tariff assigned in future years (adjustments for tariff shortfall/surplus). These deviations are recognised as revenue or expense in the year they arise only if their collection has been committed to by the regulator.

Expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets.

An expense is recognised immediately when an expenditure produces no future economic benefits or when future economic benefits do not qualify for recognition as an asset.

## 4.11 Provisions and contingencies

Provisions are recognised in the accompanying financial statements for present obligations, whether legal or constructive, arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits.

Provisions, including provisions for employee bonus payments, are measured at the present value of the best estimate of the expenditure required to settle or transfer the obligation using available information regarding the event and its consequences. The increase in the carrying amount of provisions due to the passage of time is recognised as borrowing cost as accrued.

Contingent liabilities are possible obligations with third parties and present obligations that are not recognised either because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or because the amount of the obligation cannot be measured with sufficient reliability.

Contingent liabilities are not recognised in the financial statements, but are disclosed in the accompanying notes, unless the possibility of an outflow of resources embodying economic benefits is considered remote.

At year-end 2016, the Group was defendant in a series of ongoing court cases and claims. In the opinion of the Parent's directors, after taking appropriate legal advice, the outcome of these legal claims will not give rise to any significant additional losses beyond the amounts provided at year-end (note 23).

## 4.12 Termination benefits

Under prevailing labour law, the Group is obliged to pay severance to employees that are discontinued under certain circumstances. Termination benefits that can be reasonably estimated are recognised as an expense in the year in which the redundancy decision is taken and announced.



The Group has recognised a provision in this respect of €100 thousand under "Trade and other payables - Employee benefits payable" in the consolidated statement of financial position at 31 December 2016 (€334 thousand at 31 December 2015).

#### 4.13 Environmental assets and liabilities

Environmental activities are those undertaken with the alm of preventing, mitigating or repairing damage caused to the environment.

Capital expenditure deriving from environmental activities is measured at cost and capitalised in the year incurred, following the measurement rules described in sections 4.1 and 4.2 above.

Environmental-protection expenses incurred are recognised in the income statement in the year incurred regardless of when the monetary/financial outflow occurs.

Provisions for probable or certain liabilities arising from lawsuits in process and pending settlements or obligations of an unspecified amount of an environmental nature that are not covered by insurance are recognised, if warranted, when the liability or payment/award obligation arises.

## 4.14 Post-employment obligations

Certain Group companies have committed to provide supplementary retirement or pension benefits in the form of survivor benefits for widows, orphans and surviving ancestors with the aim of topping up social security benefits for employees and their close relatives, as follows:

#### 1. Active employees

Commitment to employees who remain in employment at year-end consisting of the contribution by the Group company and the employee of a pre-defined percentage of his or her pensionable salary to the "Joint Contribution Pension Plan" offered by the Ence Group under the provisions of article 40 d) of Spain's Pension Plan and Pension Fund Regulations (defined contribution). This pension plan is part of the SERVIRENTA II F.P. pension plan and provides retirement benefits as well as permanent disability cover and life insurance.

Certain Group executives are beneficiaries of an executive pension plan that complements the standard plan; the executive plan covers beneficiaries' retirement, permanent disability and death. The Group makes defined contributions based on a percentage of plan holder salaries. The plan takes the form of collective insurance cover for pension obligations. These policies are held with an insurance provider. The executive (or his/her beneficiaries) becomes entitled to receive the plan benefits in the event of retirement, death or total permanent disability, and under certain other circumstances defined in the plan rules.

The cost of these commitments, recognised under "Employee benefits expense" in the income statement, was €1,817 thousand in 2016 (2015: €1,632 thousand).

#### 2. Retired employees

A group of former employees of Celulosas de Asturias, S.A. Is entitled to benefits in the form of life and disability insurance. This commitment was externalised in 2014, entailing the payment of a single premium of €1,182 thousand.



## 4.15 Employee benefits - Long-term bonus plans

At the Parent's Annual General Meeting of 16 March 2016, the Company's shareholders approved a "Long-term bonus plan for 2016-2018". This plan is designed to orient the management team towards delivery of the targets set by the Board of Directors throughout the term of the scheme and to help retain talent.

The bonus payment contemplated in this latest plan consists of a percentage of average annual fixed remuneration in 2016-2018 and it will vest depending on delivery of three weighted objectives:

- 50% to the level of delivery of the EBITDA targets contemplated in the 2016 2020 Business plan for 2018.
- 30% to any outperformance by Ence's shares relative to a basket of pulp sector stocks.
- 20% to the level of delivery by each beneficiary of the bonus scheme of the targets related to talent development in the team directly under him or her.

During the term of this plan, its fair value, in respect of the portion corresponding to targets tied to the Parent's share price performance, was determined using the Monte Carlo method for quanto basket options, a generally accepted method for valuing financial instruments of this kind. Meanwhile, the liability associated with the EBITDA target is estimated using the most up-to-date information about the outlook for the Group, while it is assumed that the target associated with talent management will be delivered in full.

The bonuses will be paid 30% in cash and 70% in Company shares.

The charge accrued in this respect at 31 December 2016 amounted to €984 thousand and is recognised under:

I) "Other equity instruments" in the consolidated statement of financial position in respect of the portion to be settled in shares (€689 thousand before the related tax effect); and ii) "Non-current provisions" in the consolidated statement of financial position in respect of the portion to be settled in cash (€295 thousand) (note 23).

Elsewhere, settlement of the "Long-term Bonus Plan of ENCE, Energía y Celulosa, S.A. for 2010-15" concluded in 2015 with an impact of profit and loss for that year of €1,929 thousand. Meanwhile, accrual of the "Long-term bonus plan for 2013-2015" was recognised by means of an obligation in the amount of €2,063 thousand which was paid out in 2016 (note 23).

#### 4.16 Grants

Non-repayable grants awarded to subsidise investment in productive assets are measured at the fair value of the amount awarded when all the conditions attaching to their grant have been met and are reclassified to profit or loss in the period and proportion in which depreciation expense on the related depreciable assets is recognised or, when appropriate, when the asset is derecognised or written down for impairment (grants related to assets).

Grants related to income are credited to the income statement at the time of grant unless they are granted to finance specific expenses, in which case they are deducted in reporting the related expense.

Government assistance taking the form of interest-free loans or loans at below-market rates, granted primarily to fund research and development work, is recognised at fair value in "Other financial liabilities" in the statement of financial position. The difference between the loan proceeds received and their fair value is recognised initially in "Grants" in the statement of financial position and is reclassified to profit and loss as the assets financed by the loan are depreciated.



#### 4.17 Statement of cash flows

The consolidated statement of cash flows was prepared using the indirect method and the following definitions:

- Cash flows: inflows and outflows of cash and cash equivalents, the latter understood as short-term, highly liquid investments which are subject to an insignificant risk of changes in value.
- 2. Operating activities: the principal revenue-producing activities of the Group and other activities that are not investing or financing activities.
- Investing activities: the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
- 4. Financing activities: activities that result in changes in the size and composition of the equity and borrowings of the Group.

## 4.18 Related-party transactions

The Group conducts all related-party transactions on an arm's length basis.

# 4.19 Foreign currency transactions and balances

The Group's financial statements are presented in euros, which is both its functional and presentation currency.

Credits and debits denominated in a currency other than the euro are translated to euros using the exchange rate prevalling at the transaction date; these amounts are adjusted at every reporting date, until they are cancelled, as function of exchange rate trends.

The exchange differences resulting from the collection and payment of loans and debts in currencies other than the euro and those deriving from the measurement of accounts receivable and payable denominated in foreign currency at closing exchange rates are recognised in profit or loss in the year in which they arise.

# 4.20 Non-current assets held for sale and discontinued operations

The Group classifies a non-current asset (or disposal group) as held for sale when its carrying amount is to be recovered principally through a sale transaction insofar as a sale is considered highly probable and the asset is available for immediate sale in its present condition.

These assets (or disposal groups) are measured at the lower of their carrying amount or their estimated sale price less the estimated costs necessary to make the sale. Depreciation of these assets ceases as soon as they are classified as held for sale.

Management tests that their carrying amount does not exceed their fair value less costs to sell every year. If this occurs, any required impairment losses are recognised in "Impairment of and gains/(losses) on disposals of intangible assets and PP&E" in the income statement.

Non-current assets held for sale are presented in the accompanying statement of financial position as follows: the assets are presented in a single line item called "Non-current assets held for sale", while the related liabilities are similarly presented in a single line item called "Liabilities associated with non-current assets held for sale".





In addition, the Group classifies any component (cash-generating units or groups of cash-generating units) that either represents a separate major line of business or geographical area of operations, has been sold or otherwise disposed of or qualifies for classification as held for sale as discontinued operations.

The after-tax results of discontinued operations are presented in a single line item in the income statement called "After-tax profit/(loss) for the year from discontinued operations".

## 4.21 Segment reporting

An operating segment is any significant business activity from which the Group may earn revenue and incur expenses, whose operating results are reviewed regularly by the Board of Directors and senior management and for which discrete and reliable financial information is available.

Operating segments are reported in a manner consistent with the internal reporting provided to the Executive Committee and the Board of Directors.

## 4.22 Earnings per share

Basic earnings per share is calculated by dividing profit or loss for the reporting period by the weighted average number of ordinary shares outstanding during the period (not including the average number of Parent shares held as treasury stock by the Group companies).

Diluted earnings per share, meanwhile, is calculated by dividing the profit or loss attributable to ordinary equity holders of the Parent, adjusted for the effects of all dilutive potential ordinary shares, by the weighted average number of ordinary Parent shares outstanding during the period, increased by the weighted average number of additional ordinary shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares. To this end, management assumes that conversion takes place at the beginning of the period or when the dilutive potential ordinary shares are issued in the event of issuance during the year.

Because there are no dilutive potential ordinary shares, basic and diluted earnings per share coincide in 2016 and 2015.

# 5. Energy sector regulation

This section attempts to summarise the most noteworthy highlights of prevailing energy sector regulations in Spain, as applicable to the business activities of the Ence Group:

Law 24/2013 (26 November 2013), the Electricity Sector Act, establishes the economic and financial stability of the electricity system, limiting structural tariff deficits, as the governing principle. This piece of legislation abandons the former distinction between the 'ordinary', or conventional, and 'special', or renewable, regimes, introducing a single set of regulations, without prejudice to unique considerations potentially requiring regulation, and it establishes a remuneration regime applicable to electricity generated from renewable sources, co-generation and waste based on the pool prices fetched by these facilities in the market, topped up by specific regulated remuneration designed to enable these technologies to compete with the other generation technologies on an even footing.

Framed by the overriding principle of ensuring the electricity system's economic and financial sustainability, any regulatory measure that drives an increase in system expenditure or reduction in its revenue must be associated with a balancing measure to ensure the system's equilibrium. As a result, the possibility of a new tariff deficit is ruled out, by means of the introduction of the obligation to automatically revise, from 2014 onwards, system tolls and royalties if the temporary mismatches between revenue and expenses in the electricity system exceed:



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1) 2% of estimated system revenue in a given year; or 2) the debt accumulated in prior years exceeds 5% of the system revenue estimated for a given year.

The portion of any mismatch that, without exceeding the above thresholds, is not offset by increases in tolls and royalties, must be financed by the parties covered by the settlement system in proportion to the revenue corresponding to them for the activities they carry out. Any amounts so financed will be repaid in the settlements corresponding to the following five years and shall be entitled to interest.

Royal Decree 413/2014 was published on 10 June 2014, regulating the production of electric power by means of renewable sources, co-generation and waste, establishing the methodology underpinning the specific remuneration regime applicable to facilities that fall to cover their costs by enough of a margin to enable them to compete with the rest of the generation technologies in the market on an even footing, thereby generating a reasonable return based on benchmark facilities for each affected class of technology. The new remuneration regime consists of the sum of:

- "Remuneration on investment" (€/MW), which is designed to cover any investment costs that cannot be recouped by selling electricity in the market;
- "Remuneration on operations" (€/MWh), which is designed to cover any shortfall between operating
  costs and the revenue obtained in the electricity market.

The new remuneration system is calculated on the basis of a standard facility throughout its useful life for regulatory purposes and benchmarked against the activities of an efficient and well-managed company articulated around the following parameters: 1) the revenue derived from the sale of energy; 2) the operating expenses needed to run the business; and 3) the amount of the upfront investment.

The premise underpinning this remuneration system is the provision of a reasonable return on investment, which is defined on the basis of the yield on the 10-year Spanish government bond plus a spread, initially set at 300 basis points for the first regulatory period, which ends on 31 December 2019 (i.e., a pre-tax ROI of 7.398%).

The regime establishes regulatory periods of six years and stub periods of three years. The remuneration parameters related with pool price forecasts can be revised every three years, factoring in any mismatches arising during the stub period in question. Every six years the authorities can revise the standard facility parameters other than the amount of initial investment and the facilities' regulatory useful lives, which will remain unchanged throughout. The regime also envisages the possibility of revising the interest rate used for remuneration purposes every six years, albeit only prospectively. The remuneration provided for operating a given technology depends on fuel prices and can be adjusted at least once a year.

The 'interruptibility' demand-side management service, for which the Pontevedra and Navia plants are signed up, consists of reducing their active power consumption in response to a power reduction order from the system operator. Such an order is given depending on the needs arising in the operation of the electricity system and is based on safety and lowest cost criteria. The interruptibility service is allocated using a competitive auction mechanism managed by the system operator, as stipulated in Ministerial Order IET/2013/2013, thereby guaranteeing effective provision of the service and its provision at the lowest cost for the system.

#### 6. Risk factors

With the assistance of the senior management team, the Board of Directors defines the Group's risk management policies as a function of the risk factors to which it is exposed, establishing internal control



systems designed to keep the probability and impact of occurrence of the risk events so defined within established risk tolerance levels.

The internal audit department verifies that the risk management principles and policies defined by the Board of Directors are properly implemented and oversees due compliance with the internal control systems in place throughout the organisation.

Below is a description of the main financial risk factors to which the Group is exposed and the corresponding mitigating policies and controls in place:

### 6.1 Market risk

#### Pulp prices

BEKP prices are formed in an active market. The trend in pulp prices is a significant driver of the Group's revenue and profitability. Changes in pulp prices affect the cash flows generated by pulp sales.

In addition, pulp prices tend to be markedly cyclical in nature and have exhibited substantial volatility in recent years. Price trends are primarily dictated by shifts in supply and demand and the financial situation of the various sector players.

To mitigate this risk, in recent years the Group has invested significantly in reducing its production costs, increasing productivity and enhancing the quality of the products it sells. Management also continually monitors the scope for using derivatives to hedge pulp prices on future sales.

Based on the Group's 2016 revenue, a 5% change in international pulp prices in euros would have an impact on revenue of approximately 3.5%.

#### Supply of wood

Eucalyptus wood is the main raw material used in making pulp and its price can fluctuate as a result of changes in the balance of supply and demand in the regions in which the factories are located.

The risk of a shortfall in supply in the regions in which the Group's factories are located is mitigated mainly by means of inventory management, by diversifying supply sources and by purchasing from alternative international markets, usually at higher logistics costs.

In parallel, the Group seeks to maximise its products' value-added by increasing the use of certified wood, which is somewhat more expensive, among other measures.

Based on the Group's timber purchases in 2016, a 5% increase in the price per cubic metre of eucalyptus timber for use in the productive process would decrease operating income by approximately €9.1 million.

#### **Energy sector regulations**

The generation of energy from renewable sources is a regulated business, which means the revenue it generates is conditioned by the tariffs set by the Spanish government.

As outlined in note 5 above, in recent years the Spanish government has passed a series of laws designed to reduce the so-called tariff deficit in the electricity system; these laws have had the effect of reducing the Group's revenue and profits.



Based on the Group's 2016 revenue and the average price for the year, a 5% change in the tariffs that determine the revenue generated by the energy business would have an impact on revenue of approximately 1.3%.

#### **Environmental regulations**

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Environmental regulations in the European Union have focused in recent years on tightening restrictions on wastewater discharges, greenhouse gas emissions, etc. Future changes in environmental regulations could result in higher investments and expenditure to comply with new requirements.

# Exchange rates

Although the Group generates most of its sales in Europe, revenue from pulp sales is affected by the USD/EUR exchange rate as sales prices are linked to benchmark international pulp prices quoted in USD/tonne. Since most of the Group's cost structure is denominated in euros, changes in the rate of exchange with the dollar can affect the Group's earnings significantly.

To mitigate this risk, the Group's risk management policy contemplates the possibility of arranging exchange rate hedges to complement the pulp price hedging strategy, to which end management continually monitors the need and scope for using such instruments (note 27).

Based on the Group's 2016 revenue, dollar appreciation against the euro of 5% would increase revenue before hedges by approximately 3.5%.

#### 6.2 Credit risk

Credit risk arises when a counterparty breaches its contractual obligations. Specifically, the Group's exposure to credit risk therefore arises from the balances pending collection from customers and other debtors presented in "Trade and other receivables", the derivatives written and the balances on deposit with financial institutions, shown in "Current financial assets" and "Cash and cash equivalents" in the statement of financial position.

## Trade and other receivables

This risk has been largely externalised in the pulp business by means of a credit insurance policy that covers between 80% and 90% of balances receivable. This insurance policy assigns credit limits according to the creditworthiness of the customer and covers virtually all of the Group's pulp sales.

In addition, Ence has a Global Risk Committee which regularly monitors trends in the pulp market, past due balances and exposure to customer credit risk.

The revenue generated by the energy business stems from the electricity system which is ultimately backed by the Spanish state.

The Group writes its accounts receivable down for impairment whenever there are indications that they may not be recovered; it writes down all balances outstanding by more than 6-12 months to the extent not covered by the credit insurance policy.

## Financial assets

To mitigate the credit risk posed by financial investments, the Group stipulates that counterparties must be banks with high credit ratings and establishes maximum investment/underwriting limits that are reviewed periodically.

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



## 6.3 Liquidity and capital risk

Adverse conditions in the debt and capital markets could make it hard or impossible for the Group to raise the funding needed in the course of its business operations or to execute its business plan.

This is one of the risk factors monitored most closely by the Ence Group. To mitigate this risk, it has established a series of key financial targets:

- 1. Guaranteed business continuity in any pulp price scenario.
- Support for the growth plans in the various business segments by means of a solid capital structure and adequate liquidity level.
- 3. Leverage targets (based on net debt) tailored for each business unit's revenue volatility profile. Against this backdrop, the leverage cap set for the Pulp Business is 2.5 times recurring EBITDA, the latter derived using mid-cycle pulp prices and average exchange rates. The leverage cap established for the Energy Business is 5 times.
- Diversified and tailored sources of financing for each business. At present, this means tapping the
  capital markets opportunely for the Pulp Business and using bank-provided project finance in the
  Energy Business (note 24).

Each of the Group's two businesses is financed and managed separately and optimally in light of their unique characteristics. The debt of each is non-recourse to that of the other and there are no cross-guarantees.

The Group's Finance Department draws up a financial plan annually that addresses all financing needs and how they are to be met. Funding needs for the most significant cash requirements, such as forecast capital expenditure, debt repayments (which are refinanced ahead of maturity) and working capital requirements, as warranted, are identified sufficiently in advance.

There are also policies establishing the maximum amount of equity that can be committed to projects under development before the associated long-term financing has been arranged.

The contractual maturity analysis in respect of the financial liabilities referred to in IFRS 7 is provided in notes 24, 25, 26 and 27 below.

#### 6.4 Interest rate risk

Fluctuations in the interest rates earned and borne by the Group's financial assets and financial liabilities expose it to adverse impacts on its profits and cash flows.

The goal of the Group's interest rate risk management policy is to achieve a balanced capital structure that minimises interest expense over the medium and long term while mitigating related earnings volatility.

The Group actively manages its exposure to the interest rate risk deriving from borrowings taken out at floating rates. As a general rule, it hedges 70%-80% of its floating-rate non-recourse borrowings by arranging options and/or swaps. Moreover, the debt raised in the capital markets carries fixed rates, thereby minimising interest rate risk (note 24).

## 7. Critical accounting estimates and judgements

The preparation of the 2016 consolidated financial statements in accordance with EU-IFRS requires the use of assumptions and estimates that affect the amounts of related assets, liabilities, revenues, income and expenses



recognised and the corresponding disclosures. The accounting policies and transactions that incorporate management assumptions and estimates that are material in respect of the accompanying consolidated financial statements are:

- The impact of changes in the Spanish energy sector regulatory framework (note 23)
- The fair value of the net assets acquired in business combinations (note 2)
- The industrial asset impairment charges associated with the discontinuation of pulp production at the Huelva plant (note 23)
- Calculation of income tax and the recoverable amount of deferred tax assets (note 28)
- The assumptions used to calculate certain obligations to employees (note 4.15)
- The fair value of certain assets, principally financial instruments (notes 4.6, 26 and 27)
- The recoverable amount of specific assets, mainly biological assets and certain assets related to the closure of Huelva (notes 4.4, 15 and 16)
- The useful lives of fixed and intangible assets (notes 4.1 and 4.2)
- Calculation of the provisions recognised to cover liabilities arising under lawsuits in progress and bad debt (notes 19 and 23)

Some of these accounting policies require management to exercise judgement in selecting the best assumptions for arriving at these estimates. These assumptions and estimates are based on historical experience, the advice of expert consultants, forecasts and other circumstances and expectations at year-end.

By their very nature, these judgements are subject to a high degree of intrinsic uncertainty, which is why actual results could differ materially from the estimates and assumptions used. At the date of authorising these consolidated financial statements for issue, these estimates are not expected to change significantly; accordingly, no significant adjustments to the carrying amounts of the assets and liabilities recognised at 31 December 2016 are foreseen.

Although these estimates were made on the basis of the best information available at each reporting date regarding the facts analysed, events occurring after the date of authorising these financial disclosures for issue could make it necessary to revise these estimates (upwards or downwards) in the future. Changes in accounting estimates would be applied prospectively in accordance with IAS 8, recognising the effects of the change in estimates in the related consolidated income statement. The most important accounting policies applied by the Group are described in greater detail in note 4.

#### 8. Revenue

The breakdown of Group revenue by business in 2016 and 2015 is as follows:



The state of the s		2016		2015				
Thousands of euros	Pulp Business	Energy Business	Consolidated Group	Pulp Business	Energy Business	Consolidated Group		
Business metrics Pulp sales volume (tonnes) Energy sales volume (MWh)	923,408 679,700	628,386	923,408 1,308,086	885,280 709,464	615,397	885,280 1,324,861		
Effet By Sales volume (www.)	0/0//00	020,000						
Revenue Pulp	428.849		428,849	483,072		483,072		
Electric energy	66,616	94,078	160,694	72,249	95,251	167,500		
Sales of timber and forestry	15,898	7	15,905	13,340	1	13,340		
services	2,893	1,899	-	1,110	1,756	* =		
Inter-segment	514,256	95,984	605,448	569,771	97,007	663,912		

<sup>(\*)</sup> The difference between the figures presented under "Consolidated Group" for 2016 and 2015 and the addition of the figures corresponding to the "Pulp" and "Energy" businesses corresponds to the elimination of transactions performed between these business segments in 2016 and 2015 in the amounts of €4,792 thousand and €2,866 thousand euros, respectively.

In 2016, the Group companies made sales in currencies other than the euro, mainly US dollars, totalling €138.3 million (2015: €101.6 million).

## 8.1 Geographic revenue split

Virtually all of revenue from energy sales was generated in Spain. The breakdown of revenue from pulp sales by geographic market is as follows:

Percentage of pulp sales	2016	2015
Germany	22.9	25.8
Spain	14.3	17.2
Italy	12.9	12.5
Poland	8.3	5.3
France	6.7	6.5
Turkey	5.3	3.7
Austria	5.0	9.3
United Kingdom	3.6	2.2
Portugal	3.5	2.0
Slovenia	2.9	3.9
Hungary	2.9	1.4
Greece	1.7	2.6
Netherlands	1.4	3.5
Other	8.6	4.1
Oute.	100	1.00

Just one customer's sales volumes accounted for over 10% of Group revenue from pulp sales.



#### 9. Cost of sales

Consumption of raw materials and other consumables breaks down as follows in 2016 and 2015:

Thousands of euros		2016		2015			
	Pulp Business	Energy Business	Consolidated Group	Pulp Business	Energy Business	Consolidated Group	
Purchases	216,011	23,184	235,704	224,754	16,675	239,472	
Change in raw materials and other inventories	367	2,218	2,585	1,830	(1,227)	603	
Other external expenses	27,378	3,878	29,962	24,986	7,923	32,909	
Tale Control of the C	243,756	29,280	268,251	251,570	23,371	272,984	

<sup>(\*)</sup> The difference between the figures presented under "Consolidated Group" for 2016 and 2015 and the addition of the figures corresponding to the "Pulp" and "Energy" businesses corresponds to the elimination of transactions performed between these business segments in 2016 and 2015 in the amounts of €4,785 thousand and €1,957 thousand euros, respectively.

This heading mainly includes timber, chemical products, fuel and other variable costs.

# 10. Employee benefits expense

The breakdown of the employee benefits expense incurred in 2016 and 2015 is provided below:

	A WILLIAM STATE	2016		2015			
Thousands of euros	Pulp Business	Energy Business	Consolidated Group	Pulp Business	Energy Business	Consolidated Group	
Wages and salaries Social Security	48,272	2,875	- ALIO, # 000 EM	45,240		45,240	
Pension commitments and other benefits	11,095 2,957	654 110	11,749 3,067	10,855 2,709		10,855 2,709	
Long-term remuneration plans Termination benefits	929	55	984	3,333	:4	3,333	
termination benefits	1,040	441	1,481	389		389	
Vest Vest	64,293	4,135	68,428	62,526		62,526	

Several measures were taken in 2016 to complete the separation of the Pulp and Energy business units. Among other things, the 89 people who were devoted exclusively to energy-related work were transferred to the Energy business, along with certain assets located within the Huelva industrial complex that service the 41-MW Huelva power plant.

## 10.1 Headcount figures

The average Group headcount in 2016 and 2015:



	Average headcount during the year								
<del></del>	2016			2015					
Job category	Male	Female	Total	Male	Female	Total			
A Section 2010	6	1	7	6	1	7			
Executives Individual job contracts	221	64	285	196	56	252			
Collective bargaining	404	55	459	400	57	457			
agreements Femporary workers	102	38	140	79	37	116			
Temporary workers	733	158	891	681	151	832			

The breakdown of the year-end Group headcount by Job category and gender:

	Year-end headcount								
-		2016		2015					
Job category	Male	Female	Total	Male	Female	Total			
	7	1	8	6	1	7			
Executives ndividual job contracts	220	68	288	218	58	276			
Collective bargaining	408	59	467	399	57	456			
agreements Temporary workers	82	32	114	78	35	113			
Temporary workers	717	160	877	701	151	852			

At year-end 2016, 14 employees had a disability of a severity of 33% or higher.

The Board of Directors was made up of 13 directors at both year-ends, 12 of whom men. Two of the directors represent legal person directors.

# 11. Other operating expenses

The breakdown of this consolidated income statement heading in 2016 and 2015 was as follows:

		2016		2015			
Thousands of euros	Pulp Business	Energy Business	Consolidated Group	Pulp Business	Energy Business	Consolidated Group	
External services Use of emission allowances (notes 18 and 23) Taxes other than income tax and other management charges Electricity generation levy Change in trade and other provisions Impact of regulatory changes on the energy business (note 23) Impact of the closure of the Huelva factory (note 23) Other non-recurring charges	117,722 1,600 3,174 4,687 (257) 145 10,127	24,620 5 295 6,609 45 4,244 35,818	1,605 3,469 11,296 (212) 145 14,319	103,608 1,002 3,328 5,084 885 2,371 7,151 123,429	40,292 (619) 180 6,692 (391) (4,658) 442 41,938	1,652 3,507 11,777 494 (4,658) 2,371 7,593	

<sup>(\*)</sup> The difference between the figures presented under "Consolidated Group" for 2016 and 2015 and the addition of the figures corresponding to the "Pulp" and "Energy" businesses corresponds to the elimination of transactions performed between these business segments in 2016 and 2015 in the amounts of €13,549 thousand and €7,453 thousand euros, respectively.



"Other non-recurring charges" includes €2,857 thousand corresponding to the difference between estimated remuneration for the generation and sale of energy from renewable sources at the 41-MW biomass power plant in Huelva between 2013 and 2015 and that ultimately recognised by the regulator (note 19). This heading also includes the costs of promoting new projects, consultancy fees incurred as part of the plant efficiency projects and the impact of non-recurring equipment breakdowns.

#### 11.1 External services

The breakdown of "External services" in 2016 and 2015 is as follows:

	- pl	2016		2015			
Thousands of euros	Pulp Business	Energy Business	Total	Pulp Business	Energy Business	Total	
Transport, freight and business expenses Utilities	32,787	80	32,867	33,502	352	33,854	
	31,409	708	32,117	38,141	650	37,919	
Repairs and upkeep	14,801	6,449	21,250	15,762	5,233	20,995	
Rent and fees	4,652	394	4,972	3,042	2,190	4,791	
Insurance premiums	2,934	466	3,400	3,532	394	3,926	
Independent professional services	3,863	278	4,141	4,599	217	4,816	
Banking and similar services	1,084	70	1,154	1,363	12	1,375	
Advertising, publicity and public relations	658	-	658	718		718	
Research and development expenses	1,576		1,576	1,373		1.07	
Other services	23,958	16,175	26,710	1,577	31,244	1,373 25,411	
	117,722	24,620	128,845	103,609	40,292	135,178	

<sup>(\*)</sup> The difference between the figures presented under "Consolidated Group" for 2016 and 2015 and the addition of the figures corresponding to the "Pulp" and "Energy" businesses corresponds to the elimination of transactions performed between these business segments in 2016 and 2015 in the amounts of €13,497 thousand and €8,723 thousand euros, respectively.

Ence has arranged civil liability insurance which covers all its directors and executives against damages caused by acts or omissions in the course of discharging their duties. In 2016, this policy cost the Group €28 thousand euros.

#### 11.2 Audit fees

The fees paid for account auditing and other services to the Group's auditor and entities related to the latter in 2016 and 2015 are shown in the next table:

Thousands of euros	2016	2015
Audit services	143	170
Other services (*)	17	200

<sup>(\*)</sup> In 2016, this figure included €14 thousand of other audit-related services (2015: 144 thousand)

#### 11.3 Leases

At year-end 2016, the Group's future minimum payments under non-cancellable leases, without factoring in costs to be reimbursed by the lessor, inflation-related adjustments or contractually-agreed rent increases, are as follows:



Thousands of euros	2016	2015
Within one year	2,160	2,405
Between one and five years	7,000	7,159
More than five years	10,118	10,396
The state of the s	19,278	19,960

At year-end 2016, the Group managed 25,303 hectares of forest assets earmarked for the production of biological assets under leases and via consortia (26,304 hectares at year-end 2015). The average term of these lease agreements is 30 years.

The annual royalty associated with the concession granting the Group the right to use the site where the Pontevedra pulp mill is located amounts to €1,576 thousand (note 15.4).

#### 12. Finance costs

The breakdown of this consolidated income statement heading in 2016 and 2015 was as follows:

		2016			2015	
Thousands of euros	Pulp Business	Energy Business	Total	Pulp Business	Energy Business	Total
	13,438	12.	13,438	17,348	97	17,348
High-yield bond	23,130	3,068	3,068	*	3,686	3,686
Project finance facilities	1,575		1,575	1,559	37	1,596
Credit, factoring and reverse factoring lines	1,900	521	2,421	3,777		3,777
Fees recognised in profit and loss	(79)	-	(79)	(115)		(115)
Capitalised borrowing costs	202	2,468	(95)75#. ) (6)	4,320	4,617	*
Finance costs - Group companies				4		4
Other	17,036	6,057	20,423	26,893	8,340	26,296
Non-recurring costs associated with refinancing work:						
Cancellation of bonds Issued in 2013	19.5		-	23,196	-0.0	23,196
Refinancing of project finance facilities		2 E	¥	40-	2,934	2,934
Remnancing of project mance facing co			4	23,196	2,934	26,130
Derivatives:		/FO\	(59)	_	1,510	1,510
Settlement of the project finance interest-rate swap	5	(59)	(35)	(15)	1,510	(15)
Settlement of the equity swap	-	(59)	(59)	(15)	1,510	1,495
	17,036	5,998	20,364	50,074	12,784	53,921

<sup>(\*)</sup> The difference between the figures presented under "Consolidated Group" for 2016 and 2015 and the addition of the figures corresponding to the "Pulp" and "Energy" businesses corresponds to the elimination of transactions performed between these business segments in 2016 and 2015 in the amounts of €2,670 thousand and €8,937 thousand euros, respectively.

On 4 June 2015, the Company bought back 10% of its 2013 bond issue. On 30 October 2015, it issued €250 million of new bonds, using the proceeds to refinance the 2013 issue (note 24). The cost of the bond buyback totalled €23,196 thousand, which amount includes a charge of €6,201 recognised in profit and loss to write off the 2013 bond arrangement fees.



Elsewhere, on 31 July 2015, the Group refinanced the project finance facilities that fund the blomass power generation plants in Huelva (50 MW) and Merida (20 MW) (note 24). The costs associated with the financing cancelled - recognised in profit and loss in 2015 - totalled €2,934 thousand.

This transaction also included the restructuring of the interest-rate swaps arranged to hedge the interest rate exposure implied by these facilities which carried floating rates of interest. The restructuring work triggered the discontinuation of the hedge accounting applied up until that juncture. As a result, the fair value loss on these instruments (€12,190 thousand), which was recognised in equity at the time of the restructuring work, was reclassified to profit and loss (this loss is recognised under "Change in the fair value of financial instruments").

## 13. Operating segments

The Group has defined the following reporting segments for which detailed and discrete financial information is available that is reviewed regularly along with the operating results by senior management in order to take decisions about the allocation of resources and assess their performance. These reporting segments are articulated around the Group's two core lines of business, namely:

#### **Pulp Business**

This business line encompasses the following reportable segments:

- Pulp. This segment includes the pulp production activities carried out at the productive facilities located in Pontevedra and Asturias and the power co-generation and generation activities related to the production of pulp and Integrated therein, making use of the parts of timber that cannot be transformed in pulp, essentially lignin and biomass, as inputs.
- Forest Management This operating segment essentially includes the forest crops and forest cover that are later used as raw materials in the pulp production process or sold to third parties.
- Forest Services & Other This segment includes residual business activities carried out by the Group, including forest services provided to third parties, etc.

#### **Energy Business**

This business line/segment includes the plants that generate electric power using forestry and agricultural biomass; they are developed and operated separately and independently from the pulp business. This segment currently encompasses the 50-MW Huelva, 41-MW Huelva, 20-MW Merida, Ciudad Real 16-MW and Jaen 16-MW biomass generation plants (note 1).

In order to expand the disclosures provided in this note, the appendices include the consolidated statement of financial position at 31 December 2016 and 2015 and the consolidated income statement and consolidated statement of cash flows for the years then ended broken down between the Pulp and Energy businesses.

#### 13.1 Operating segment reporting

The table below details the earnings performance by operating segment in 2016 and 2015, based on the management information reviewed regularly by senior management:



2016

				Thousands	of euros			-
Income statement	Pulp	Forest Management	Forest Services & Other	Adjustments & Eliminations	Total Pulp	Energy Business & Segment	Adjustments & Eliminations	Total
Revenue:					E44 262	94,085		605,448
From third parties	508,153	2,934	276	(2.240)	511,363	1,899	(4,792)	
Inter-segment revenue	2,465	7,157	511	(7,240)	2,893	95,984	(4,792)	605,448
Total revenue	510,618	10,091	787	(7,240)	514,256	93,304	(4), 22,	000,110
Earnings:	88,350	6,925	241	(99)	95,417	30,151		125,568
EBITDA (*)		16,355	4	(11)	52,900	19,823		72,723
Operating profit/(loss)	36,552	10,333	74	(9,761)	2,645	310	(2,670)	285
Finance income	12,332	(4,155)	(150)	4,383	(17,036)	(5,998)	2,670	(20,364)
Finance costs	(17,114) (100)	(4,100)	(250)	,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,	(100)	-		(100)
Hedging derivatives	164		(1,616)	_	(1,452)	6	==	(1,446)
Exchange gains/(losses)	(5,342)	(3,419)	32		(8,729)	(3,658)	98	(12,387)
Income tax Profit for the year	26,492	8,781	(1,656)	(5,389)	28,228	10,483	14.	38,711
ribit for the year		1.1						
Capital expenditure	59,310	2,587	2,418		64,315	6,533	(2,736)	68,112
Accumulated depreciation and depletion of forest	(790,815)	(55,935)	(1,091)	-	(847,841)	(143,163)	3,407	(987,597
reserves Provision and impairment charges	(53,444)	(29,065)	(2,853)		(85,362)	(8,742)	4	(94,104

<sup>(\*)</sup> This metric is not disclosed in the consolidated income statement; it is calculated as earnings before depreciation and amortisation charges, depletion of forest reserve charges, impairment charges and gains/losses on non-current assets. This metric is not defined in IFRS.

		Thousands of euros							
	Pulp (*)	Forest Management	Forest Services & Other	Adjustments & Eliminations	Total Pulp	Energy Business & Segment (*)	Adjustments & Eliminations	Total	
		#							
Assets	781,377	165,928	4,623	(130,284)	821,644	248,044	(270,405)	799,283	
Non-current	256,045	6,467	3,713	(4,567)	261,658	134,823	(32,486)	363,995	
Current Total assets (a)	1,037,422	172,395	8,936	(134,851)	1,083,302	382,867	(302,891)	1,163,278	
Liabilities				/70 CEN	327,053	188,313	(71,798)	443,568	
Non-current	326,732		4,426	(78,650)	E 200 CO	51,671	(32,491)	206,089	
Current	187,306	3,065	1,708	(5,170)			(104,289)	649,657	
Total liabilities (a)	514,038	77,610	6,134	(83,820)	513,962	239,984	(104/203)	O-fajour	

<sup>(</sup>a) Does not include either equity or deferred tax assets/liabilities



2015

	-			Thousand	ds of euros			
Income statement	Pulp	Forest Management	Forest Services & Other	Adjustments & Eliminations	Total PULP Business	ENERGY Business & Segment	Adjustments & Eliminations	TOTAL
Revenue:								
From third parties Inter-segment revenue	564,077 841	3,985 8,410	599	(0.440)	568,661	95,251	£	663,912
Total revenue	564,918	12,395		(8;142)		1,756	(2,865)	
Earnings:	304,310	12,393	599	(8,142)	569,770	97,007	(2,865)	663,912
EBITDA (*)	151,887	4,718	1,387		157,992	35,061	(1,268)	191,785
Operating profit/(loss)	96,594	10,024	1,043	3	107,664	25,829	(258)	133,235
Finance Income	36,351	*		(27,959)	8,392	4,322	(12,370)	344
Finance costs	(51,795)	(7,550)	(79)	7,727	(51,697)	(25,152)	8,938	(67,911)
Exchange gains/(losses)	325	- 4	1,053		1,378	(8)		1,370
Income tax	(13,724)	(2,646)	85	(76)	(16,361)	(611)	(211)	(17,183)
Profit/(loss) for the year	67,751	(172)	2,102	(20,305)	49,376	4,380	(3,901)	49,855
Carlo III III III								
Capital expenditure (**) Accumulated	54,864	3,224	2,336	*	60,424	4,679	51	65,103
depreciation and depletion of forest reserves	(608,511)	(53,246)	(847)	-	(662,604)	(37,315)	3,407	(696,512)
Provision and impairment charges	(6,178)	(32,115)	(2,853)	-	(41,146)	(12,518)	ж.	(53,664)

<sup>(\*)</sup> This metric is not disclosed in the consolidated income statement; it is calculated as earnings before depreciation and amortisation charges, depletion of forest reserve charges, impairment charges and gains/losses on non-current assets. This metric is not defined in IFRS.

<sup>(\*\*)</sup> Does not include emission allowances.

	Thousands of euros								
	Pulp	Forest Management	Forest Services & Other	Adjustments & Eliminations	Total PULP Business	ENERGY Business & Segment	Adjustments & Eliminations	TOTAL	
Assets									
Non-current	765,650	171,009	2,436	(148,593)	790,502	216,258	(261,293)	745,467	
Current	271,472	33,587	13,652	(16,206)	302,505	123,420	(34,432)	391,493	
Total assets (a)	1,037,122	204,596	16,088	(164,799)	1,093,007	339,678	(295,725)	1,136,960	
Liabilities			-			333,070	(200)1201	1,130,900	
Non-current	336,300	110,803	1,639	(121,138)	327,604	184,542	(90,662)	421,484	
Current	172,099	5,608	4,569	(6,343)	175,933	56,107	(34,511)	197,529	
Total liabilities (a)	508,399	116,411	6,208	(127,481)	503,537	240,649	(125,173)	619,013	



# 13.2 Disclosures by productive plant

To complement the operating segment disclosures, the table below provides profit and loss disclosures by pulp and energy production facility:

			Thousa	nds of euros			re ulu
2016	Pontevedra factory	Navia factory	Corporate	Other (a)	Subtotal	Eliminations	Total
Business metrics:					931,443		931,443
Pulp output (ADt)	422,257	509,186			923,408		923,408
Pulp sales volume (ADt)	414,693	508,715	*		1,308,085		1,308,085
Energy sales volume (MWh)	194,731	484,968	-	628,386	1,508,009		54.00.04.0000
Continuing operations:				400 000	658,862	(53,414)	605,448
Revenue	210,337	285,716	1 3 3 4	162,809	971	(33,414)	971
Gain/(loss) on hedging transactions	-	711	(1,975)	2,235	9/1	τ.	
Changes in inventory of finished goods and work in	1,821	(714)	è		1,107	ř.	1,107
progress	(0.4)	0.50		(79,649)	(320,552)	52,301	(268,251)
Cost of sales	(103,221)	(137,682)		- Day - Control of the Control of th	340,388	(1,113)	339,275
GROSS PROFIT	108,937	148,031	(1,975)	85,395	240,300	(2)223/	##### <b>#</b> ##############################
r . t handler avanna	(23,499)	(24,058)	(12,457)	(8,404)	(68,428)		(68,428)
Employee benefits expense Depreciation/amortisation charge	(9,112)	(28,878)	(2,441)	(29,297)	(69,728)	) ·	(69,728)
	,0,000	1.000	+	(7,151)	(7,151)	8	(7,151)
Depletion of forestry reserve Impairment of and gains/(losses) on disposals of	(6)	(71)	(25)	24,136	24,034	*	24,034
intangible assets and PP&E	(50,798)	(51,611)	(10,830)	(33,153)	(146,392)	1,113	(145,279)
Other operating expenses	(13,238)	(12,278)	27,728	(2,212)	(e.		
Fixed costs passed on	12,284	91,125		29,314	72,723		72,723
OPERATING PROFIT/(LOSS)	The second secon	(6,959)		(11,325)	(21,625)	-	(21,625)
Net finance cost	(3,341)	24,166	-	17,989	51,098		51,098
PROFIT/(LOSS) BEFORE TAX	8,949			(4,361)	(12,387)		(12,387)
Income tax .	(2,168)	(5,858)		19,628	38,711		38,711
PROFIT/(LOSS) FOR THE YEAR	6,775	18,308		ADJUAU	OOFFICE		

<sup>(</sup>a) Includes the forestry and energy crop activities, the 50-MW Huelva, 41-MW Huelva and 20-MW Merida plants, companies that are virtually inactive and the Group's subsidiaries in Uruguay.



			Thousa	nds of euros			-
2015	Pontevedra factory	Navia factory	Corporate	Other (a)	Subtotal	Eliminations	Total
Business metrics:		-					
Pulp output (ADt)	429,054	469,112	Tay.	100	898,166		Name and American
Pulp sales volume (ADt)	424,459	460,821		-	885,280	9,59	898,166
Energy sales volume (MWh)	215,152	494,912	4	615,397	1,524,860	4	885,280 1,324,860
Continuing operations:							
Revenue	252,551	410,930	42	121,745	785,068	(121,156)	
Gain/(loss) on hedging transactions	196	(586)	(287)	(757)	(1,630)	(121,130)	663,912
Changes in inventory of finished goods and work in		4-2-3-*	1257		(1,030)	*	(1,630)
progress	1,939	2,953	2.00	(92)	4,800	Ŷ	4,800
Cost of sales	(110,147)	(227,645)	(16)	(55,368)	(393,176)	120,192	(272,984)
GROSS PROFIT	144,143	185,652	(261)	65,528	395,062	(964)	394,098
Employee benefits expense	(20,917)	(21,776)	(13,925)	(5,908)	(62,526)		7) (1200) (1200)
Depreciation/amortisation charge	(17,795)	(26,645)	(1,979)	(12,561)	• • • • • • • • • • • • • • • • • • • •	*	(62,526)
Depletion of forestry reserve		(1030 15)	(1,575)	(8,182)	(58,980)		(58,980)
mpairment of and gains/(losses) on disposals of			-	(8,102)	(8,182)	•	(8,182)
ntangible assets and PP&E	513	317	7	7,775	8,612	¥.	8,612
Other operating expenses	(30,423).	(53,034)	(9,939)	(47,955)	(140,751)	964	(400.70%)
ixed costs passed on	(12,170)	(10,019)	26,097	(8,908)	(270)/02/	07.227	(139,787)
OPERATING PROFIT/(LOSS)	63,351	74,495		a atticiberry of an analysis	133,295	*	
let finance cost	(21,857)	(23,897)		(20,443)	(66,197)		133,235
PROFIT/(LOSS) BEFORE TAX	41,494	50,598		(25,054)			(66,197)
ncome tzx	(10,636)	(12,969)		6,422	67,038	7	67,038
PROFIT/(LOSS) FOR THE YEAR	30,858	97,629		(18,632)	(17,183) 49,855		(17,183) 49,855

<sup>(</sup>a) includes the forestry and energy crop activities, the 50-MW Huelva, 41-MW Huelva and 20-MW Merida plants, companies that are virtually inactive and the Group's subsidiaries in Uruguay.

## 14. Intangible assets

The reconciliation of the carrying amounts of the various components of Intangible assets and accumulated amortisation in 2016 and 2015 is as follows:

	Balance at	Additions/	Transfers	Balance at
2016 (thousands of euros)	01/01/2016	charges	(notes 15 and 18)	31/12/2016
Computer software	17,510	31	1,519	10.050
Emission allowances (note 18)	1,303	-	(1,303)	19,060
Development costs	12,340	2,418	2,334	17,092
Prepayments	2,366	2,765	(3,683)	1,448
Other intangible assets	2,092	1,075	(4)555)	3,167
Total cost	35,611	6,289	(1,133)	40,767
Computer software	(9,019)	(2,152)	(4)200/	(11,171)
Development costs	(9,075)	(362)	_	(9,437)
Other intangible assets	(1,304)	(13)		(1,317)
Total amortisation	(19,398)	(2,527)	*	(21,925)
Development costs	(2,854)	4	4	(2,854)
Other intangible assets	(746)	-	in the second	(746)
<b>Total impairment</b>	(3,600)	+		(3,600)
Total	12,613			15,242



	Balance at	Additions/	Derecognitions/	A Para	Balance at
2015 (thousands of euros)	01/01/2015	charges	decreases	Transfers	31/12/201
Computer software	10,300	2,924	(109)	4,395	17,510
Emission allowances (note 18)	5,784	624	(5,105)	,	1,303
Development costs	12,340	-	-		12,340
Prepayments	4,422	2,339	•	(4,395)	2,366
Other intangible assets	2,092		-		2,092
Total cost	34,938	5,887	(5,214)	*	35,611
Computer software	(7,381)	(1,699)	61	÷	(9,019)
Development costs	(8,956)	(119)	**	-4	(9,075)
Other intangible assets	(1,303)	(1)	- F		(1,304)
Total amortisation	(17,640)	(1,819)	61	н	(19,398)
Development costs	(2,854)	.es.)	*		(2,854)
Other intangible assets	(746)	-		*	(746)
Total impairment	(3,600)		<u> </u>		(3,600)
Total	13,698		- 1 - 1 - 1 - 1 - 1 - 1 - 1 - 1 - 1 - 1		12,613

Own work capitalised within intangible assets amounted to €2,025 thousand euros in 2016 (€2,334 thousand in 2015).

#### 14.1 Software and other intangible assats

The Group continues to strategically upgrade the IT systems that support its key business processes, having implemented its SAP platform in 2015.

In June 2016, Ence successfully culminated what it had dubbed Project FARO, which consisted of redesigning the operating processes in the Pulp business with a view to boosting efficiency, increasing mill availability and eking out scalable competitiveness gains. The investments capitalised in 2016, which correspond to own staff costs and, mainly, the cost of services received from one of the leading engineering and consultancy firms in the sector, amounted to €2,009 thousand. These costs have been capitalised within "Development costs".

## 14.2 Fully-amortised assets

At 31 December 2016, there were fully-amortised intangible assets still in use with an original cost of €16,669 thousand (year-end 2015: €16,243 thousand).

## 15. Property, plant and equipment

The reconciliation of the carrying amounts of the various components of property, plant and equipment and accumulated depreciation in 2016 and 2015 is as follows:



Thousands of euros - 2016	Balance at 01/01/2016	Changes In scope (note 2)	Additions/ charges	Derecognitions/ decreases	Transfer to held for sale (note 17)	Transfers	Baiance at 31/12/2016
Forest land	82,867		- 21	.+	(2)		82,865
Other land	8,108	146	1,159	- 1		9	9,422
Bulldings	96,875	4,749	522	(33)	34	5,532	107,679
Plant and machinery	1,034,869	62,474	7,066	(6,798)	245,171	57,860	1,400,642
Other Items of PP&E	23,582	153	1,409	(1)	16,669	1,565	43,377
Prepayments and PP&E In progress	34,989	563	48,290	(386)	=	(65,858)	17,598
Cost	1,281,290	68,085	58,446	(7,218)	261,872	(892)	1,661,583
Buildings	(58,632)		(2,168)	13	= 1 5 7		(60,787)
Plant and machinery	(556,142)	(43,966)	(60,905)	3,885	(176,567)	722	(832,973)
Other Items of PP&E	(12,688)	(63)	(4,128)	1	(8,673)		(25,551)
Depreciation	(627,462)	(44,029)	(67,201)	3,899	(185,240)	722	(919,311)
Land and buildings	(1,985)			*:	2 <b>-</b> 2		(1,985)
Plant and machinery	(8,334)	-	(10,714)	22,571	(55,932)	±.	(52,409)
Other Items of PP&E	(1,579)						(1,579)
Impairment	(11,898)		(10,714)	22,571	(55,932)		(55,973)
Carrying amount	641,930			w deleter was		*	686,299

Thousands of euros - 2015	Balance at 01/01/2015	Additions/ charges	Derecognitions/ decreases	Transfer to held for sale (note 17)	Transfers	Balance at 31/12/2015
Forest land	83,549	655		(1,337)		82,867
Other land	8,101	28	(21)	(1,337)		8,108
Bulldings	94,982	969	(1,063)	7	1,987	96,875
Plant and machinery	1,014,333	16,455	(6,036)	3,007	7,110	1,034,869
Other Items of PP&E	18,709	2,926	(131)	4	2,078	23,582
Prepayments and PP&E in progress	13,667	32,504	(7)	(2.2	(11,175)	34,989
Cost	1,233,341	53,537	(7,258)	1,670	<u> </u>	1,281,290
Buildings	(56,333)	(2,767)	488	· .	(20)	(58,632)
Plant and machinery	(465,416)	(52,361)	642	(582)	(38,425)	(556,142)
Other Items of PP&E	(49,222)	(2,033)	122	-	38,445	(12,688)
Depreciation	(570,971)	(57,161)	1,252	(582)		(627,462)
Land and buildings	(2,588)	:+:	603			(1,985)
Plant and machinery	(14,206)		5,872	·=	18	(8,334)
Other Items of PP&E	(1,580)		1		-	(1,579)
Impairment	(18,374)	*	6,476			(11,898)
Carrying amount	643,996				(Web-Man	641,930



#### 15.1 Additions

The Group invested at all its pulp facilities with a view to making its production processes more efficient, boosting power generation and making them more environmentally friendly. It also invested in upgrading its power generation plants. This capital expenditure breaks down as follows by facility:

	Thousands of euros		
	2016	2015	
Pulp Business:			
Navia	33,060	38,476	
Pontevedra	22,378	9,084	
Other	*	687	
Energy Business:			
41-MW Huelva plant	1,682	4,526	
50-MW Huelva plant	814	212	
Other	512	552	
	58,446	53,537	

During 2016, the Group completed phase two of its project for the addition of 40,000 tonnes of pulp production capacity at the Navia industrial complex (Asturias). In addition, it made investments designed to make the complex more efficient and reduce production costs. At the Pontevedra facility, capital expenditure was earmarked mainly to improving its environmental performance as well to replacement investments.

#### Capital commitments

At year-end 2016, the Group had contractually committed to capital expenditure at its factories of €8.4 million, most of which will be incurred in 2017.

The concession entitling the Group to use the land on which its Pontevedra pulp mill is located was extended by 50 years in 2016; the concession will be extended by further 10 years so long as Ence makes the following investments (worth €61 million in total) in the coming years:

- 1. €30.2 million to be earmarked to increasing the mill's capacity and making it more efficient.
- €27 million to be earmarked towards environmental upgrades in order to slash the volume of wastewater, eliminate process odour, noise and steam and raise the facility's environmental performance above the legally required thresholds.
- 3. €4 million to be devoted to designing and executing a landscaping project for the factory in Lourizán.

Of this total, €12.7 million has already been Invested, while the Group is contractually committed to investing another €1.6 million.

These investment undertakings in Pontevedra have been similarly factored into the Environmental Pact entered into with the Environmental Department of the regional government of Galicia (note 31), along with





other commitments such as the installation of three bioenergy centres and one biomass CHP facility in Galicia entailing an estimated investment of €94 million.

### 15.2 Derecognitions

In 2015, Ence completed its withdrawal from the energy crop business, a decision forced by the regulatory changes introduced in the energy sector in 2013 and 2014. The assets derecognised in 2016 correspond mainly to irrigation systems that had already been fully written down.

## 15.3 Fully-depreciated assets

The breakdown at year-end of the original cost of fully-depreciated items of property, plant and equipment still in use is shown in the next table:

	302,798	265,056
Other	2,029	1,756
Furniture & fittings	3,799	2,401
Tools	1,149	1,056
Machinery	265,845	229,646
Buildings	29,976	30,197
Thousands of euros	2016	2015

#### 15.4 Public-domain concession arrangement

The concession for the use of the public-domain coastal land on which the Pontevedra operations centre sits was granted to Ence by Ministerial Order on 13 June 1958 and was due to terminate on 29 July 2018. On 20 January 2016, the Spanish Ministry of Agriculture, Food and the Environment agreed to extend the concession for 60 years, i.e., until 8 November 2073. Of the agreed-upon 60-year extension, 10 years are the result of a commitment on the part of Ence to make certain investments at the facility, as outlined in note 15.1 above.

Ence had been depreciating the Industrial assets located at its industrial complex in Pontevedra over the shorter of their remaining useful life and the term of the concession agreement. Against this backdrop, the ministerial ruling extending the concession has had the effect of eliminating the time limit implied by the concession termination date and consequently had a positive impact on the income statement via reduced industrial asset depreciation charges, an effect estimated at approximately €8.5 million.

#### 15.5 Asset revaluations

The Group restated all its forest land to fair value as of 1 January 2004, the date of transition to IFRS-EU. This value was determined by independent expert appraisers. As permitted under IFRS, these revalued amounts were considered deemed cost. The gain on the revaluation, net of the corresponding deferred tax liability of €13,876 thousand (€17,076 thousand at 31 December 2015), amounts to €41,690 thousand at year-end (€51,290 thousand at 31 December 2015) and is included in "Valuation adjustments" in equity. That fair value benchmark has been used as deemed cost in subsequent years.



## 15.6 Impairment

The decision to cease pulp production at the Huelva industrial complex at the end of 2014 meant that some of its industrial assets were no longer used for productive purposes, prompting an active disposal process.

At that time, those assets were classified as "Non-current assets held for sale" and they were restated to fair value using the appraisal performed by a renowned independent expert; specifically, they were written down for impairment by €44,744 thousand to their estimated recoverable amount of €34,632 thousand.

In 2016, the appraisal performed in 2014 was updated. As a result, the impairment charge recognised in 2015 was increased by €8,453 thousand. Elsewhere, in 2015, the Group obtained additional information concerning some of the assets not used in the business, prompting the recognition of an impairment charge of €6,000 thousand (notes 17 and 23).

#### 15.7 Insurance cover

It is Group policy to take out the insurance policies necessary to cover the potential risks to which the various items of property, plant, and equipment are exposed. The Parent's directors believe that the coverage provided by these policies at the reporting date is sufficient.

## 15.8 Additional considerations

Ence has been awarded the concession to operate 40 MW of capacity pursuant to the auction held in Spain on 14 January 2016 to adjudicate up to 200 MW of capacity entitled to the remuneration regime specifically applicable to new biomass facilities, as defined in section two, 1.a) of Spanish Royal Decree 947/2015, of 16 October 2015, and in article 2.1.a) of Ministerial Order IET/2212/2015, of 23 October 2015. As a result, Ence has begun the process of permitting a new facility to be located in Huelva.

# 16. Biological assets

"Biological assets" exclusively comprises the Group's forest cover; the forest land owned by the Group is presented under "Property, plant and equipment - Forest land". The breakdown of these assets at year-end 2016 and 2015 is as follows:

Thousands of euros	31/12/2016	31/12/2015
Cover earmarked for pulp	82,768	86,814
Cover earmarked for energy crops	· é	663
Cover earmarked for other uses	643	416
<del></del>	83,411	87,893

The movement in this heading 2016 and 2015:



			Thousands of e	uros	
2016	Balance at 01/01/2016	Additions/ (charges)	Derecognitions	Transfers (note 17)	Balance at 31/12/2016
Pulp Business:					
Forest cover	164,214	2,751	(6,840)	(1,169)	158,956
Depletion of forest reserve	(40,523)	(6,701)	918	842	(45,464)
Provision for impairment	(36,461)		5,410	327	(30,724)
Energy Business:	87,230	(3,950)	(512)	-	82,768
Forest cover	11,497	626	(6,776)		5,347
Depletion of forest reserve	(763)	(134)			(897)
Provision for impairment	(10,071)		6,264		(3,807)
	663	492	(512)	-	643
	87,893				83,411

			Thousand	ls of euros		
2015	Balance at 01/01/2015	Additions/ (charges)	De- recognitions	Transfer to available-for- sale (note 17)	Transfers (note 23)	Balance at 31/12/2015
Earmarked for pulp & other uses:						
Forest cover	150,929	2,385	(1,522)	(61)	12,483	164,214
Depletion of forest reserve	(34,219)	(4,835)	(546)	(02)	(923)	(40,523)
Provision for impairment	(31,081)	(1,691)	3,246	91	(7,026)	(36,461)
Earmarked for energy crops:	85,629	(4,141)	1,178	30	4,534	87,230
Forest cover	47,463	3,918	(26,826)	· ·	(13,058)	11,497
Depletion of forest reserve	(864)	(928)		=	1,029	(763)
Provision for impairment	(41,981)		28,282	-	3,628	(10,071)
	4,618	2,990	1,456		(8,401)	663
	90,247					87,893

<sup>(\*)</sup> The column headed "Transfers" in the table above reflects the transfer of biological assets located on land owned by the Ence Group that were initially intended for use as cover for energy crops; given their characteristics, these assets have been transferred to "Cover earmarked for pulp".

In 2016, the Group planted 251 hectares of land (2015: 28 hectares) and carried out forest preservation and protection work encompassing 2,199 hectares (2014: 1,517 hectares).

## 16.1 Breakdown of forest cover

An analysis of the Group's forest cover at year-end 2016 and 2015 is provided below:



## 16.3 Derecognitions and impairment

In 2014, the Group recognised impairment losses on its biological assets of €59,327 thousand. Of this sum, €31,055 thousand was caused by the impairment of energy crops due to regulatory changes in the Spanish energy sector. These crops were abandoned in an orderly fashion in 2015 (note 23).

In parallel, the decision to cease pulp production in Huelva required identifying an alternative use for the Group's forestry assets in southern Spain; this timber will now be sold to third parties, an alternative that could imply additional costs (mainly transportation), or used as biomass for power generation purposes. These assets have been tested for impairment using the methodology and assumptions outlined in note 4.2; this exercise yielded a net realisable value that was €21,835 thousand below the carrying amount of these assets; the related impairment charge was recognised in full in 2014. In addition, an impairment loss of €8,956 thousand was recognised against forest assets in northern Spain in 2014.

An increase in market timber prices of 1% would have the effect of reducing the impairment charges recognised by approximately €2.4 million. Conversely, a drop in the market sales price would have the effect of increasing the impairment loss by the same amount.

#### 17. Non-current assets held for sale

The Group classifies a non-current asset (or disposal group) as held for sale when its carrying amount is to be recovered principally through a sale transaction insofar as a sale within the next 12 months is considered highly probable. These assets are measured at the lower of their carrying amount and fair value less costs to sell.

The breakdown of "Non-current assets held for sale" at 31 December 2016 and 2015 is as follows:

Thousands of euros - 2016	Balance at 01/01/2016	Used	Sold	Transfers (note 15)	Impairment (note 15)	Balance at 31/12/2016
NON-CURRENT ASSETS						
Huelva industrial complex	26,207	inc)	(346)	(20,700)	(899)	4,262
Forest land and cover						
Forest land	22,276		(20,187)	ě	<u>u</u>	2,089
Forest cover	1,855	(316)	(1,007)	Ē	E.	532
Total	50,338	(316)	(21,540)	(20,700)	(899)	6,883



		Spain & F	ortugal		
2016	Pulp		Energy crops		
	Productive	Carrying amount in € '000	Productive	Carrying amount in € '000	
Age (years)	hectares	III € 000	hectares	111 000	
> 17	915	2,343	-	ж	
14 - 16	966	3,935	ratio	<del>.</del>	
11 - 13	8,887	30,833	36	10	
8 - 10	13,046	36,272	3	2	
4 - 7	18,207	31,399	1,815	2,226	
0-3	12,465	8,710	1,444	2,222	
Impairment of biological assets		(30,724)		(3,807)	
	54,486	82,768	3,262	643	

		Spain & P	in & Portugal		
2015	Pulp		Energy crops		
		Carrying amount		Carrying amount	
Age (years)	Productive hectares	In € '000	Productive hectares	in € '000	
> 17 -	558	2,471	-		
14 - 16	3,981	5,250	*	1	
11 - 13	7,323	20,244	**	263	
8 - 10	15,410	50,834	2	98	
4 - 7	18,935	37,467	1,017	1,044	
0-3	12,361	7,425	1,171	963	
Impairment of biological assets		(36,461)		(1,705)	
	58,568	87,230	2,190	663	

In addition, the land under management includes 2,598 hectares located in Portugal that the Group sold in 2013, having entered into an agreement with the buyer covering the purchase by the Ence Group, at market prices, of the wood produced from the land sold for a term of 20 years.

#### 16.2 Additions to forest cover

Own work capitalised by the Group in 2016 corresponding to forest plantation, preservation and silviculture services received amounted to €3,298 thousand (€6,188 thousand in 2015).

The Group also capitalised €79 thousand of borrowing costs under forest cover in 2016 (€115 thousand in 2015); this addition is accounted for in the consolidated income statement as a reduction in "Other finance costs" (note 12).



Thousands of euros - 2015	Balance at 01/01/2015	Additions	Used	Sold	Transfers (notes 15 & 16)	Impairment (note 15)	Balance at 31/12/2015
NON-CURRENT ASSETS	4						
Huelva industrial complex	34,632	_	ä		(2,425)	(6,000)	26,207
Forest land and cover							-77-07 \$170-4
Forest land	33,955	1,412	-	(14,428)	1,337	=	22,276
Forest cover	4,867	142	(2,419)	(705)	(30)	*	1,855
Investment and other properties	3,925	.9	+	(3,925)	8) /#-	~	-
Total	77,379	1,554	(2,419)	(19,058)	(1,118)	(6,000)	50,338

#### **Huelva industrial complex**

The decision to cease pulp production at the Huelva industrial complex meant that some of its industrial assets were no longer used for productive purposes and were accordingly transferred to assets held for sale. These assets are measured at fair value, determined using appraisals performed by experts in valuing this class of assets and non-binding bids, an exercise that implied the recognition in 2016 and prior years of impairment charges totalling €59,197 thousand on aggregate (notes 15, 16 and 23).

Various actions were taken in 2015 and 2016 to bring about their sale, which has materialised in part. As a result, it has been decided to reclassify the industrial assets that are currently not used in the business that are expected to take more than 12 months to sell or are in the end going to be used by the Group to "Property, plant and equipment". This reclassification has led to the recognition in 2016 of the depreciation discontinued during the time for which these assets had been classified as 'held for sale' in the amount of €14,262 thousand (note 15).

Ence continues to pursue specific actions under the scope of the original disposal plan to bring about the sale of the remaining assets held for sale in 2017.

## Forest land and cover

At the end of 2014, Ence began the process of exiting the forest management business in southern Spain in an orderly fashion; these assets are related to energy crops, with watering entitlements, encompassing approximately 2,000 hectares of irrigated land and an additional 1,000 hectares of adjacent non-irrigated land.

In 2016, it sold 1,736 hectares (1,328 hectares in 2015) (67% of which, irrigated land) for €37,494 thousand (2015: €28,037 thousand), generating a gain of €16,297 thousand (2015: €11,578 thousand), which is recognised under "Impairment of and gains/(losses) on disposals of intangible assets and PP&E" in the accompanying 2016 condensed consolidated income statement.

In addition, at year-end the Group had signed deposit agreements for the sale of the remaining 165 hectares up for sale. The sales of this land is expected to close in 2017.



#### 18. Inventories

The breakdown of the Group's inventories at 31 December 2016 and 2015 is as follows:

Thousands of euros	31/12/2016	31/12/2015
Timber	17,394	19,201
Other raw materials	859	1,210
Spare parts	21,862	20,876
Greenhouse gas emission allowances (note 14)	1,263	
Finished goods	16,547	15,440
Prepayments to suppliers	566	636
Impairment (*)	(14,884)	(17,148)
	43,607	40,215

<sup>(\*)</sup> Related primarily to slow-moving parts.

There are no restrictions on title to inventories.

At 31 December 2016, the Group had entered into agreements with suppliers for the purchase, during the next four years, of 3.9 million tonnes of biomass for use at the power plants constituting the business.

It is Group policy to take out the insurance policies necessary to cover the potential risks to which its inventories are exposed and management believes that coverage at year-end is adequate.

#### 18.1 Greenhouse gas emission allowances

The reconciliation of the opening and year-end Group-owned emission allowance balances for 2016 and 2015 is provided in the next table:

	20:	16	2015		
	Number of allowances	Thousands of euros	Number of allowances	Thousands of euros	
Opening balance	122,605	1,303	376,241	5,784	
Allocations (notes 22 & 23)	91,287	734	92,998	624	
Delivered (*)	(162,503)	(1,564)	(346,634)	(5,105)	
Purchased	50,000	790		-	
Closing balance	101,389	1,263	122,605	1,303	

<sup>(\*)</sup> Corresponds to the allowances used during the previous year

In November 2013, the Spanish Parliament approved the New National Allocation Plan under which it will allocate emission allowances free of charge in 2013-2020. The new plan upholds the criteria adopted by Decision 2011/278/EU of the European Commission. Under the Plan, the Group received allowances equivalent to 91,287 tonnes of carbon emissions, valued at €734 thousand, in 2016 (92,998 tonnes valued at €624 thousand in 2015).



"Non-current provisions" on the liability side of the consolidated statement of financial position includes €1,605 thousand in this respect at 31 December 2016 (€1,604 thousand at year-end 2015) corresponding to the liability derived from the consumption of 162,855 tonnes of carbon in 2016 (159,039 tonnes in 2015) (note 23).

Elsewhere, the Group has contractually committed to the forward purchase of allowances covering a total of 551,000 tonnes of carbon at a price of €15.87/tonne and exercisable in 2017 and 2018. It is estimated that part of the allowance purchases committed to, approximately 234 thousand allowances, will not be consumed within the term of the current 2013-2020 Plan, to which end these allowances have been valued at market value. This has entailed the recognition of a €2,190 thousand euro provision within "Non-current provisions" on the accompanying consolidated statement of financial position (year-end 2015: €1,908 thousand) (note 23).

# 19. Trade and other receivables

The breakdown at year-end of "Trade and other receivables" on teh asset side of the consolidated statement of financial position is as follows:

The wood of ouros	31/12/2016	31/12/2015
Thousands of euros	01/12/2010	
Trade receivables:		
Pulp	47,431	73,401
Energy	29,803	40,515
Other items	4,126	1,466
Sundry receivables	1,998	9,456
Provision for impairment	(3,137)	(2,869)
fundaumdasə sənə revafilli	80,221	121,969

The regulatory changes introduced in the Spanish energy sector have introduced, among other measures, the obligation on the part of all parties receiving remuneration from the system operator to finance the so-called electricity tariff deficit (note 6). The Group's share of the financing of the tariff deficit pending collection at 31 December 2016 amounted to €8,935 thousand (€4,840 thousand at year-end 2015).

Elsewhere, in the course of implementing Ministerial Order IET/1045/2014 (of 16 June), the Spanish Ministry of Industry Initially classified the Pontevedra (34.57 MW), Navia (37 MW) and Huelva (41 MW) power plants Incorrectly, including them in the wrong category. The appeals lodged by the Group with the alm of rectifying this classification error were resolved favourably in respect of the Navia and Pontevedra power plants in 2015. On 20 June 2016, the Group also received a favourable ruling with respect to the 41-MW Huelva plant, triggering the collection of the premiums due to this facility since the Electricity Sector Act (Law 24/2013, of 26 December 2013) took effect in the amount of €28,838 thousand.

The average credit period on pulp sales averages between 60 and 65 days. The fair value of pulp receivables does not differ significantly from their carrying amount.

At year-end, the Group had €6.8 million of US dollar-denominated accounts receivable (year-end 2015: €22.5 million).

The Group had drawn down €47,198 thousand under several factoring agreements deemed non-recourse (as all the risks intrinsic to monetisation of the underlying receivables have been transferred) with an aggregate limit of €70,000 thousand at 31 December 2016 (€44,746 thousand and €70,000 thousand, respectively, at 31 December 2015). The Group pays interest equivalent to 3-month Euribor plus a spread ranging between 1% and 2% on the receivables discounted under these agreements.



## 20. Trade and other payables

The breakdown at year-end of "Trade and other payables" on the liability side of the consolidated statement of financial position is as follows:

Thousands of euros	31/12/2016	31/12/2015
Trade payables	129,768	139,101
Payable to fixed asset suppliers	16,963	16,027
Employee benefits payable .	7,438	6,945
	154,169	162,073

The average payment period on goods and services purchased ranges between 70 and 75 days. The fair value of trade payables does not differ significantly from their carrying amount.

The Group had drawn down €56,503 thousand under non-recourse reverse factoring agreements with an aggregate limit of €105,000 thousand at 31 December 2016 (€58,377 thousand and €105,000 thousand, respectively, at 31 December 2015).

At 31 December 2016, the Group had €144 thousand of US dollar-denominated accounts payable (year-end 2015: €37 thousand).

Spanish Law 15/2010 (5 July 2010) on addressing non-payment of commercial transactions stipulates certain disclosure requirements in the notes to the annual financial statements on transaction settlement performance. Against this backdrop, the table below details the trade payables settled in 2016 and 2015 and the amounts outstanding at year-end (excluding intra-group transactions and payments to fixed asset suppliers):

	2016	2015
Average supplier payment term (days)	67	57
Paid transactions ratio (days)	69	57
Outstanding transactions ratio (days)	41	49
	Thousands of	of euros
Total payments made	509,762	527,898
Total payments outstanding	38,970	43,112

## 21. Equity

#### 21.1 Issued capita!

The share capital of ENCE Energía y Celulosa, S.A. at 31 December 2016 was represented by 250,272,500 fully subscribed and paid bearer shares, each with a par value of €0.90.

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



The table below depicts the Company's shareholder structure at 31 December 2016 and 31 December 2015:

A 100	9	6
Shareholder	31/12/2016	31/12/2015
Retos Operativos XXI, S.L.	26.7	26.5
Asúa Inversiones, S.L.	6.2	5.2
Alcor Holding, S.A.	5.9	5.9
Mendibea 2002, S.L.	5.6	5.4
Amber Capital UK LLP (*)		4.0
LSV Asset Management (*)	å:	3.0
Treasury shares	2.2	0.6
Free float	53.4	49.4
Total	100.0	100.0

<sup>(\*)</sup> This shareholder has informed the securities market regulator that its shareholding has been reduced to below the 3% threshold, so that this investor is now included within the free float

The Company's shares are represented by book entries and are officially listed on the Spanish stock exchanges and traded on the continuous market. All of its shares confer equal voting and dividend rights.

## 21.2 Legal reserve

In accordance with the Consolidated Text of the Spanish Corporate Enterprises Act, 10% of profits must be transferred to the legal reserve each year until it represents at least 20% of share capital. The Parent's legal reserve of €45,050 thousand covers the stipulated 20% of share capital.

The legal reserve may be used to increase capital in an amount equal to the portion of the balance that exceeds 10% of capital after the increase. Otherwise, until it exceeds 20% of share capital and provided there are no sufficient available reserves, the legal reserve may only be used to offset losses.

## 21.3 Share premium

The Consolidated Text of the Spanish Corporate Enterprises Act expressly permits the use of the share premium account balance to increase capital and provides no specific limitation with respect to the availability of this reserve.

#### 21.4 Reserves in fully-consolidated companies

The next table breaks down "Equity – Reserves in fully-consolidated companies" by company at 31 December 2016 and 2015:



Thousands of euros	31/12/2016	31/12/2015
PULP business:		
Celulosas de Asturias, S.A.U.	125,232	115,165
Norte Forestal, S.A.U.	4,972	6,604
Silvasur Agroforestal, S.A.U.	1,458	(12,351
Iberflorestal, S.A.U.	(4,721)	(473
Ibersilva, S.A.U.	(18,115)	(18,484)
Ence Investigación y Desarrollo, S.A.U.	(5,157)	(5,126)
Maderas Aserradas del Litoral, S.A.	(5,363)	(5,394)
Las Pléyades, S.A. (SAFI)	1,945	1,893
Sierras Calmas, S.A.	5,900	5,659
ENERGY business:		
Celulosa Energía, S.A.U.	24,809	38,196
ENCE Energía, S.L.U.	(29,413)	(26,704)
ENCE Energía Huelva, S.L.U.	(19,789)	(21,563)
ENCE Energía Extremadura, S.L.U.	(14,556)	(12,439)
Consolidation and other adjustments	(9,641)	(4,473)
The control of the c	57,561	60,510

The balance of reserves in consolidated companies that is restricted at year-end stood at at €12,412 thousand (year-end 2015: €12,851 thousand) and corresponds mainly to the legal reserves endowed by the various Group companies.

## 21.5 Shareholder remuneration

#### **Dividend payments**

At the Annual General Meeting held on 16 March 2016, the shareholders of Ence Energía y Celulosa, S.A. ratified the motion to pay a final dividend against 2015 profits in the amount of €0.10 per Ence Energía y Celulosa, S.A. share. The dividend, which totalled €24,886 thousand, was paid out on 14 April 2016. The Company had already paid out an interim dividend from 2015 profits of €0.044 per share as per a board resolution dated 30 September 2015.

At a meeting held on 22 November 2016, the Board of Directors of the Parent resolved to pay an interim dividend from 2016 profits of €0.032 per share (before withholdings), in cash. This dividend entailed the payment of €7,825 thousand and was pald out on 1 December 2016 (note 1).

## Share buyback programme

In addition, on 23 June 2016, the Board of Directors approved a share buyback programme with the aim of complementing shareholder remuneration by subsequently cancelling the shares, thereby increasing earnings per share.

The programme entailed the buyback of 4 million shares in total for €8,553 thousand, implying an average purchase price of €2.138/share. The programme was completed on 29 September 2016. The programme was



managed by Mercados y Gestión de Valores Agencia de Valores, S.A., the financial broker similarly appointed to manage the share liquidity contract entered into by Ence on 22 December 2015.

At the next Annual General Meeting, the Board of Directors of Ence Energía y Celulosa, S.A. will submit a motion for the cancellation of the four million shares bought back under the scope of the programme approved by the Board on 23 June 2016.

### 21.6 Earnings per share

The basic and diluted earnings per share calculations are shown below:

		AND AND AND ADDRESS.
Earnings per share	2016	2015
Group profit/(loss) attributable to owners of the parent		
(€ 000)	38,711	49,855
Weighted average number of ordinary shares		
outstanding during the year	250,272,500	250,272,500
Basic earnings per share (euros)	0.15	0.20
Diluted earnings per share (euros)	0.15	0.20

## 21.7 Parent Company shares

The reconciliation of "Own shares" at the beginning and end of 2016 and 2015 is as follows:

	2016		2015		
	No. of shares	Thousands euros	No. of shares	Thousands euros	
Opening balance	1,406,466	3,108	2,920,663	5,744	
Purchases	16,560,137	39,387	363,397	1,093	
Sales	(12,458,140)	(30,532)	(1,877,594)	(3,729)	
At year-end	5,508,463	11,963	1,406,466	3,108	

The own shares held by the Company at 31 December 2016 represent 2.2% of its share capital (0.6% at year-end 2015) and are carried at €4,958 thousand (€1,266 thousand at 31 December 2015). These shares were acquired at an average price of €2.17 per share. The own shares held as treasury stock are intended for trading in the market as well as cancellation under the scope of the share buyback programme (note 21.5).

# 21.8 Valuation adjustments

"Valuation adjustments" within equity includes the impact of the changes in the fair value of the Group's hedging derivatives (note 27) and the reserve generated by recognising the Group's forest land at market value as of 1 January 2004 (note 15) in the amount of €41,690 thousand at year-end 2016 (€51,290 thousand at year-end 2015). The latter reserve is freely distributable.

The breakdown of the changes in the fair value of the hedging derivatives in 2016 and 2015 is shown below:



	2016		2015			
Thousands of euros	Fair value	Tax effect	Adjustment in equity	Fair value	Tax effect	Adjustment in equity
Interest rate swap - project						
finance facility:						
Opening balance	325	82	243	(11,197)	(3,920)	(8,397)
Reclassified to profit or loss	(60)	(15)	(45)	13,768	3,442	10,326
Other changes in value	(3,927)	(982)	(2,945)	(2,246)	560	(1,685)
Closing balance	(3,662)	(915)	(2,747)	325	82	244
Foreign exchange hedges:						
Opening balance	(922)	(231)	(691)	·	_	_
Reclassified to profit or loss	659	165	494	54	13	40
Other changes in value	(11,377)	(2,844)	(8,533)	(976)	(244)	(732)
Closing balance	(11,640)	(2,910)	(8,730)	(922)	(231)	(692)
nergy sale hedges:						
Opening balance	245	61	184	999	349	750
Reclassified to profit or loss	(1,630)	(408)	(1,222)	1,578	394	1,183
Other changes in value	(139)	(35)	(104)	(2,332)	(682)	(1,749)
Closing balance	(1,524)	(382)	(1,142)	245	61	184
	(16,826)	(4,207)	(12,619)	(352)	(88)	(264)

# 21.9 Non-controlling interests

The reconciliation of the carrying amount of this consolidated statement of financial position heading (in thousands of euros) at the beginning and end of 2016 and 2015 is as follows:

Company	Balance at 01/01/2016	Changes in consolidation scope (note 2)	Balance at 31/12/2016
Energía de la Loma, S.A.	н	4,122	4,122
Energías de la Mancha Eneman, S.A.		3,112	3,112
Total	-	7,234	7,234

## 22.Grants

The reconciliation of the carrying amount of this consolidated statement of financial position heading at the beginning and end of 2016 and 2015 is as follows:



Thousands of euros	Subsidised loans (note 25)	Grants relating to assets	Emission allowances (note 18)	Total
Balance at 01/01/2015	1,043	9,989		11,032
Additions, new grants (*)	218	1,986	Ŧ	2,204
Emission allowances allocated for 2015		¥	624	624
Reclassified to profit or loss	(488)	(1,494)	(624)	(2,606)
Balance at 31/12/2015	773	10,481		11,254
Additions, new grants (*)		118	##S	118
Emission allowances allocated for 2016		ě	734	734
Reclassified to profit or loss	(227)	(1,474)	(734)	(2,435)
Balance at 31/12/2016	546	9,125	•	9,671

<sup>(\*)</sup> Net of expenses incurred in obtaining them

The Group has been granted non-repayable grants by several public bodies that are intended to finance investments earmarked to enhancing the productive structure with a significant impact on job creation, energy savings and efficiency and recovery of the energy generated.

In addition, the Group has been extended loans carrying no interest or below-market rates of interest with terms of up to 10 years. These loans finance projects undertaken by the Group to expand and upgrade the productive capacity of its pulp plants as well as the Group's research and development work.

The difference between market rates and the subsidised rate as per the loan agreement is considered a grant and is recycled to the consolidated income statement over the life of the loans on a systematic financial basis (note 25).

In 2016, the Group was awarded €1,988 thousand of aid by the IDAE (acronym in Spanish for the energy savings and diversification institute) to fund projects which lead to significant energy savings. This aid will accrued once the related investments and projects have been executed.

### 23. Provisions, impairment charges, guarantees and contingent liabilities

### 23.1 Provisions and Impairment charges

The reconciliation of the opening and closing balances of current and non-current provisions in 2016 and 2015 is as follows:



		Thousands of euro						
2016	Balance at 01/01/2016	Additions/ (charges)	Derecognitions or decreases	Transfers	Balance at 31/12/2016			
Non-current:								
Employee commitments (note 4.15)	2,063	295	27	(2,063)	295			
Emission allowances (note 18)	1,604	1,605	(1,604)		1,605			
Emission allowance purchase commitment (note 18)	1,908	282	*	4	2,190			
Discontinuation of pulp production in Huelva	1,494		(1,041)	÷	453			
Other	2,191	583	(1,150)	· · · · · · · · · · · · · · · · · · ·	1,624			
Current	9,260	2,765	(3,795)	(2,063)	6,167			
Employee commitments (*)	_	<del>**</del> .)	(2,063)	2,063	*			
Discontinuation of pulp production in Huelva	6,306	766	(2,446)	-,005	4,626			
	6,306	766	(4,509)	2,063	4,626			

<sup>(\*)</sup> This obligation corresponds to the "Long-term bonus plan for 2013-2015" which expired on 31 December 2015 and was settled during the fourth quarter of 2016 (note 4.15).

			Thousands	of euros	
2015	Balance at 01/01/2015	Additions/ (charges)	Derecognitions or decreases	Transfers	Balance at 31/12/2015
Non-current:					
Employee commitments (note 4.15)	712	3,333	(1,982)		2,063
Emission allowances (note 18)	5,081	1,604	(5,081)		1,604
Emission allowance purchase commitment (note 18)	2,423		(515)		1,908
Discontinuation of pulp production in Huelva	1,494			- *	1,494
Other	1,437	783	(742)	713	2,191
Current	11,147	5,720	(8,320)	713	9,260
Costs of unwinding energy crop and other lease agreements	9,898	Ę.	(5,318)	(4,580)	
Discontinuation of pulp production in Huelva	9,822	1,500	(5,016)		6,306
	19,720	1,500	(10,334)	(4,580)	6,306

### Impact of changes in the Spanish energy sector's regulatory framework

In 2013 and 2014, the Spanish government passed a series of laws and regulations which have had the effect of modifying the remuneration and tax regime applicable to the generation of energy from renewable sources, including generation and co-generation facilities fuelled by biomass.

These new regulations, which put energy crops in the same category as forest and agricultural waste for remuneration purposes, obliged Ence to abandon the management of its energy crop plantations in an orderly fashion, a process it concluded in 2015. Moreover, the regulatory changes were undertaken without any consideration whatsoever for compensating developers for these heavy investments, triggering the need to write down the investments in energy crops and other assets for impairment and to recognise provisions to cover the costs of unwinding the related lease agreements and other associated costs.



The impact on profit and loss of the corresponding impairment provisions recognised against the Group's various assets, coupled with the costs incurred to unwind the estate lease arrangements, recognised between 2013 and 2015, totalled €57,225 thousand.

On 14 and 31 July 2014, several Group companies exercised their right to seek damages from the Spanish state, specifically seeking an award of €52,069 thousand for damages caused by the retroactive application of the new regulatory regime applicable to the generation of power using blomass obtained from energy crops. The claim has been presented as an open-ended claim and the award sought will be increased to reflect the costs the Ence Group has been incurring in dismantling energy crop estates and unwinding leases at the estates on which the energy crops are being grown. The administration has yet to rule on this claim.

### Discontinuation of pulp production in Huelva

The lack of competitiveness of the industrial complex in Huelva caused, among other factors, by the impact of the regulatory reforms undertaken in the Spanish energy sector, forced Ence to announce, on 4 September 2014, its decision to specialise in clean energy generation at the Huelva complex and to cease the production of pulp.

The impact of the discontinuation on the income statement totalled €125,033 thousand. Of the total, €86,440 thousand corresponded to the impairment charges recognised against the Group's various assets, €18,198 thousands to costs incurred under contractual obligations and €20,395 thousand to employee costs. The bulk of these charges were recognised in profit and loss in 2014; the charges recognised in 2016 and 2015, mainly asset impairment charges, amounted to €7,782 thousand and €7,892 thousand, respectively.

### 23.2 Guarantees extended to third parties

At 31 December 2016, several financial institutions had extended the various Group companies guarantees for an aggregate amount of approximately €45,437 thousand (€52,980 thousand at 31 December 2015), as broken down in the table below.

	Thousands of euros
Electricity market regulator	2,751
Subsidised loans (note 25)	8,784
Receivable discounting lines	6,000
Tax claims (note 23.3)	4,517
Pontevedra concession (note 15.4)	3,050
Execution of forest projects	3,209
Payments to suppliers	758
Environmental performance	1,511
Customs	1,241
Other	13,616
- Table 1	45,437

The Board of Directors does not expect the amounts guaranteed or the guarantees extended to result in material liabilities for the Group.



### 23.3 Assets and liabilities

At year-end 2016, the Group is party to legal claims and controversies that arose in the ordinary course of its business. The most significant claims are detailed below. Management estimates that none of these, either individually or on aggregate, will have a material adverse impact on the consolidated financial statements:

### Changes in the Spanish energy sector regulatory framework

On 30 July 2014, a challenge was lodged before appeal court three of the Supreme Court against Royal Decree 413/2014 (6 June 2014), regulating the production of electric power using renewable sources, co-generation and waste, and Ministerial Order IET/1045/2014 (16 June 2014), enacting the standard facility remuneration parameters applicable to certain electricity producing facilities that use co-generation, renewable energy sources or waste.

On 19 May 2016, Ence formally presented a lawsuit seeking acknowledgement within the new regulatory regime of the real cost of lignin, the fuel used in the Group's existing co-generation plants integrated within its pulp operations and, by extension, an update of the remuneration parameters in order to reflect these real costs. Management estimates that lignin costs per MWh produced are €40-€60 higher than the cost contemplated in the current regulations, which translates into an impact at the Pontevedra and Navia industrial complexes in the range of €20,000 - €30,000 thousand in annual revenue terms.

In the wake of the Solicitor General's response to its lawsuit, Ence asked to have the expert reports issued by KPMG Asesores, S.L. and Roland Berger Strategies Consultant, S.A. ratified. The Supreme Court ratified these expert reports on 21/12/2016. The ruling on the case is expected in March 2017.

### Pontevedra public-domain concession

As a result of a Supreme Court ruling dated 11 July 2014 (upholding a ruling issued by the Appellate Court on 19 May 2011), the Pontevedra Provincial Coastal Service Initiated proceedings seeking termination of the concession for the use of the public-domain coastal land on which Ence's factory in this Spanish province sits; the Company has already presented its arguments in this case.

This case was resolved by means of a resolution of the Ministry for Agriculture, Food and the Environment on 24 July 2015. That resolution declares the concession partially terminated, specifically in respect of the land affected by the wastewater treatment plant, the underwater discharge pipeline and the football pitch, enabling the continuation of the Company's activities at the Pontevedra Operations Centre. The 24 July 2015 resolution has been challenged by the town council of Pontevedra and a local association, Asociación pola Defensa da Ría, before the National Appellate Court (Chamber for Contentious Administrative Proceedings), giving rise to two court cases numbered 85/2016 and 373/2016. In both cases Ence is acting as co-defendant, upholding the legality of the Ministry's actions. Both cases are ongoing.

Subsequently, the Ministry issued another resolution on 20/01/2016 granting the extension of the concession for a total term of 60 years (10 years of which subject to the performance of specific works in the energy efficiency, water savings and environmental areas). That resolution has also been challenged firstly through administrative channels and subsequently in court by Greenpeace Spain, the same local association and the town council of Pontevedra.

Their challenges have given rise to the court proceedings numbered 700/2016, 268/2016 and 484/2016 which are still with the above Chamber of the Appellate Court. Ence has appeared in court in all three cases in its capacity as co-defendant, arguing the legality of the actions of the Ministry in extending the concession. All three proceedings remain ongoing. The second resolution has also been challenged administratively by another



local association, Petón do Lobo. As far as management is aware, this association has not brought its case to the courts to date.

### Tax contingencies

The Spanish tax authorities concluded several tax inspections encompassing several Group companies during the first half of 2013. As a result of that process, the income tax assessments for 2007-2009, seeking a settlement in respect of unpaid taxes and late-interest payment of €6,730 thousand (in the opinion of the inspection team, the object of the assessments is not subject to fine) were signed under protest; of this balance, just €4,037 thousand would result in an outflow of cash.

Ence appealed the assessments before the National Economic-Administrative Court, which rejected its appeal on 16 June 2016. Ence has since lodged a new appeal against this ruling before the National Appellate Court.

In the opinion of Ence and its tax advisors, there are solid arguments in favour of a positive ruling on the appeals lodged before the latter court, which is why it has not recognised any provision in this respect.

### 24. Borrowings and cash and cash equivalents

The breakdown of the Group's borrowings at 31 December 2016 and 2015 is as follows:

	201	6	2015		
Thousands of euros	current	Non- current	current	Non- current	
		250,000	4	250,000	
ligh-yield bond Loans and credit facilities	5,286	39,714	300	30,000	
Project finance facilities	12,754	94,983	12,040	115,791	
Arrangement fees (a)	*	(8,134)	*	(9,156)	
Accrued interest payable and other	2,436	1.57	2,473	2	
nou dea mission per justice and o	20,476	376,563	14,813	386,635	

<sup>(</sup>a) High-yield bond: €6,369 thousand at 31 December 2016 (€6,892 thousand at year-end 2015). Project finance facility: €1,765 thousand at 31 December 2016 (€2,264 thousand at year-end 2015).

The breakdown of bank borrowings at 31 December 2016 and 2015 corresponding to loans, credit facilities and discounting facilities, classified by their respective maturities, is as follows:



A A COLUMN COLUMN ACCORDANCE AND ACC		Drawn		Maturity				
Year-end 2016 (thousands of euros)  Limit	Limit	down	2017	2018	2019	2020	Beyond	
High-yield bond	250,000	250,000		_			250,000	
Revolving credit facility	90,000		_				230,000	
Project finance facilities	107,737	107,737	12,754	13,424	13,590	13,587	54,382	
Other loans	45,000	45,000	5,286	5,445	22,695	5,552	6,022	
Arrangement fees	140	(8,134)	* *** *** ***	(1,343)	(1,357)	(1,374)	(4,060)	
Interest and other	-41	2,436	2,436	-	(=)==-	(2,37-1)	(4,000)	
	492,737	397,039	20,476	17,526	34,928	17,765	306.344	

Year-end 2015 (thousands of euros)		Balance			Due in		
	Limit	Drawn	2016	2017	2018	2019	Beyond
High-yield bond	250,000	250,000	_		_		250,000
Revolving credit facility	90,000	-	*	4		-	230,000
Project finance facilities	127,831	127,831	12,040	12,754	13,424	13,590	76,023
Other loans	30,300	30,300	300	4,286	4,286	19,286	2,142
Accrued interest payable and other	= =	2,473	2,473		-	-	2,172
Arrangement costs	-	(9,156)		(1,277)	(1,288)	(1,301)	(5,290)
	498,131	401,448	14,813	15,763	16,422	31,575	322,875

In addition, the Group has receivables factoring facilities with a limit of €70,000 thousand (note 19) and reverse factoring lines with a limit of €105,000 thousand (note 20).

### 24.1 Bond issue and revolving credit facility

On 30 October 2015, ENCE Energía y Celulosa, S.A. closed the placement of a €250 million bond issue with qualified institutional investors under Rule 144A and Regulation S of the US Securities Act of 1933, as amended. The issue was carried out under New York state law and the bonds are traded on the Luxembourg Euro MTF exchange. They were issued to refinance the Company's 2013 bond issue.

On 1 December 2015, the Company bought back 100% of the outstanding principal on the bonds it had issued in 2013 (note 12).

The newly-Issued bonds are due on 1 November 2022. They carry a fixed annual coupon of 5.375%, payable twice-yearly, and are guaranteed by the main subsidiaries devoted to the PULP business (note 2) and are therefore non-recourse to the ENERGY business.

As is customary for these kinds of securities, the new bonds imply certain disclosure requirements and restrictions on the payment of dividends and arrangement of additional borrowings in the event of failure to comply with certain financial ratios. The cost of issuing these long-term bonds was approximately €7 million.



In conjunction with this issue, two international credit ratings agencies issued an opinion on the creditworthiness of the Group as a whole and of its bond issue. The current issuer and issue credit ratings assigned by Standard&Poors and Moody's are BB-/BB- and Ba3/B1, respectively.

Also under the scope of this issue, a revolving €90 million credit facility was arranged with a syndicate of prestigious Spanish and international banks. This facility accrues interest at a rate benchmarked to Euribor and matures in 2021, having been renegotiated in 2016. It was fully available for draw down at the reporting date.

Both the bond indenture and the revolving credit agreement are governed by UK and Welsh law.

### 24.2 Huelva 50-MW and Mérida 20-MW project finance facility

On 31 July 2015, the Group and a syndicate of six banks entered into project finance loan agreements to fund the construction of two biomass-fuelled power generation plants. The loan agreement executed by Ence Energía Huelva, S.L.U. and Ence Energía Extremadura, S.L.U. in an aggregate amount of €135,018 thousand encompass two tranches of €96,531 thousand and €38,487 thousand, which are assigned to the Huelva 50-MW and Mérida 20-MW power plants, respectively.

Amortisation of the refinanced facility began on 30 December 2015; it is scheduled for full repayment by 30 December 2024. It accrues interest at a floating rate benchmarked to Euribor plus a spread ranging between 2.50% and 3.00%, depending on the loan repayment period. The commissions paid in connection with this facility in 2015 totalled €2,540 thousand.

The main collateral securing this loan is a pledge over the shares of ENCE Energía, S.L.U., a 100%-owned subsidiary of ENCE Energía y Celulosa, S.A., ENCE Energía Huelva, S.L.U. and ENCE Energía Extremadura, S.L.U., as well as their current and future assets and credit claims. In parallel, ENCE Energía, S.L.U. has presented additional guarantees: it has entered into a 2-year supply agreement covering 130% of the plants' needs, provided a financial biomass stock guarantee equivalent to €10 million and warranted to unwind the former energy crop estate lease agreements and to keep the plants operational and available.

This loan similarly includes certain obligations, which are customary in these types of facilities, mainly related to the disclosure of specific business and financial information, compliance with certain financial ratios determined on the basis of the annual financial statements of ENCE Energía Huelva, S.L.U. and ENCE Energía Extremadura, S.L.U., the requirement to maintain a specific volume of felled biomass stock, and cash sweeps, namely the earmarking of 50% of surplus cash to early repayment of the loan until 50% has been repaid and, subsequently, 25% of surplus cash until facility maturity date (note in this respect that as at 30 June 2016, €8,054 thousand had been early repaid from the 2015 cash surplus, thereby eliminating the loan's final instalment). The covenants similarly impose certain restrictions, mainly on the distribution of dividends and the raising of new financing.

In order to hedge the risk deriving from this floating-rate financing facility, the Group restructured its interestrate hedges with four of the project financiers in order to adapt them to the new loan structure. The restructured hedges have been written over approximately 80% of the estimated drawdowns to be made throughout the term of the loan, locking in a fixed rate of 2.8% (note 27).

### 24.3 Other loans

On 29 December 2016, Ence Energía, S.L. arranged two separate €7.5 million loans which fall due on 29 December 2021 and 2023, respectively, and bear interest at Euribor plus a spread of 1.9% and 2,25%, respectively. They are secured by the shareholdings acquired by the ENERGY business in Energías de la Mancha ENEMAN, S.A. and Energía de la Loma, S.A. (note 2).



Ence has also taken on two loans to fund some of the investments carried out at the Navia factory (Asturias) related with the capacity additions (outlined in note 15 above). The first was arranged on 23 April 2015 for €15 million, repayable in a single bullet payment on 24 March 2019. This loan accrues interest at Euribor plus 2.1% and is guaranteed solely by the Group companies devoted to the Pulp business.

The second was arranged on 15 July 2015, similarly for €15 million and is repayable in a single bullet payment on 30 June 2020. This loan has a two-year grace period after which it will be repaid in equal instalments during the remaining three years. It accrues interest at a fixed rate of 2.1% and is secured by several of the Group companies engaged in the Pulp business.

### 24.4 Cash and cash equivalents

"Cash and cash equivalents" includes the Group's cash on hand and short term bank deposits with original maturities of three months or less. The carrying amount of these assets approximates their fair value. These assets earned an average rate of 0.06% in 2016 (0.35% in 2015).

The Group had €209,864 thousand of cash and cash equivalents at year-end 2016 (€112,098 thousand of which corresponding to the PULP business and €97,766 thousand to the ENERGY business). Of this total, some €28,669 thousand is subject to certain restrictions (€9,580 thousand of which corresponding to the PULP business and €19,089 thousand to the ENERGY business). Specifically:

- 1. €9,089 thousand can only be used to service debt under the Huelva and Merida project finance facility during the first half of 2017.
- €10,000 thousand secures the obligation assumed under the refinanced project finance agreement in relation to the covenanted minimum stock of biomass for the power plants, as detailed in note 24.2 above. This deposit was replaced by a bank surety on 16 January 2017, so that this sum has been freely drawable since then.
- 3. €9,580 thousand mainly secures obligations undertaken under the electricity price hedge agreements entered into with the Nominated Electricity Market Operator, OMIE, and under forward carbon allowance purchase commitments (notes 18 and 25).

The year-end 2015 statement of financial position includes €6,892 thousand of cash denominated in US dollars (year-end 2015: €5,721 thousand).

### 25. Other financial assets and liabilities

### 25.1 Other financial assets

The reconciliation of the carrying amount of this consolidated statement of financial position heading at the beginning and end of 2016 and 2015 is as follows:



	20	16	2015		
Thousands of euros	Current	Non- current	Current	Non- current	
Adjustments for tariff shortfall	٠	10,044	2		
Collateral under hedges and emission allowances (notes 27 and 18)	8,466	##s;	4,754		
Ence's share liquidity agreement (note 21)	41	<b></b>	2,386		
Other	1,073	1,590	1,559	3,027	
	9,580	11,634	8,699	3,027	

This heading of the accompanying consolidated statement of financial position at 31 December 2016 includes the non-current portion of the Group's claim vis-a-vis the sector regulator, the CNMC, (the current portion of €770 thousand is presented under "Trade and other receivables" on the statement of financial position at 31 December 2016), under the scope of Spanish Royal Decree 413/2014, regulating the production of electric power using renewable sources, co-generation and waste, in respect of "Adjustments for tariff shortfall" corresponding to 2014-2016. As provided for in that piece of legislation, this balance will be collected, as a general rule, over the remaining useful lives, for regulatory purposes, of the power generation and cogeneration plants, earning interest at a rate of 7.398%.

This heading also includes the deposits set up to guarantee obligations assumed in writing certain derivative financial instruments (described in note 27), as well as those deriving under the agreements entered into for the future purchase of emission allowances (described in note 18).

### 25.2 Other financial liabilities

The amounts recognised under this heading in the accompanying consolidated statement of financial position correspond primarily to the loans extended at below-market or zero interest rates, as detailed in note 22.

The breakdown by maturity at year-end 2016 and 2015 is as follows:

Thousands of euros	2016	2015
2016		1,356
2017	1,305	1,212
2018	1,213	1,254
2019	1,213	1,254
2020	6,060	1,254
2021 and beyond	31,479	2,486
Unwinding of discount (note 22)	(546)	(773)
The state of the s	40,724	8,043

On 1 December 2016, Ence was awarded three loans by the Spanish Ministry for the Economy, Industry and Competitiveness against the backdrop of its so-called Re-industrialisation and Manufacturing Competitiveness Stimulus Programme for a total amount of €33,925 thousand. The money must be used primarily to finance certain investments at the Pontevedra pulp mill. The loans are repayable over a 10 year term and bear interest at a fixed rate of 2.29%. There is a three-year grace period.



### 26. Financial instruments by category - Fair value

The Group's financial instruments mainly include deposits, trade and other receivables, derivatives and loans. The table below reconciles the Group's financial instruments by category and the consolidated statement of financial position headings:

2016 Thousands of euros	Loans and receivables / payables	Hedging derivatives	Held-to- maturity investments	Total at 31/12/2016
Non-current financial assets	T-a	-	11,634	11,634
Financial accounts receivable		: #	9,580	9,580
Trade and other receivables	90,491	-	12:	90,491
Cash and cash equivalents	209,864	9	Ŧ	209,864
Total financial assets	300,355	2	21,214	321,569
Non-recourse borrowings	105,980			105,980
Recourse borrowings	291,059	-		291,059
Derivative financial instruments		26,489		26,489
Trade and other payables	164,941			164,941
Other financial liabilities	40,724	•	14	40,724
Total financial liabilities	602,704	26,489	п	629,193

2015 Thousands of euros	Loans and receivables / payables	Hedging derivatives	Held-to- maturity investments	Total at 31/12/2015
Non-current financial assets			3,027	3,027
Derivative financial instruments	-	245	-,	245
Financial accounts receivable		-	8,699	8,699
Trade and other receivables	131,969		4	131,969
Cash and cash equivalents	159,565		*	159,565
Total financial assets	291,534	245	11,726	303,505
Non-recourse borrowings	125,585			125,585
Recourse borrowings	275,863	ie:		275,863
Derivative financial instruments	*	13,570		13,570
Trade and other payables	169,132		_	169,132
Other financial liabilities	8,043	<u> 1</u>	_	8,043
Total financial liabilities	578,623	13,570		592,193

The financial assets and liabilities measured at fair value are mostly derivative financial instruments. They are valued using different quoted price variables that are observable, either directly, or indirectly using valuation techniques (fair value hierarchy level 2).



The fair value of the Group's financial assets and liabilities is not significantly different from their carrying amount. Note that the bonds issued by Ence in 2015 were trading at 105.52% of par at 31 December 2016.

### 27. Derivative financial instruments

In keeping with the risk management policy outlined in note 6, the Group arranges derivative financial instruments primarily to hedge the risks deriving from fluctuations in interest rates, exchange rates, pulp prices, gas prices, fuel-oil prices and the cost of the electricity used in its productive processes.

The breakdown of this consolidated statement of financial position heading at 31 December 2016 and 2015 (showing the fair value of the derivatives at year-end), is provided in the next table:

Thousands of euros	Current	Current assets		Non-current liabilities		Current liabilities	
	2016	2015	2016	2015	2016	2015	
Cash flow hedges:							
Energy sale hedges	<b>#</b> :	245	·-	-	1,524	•	
IRS - project finance facilities	-	e	7,756	6,982	2,729	2,924	
Currency hedges	-	*	3,992	665	10,488	2,999	
Total		245	11,748	7,647	14,741	5,923	

These financial instruments arranged have been measured subsequent to initial recognition by reference to observable market data, either directly (i.e., prices), or indirectly (i.e. inputs derived from prices).

The techniques used to value the instruments written, in keeping with prevailing accounting rules, consist of discounting known or estimated future cash flows to present value using discount curves built from benchmark market interest rates adjusted for credit risk as a function of the terms of the various instruments. The main inputs used to value the financial instruments vary by instrument type but predominantly include exchange rates (spot and forward), interest rate curves, counterparty risk curves and volatility metrics for all of these inputs. In all instances the market data are obtained from reputed information providers or correspond to the prices published by official bodies.

A fair value gain of €1,030 thousand on derivatives designated as hedging instruments was reclassified to profit or loss in 2016 (a loss of €15,400 thousand in 2015).

### 27.1 Currency hedges

In order to hedge the risks to which the Group is exposed as a result of fluctuations in the dollar-euro exchange rate, which have a significant impact on pulp sales prices, Ence has arranged a tunnel option strategy (Asian options) over US dollars (this means using the average exchange rate for a given period instead of the rate on a specific date as the benchmark). The break down of these options at 31 December 2016 is as follows:



		Strike price	Strike price	Notional amount
Underlying	Expiry	Call	Put	(USD)
EUR/USD	1Q17	1.072	1.146	74.5
EUR/USD	2Q17	1.055	1.137	85.5
EUR/USD	3Q17	1.105	1.164	81.5
EUR/USD	4Q17	1.101	1.162	78.0
				319.5
EUR/USD	1Q18	1.106	1.167	69.0
EUR/USD	2Q18	1.065	1.144	38.6
EUR/USD	3Q18	1.075	1.147	12.8
EUR/USD	4Q18	1.075	1.147	12.8
				133.2

<sup>(\*)</sup> The contracts outstanding at 31 December 2016 cover approximately 70% and 30% of forecast pulp sales in 2017 and 2018, respectively.

These instruments presented a negative fair value at 31 December 2016 of €14,480 thousand.

The change in the fair value of these instruments in 2016 is recognised as follows: 1) a loss in "Change in the fair value of financial instruments" in the 2016 consolidated income statement in respect of the time value of these instruments in the amount of €100 thousand (€2,740 thousand at year-end 2015); and 2) a charge to "Equity - Valuation adjustments" in the consolidated statement of financial position in respect of the intrinsic value of the instruments in the amount of €11,640 thousand (before the related tax effect).

The intrinsic value of the currency hedging derivatives initially recognised in "Other comprehensive income" and reclassified to profit and loss in 2016 implied a loss of €659 thousand (2015: loss of €52 thousand), which is presented under "Gain/(loss) on hedging transactions" in the accompanying consolidated income statement.

Considering the hedges arranged at year-end 2016, dollar depreciation of 5% relative to the spot price as at 31 December 2016 would imply a cash inflow of €290 thousand in 2017. In contrast, dollar appreciation against the euro of 5% would imply a cash outflow of €24,163 thousand in 2017.

### 27.2 Energy sale hedges:

The Group has written commodity swaps covering the price at which it sells its power output to the national electricity system (OMEL). The breakdown of the hedges outstanding at 31 December 2016:

Expiry	Amount (MWh)	Price range in euros
1H17	208,200	47.74/38.18
2H17	46,368	44.95

These instruments presented a negative fair value of €1,524 thousand at 31 December 2016 (a positive fair value of €245 thousand at year-end 2015).



The net fair value of the energy sales hedging derivatives initially recognised in "Other comprehensive income" and reclassified to profit and loss in 2016 implied a gain of €1,630 thousand (2015: loss of €1,578 thousand), which is presented under "Gain/(loss) on hedging transactions" in the accompanying consolidated income statement.

Considering the hedges arranged at 31 December 2016, an increase in electricity sales prices of 10% would imply a cash outflow of €1,186 thousand in 2017. In contrast, a 10% drop in electricity sales prices would result in a cash inflow of the same magnitude in 2017.

### 27.3 Interest rate swaps:

The Group actively manages its exposure to the interest rate risk deriving from borrowings taken out at floating rates, as detailed in note 7 above.

The Interest rate derivatives arranged by the Group and outstanding at year-end 2016 and 2015 are shown below:

### 31 December 2016

Thousands of euros	Fair	Notional amounts at reporting date:				
	value	2017	2018	2019	2020	2021
IRS - project finance facilities	10,485	82,420	71,691	60,819	49,950	38,322

### 31 December 2015

	Fair	1	Notional amounts at reporting date:					
Thousands of euros	value	2016	2017	2018	2019	2020	2021	
IRS - project finance facilities	9,906	92,632	82,420	71,691	60,819	49,950	38,322	

The table below provides the maturity analysis for the Group's interest rate derivatives at 31 December 2016. It is prepared on the basis of undiscounted cash flows.

	Thousands of euros			
	3 months - 1 year	1 - 5 years		
IRS - project finance facilities	2,729	7,756		

A fair value gain of €59 thousand on interest rate swaps designated as cash-flow hedges was reclassified to profit and loss in 2016 (2015: a fair value loss of €1,578 thousand).

Considering the hedges arranged at 31 December 2016, a 10% increase in the Euribor forward curve would imply a cash inflow of €10 thousand in 2017. In contrast, a 10% decline in the Euribor interest rate curve would result in a cash outflow of the same magnitude in 2017.



### 28. Tax matters

The balances receivable from and payable to the tax authorities at year-end 2016 and 2015 are shown below:

	Thousands of euros					
	31 Decem	31 December 2016		ber 2015		
	Taxes receivable	Taxes payable	Taxes receivable	Taxes payable		
Non-current:						
Deferred tax assets	68,456	-	70,831			
Deferred tax liabilities	<b>2</b>	20,512	=	20,560		
Total	68,456	20,512	70,831	20,560		
Current:						
Income tax receivable and VAT payable	8,135	2,922	8,532	1,657		
Current tax on profits for the year	1,459	117	959	57		
Electricity levy	217	4,519	·	3,062		
Sundry taxes receivable from and payable to the tax authorities	459	3,214	503	2,283		
Total	10,270	10,772	9,994	7,059		

### 28.1 Regimes applied and tax groups

### Group companies resident in Spain for tax purposes:

For income tax purposes, ENCE Energía y Celulosa, S.A. files its tax returns under the consolidated tax regime provided for in Chapter VII of Title VIII of the Consolidated Text of the Spanish Corporate Income Tax Act, as the parent of Tax Group 149/02, created in 2002.

Application of this regime, on a perpetual basis unless expressly waived, means that the various companies included in this tax group (namely, all the Spanish companies itemised in note 2 in which Ence has a shareholding of over 75%) do not file their taxes individually.

The applicable statutory income tax rate was 28% in 2015 and 25% from 2016.

### Group companies resident in Uruguay and Portugal for tax purposes:

For income tax purposes, the Group companies located in Uruguay pay income tax under the general tax on income from economic activities regime at a statutory rate of 25% of accounting income adjusted for applicable prevailing deductions.

Group company Iberflorestal, S.A., meanwhile, pays income tax under the general Portuguese corporate income tax regime at a statutory rate of 21% since 2015 (before that the rate was 23%).

### Tax consolidation group

Taxable income is not determined on the basis of the Group's consolidated accounting profit but rather the aggregate of the individual taxable incomes of the companies comprising the tax group, determined in



accordance with their respective individual tax regimes, which are then restated for eliminations and adjustments. To this end, the individual taxable income of the Group companies with tax residence in Spain in which the Group has a shareholding of over 75% is aggregated to arrive at the taxable income of Tax Group No. 149/02; tax losses deriving from non-resident companies cannot be offset for this purpose.

### Regulatory changes

The tax regime applicable to the entities incorporated in Spain has been overhauled in recent years.

The new regulations attempt to simplify taxation, adapt Spanish standards to European Community law and stabilise corporate income tax revenue by broadening taxable income in exchange for lowering the statutory rate. Against this backdrop, the general statutory rate has been reduced on a staggered basis to 25% in 2016 (from 28% in 2015), while a new tax break, the capitalisation reserve, has been introduced which will have the effect of reducing taxable income by up to 10% if certain requirements are met. A cap has been introduced on the ability to utilise tax losses accredited in prior years, which has been set at 25% of taxable income, in exchange for elimination of the deadline on their application. Limits have been set on the ability to deduct interest expense, while the ability to deduct impairment losses on non-current assets for tax purposes has been eliminated.

### 28.2 Reconciliation of accounting profit/(loss) to taxable income/(tax loss)

The reconciliation of accounting profit/(loss) to tax income/(tax expense) in 2016 and 2015 is provided below:

Thousands of euros	2016	2015
Profit before tax (*)	51,098	67,038
Permanent differences:		
Arising in profit or loss	144	(1,906)
Arising in equity	(22)	(12)
Capitalisation reserve	(1,848)	÷
Temporary differences:		
Arising during the year	14,303	14,851
Arising in prior years	(17,286)	(26,705)
Arising from reclassifications from equity	2	8,966
Consolidation adjustments	14,415	(254)
Utilisation of tax losses	(15,435)	(16,946)
Taxable income / (tax loss)	45,369	45,032

### (\*) Profit before tax was generated exclusively by continuing operations

The temporary differences arise from the recognition of income and expense in different periods due to differences between prevailing accounting and tax legislation. A breakdown of these differences by nature is provided in section 28.4.

"Consolidation adjustments" mainly reflect the impact of the forest cover revalued in 2004 (notes 16 and 21) in respect of the land sold in 2016.



### 28.3 Reconciliation of accounting profit and tax expense

The reconciliation of accounting profit/(loss) to tax income/(tax expense) in 2016 and 2015 is provided below:

Thousands of euros	2016	201
Accounting profit (profit/loss before tax)	51,098	67,038
Permanent differences arising in profit or loss	144	(1,906
Capitalisation reserve	(1,848)	-
Elimination of the accounting profit of entities not resident in Spain	937	2,482
Consolidation adjustments and eliminations	1,592	(12
Taxable income / (tax loss)	51,923	67,602
Tax payable / (receivable) before adjustments	12,981	18,929
Deductions and adjustments in respect of the prior	(812)	*
year		(2,258)
Change in tax rate	*	(847)
Taxation on non-resident companies and other items	218	1,359
Tax expense /(income)	12,387	17,183

The breakdown of tax expense / (income) in 2016 and 2015:

Thousands of euros	2016	2015
Current tax and other movements	11,641	13,017
Deferred tax	746	3,319
Impact of the change in tax rate		847
Tax expense /(income)	12,387	17,183

### 28.4 Recognised deferred tax assets and liabilities

The reconciliation of the related consolidated statement of financial position headings at the beginning and end of 2016 and 2015 is as follows:





### Deferred tax assets

		Th	ousands of euro	S	
2016	Balance			Transfers	Balance
	01/01/2016	Increases	Decreases	& other	31/12/2016
Deferred tax assets recognised in profit or loss:					
Non-current asset depreciation	8,175	140	(908)		7,267
Non-current asset Impairment	10,472	3,390	(1,174)	(6)	12,682
Provisions	844	52	(294)		602
Employee commitments	1,156	63	(482)	(43)	694
Current-asset impairment	882	71	(193)	(46)	714
Interest expense (cap on deductibility)	1,547	09.0	(1,457)	(90)	-
Non-resident companies and consolidation adjustments	132	55	(187)	1	1
Additions to consolidation scope	nii .	19.1	<b>™</b> .	587	587
Unused tax losses	44,578	+:	(3,859)	16	40,735
Unused tax credits	3,109		(3,076)	936	969
Dilasto tan di caro	70,895	3,631	(11,630)	1,355	64,251
Deferred tax assets recognised in equity:					
Hedging derivatives (note 21)	(64)	4,288		(19)	4,205
	(64)	4,288		(19)	4,205
Total	70,831				68,456

		Th	ousands of euro	<b>.</b>	
2015	Balance			Transfers	Balance
	01/01/2015	Increases	Decreases	& other	31/12/2015
Deferred tax assets recognised in profit or loss:					
Non-current asset depreciation	9,088	+	(1,023)	110	8,175
Non-current asset impairment	8,830	1,731	(2,671)	2,582	10,472
Provisions	3,262	37	(2,657)	203	844
Employee commitments	831	432	(393)	286	1,156
Current-asset impairment	1,766	229	(1,255)	142	882
Interest expense (cap on deductibility)		1,733	*	(186)	1,547
Non-resident companies and consolidation adjustments	1,093	ت	(1,095)	115	132
Unused tax losses	49,957		(4,520)	(859)	44,578
Unused tax credits	3,823		(3,415)	2,700	3,109
Gildsed (by circuit)	78,650	4,181	(17,029)	5,093	70,895
Deferred tax assets recognised in equity:					
Hedging derivatives (note 21)	2,938		(3,020)	18	(64)
	2,938		(3,020)	18	(64)
Total	81,588	-			70,831

Management has recognised deferred tax assets in the statement of financial position as it believes it is probable that they will be realised within a period of around 10 years. In making this judgement, management factored in the outlook for the Group's earnings, based on internal projections, as well as the tax rate expected to apply at the time of their realisation.



As provided in Spanish legislation, accredited unused tax losses can be offset against taxable income generated by the consolidated Tax Group No. 149/02 in successive years, as they do not prescribe. Elsewhere, accredited tax credits associated with environmental investments must be utilised within 15 years, while those associated with R&D investments must be utilised within 18 years.

### Deferred tax liabilities

		Tì	nousan <mark>ds of e</mark> uro	s	
2016	Balance 01/01/2016	Increases	Da	Transfers	Balance
Deferred tax liabilities recognised in profit or loss:	01/01/2010	nicreases	Decreases	& other	31/12/2016
Accelerated depreciation	1,838		(187)		1,651
Additions to consolidation scope (note 2)		(*)	(201)	2,997	2,997
Other	1,781	÷.	-	-	1,781
	3,619		(187)	2,997	6,429
Deferred tax assets recognised in equity:		- Indian			
Revaluation of forest land (notes 15 & 21)	17,076	-	(3,200)	-	13,876
Hedging derivatives (note 21)	(169)	365	(189)	137	144
Consolidation and other adjustments	34	722	(807)	114	63
	16,941	1,087	(4,196)	251	14,083
Total	20,560			1-10	20,512

		TI	ousands of euro	s	
2015	Balance 01/01/2015	Increases	Decreases	Transfers & other	Balance 31/12/2015
Deferred tax liabilities recognised in profit or loss:					
Accelerated depreciation	2,027		(211)	22	1,838
Other .	205		4	1,576	1,781
	2,232	-	(211)	1,598	3,619
Deferred tax assets recognised in equity:					
Revaluation of forest land (notes 15 & 21)	19,319	v.	(2,244)	1	17,076
Hedging derivatives (note 21)	389	24	(582)		(169)
Consolidation and other adjustments	8	79	(248)	195	34
	19,716	103	(3,074)	196	16,941
Total	21,948			,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,	20,560

### 28.5 Unrecognised deferred tax assets

The Group did not recognise certain deferred tax assets in 2016 and 2015, mainly corresponding to tax losses generated in Uruguay, in the amount of €4 million, and in Portugal, in the amount of €3 million.

### 28.6 Years open to inspection and tax inspections

Under prevailing tax regulations, tax returns may not be considered final until they have either been inspected by tax authorities or until the inspection period in effect in each tax jurisdiction has prescribed (four years in Spain and Portugal and five years in Uruguay). The Spanish tax authorities are currently investigating the VAT and income tax returns of Energía de la Loma, S.A. for 2014 and 2015. The directors believe that the tax



contingencies that could arise from the investigations underway and from any review of the returns still open to inspection, if any, will not have a material impact on the accompanying consolidated financial statements.

### 29. Director and key management personnel pay and other benefits

### 29.1 Compensation paid to the members of the Board of Directors

As stipulated in articles 42 and 43 of the Articles of Association, the directors, in their capacity as members of the Board and in exchange for discharging the supervisory and decision-making duties intrinsic to Board membership, are entitled to receive a fixed annual payment that may not exceed the ceiling established to this end at the Annual General Meeting or in the Company's Director Remuneration Policy; it is up to the Board of Directors to determine the precise amount payable within that limit and its distribution among the various directors, factoring in the duties and responsibilities attributed to each director, membership of the Board's various committees, the positions discharged by each within the Board and any other circumstances they deem pertinent.

The upper limit established in the Director Remuneration Policy approved at the Annual General Meeting held on 28 June 2016 is €1.5 million.

The remuneration accrued by the members of the Board of Directors in 2016 and 2015 in their capacity as directors:

		Th	ousands of euro	S
2016 - Director	Class of director	Fixed remuneratio n	Per diems & other	Total
Juan Luis Arregui Ciarsolo	Proprietary	134	75	209
Retos Operativos XXI, S.L.	Proprietary	44	33	77
Pedro Barato Triguero	Independent	44	59	103
Fernando Abril-Martorell Hernández	Other external	44	43	87
José Guillermo Zubía Guinea	Independent	44	63	107
José Carlos de Álamo Jiménez	Independent	44	45	89
Pascual Fernández Martínez	Proprietary	44	42	86
Isabel Tocino Biscarolasaga	Independent	44	38	82
Javier Echenique Landiribar	Other external	44	45	89
Gustavo Matías Clavero	Independent	11	12	23
Víctor de Urrutia Vallejo	Proprietary	44	37	81
Mendibea 2002, S.L.	Proprietary	44	31	75
Luis Lada Díaz	Independent	33	25	58
Ignacio de Colmenares Brunet	Executive	40	w.	40
		658	548	1,20



		Th	ousands of euro	s
2015 - Director	Class of director	Fixed remuneratio n	Per diems & other	Total
Juan Luis Arregui Ciarsolo	Proprietary	134	77	211
- Retos Operativos XXI, S.L.	Proprietary	44	47	91
Pedro Barato Triguero	Independent	104	64	168
Fernando Abril-Martorell Hernández	Other external	44	37	81
José Guillermo Zubía Guinea	Independent	44	73	117
José Carlos de Álamo Jiménez	Independent.	44		89
Pascual Fernández Martínez	Proprietary	44	47	91
Isabel Tocino Biscarolasaga	Independent	44	43	87
Javier Echenique Landiribar	Proprietary	44	51	95
Gustavo Matías Clavero	Independent	44	40	84
Víctor de Urrutia Vallejo	Proprietary	44	33	77
Mendibea 2002, S.L.	Proprietary	44	43	87
		678	600	1,278

The non-executive directors only receive the fixed remuneration indicated in the table above; they are excluded from the Company's short and long term performance-based bonus schemes.

The Company has arranged insurance to cover its directors as a group against the following accident risks: death, permanent outright disability and permanent partial disability (the risk of permanent disability only covers directors up to the age of 70). In addition, the Company offers its directors and their spouses an annual medical check-up. It also has a health insurance policy in the name of the Chairman of the Board of Directors.

The Parent has not extended its directors any advances or loans.

The directors did not conclude any material transactions with the Company or any of the Ence Group companies outside the ordinary course of business or on terms other than on an arm's length basis in either 2016 or 2015.

Other than as indicated below, the Parent has no pension or alternative insurance related obligations to its directors.

### 29.2 Key management personnel and their pay

The list of key management personnel in 2016 is as follows:



Name	Position
Ignacio de Colmenares y Brunet	Chief Executive Officer
Jaime Argüelles Álvarez	Pulp Operations Officer
Jordi Aguiló Jubierre	<b>Energy Operations Officer</b>
Javier Arregui Abendivar	Director of New Power Plant Development and Forest Assets
Alvaro Eza Bernaola	Director of Supply Chain Operations
María José Zueras Saludas	Corporate Resources Officer
Alfredo Avello de la Peña	Finance and Corporate Development Officer
Luis Carlos Martínez Martín	Communication and Institutional Relations Office

<sup>(\*)</sup> At a Board meeting held on 21 December 2016, the directors approved the addition of Jordi Aguiló, Energy Operations Officer, to the Executive Committee.

The total remuneration accrued by the members of the Executive Committee in 2016, including that accrued for the vice-chairmanship and chief executive duties carried out by Ignacio de Colmenares y Brunet under a service provision agreement, totalled €4,095 thousand (2015: €4,100 thousand). The Vice-Chairman and CEO and team of key management personnel received €894 thousand in 2016 in connection with the "Long-term Bonus Plan of ENCE, Energía y Celulosa, S.A. for 2010-15" as part of their performance-based pay; in addition, they are beneficiaries of the "Long-term Bonus Plan of ENCE, Energía y Celulosa, S.A. for 2016-2018" (notes 4.15 and 23).

This remuneration includes the premium paid for a retirement insurance policy in the name of the Vice-Chairman and CEO. The benefit payable under this plan is one year's remuneration, to be received upon termination of his contract, so long as this happens when he is aged 62 or more. In addition, the Chief Executive Officer, by virtue of his service agreement, participates in certain company benefits, including mixed savings, life and accident insurance coverage. In terms of the savings portion of the policy, the CEO contributes 1% of his fixed remuneration to the plan and the Company contributes an additional amount equivalent to 5.25% of the latter. The contingencies covered by the insurance include retirement, total permanent disability, full permanent disability, severe disability and death. The sum of capital underwritten is equivalent to 35 times his fixed monthly remuneration; in the event the contingencies result from an accident, the CEO would receive a lump sum equivalent to 70 months¹ pay.

The 2015 remuneration figures include the exercise of 767,237 options over shares of ENCE Energía y Celulosa, S.A. that year on the terms established in the "Long-term Bonus Plan of ENCE, Energía y Celulosa, S.A. for 2010-15".

### 29.3 Additional considerations

The composition of the Board of Directors of ENCE Energía y Celulosa, S.A. changed as follows in 2016: Luis Lada Díaz joined the board as an independent director, while Gustavo Matías Clavero stepped down. The Board composition did not change in 2015.

Note that, as per the notifications provided in this respect by the members of the Board of Directors, no direct or indirect conflicts of Interest arose during the reporting period on the part of the directors or their related parties vis-a-vis the Interests of the Company, as defined in article 229 of Spain's Corporate Enterprises Act.



### 30. Related-party transactions

The Company entered into the following transactions with related parties in 2016 and 2015:

*		Thousand	s of euros
Related party	Item	2016	2015
Agroluan, S.L.	Services received		50
Grupo Foresta	Purchase of biomass	171	713
Grupo Foresta	Interest receivable	*	(25)

These transactions were arranged on an arm's length basis and in accordance with agreements entered into on 20 December 2012.

### 31. Environmental performance

Each of ENCE Energía y Celulosa's four Operations Centres, located in Huelva, Navia, Pontevedra and Merida, holds the corresponding integrated environmental permit for the pursuit of its industrial activity and the generation of electricity from biomass.

In December 2016, the Group acquired Enel Green Power España's (Endesa) shareholdings in two separate biomass renewable power plants located in Enemasa (Ciudad Real) and La Loma (Jaén). This transaction increases Ence's energy business's installed capacity by 29% to 143 MW.

These plants prioritise the use of olive pomace (biomass derived from the processing of olives to extract their oil), which is very abundant in the vicinity of both facilities, as fuel. Between them, they have installed capacity of 32 MW and produced an estimated 175 million kWh in 2016 (stated at the Group's ownership interest).

Ence has implemented a total quality management (TQM) system in all its Operations Centres; by embedding the quality concept into all their processes, the latter are oriented towards managerial excellence. The TQM system is articulated around three cornerstones:

- 1) Managing improvement
- 2) Managing processes
- Managing everyday activities

This management model is based on a continuous improvement approach, oriented towards maximising efficiency and competitiveness by addressing matters related to quality, health and safety, environmental protection and pollution prevention as one. Against this backdrop, the Group has established targets with a clear environmental focus aimed specifically at:

- Reducing odour pollution
- Improving the quality of wastewater
- Boosting energy efficiency
- Reducing the consumption of raw materials
- Cutting waste generation

In addition, the Huelva, Navia and Pontevedra Operations Centres have an integrated management system which meets the following international standards:

- UNE-EN-ISO 9001 (quality management)
- UNE-EN-ISO 14001 (environmental management)
- OHSAS 18001 (workplace health and safety management)



This integrated system is certified by an accredited organism which audits it annually. The overriding goal of the system is to ensure that all of Ence's activities are carried out under the scope of the management policy set by senior management and the Group's defined strategic targets are met. The management system is articulated around processes that are identified and evaluated in order to facilitate control tasks and their continual improvement.

These three factories also participate in the Community eco-management and audit scheme (EMAS) governed by Regulation (EC) No. 1221/2009. Validation of the environmental statement enables continued participation by these facilities in this scheme, each of which was the first in their respective regions to assume this demanding voluntary commitment which only a limited number of companies uphold today.

The various environmental requirements are laid down in the corresponding integrated environmental permits which define the environmental criteria for operating an industrial facility. The goal is to prevent, or at least minimise, and control the impact each industrial facility's operations have on air, water and soll contamination with a view to protecting the environment as a whole.

Accordingly, the permit sets emission limits for each facility based on best available techniques as well as monitoring and control plans in respect of all significant environmental parameters.

However, Ence's environmental management strategy seeks to go beyond mere compliance with prevailing legislative. Ence wants to set an example with its environmental management and record. To this end, under the scope of the TQM model, it has developed the operating standards needed to optimally control and manage potential environmental fallout. Improved process control thanks to the Standardise-Do-Check-Act (SDCA) and Plan-Do-Check-Act (PDCA) cycles and improvements in the key process indicators (KPIs) are delivering results that evidence the effectiveness of this management model.

These achievements are the result of the commitment of all the people working at Ence and the Investment effort undertaken in recent years, underpinned by implementation of the best available techniques (BAT) and best environmental practices (BEP) defined in the sector BREF (Best Available Techniques Reference Document for the pulp and paper industry, 2014) approved by the European Parliament's ENVI Committee.

By way of example of what can be achieved with these environmental milestones, the pulp produced in Pontevedra and Navia carries the Nordic Swan seal. This is the official Scandinavian ecolabel, which was created in 1989 by the Nordic Council of Ministers with the aim of making a positive contribution to sustainable consumption. The goal of this ecolabel is to help consumers take purchasing decisions that respect environmental sustainability.

### **31.1 PULP BUSINESS**

### Navia Operations Centre

At the Navia factory, the project for upgrading and fine-tuning the facility's technology, initiated in 2015, forged ahead. This initiative encompasses technical improvements to a significant number of productive processes, delivering an aggregate increase in capacity of 40,000 ADt. Notably, during the last quarter of 2016 production reached 141,000 tonnes, up 8% year-on-year, with December standing out, with production approaching 50,000 tonnes that month.

During the second half of the year, work continued to reduce noise in the vicinity of the complex, having completed phase one of this project, which contemplated the assembly of mufflers and noise absorbers in noisy equipment and work on the new timber feeding line.

At the end of the second half, work finished on the project designed to reduce the Navia mill's odour impact, doubling the capacity for treating diluted odorous gases at the facility. When this new facility's operations reach

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cruising speed, odour with repercussions outdoors will be cut by 85%, underpinned by an exhaustive study of the complex's diffuse sources of odour.

As a result, odour emissions from channelled sources are down by 99.5% since the "Zero odour" programme was rolled out in 2011; work is currently focused on controlling the impact of emissions from diffuse sources.

The Company also worked on stabilise and fine-tune the operation of the new facilities built as part of the projects executed in the first half of the year, such as the new higher-capacity blow tank, designed to eliminate bottlenecks in the process, the technology switch introduced in the bleaching process, adding a Dual D sequence and increasing lignin extraction during the EPO sequence, and the installation of a new debarking and chipping line to add flexibility and capacity to the timber processing phase, increasing the availability of raw material at the complex and feeding more blomass into the bark furnace.

To reduce particles emissions from the blomass furnace, internal furnace elements were reconfigured to optimise the temperature in the gas circuit. Rectifiers were installed in the electro-filters to ensure their continuous availability. These initiatives combined to cut particle emissions by 44% from 2015, cementing compliance with the upper emissions threshold stipulated in Spanish Royal Decree 815/2013.

As for air pollution, the technical and operating improvements made to the recovery furnace drove an 18% year-on-year reduction in nitrogen oxide (NOx) emissions and a 40% year-on-year reduction in sulphur oxide ( $SO_2$ ) emissions in 2016.

As for liquid effluents, the biological plant has been delivering steady operating improvements and growing stability since commissioning, so that the performance indicators were stable year-on-year, implying a 77% improvement in wastewater chemical oxygen demand readings with respect to the old treatment system.

Environmental capital expenditure at the Navia factory totalled €2,400 thousand in 2016 (€859 thousand in 2015).

### Pontevedra Operations Centre

On 20 January 2016, Spain's Ministry of Agriculture, Food and the Environment agreed to extend the concession over the land on which its Pontevedra complex is located for an initial term of 50 years, with scope for extension by a further 10 years. The extension is contingent upon a series of investments in efficiency and environmental performance, including:

- Optimisation of the productive process
- Odour reduction
- Noise reduction
- Reduction in plumes
- Landscaping
- Improved environmental reliability
- Enhanced process efficiency
- Enhanced counter pressure turbine efficiency

Ence and the environment department of regional government of Galicia entered into an "Environmental Pact" on 28 June 2016 triggering the rollout of a five-year programme comprising environment-related investments and projects designed to contribute to economic development in Pontevedra and Galicia and boost the sustainability of the activities performed by Ence at its Pontevedra Operations Centre under the scope of its corporate social responsibility strategy.

The Pact is a legal concept provided for in Galician legislation and already used by Ence and the regional government in the past. Under such a pact, a company undertakes to bring its environmental management



beyond that stipulated in prevailing environmental legislation by pursuing best available techniques in this arena.

Under the pact, Ence has committed to:

- Introduce environmental upgrades at the Pontevedra industrial complex, specifically with the aim of reducing water consumption, improving energy efficiency, better integrating the factory into the landscape, reducing emissions and improving wastewater quality.
- Foster job creation by using regional forest resources.
- Create a a research centre focused on creating specialist jobs and help to refurbish a building to house this centre.
- Install a biomass-fuelled co-generation plant and three bioenergy centres.
- Negotiation of a collaboration agreement, which was ultimately signed on 28 July 2016, designed to enhance the living standards of all residents of Galicia, particularly those living in the Pontevedra Bay area, their safety and their development, the environment and the natural, community and economic surroundings and their sustainability. The following measures are envisaged to facilitate execution of the pact;
  - i. A commitment to contribute up to €15 million to any investments mandated to the regional government's department for the environment and planning and the regional public water body in relation to the expansion and modernisation of the urban waste treatment facility in the city of Pontevedra;
  - ii. A commitment to contribute up to €5 million to refurblshment of Pazo de Lourizán, an equivalent building or new build to house the research centre in the process of being set up and up to €1 million to construction of a football pitch in the vicinity of Lourizán;
  - iii. Creation of a framework agreement for application in tandem with Ence's corporate social responsibility policy with annual funding of up to €3 million for the following lines of initiative: forest sustainability, energy efficiency, renewable energy, environmental reliability, environmental quality, safety, sustainable development, social progress, equal opportunities, education and training, job training, talent and entrepreneurship, grassroots sports and sports facilities, research and science and community relations.

Effectiveness of these commitments and projects is contingent upon effectiveness and survival of Ence's concession rights in Pontevedra and the grant of the necessary permits and authorisations, which have already been applied for from the competent body of the regional government of Galicia and are accordingly in the midst of being processed.

Against this backdrop, an addendum to the Pact was signed on 16 January 2017 under which, exceptionally and with effect solely in 2017, Ence assumes, in proportion to the budget for the works and installations contemplated in the terms and conditions of the concession term extension that obtain the corresponding permits during the year, the commitments outlined in the "Framework agreement for the specific crystallisation in the area of Lourizán of Ence's corporate policy", which contemplates annual funding of up to €3 million.

The landscaping project has already been authorised and work is already underway.

"Zero odours" Is a priority goal for Ence in Pontevedra on which it is working tirelessly. To this end, and to improve the Pontevedra Operations Centre's environmental performance, Ence completed phase two of the Environmental Reliability Plan designed to prevent air emissions, focusing on the diluted and concentrated gas circuits.



In addition, the Improvements achieved thanks to the SDCA and PDCA cycles have driven a 29% drop in odour (measured in minutes) at channelled sources in 2016; this figures increases to 50% compared to 2015 in the case of minutes from diffuse sources.

This implies that the number of odorous episodes has declined by over 99% since the facility embarked on its odour elimination programme in 2010.

The wastewater discharge readings cement the Pontevedra Operations Centre's position as a sector benchmark in this respect. For example, chemical oxygen demand was 4.19kg/ADt, which is nearly 80% below the threshold recommended in the pulp and paper BREF paper. Elsewhere, the facility is also outperforming the BREF recommendations on suspended solids by 65 %.

As for all remissions, all readings are well below the limits stipulated in the integrated environmental permit. To improve this complex's environmental performance, management deployed Six Sigma improvement methodology setting Green Belt teams to work on reducing particle emissions and TRS levels in the recovery furnace. This effort translated in considerably lower emissions.

These figures mean that the Pontevedra Operations Centre is already compliant with the BREF benchmark ranges that will be mandatory from 2018.

However, Ence has set its sights on making the Pontevedra Operations Centre a global benchmark for Innovation. It is to this end it has rolled out a project called "New Water Cycle". This project, which is the first of its kind in the pulp industry, will entall the construction of a new wastewater treatment facility to complement the existing one which will reduce the amount of water taken from the Lérez River and the volume of wastewater discharged into the bay by up to 90%.

The Pontevedra Operations Centre has been selected to participate in a European Union project called "Strengthening the administrative capacity on the central and local level for the transposition and Implementation of the new Industrial Emission Directive 2010/75/EU", which is being spearheaded by the Austrian environment agency and the department of the environment of the regional government of Galicia. Against this backdrop, a delegation from the environmental protection ministry of the Republic of Macedonia visited the Centre with the aim of observing the progress made on the environmental management front in recent years which has positioned the Pontevedra factory at the industry forefront and made it a benchmark for its environmental performance.

The Galician regional administration's quality and environmental assessment division inspected the complex during the fourth quarter to verify the level of compliance with all the aspects contemplated in its integrated environmental permit, concluding once again that the facility is fully compliant with all matters and parameters analysed.

Lastly, true to its environmental pledge, the Pontevedra Operations Centre publishes daily environmental performance indicators on its website (<a href="www.encepontevedra.com">www.encepontevedra.com</a>) showing levels for the last 30 days; the reported figures are adapted for ready comparison with the parameters defined in the integrated environmental permit and the benchmark indicators used in the EU's pulp and paper sector BREF report.

Environmental capital expenditure at the Pontevedra factory totalled €5,210 thousand in 2016 (€2,214 thousand in 2015).

### **Forestry**

Over the course of 2016, Ence consolidated its position and role as the leading private forest manager and a key dealer in timber-based products in Spain. The corporate team of forestry experts is responsible for the technical and commercial management of this business. The proprietary forest management business involves the properties and tracts of forest operated under consortia and leased by its forest management subsidiaries. Meanwhile, the entire commercial side of the business - supplies and standing timber and biomass purchases is handled by the corporate supply chain management department. In both the proprietary and third-party segments, the management requirements are based on an integrated forest management system which is in



turn articulated around the benchmark sustainable forestry management and chain of custody standards: FSC® (Forest Stewardship Council) and PEFC® (Programme for the Endorsement of Forest Certification Schemes).

The environmental sustainability approach is complemented by the corporate social responsibility strategy targeted at the generation of earnings and jobs in rural areas, thereby contributing to regional development. The work performed to finance certification bodies, transfer know-how to forest owners and companies and disseminate information through regular meetings and bulletins makes a real contribution to the sector's development, all of which underpinned by the Group's environmental and social responsibility policies.

The biggest challenge lies with the development of stakeholder policies (owners, suppliers, sellers of standing timber, associations, etc.). Accordingly, the Group's specific environmental and social policies are transmitted to the company's stakeholders before work begins. This management approach is focused on ensuring forest asset longevity, minimising impacts, preserving structural and specific diversity, fostering multiple uses for goods and services, stimulating ongoing innovation, extending forestry in rural areas out of principle, actively engaging with stakeholders and promoting forest certification. These principles are applied across the board to all sources of supply (own assets, whether held for production or conservation, standing timber purchases and suppliers). The fruits of this policy are evident in the gradual increase in the percentages of incoming timber that is certified, which have risen from 42% and 6% at Navia and Pontevedra, respectively, in 2011 to levels of 80% and 92%, at year-end 2016.

In the proprietary forestry management segment, the optimisation of the acreage managed by Ence via the deployment of sustainable forest management criteria enabled the production of 178,021m³ of timber and 98,363 tonnes of biomass, implying an investment of close to €3.72 million in these assets as a whole, €1.86 million of which corresponding to the generation of income and royalties and €1.86 million to forestry care work. All of Ence's proprietary forestry management activity was audited during the first half of last year in accordance with the PEFC and FSC standards with satisfactory outcomes. As a result, Ence's management of its owned forests remains a benchmark not only in terms of technical management at the national level but also as a source of timber, for the large part with dual certification, making it an example of the effectiveness of the dual-certification policy Ence has advocated in the market; in fact, all of the certification bodies have adopted and implemented it.

Not only does Ence's forest management division produce timber, it is an active generator of income and of intangible environmental and social benefits. Against this backdrop, Ence wants to take its strategy to the next level with the rollout of carbon footprint and fair timber certification demonstrations: after the initial demonstrations given in 2016, this process will be completed during the first half of 2017.

On the technical management front, the following benchmark projects stand out:

- Development of the SAP IT system throughout the forestry business unit, following the Initial phases, Implementing new management and monitoring tools such as Business Warehouse (BW);
- Culmination of the environmental recovery project at the Rubín marsh in Cantabria, a project carried out in collaboration with FAPAS (the Astur Fund for the Protection of Wild Fauna) and the Banco Santander Foundation; the eucalyptus trees and other invasive species have already been cleared allowing the tide to flow into the area once again;
- The project for the recovery of forest tracts affected by fire, which consists of helping with the technical management of these sites, fostering the generation of new productive plantations framed by efficiency, profitability and adequate planting and management criteria;
- Geographic information system monitoring the sale of plants at nurseries to enable analysis of where enhanced plants are being introduced to in turn facilitate oversight of the distribution by region of the various species of eucalyptus, their production and management, etc.



- Creation of a cross-border group (Spain-Portugal) for the exchange of know-how and strategies for fighting the eucalyptus snout beetle; and
- The rollout of two bio-factories (in Huelva and Pontevedra) related with the Anaphes niten egg parasite to demonstrate to the sector the viability of integrated pest control efforts framed by efficiency criteria.

On the environmental management front, the biodiversity strategies are worth highlighting. To this end it has agreements with the University of Huelva for the inventorying and classification of the so-called 'forest land with high conservation value' and the areas of special importance for conservation and production purposes.

In addition to the management of its own forests, Ence takes a proactive stance towards third-party forests, articulating know-how transfer policies (the provision of training and support for producers and associations via forums, talks and financing formulae addressing issues such as forest care, plant selection, pest control, legal compliance and forestry certification) and policies for the promotion of standing timber and supplier purchases. Some 14 talks were given in 2016, up from nine in 2015.

Standing timber and supplier purchases constituted 93% of the 26 million m<sup>8</sup> of timber supplied to the Navia and Pontevedra factories in total in 2016. Approximately 1 million m<sup>8</sup> of this sum corresponded to standing timber bought directly from forest owners or through associations with their own harvests, and the rest to suppliers. It is company policy to reinforce purchasing of this nature in order to build a closer relationship with forest producers. It is worth highlighting the biomass purchasing activity, having supplied the factories with almost 1 million tonnes.

In 2016, Ence carried out the corresponding traceability audits in accordance with the FSC and PEFC regimes encompassing all of its business activities (the entire chain, from timber production through purchases and procurements to pulp sales). Ence's overall certification performance has improved considerably, with over 2.2 million tonnes of certified timber going through its factories. Even more noteworthy is the volume of timber with dual certification which accounted for 83% of incoming timber in Navia and 70% in Pontevedra.

Ence has been particularly active in applying the European timber regulation (EUTR), specifically the due diligence requirement with respect to the legal origin of timber and the Royal Decree transposing it into Spanish law. In its capacity as agent, it has submitted its first document attesting compliance with the the EUTR and decisively fostered sector engagement by giving briefing talks, distributing bulletins and providing sector companies with an e-mail inbox for resolving queries regarding legal compliance vis-a-vis the authorities. All of this has contributed to the fact that the sector, for the large part, has managed to comply with the new requirements.

On the forestry logistics fronts, the reorganisation of the logistics effort, coupled with market adjustments, enabled a reduction in the distance the timber consumed in the Pontevedra and Navia factories has to travel from source, declining from an average supply distance of 125km in Pontevedra in 2015 to 114km in 2016, and from 103km to 100km in Navia. As for the companies working on forest logistics tasks, the number of trucks was increased further to 253 in the northern region, continuing to making the fleet in use more flexible and diverse. On another front, the Company is analysing the possibility of testing the use of dual-fuel natural gas trucks to transport timber, which would make transportation more efficient and drive emissions lower.

Lastly, on the occupational safety front, Ence continued to give safety talks at the firms it subcontracts (bimonthly talks, refresher sessions at the start of works) and to its own staff (training courses at which attendance is mandatory).

### 31.2 ENERGY BUSINESS

**Huelva Operations Centre** 



At the Huelva facility, 2016 was marked by consolidation of the forest blomass-fuelled power generation business at the Hu-40 and Hu-50 plants.

All of this facility's wastewater readings, both the volume discharged into the Tinto River, and the main indicators tracking the quality of the effluents discharged, were consistently below the thresholds stipulated in the environmental permit and similar to those observed in 2015.

In relation to air pollution, a large-scale modification to the existing electro-filter in the biomass furnace at the Hu-40 plant was carried out during the annual stoppage, enabling, following its start-up, an 87% reduction in particle emissions, putting this reading was well below the level stipulated in prevailing legislation.

As for particles emanating from diffuse sources, a taskforce was set up in 2016 to focus on their reduction, leading to several initiatives, including a canvas cover for the reclaimer, the installation of sprinkler systems at critical points and fine-tuning of the equipment for capturing these particles. In addition, to enable adequate monitoring and control, a piece of equipment was installed that will measure overall total particles from diffuse sources.

Lastly, in relation to waste generation and management, the sand and ash from the biomass furnaces was used to make technical flooring, thereby consolidating this alternative for managing this waste pursued for the first time in 2015.

### Merida Operations Centre

After two years of operations at the Merida plant and having achieved the production objectives set, 2016 was a year of consolidation, fine-tuning and optimisation of the various systems, framed by the pursuit of continuous improvement.

The wastewater and air emissions readings have remained at all times within the limits established in the Integrated Environmental Permit.

The Guadiana Water Confederation revised some of the discharge limits stipulated in the permit, specifically nitrates and residual chlorine, as the limits initially set were very similar to those observed in the incoming water, leaving little or no room for operations adjustments.

As for noise emissions, the sources of noise across the plant have been mapped with the aim of working specifically and individually on those points to prevent breaches of the limits established in the permit.

An Environmental Monitoring Programme to Control Risks to Fauna was also carried out with the goal of ensuring that operation of the plant, and all of the activities that this entails, is being conducted in keeping with the environmental limits imposed in the environmental impact study and declaration with respect to birds and animals.

Lastly, on the waste management front, slag volumes increased slightly as a result of higher consumption of agricultural waste. Elsewhere, the plant continues to collaborate with other companies in the region on the LIFE ICIRBUS project, researching how to recover ash waste. This project is in phase two, which means that work on making the prototype that will test the promising results obtained in the lab in the field is underway.

### 32. Events after the reporting date

Ministerial Order ETU/130/2017, of 17 February 2017 updates the standard facility remuneration parameters applicable to certain electricity producing facilities that use co-generation, renewable energy sources or waste with effect for the regulatory stub period which began on 1 January 2017.





### **Appendices**

Statement of financial position at 31 December 2016 and 31 December 2015 and income statement and statement of cash flows for the years then ended for the PULP and ENERGY businesses



# CONSOLIDATED STATEMENT OF FINANCIAL POSITION BY BUSINESS AT 31 DECEMBER 2016 AND 2015

		Year-er	Year-end 2016			Year-er	Year-end 2015	
Thousands of euros	Pulp Business	Energy Business	Adjustments & Eliminations	CONSOLIDATED TOTAL	Pulp Business	Energy Business	Adjustments & Ellminations	CONSOLIDATED TOTAL
NON-CURRENT ASSETS:								
Intangible assets	15,204	2,735	540	17,939	12,573	40	,	12.613
Property, plant and equipment	451,359	234,940	40	686,299	457,716	184,214	*	641,930
Biological assets	79,038	4,373	٠	83,411	83,658	4,235	9	87,893
Non-current investments in group companies				*.				1
Equity instruments	198,599	•	(198,599)	*	170,544	ě	(170,544)	1
Loans to group companies	71,804		(71,805)	Ŷ.	63,310	27,445	(90,755)	
Other financial assets	5,640	5,994	O.	11,634	2,703	324	. ,	3.027
Deferred tax assets	57,174	11,283	(1)	68,456	61,104	9,727	4.	70,831
	878,818	259,326	(270,405)	867,739	851,608	225,985	(261,299)	816,294
CURRENT ASSETS:								
Non-current assets held for sale	6,487	396		6,883	48,143	2,195	· P	50,338
Inventories	35,363	8,244	1	43,607	34,473	5,742	ŗ	40,215
Trade and other receivables								
Trade receivables, third parties	73,597	4,625	7	78,222	70,161	42,352	Tig.	112,513
Trade receivables, related parties	9,721	22,797	(32,518)	1	27,092	7,335	(34,427)	£
Other receivables	1,943	56	*	1,999	9,393	83		9,456
Receivable from public authoritles	8,477	302	32	8,811	8,952	83	1	9,035
Income tax receivable from tax authorities	912	547		1.459	959	Ov.	Э.	959
Current financial assets:			é					
Derivatives			760	*	127	118		245
Other financial assets	9,575	ın	d.	9,580	8,695	u	.4	8,699
Cash and cash equivalents	112,098	97,766	4	209,864	93,895	65,670	*	159,565
Other current assets	3,485	88	18	3,570	614	(142)	¥	472
	261,558	134,823	(32,486)	363,995	302,504	123,420	(34,427)	391,497
TOTAL ASSETS	1,140,476	394,149	[302,891]	1,231,734	1,154,112	349.405	(295,726)	1207.791
בושמים ושונטן	O LLONGE OF THE PARTY OF THE PA	Chapteron	( management	1. 1. 1. 1. 1. 1. 1. 1. 1. 1. 1. 1. 1. 1	District Control	4040	3	



## CONSOLIDATED STATEMENT OF FINANCIAL POSITION BY BUSINESS AT 31 DECEMBER 2016 AND 2015

		Year-er	Year-end 2016					
Thousands of puros	0 200		Adjustments &	CONSOLIDATED		Year-end 2015	d 2015	
SO DO COMPANY	Fulb Business	Energy Business	Eliminations	TOTAL	Pulp Business	Energy Business	Adjustments & Fliminations	CONSOLIDATED
EQUITY:								1800
Equity attributable to owners of the parent Non-controlling interests	609,203	143,727	(198,599)	554,331	630,260	108,499	(170,539)	568,218
TOTAL EQUITY	609.203	150 051	(400 500)					
		TOCOCO TO	(120,033)	261,565	630,260	108,499	(170,539)	568,218
NON-CURRENT LIABILITIES:							٠	
Bonds and other marketable securities	243,631	V		243 631	977 576			
Bank borrowings	25,714	107,218	7	137 937	20000	, ,	-	243,108
Grank	8,454	1217		10000	ODDA	/25'STT	•	143,527
Derivative financial Instruments	3,992	7.756	F. (*	07017	11,206	48	Ÿ	11,254
Other financial liabilities	39,419	9		20,748	665	6,982	)	7,647
Deferred tax liabilities	17.308	3 204		25,419	189'9	£	¥	6,687
Non-current provisions	1 2 3	1036	•	70,512	20,304	256	4	20,560
None and the second for the second se	2,645	377	ř.	6,167	8,498	762		d Jr. o
Non-current porrowings from group companies	e4	71,800	(71,801)		27,439	52,723	100000	002,6
	344,364	191,517	(71,801)	464,080	347,907	184 798	(20,000)	
CURRENT LIABILITIES:							(30000)	442,043
Bank burrowings	6.713	13.763		20				
Derivative financial instruments	11.663	3078		20,4/0	2,763	12,050	78.2	14,813
Other financial liabilities	1.305		i	14/'47	2,999	2,924	*	5,923
Trade and other payables				1,305	1,356	Š.	•	1,356
Trade payables, third parties	132,552	21,617		154.169	370 076			71197788
Irade payables, related parties	22,800	9,722	(32,522)		2007	740,77	(395)	162,073
income tax payable	117	3	4	117	250	70,/65	(34,098)	•
Other payables to public authorities	7,133	3,495	72	10.655	7 28/1		2	57
Other current liabilities						4,710		7,002
Current provisions	4,626			4,626	6306	ים	(30)	1
	186,909	51,671	(32,491)	206,089	175,945	56,108	(34,523)	197,530
TOTAL EQUITY AND LIABILITIES	1.140.476	394.149	1203 0041	4 974 704				
			(Teerimon)	4,534,54	1,154,112	349,405	(295,724)	1,207,791

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## CONSOLIDATED INCOME STATEMENT BY BUSINESS FOR 2016 AND 2015

		2	2016			20	2015	
Thousands of euros	Pulp Business	Energy Business	Adjustments & Eliminations	Adjustments & CONSOLIDATED Eliminations TOTAL	Pulo Business	Energy Business	Adjustments & CONSOLIDATED SIminations TOTAL	CONSOLEDATED
Constant annual to the								
	025	200 10	14 2021					
DOI 1000	374,430	ton'cn	7674	505,448	269,771	97,006	(2,865)	663,912
Gain/lloss] on hedging transactions	(224)	1,195	£.,	971	(874)	(756)		(1,630)
and the second of the second o	1,107		i <b>e</b>	1,107	4.800	-		4,800
Change in the choice of this side goods and work in progress								
Cost of sales	(243,756)	(29,280)	4,785	(268,251)	(251,570)	(23,371)	1,957	(272,984)
GROSS PROFIT	271,383	62,899	[2]	339,275	322,127	72,879	(808)	394,098
Own work capitalised	5,602	939	٠	6.541	5.403	A 122		0
Other operating Income	17,586	1,168	(13,542)	5.212	19.814	E E	12 64.61	1007
Grants taken to income	2,336	6		2676	909	ī	DTQ()	ceeee
Employee benefits expense	(64,293)	(4,135)		168.4781	(62 526)			2,505
Depreciation and amortisation charges	(56,739)	(12,989)		(80 728)	(00000)	10000		(075,250)
Depletion of forest reserve	(5.976)	11 1751		(7.154)	(100,00)	(poers)		(088/84)
Impairment of and sains/(losses) on disposals of intaneible assets and PP&F	20.198	3 836		750 92	(705'5)	(2,865)	265	(8,182)
Other operating expenses	(197 197)	(25 910)	12 540	TON'T OFFI	2000	5557	/4/	8,612
	10000	(CTO'CC)	Short	(129,401)	173,431)	(41,938)	7,455	(157,914)
OPERALING PROFIT/(LOSS)	22,900	19,823	-	72,723	107,663	25,829	(257)	133,235
Finance Income:								
From interests in equity instruments in group companies	×	9	>	•	1			
From marketable securities & other financial Instruments:				C TO	ŕ			
Related narries	2 452	200	100201				1	j
The lead manufactured	2000	707	(4,010)		4,617	4,320	(8,937)	
	//7	303	ľ	582	341	m)		344
The state of the s	T. C.			0-1				
Related-party borrowings	(202)	(2,468)	2,670		(4,320)	(4,518)	8,938	•
Third-party borrowings	(16,834)	(3,530)		(20,364)	(44,507)	(9,414)		(53,921)
Change in fair value of financial instruments	(100)	í.	6	(100)	(2,858)	(11,122)		(13,990)
Exchange differences	(1,AS2)	ıρ	é	[1,446]	1,379	(6)		1370
Impairment of and gains/(losses) on disposal of financial assets		ŝ		10 M	3,434		(3,434)	
NET FINANCE COST	(15,943)	(5.532)	•	(21,625)	(41,924)	(20,840)	(3,433)	(66,197)
9			1					
PROFIT/(LOSS) BEFORE TAX	36,957	14,141		51,098	65,739	4,989	(3,690)	67,038
Іпсоте тах	(8,729)	(3,658)		(12,387)	(16,361)	(611)	(211)	[17,183]
PROFIT/(LOSS) FOR THE YEAR FROM CONTINUING OPERATIONS	28,228	10,483		38,711	49,378	4,378	(3,901)	49,855
PROFIT/(LOSS) FOR THE YEAR	28.228	10,483	ė	38.711	46 278	07.E.N	12000	110.00
				444	0.000	0704	TORYC	45,855

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### CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN CASH FLOW BY BUSINESS FOR 2016 AND 2015

		-	2016				2015	
Thousands of euros	Pulp Business	Energy Business	Adjustments & Eliminations	CONSOLIDATED TOTAL	Pulp Business	Energy Business	Adjustments & Eliminations	CONSOLIDATE TOTAL
CASH FLOWS FROM OPERATING ACTIVITIES:								
Consolidated profit/(loss) for the period pefore tex	36,957	14,141		51,098	55,738	4,993	(3,693)	67,038
Adjustments for:							7.0	
Depreciation and amorbiation	64,801	12,083		76,881	56,262	11,165	(265)	67,162
Charges in provisions and other deferred expense (net)	3,031	2,711		5,742	9,059	(6,266)	a	2,793
impairment of and gains/liosses; on disposals of intergible assets and	(20,190)	(3,836)		(24,026)	(12,140)	18281	3,958	(8,990)
Finance income	de nest	/ 1				044.4840		99000 TENES
Financecosts	17,223	5,999	1,385 (1,985)	-' ''(286) ' 21,837	(4,617) 50,349	(4,322)	8,595	(344)
Grants taken to income	(1,602)	(99)	(A)JuJj	(1,701)	(1,982)	25,150	(8,595)	66,914 (1,982)
- 4	61,902	16,545		78,447	96,931	24,929	3,693	125,553
Changes in working capital:		C.ITA C.						The state of the s
Inventories	(1,386)	2,193		807	(2,883)	(1,212)		(4,095)
Trade and other receivables	16,474	20,582		97,056	(15,233)	(6,837)		(22,070)
Sher >term investments	(881)	0		(881)	(164)	Q		(164)
Tranopayebles, other payables and other Habilipes	(15,003)	3,567		(11.43E)	(10,770)	1,558		(9.212)
	(796)	26,342		25,546	(29,050)	(6,491)		(35,541)
Other cash flows from operating activities:								
-interest paid	(14,667)	(8,911)	1,385	(22,193)	(44,332)	(11,780)	8,595	(47,517)
- Interest received	1,960	310	(1,385)	285	4,517	4,322	(8,595)	344
- Income tex received (azīd) - Other receiots / (payments)	(7,247)	(1,065)	K	(8,313)	(7,803)	8,547		744
- onie secure i fostuscat	(22,618)	(9,667)		(2,064)	(47,518)	1,029		440 400)
				(32,285)				(46,429)
Net cash from operating activities (I)	75,445	47,361		122,806	86,101	24,520		110,621
CASH FLOWS FROM INVESTING ACTIVITIES:								
nvestments								
Property, plant and equipment and biological assets	(57,971)	(5,804)	2,736	(61,039)	(48,970)	(5,004)		(53,974)
ntengible assets	(6,423)	(31)		(6,454)	(4,932)	(260)		(5,192)
Other financial assets	(3,295)	(26,799)		(30,095)	(71)			(71)
**UUUUU **	(67,690)	(32,634)	2,736	(97,588)	(53,973)	(5,254)		(59,237)
Proceeds: Property, plant and equipment and biological assets		(27		2127				٥
Ther assets	38,592 2.827	c	(2.720)	98,592 91	32,266 C	٥		32,266
	41,415	0	(2,736)	38,683	32,266	0		32,266
let cash used in investing activities (ii)	(26,271)	(32,634)	d.	(58,905)	(21,707)	(5,264)		(25,971)
ASH FLOWS FROM FINANCING ACTIVITIES:				100000	1001011	(o)au-i)		(20,312)
voceeds from and payments for equity instruments								
Buyback of own equity instruments	(39,387)	0		(39,387)	(98,593)	95,500		(1,093)
Disposal of own equity instruments	30,340	0		30,340	5,023	0		5,023
	(9,047)	0		(9,047)	(91,570)	95,500		3,930
roceeds from and repayments of financial (labilities:								
Group companies and associates	(20,744)	20,744		*	65,432	(65,402)		
Proceeds from Issuance of bonds and other marketable securities, net of	(369)	0		(369)	(7,032)	0		(7,032)
isuance costs Increase/(decrease) in bank borrowings, net of Issuance costs	32,916	(5,094)		27,222	27,759			
	52,324	(3,034)		27,222	27,739	16,880		44,639
Repayment of other barrowings and cancellet on of derivatives	40.00				(4,464)	(889)		(5,293)
Grants received	[416]			(416)	2,011	0		2,011
	10,787	15,650		26,437	83,736	(49,411)	<del></del>	34,925
ividends and payments on other equity instruments								
lvidends	(32,711)	5	ar and leaves	(32,711)	(95,840)		165	(35,840)
	(32,711)	9.		(32,711)	(35,840)	40		(35,840)
ranslation differences					72	£		72
at cash used in/from financing activities (III)	(30,571)	15,650		(15,321)	(49,602)	45,089		2,487
ET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS (HIHIB)	18,203							
		30,377		48,580	20,792	65,845		86,197
ash and cash equivalents, opening balance	93,895	65,670		159,569	78,108	323		73,428
ash obtained as a result of a business combination ash and cash equivalents, closing balance	112,098	1,719 97,766		1,719	03.655			
TO BE A TO SHE I STATE OF SHEET	114,020	3/1/00		209,864	93,895	65,670		159,565



### ENCE Energía y Celulosa, S.A. and subsidiaries

### Group Management Report for the year ended 31 December 2016

### Organisational structure

Except for matters reserved for approval by the shareholders in general meeting, the Board of Directors is the highest decision-making body of ENCE Energía y Celulosa, S.A. (the "Company"). The Board's policy is to delegate the management of the Company in its executive team and to concentrate its activities on its general supervisory role, without prejudice to the duties that cannot be so delegated, such as approval of the Company's general strategies, investing and financing policies and the remuneration policy applicable to the directors and most senior officers. The Board's actions are guided at all times by the criteria of maximising the value of the Company in the interest of its shareholders.

The Board of Directors is entitled to delegate duties falling under its purview in committees made up of directors and/or chief executive officer(s), albeit exercising due oversight over these bodies and setting the guidelines under which they should operate.

The Board of Directors is made up of executive, proprietary, external and independent directors, in line with corporate governance regulations and best practices. The Board has a non-executive Chairman and a Vice-Chairman. The vice-chairmanship is currently held by the CEO. The current Secretary of the Board of Directors is not a director.

The Board is currently supported by an Executive Committee (in which it has delegated all of the powers that can be delegated) and three advisory committees tasked with providing it with information, advice and proposals on the matters falling under their respective remits: the Audit Committee, the Appointments and Remuneration Committee and the Forest Policy and Regulatory Advisory Committee.

The Vice-Chairman and Chief Executive Officer (CEO) is responsible for the Company's everyday management. He is supported in this work by the Management Committee, which comprises the Company's senior management, specifically the heads of the various business units and corporate departments: the Pulp Energy Operations Officer, the Director of New Power Plants and Forest Assets, the Director of Supply Chain Operations, the Finance and Corporate Development Officer, the Corporate Resources Officer and the Communication and Institutional Relations Officer. Given the growing momentum and importance of the Independent power generation business, on 21 December 2016, the Board of Directors decided to bring the Energy Operations Officer onto the Executive Committee. These officers report directly to the Company's CEO, who sets the guiding lines of initiative within each officer's area of responsibility.

In addition, Ence has an Internal Audit Department which reports directly to the Audit Committee.

The Company is the parent of a group of companies (the "Group"), whose management is fully integrated and centralised within the former, as the scope of the specific duties assigned to the Company's executive team extends to all the Group companies. In this respect, the Company singly manages all of the companies within its Group.



### **Business activity**

Ence has articulated its activities around two core businesses: the production of pulp, which represented 76% of Group EBITDA in 2016, and the generation of energy from renewable sources at standalone power plants, which accounted for the remaining 24%.

Ence has two eucalyptus pulp mills in Spain: a 605,000-tonne-capacity facility in the town of Navia, Asturias, and a 465,000-tonne-capacity complex in Pontevedra, Galicia.

As an integral part of its pulp production process, Ence uses the lignin and forest waste derived from its manufacturing to generate the energy needed for the process. To this end, it operates a 34.6-MW CHP plant, integrated within the Pontevedra mill, and a 40.3-MW CHP plant and a 36.7-MW biomass generation plant, both of which are integrated within the pulp production process at the Navia facility. The energy produced at these power plants is sold to the grid and subsequently repurchased.

The pulp business therefore includes both the production and sale of pulp and the generation and cogeneration of energy at the plants involved in the productive process, as well as the supply of timber from the plantations managed by the company.

The energy business, meanwhile, encompasses the generation of power from renewable sources - forestry and agricultural biomass - at plants that have no relation to the pulp production process. Ence currently has five such power plants: two in Huelva, with installed capacity of 50 MW and 41 MW, respectively, one in Merida (20 MW), one in Ciudad Real (16 MW) and one in Jaen (16 MW).

These assets position Ence as one of Europe's largest short-fibre pulp (BHKP) producers, with installed capacity of 1,070,000 tonnes between the two mills in Galicia and Asturias, and as the biggest generator of biomass-fuelled renewable energy, with installed capacity of 112 MW integrated within the pulp plants and another 143 MW distributed between five standalone plants located in Andalusia, Extremadura and Castile la Mancha. Moreover, Ence is Spanish leader in the end-to-end and responsible management of forest land and crops.

Pulp is the basic raw material used to manufacture the various kinds of paper that form part of our everyday lives. More specifically, Ence makes pulp from cultivated eucalyptus timber acquired in Galicia and along the Cantabria coast.

The eucalyptus is a natural, renewable and indigenous resource. It grows abundantly in the north of Spain but is scarce in most of the world as it only grows in very specific climate conditions, normally warm subtropical regions.

In addition, eucalyptus timber is very valuable because it provides the best quality pulp for the manufacture of tissue paper, i.e. sanitary paper products, such as kitchen paper, facial tissues, paper napkins, toilet paper, etc.

The tissue paper segment is the main end use given to the pulp sold by Ence, accounting for 59% of the total sales volume in 2016, followed by the specialty paper segment, at 31%. The tissue paper segment has been one of the fastest-growing paper segments in recent years and is expected to continue to gain weight in the Company's sales mix relative to slower-growing segments such as printing and writing papers.

Global demand for eucalyptus pulp rose at a compound annual rate of 7.6% between 2006 and 2016, driven by growth in global demand for tissue paper, in turn shaped by rapid growth in urban living and enhanced standards of living in emerging markets such as China.



Most of the pulp produced by Ence is sold in Europe, namely 96% of total sales volumes in 2016, thanks to an advanced and efficient logistics system.

Europe is the world's number-two pulp market, with annual demand for short-fibre pulp of close to 9 million tonnes, of which over 6 million tonnes are imported, mainly from Latin America due to the scarcity of eucalyptus trees in Europe.

Ence's key competitive advantages relative to other Latin American producers include the strategic location of its factories in northern Spain and its ability to produce customer-tailored pulp. The location of the Group's mills means it can service its customers in just five to seven days, compared to over 40 days when ordering pulp from Latin America; in parallel this proximity enables it to reduce logistics and transportation costs and carry lower inventory volumes.

In addition, Ence has a broad and penetrating sales reach in Europe, servicing over 100 customers. In fact, Ence commands a leading position in Germany, Spain, Italy, Poland and France, markets which accounted for 23%, 18%, 13%, 8% and 7% of the Group's revenue from pulp sales in 2016, respectively.

Elsewhere, the rapid growth in city populations poses a challenge for the supply of energy from renewable sources.

Against this backdrop, there is clear potential for the development of capacity for the generation of power using biomass. In fact, blomass is the only renewable source which presents a positive economic balance thanks to its far-reaching benefits, including job creation, the development of rural areas and environmental contributions both via carbon capture and the implicated process of caring for and cleaning the woods, which reduces the risk of fires by up to 70%. It is moreover the most stable and only manageable source of renewable energy as it does not depend on unpredictable variables such as the sun or wind.

At Ence, we have developed proprietary know-how for the management of forestry and agricultural resources and for the operation of power generation plants that has demonstrated its economic, environmental and technical benefits for the Spanish electricity system. Not only are we working to consolidate our leadership position in Spain, but we are also looking to export this model to other markets.

In November 2015, Ence unveiled its 2016-2020 business plan which aims at virtually doubling EBITDA and making it more recurring by investing €662 million.

Almost half of this investment, €337 million, will be earmarked to the pulp business with the overriding goal of continuing to make production at the Navia and Pontevedra mills more efficient and remain among the most competitive producers in Europe, bringing cash costs under €330/tonne by 2020.

In addition, the Business Plan contemplates an 18% increase in production to 1,110,000 tonnes by 2020 via the elimination of bottlenecks and the introduction of productivity enhancements at the existing mills.

Between 2015 and 2016, the Group invested €75 million to expand installed capacity in Navia by 40,000 tonnes and to upgrade factory efficiency and environmental excellence, all of which translated into a considerable reduction in cash costs to €341 per tonne by the last quarter of 2016.

The remaining €325 million of capital expenditure is earmarked to development of the biomass-based renewable energy business, with the aim of boosting EBITDA to €78 million by 2020.

An initial €22m was Invested in 2016 to acquired shareholdings of 68.4% and 64.1% in two biomass power plants located in Ciudad Real and Jaen, respectively, each with installed capacity of 16 MW.



Execution of this capital expenditure programme is compatible with maintenance of a conservative financial profile, i.e., keeping leverage below 2.5x in the pulp business and 5x in the energy business.

# **Business performance and financial results**

#### **Business environment and outlook**

Global growth continued to slow throughout 2016 and continues to be propped up by intervention by the main central banks. In its report analysing the outlook for global growth dated January 2017, the IMF was estimating global growth of 3.1% in 2016 compared to 3.2% in 2015.

However, this performance masked a turnaround in the second half, marked by the recovery in commodity prices, the replacement of expansionary monetary policies with fiscal stimuli and rising expectations for both growth and inflation. The IMF is estimating global growth of 3.4% and 3.6% in 2017 and 2018, respectively.

The fear of a hard landing in China, which is in the midst of transitioning towards a consumption-based economy following a decade of sharp growth in credit and investment, triggered a sharp correction in the prices of risk assets and commodities at the start of the year. However, the stimulus measures taken by the Chinese government reduced the risk of a hard landing and the Chinese economy registered growth of 6.7% in 2016, compared to 6.9% in 2015. The IMF is forecasting growth of 6.5% in 2017 and 6.0% in China in 2018.

The recovery in commodity prices over the course of the year has translated into brighter prospects for growth and exchange rates in other commodity-dependent emerging markets such as Russia and Brazil. The IMF is forecasting growth of 1.1% in Russia and 0.2% in Brazil in 2017, compared to contractions of 0.6% and 3.5% in 2016, respectively.

The recovery in commodity prices received a boost towards the end of the year when the OPEC announced, in November, restrictions on global oil production; other non-OPEC producers have since joined the quota scheme.

In parallel, the economic recovery in the main developed economies continued to gain traction in 2016. This, coupled with the recovery in commodity prices and uptick in inflation expectations, points to the gradual rollback of the quantitative easing measures deployed by the world's main central banks in recent years.

In the US, GDP growth was 1.6% in 2016, with the labour market ending the year at close to full employment (unemployment rate: 4.7%) and inflation ticking up to 2.1% in December. Donald Trump's unexpected victory in November has helped fuel expectations for higher public investment, growth and inflation. The IMF is forecasting growth in the US of 2.3% and 2.5% in 2017 and 2018, respectively. Against this backdrop, at its December 2016 meeting, the Fed announced its second 25 basis point rate hike since 2006, putting benchmark rates in a range of 0.5% - 0.75%. Analysts are expecting another three 25bp increases over the course of 2017.

Economic recovery also gained momentum in the eurozone in 2016, coming in at 1.7%, while inflation (which had remained subdued all year) surprised market observers by jumping to 1.1% in December. Faced with these developments, the ECB announced it was extending its asset purchase programme until the end of 2017, albeit paring its monthly purchase volumes back by €20 billion. The spike in Inflation has increased the likelihood of further reductions in buyback volumes mid 2017.

Elsewhere, the political agenda is set to remain at the forefront in 2017 marked by the start of Brexit negotiations and general elections in Netherlands, France and Germany. The IMF is forecasting growth 1.6% in each of 2017 and 2018 in the eurozone.



These factors combined to fuel a recovery in the global financial markets and in sovereign bond yields in the second half of the year, whereas the decoupling of monetary policy in Europe versus the US kept the exchange rate at €/\$1.11 on average in 2016.

Demand for eucalyptus pulp is directly correlated to consumption of tissue paper in its various everyday uses. In turn, demand for tissue paper is directly related with rapid urban growth and improving living standards in emerging markets, as well as shifting citizen habits in developed economies.

Demand for eucalyptus pulp accordingly remained strong in 2016, up 7.7% from 2015, which is equivalent to 1.7 million tonnes. Growth was spearheaded by China, where demand surged 23.8%.

Despite demand strength, the average price of the short-fibre pulp produced by Ence corrected by 11% in 2016 to \$697 per tonnes in Europe.

In addition to the widespread correction in commodity prices sustained during the first half of the year, shortfibre prices were hurt by the trend in the spread with the price of its natural substitute, long-fibre pulp, and expectations for new capacity as a result of a new APP mill in Indonesia.

However, the spread between short- and long-fibre prices, which had been at lows of close to \$10 per tonne in January, widened to \$156 per tonne by the end of the year, which is above the trailing 10-year average of \$90; this should fuel stronger demand for short-fibre pulp in the months to come driven by substitution dynamics.

Meanwhile, the delay in the start-up of APP's new mill in Indonesia and a reduction in its production target for 2017 to 1.2 million tonnes, down from 2 million, translated into a swift recovery in short-fibre prices in China from September. Price strength is also being felt in Europe in early 2017.

Against this backdrop, in early 2017, Ence secured forward pulp sales agreements covering 975,100 tonnes, which is equivalent to up to 100% of its targeted output for the year. It has also announced to its customers that it will increase the price of its pulp to \$740/tonne from March.

#### **Pulp Business**

In 2016, the Company sold 4.3% more tonnes of pulp than in 2015, in line with the growth in pulp production in the wake of two successive 20,000-tonne capacity expansions at the Navia mill carried out during the maintenance stoppages of June 2015 and June 2016.

The growth in sales volumes in 2016 partially offset the drop in average sales prices with respect to 2015, as a result of which revenue from pulp sales declined by 11.2% to €428.8 million.

As is customary, the Pontevedra mill was stopped for maintenance for 12 days in March and the Navia mill was halted for 13 days in June; the latter maintenance stoppage was accompanied by a longer stoppage at the CHP plants for maintenance work that is carried out every five years.

The stoppage at Navia in June was used to finalise the programmed efficiency measures and 40,000-tonne capacity expansion work; these measures, contemplated in the Business Plan, were designed to translate into a lower cash cost at this complex, as was already clearly tangible in the second half of the year. Following these investments, annual capacity at the Navia complex stands at 605,000 tonnes.



The cash cost amounted to €356.7/tonne in 2016, down €2.60/tonne from 2015, despite the impact of the breakdown of the turbine rotor at the Pontevedra CHP plant during the first quarter, which rendered it Idle for over a month and was fixed during the March maintenance stoppage. As a result, the 1Q16 cash cost rose to €375.4/tonne, going on to decline to €362.7/tonne in the second quarter, €351.0/tonne in the third quarter and €340.9/tonne in the last quarter.

The fourth-quarter cash cost was €10.1/tonne lower quarter-over-quarter and €13.9/tonne lower year-over-year thanks to the successive efficiency investments and capacity expansion work carried out at the Navia mill which have translated into considerably lower transformation costs, as well as generating economies of scale. In addition, timber consumption costs at this facility were lower in comparison to 4Q15.

EBITDA, adjusted for non-recurring items in 2016, totalled €104 million in 2016, down 38.7% year-over-year, due mainly to the decline in average pulp sales prices, partially mitigated by growth of 4.3% in sales volumes.

The 26.5% quarter-over-quarter Improvement in adjusted EBITDA in the fourth quarter stands out: this performance was shaped by the aforementioned reduction in the cash cost, coupled with the recognition that quarter of the difference between the pool price estimated by the regulator and the actual pool price observed in 2016, which had the effect of boosting adjusted EBITDA by €3.6 million.

Recurring cash flow generation totalled €61.5 million in 2016; this figure is arrived at by subtracting from adjusted EBITDA the change in working capital (€0.8 million), maintenance capital expenditure (€21.1 million), interest payments (€13.3 million) and tax payments (€7.2 million).

Investments in efficiency and expansion work totalled €35.8 million in 2016, mainly related to the successive efficiency improvements and the 40,000-tonne capacity expansion carried out at Navia.

This heading also includes €7.5 million earmarked to improving environmental excellence, primarily at the Pontevedra factory, as well as financial investments of €3.3m, corresponding to the difference between the pool price estimated by the regulator and the actual pool price observed between 2014 and 2016 which will be collected over the facilities' remaining useful lives for regulatory remuneration purposes, capitalised at 7.4%.

Elsewhere, in 2016, the Group concluded the orderly sale of the forest land owned in Huelva, a process embarked on at the end of 2014 after pulp production at that complex was discontinued, collecting €37.5 million from the sale of 1,736 hectares.

Disposal proceeds also included €1.2 million from the sale of other assets and another €2.7 million corresponding to the internal transfer during the fourth quarter of certain industrial assets to the Energy business.

As a result, after factoring in non-recurring payments totalling €10.5 million, the Pulp business generated free cash flow of €50 million.

Net debt in this business increased by €13.8 million from year-end 2015 to €195.1 million: this figure is arrived at by deducting from the €50 million of free cash flow the distribution of the final dividend from 2015 profits (€24.9 million), execution of the share buyback programme (€8.6 million) and payment of the interim dividend from 2016 profits (€7.8 million).

In addition, movements between the Pulp and Energy businesses, related mainly to the segregation exercise carried out in the last quarter of 2015, had the effect of increasing the pulp unit's net debt by €20.7 million.

The gross debt of €316.8 million at the December close corresponds mainly to the €250 million corporate bonds due 2022, two separate €15-million bilateral loans due in 2019 and 2020 taken on to finance the

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



capacity expansion work undertaken in Navia, and a series of loans totalling nearly €40 million awarded by the CDTI (acronym in Spanish for the Centre for the Development of Industrial Technology) and Spanish Ministry of Industry to finance investments in efficiency upgrades and capacity expansion work; these loans fall due between 2021 and 2026.

At 31 December 2016, the Company had cash and cash equivalents of €121.7 million in addition to an undrawn €90-million credit facility.

# **Energy Business**

In 2016, pool prices in mainland Spain averaged €39.8/MWh, down 20.9% from 2015. This in turn primarily reflects the 41.6% increase in generation at hydro power plants to the detriment of coal and gas-fired stations during the first half of the year. This situation partially reverted during the second half, favouring a recovery in pool prices.

During the fourth quarter, pool prices averaged €56.5/MWh, up 35.3% quarter-over-quarter and up 10.3% year-on-year.

In light of the low pool prices prevailing during the first half of the year and the annual limit on operating hours of 6,500 hours for regulatory remuneration purposes, in the first half of the year, Ence decided to pare back generation at its biomass power plants from a quarterly average of 1,289 hours in 1H15 to a quarterly average of 1,084 hours.

However, during the second half of the year, the power plants operated at a quarterly average of 1,809 hours so that generation volumes rose 64% from first-half levels. In addition, the recovery in pool prices enabled output 19,080 MWh above the 6,500-hour threshold in the fourth quarter.

For the year as a whole, output was 1% lower than in 2015, partially mitigating the 7.1% drop in average sales prices on the back of lower pool prices.

Elsewhere, the difference between the pool price estimated by the regulator and the actual pool price observed in 2016 was partially offset by a €3.9-million increase in remuneration for investment in the fourth quarter, countering the adverse impact (€1.8 million) of the classification of the Huelva 41-MW plant as a hybrid plant (85%-biomass; 15%-lignin) in the second quarter.

In all, revenue in the Energy business narrowed just 1.1% in 2016 to €96 million. Adjusted EBITDA in this business, meanwhile, amounted to €34 million, up 9% from 2015, thanks to the progress made on diversifying biomass supply sources.

The amount of agricultural biomass used last year averaged 40% of the total, compared to 14% in 2015, which drove margin expansion despite lower pool prices and the reduction in the remuneration for investment accruing to the Huelva 41-MW plant.

Recurring cash flow generation totalled €44.8 million in 2016; this figure is arrived at by adding the reduced working capital requirement (€26.3 million) back to adjusted EBITDA and then subtracting maintenance capital expenditure (€5.9 million), interest payments (€8.6 million) and tax payments (€1.1 million).

The €26.3 million reduction in the working capital requirement stands out and was shaped by the collection of €28.8 million due from the electricity system in connection with the reclassification of the 41-MW Huelva plant in the second quarter.



Growth capital expenditure amounted to €22 million in 2016, reflecting the aforementioned acquisition in December of shareholdings of 68.4% and 64.1% in two biomass power plants located in Ciudad Real and Jaen, respectively, each with installed capacity of 16 MW.

The net cash outflow in respect of non-recurring items amounted to €7.6 million, related primarily to (i) the difference between the pool price estimated by the regulator and the actual pool price observed between 2014 - 2016, which will be collected over the plants' remaining regulatory useful lives, capitalised at 7.4%; and (ii) the restatement of the revenue recognised for the Huelva 41-MW plant between 2013 and 2015 following its reclassification.

The €121 million of gross debt at year-end corresponds mainly to the outstanding balance on the project finance facility arranged to fund construction of the Huelva 50-MW and Merida 20-MW plants (€106 million) and two €7.5-million loans taken out to finance the acquisition last December of two separate 16-MW blomass plants for €22.5 million in total.

Cash in this business stood at €98 million at year-end.

#### **Environmental disclosures**

The most important matters of an environmental nature – the environmental protection goals, the policy that defines the Group's environmental management strategy, the resources at its disposition for delivering these objectives, the environmental management systems and how they work and the regulatory framework governing these policies – are detailed in note 31 to the accompanying annual financial statements.

# **Human resources**

# Recruitment

The hiring process is a priority component of the Group's human resources management and the criteria underpinning its recruiting process are divided into different phases. The first phase is to define the job description and the essential requirements for the position. Later, during the job interview, mutual commitments are established in keeping with the Company's values. During the subsequent hiring phase, specifically through the induction training programme, the new hires learn about the organisation and its values and principles, as well as receiving initial job training. The final stage of the selection process entails on-the-job monitoring. Job performance and team/company commitment and engagement are assessed by means of follow-up interviews.

The merit-based hiring process is based on objective criteria such as the acquisition of technical and management skills and alignment with Ence's values.

In 2016, the Group went to lengths to reinforce staff expertise at the Navia and Pontevedra operations centres, hiring highly-qualified professionals with experience in the sector with the overriding goal of aligning employees with the ongoing efforts to boost competitiveness and cost efficiency and prepare to tackle looming challenges. The result was seven new hires in Pontevedra, another seven in Navia and four new hires in the corporate Sales, Continuous Improvement and Pulp R&D Departments.

Also in 2016, an average of 55 new graduates participated in Ence's Talent Programme, a workplace initiative, carrying out work practice in different areas of the firm, including the Madrid offices (the corporate Finance, Sales, Communication, Internal Audit Departments, etc.) and the Operations Centres, where they assisted with the operational side of the pulp, energy and forestry activities as well as these centres' corporate services tasks.



# Workplace climate/motivation

For management it is important to know what Ence's employees think and understand their level of satisfaction at the Company in order to design new initiatives and adapt them to their expectations and needs.

To this end, on 19 December 2016, the Company set in motion its workplace climate survey with the CEO sending the entire workforce a memorandum outlining the content, objectives and timing of the project.

The survey was launched on 9 January 2017 and the results will be published in February.

One of the cornerstones of Ence's management model is its people. This is why it is important to measure their level of engagement by assessing their level of participation in the improvement initiatives underway at the Company. It is similarly important to formally thank them for this extra effort.

One of the priorities of the Strategic HR Plan is to recognise the work done by Ence's professionals. The Company accordingly seeks to acknowledge their achievements, results and value-based conduct by means of:

- Employee of the week
- Publication of an employee newsletter
- Prize ceremony in the presence of executives
- TQM prize events
- Annual prize for the best embodiment of Ence's values
- Annual prizes for standard-setters

# Health and safety

Employee safety and health in the workplace is one of Ence's strategic human resource management priorities. The goal is to foster cultural change that results in safer operations and processes.

This cultural change is based on the following principles:

- Integration of workplace safety into daily activities and all operations under the slogan, "safety is the top priority"
- Leading by example and the palpable commitment of management
- Systematic evaluation of safety-related risks and behaviours as the first step in preventing accidents

  Registration and analysis of all workplace accidents and incidents, learning lessons and providing resources for preventing recurrence.
- Correction of all unsafe actions taking a "zero tolerance" approach
- Investment in ongoing employee safety training programmes
- Selection of safety-certified suppliers and subcontractors combined with monitoring of ongoing compliance with Ence's safety rules
- Devotion of time to safety, taking the approach that safety is the responsibility of each and every employee and cannot be shirked
- Incorporation of safety and ergonomics principles at the drawing board phase



- Provision of the resources and means for eliminating sources of risk
- Rollout of safety tools at all levels of the organisation

A preventative culture entails individual and collective attitudes and skills and behaviour patterns that affect and influence workplace health safety and, therefore, drive prevention. The Group has a series of Workplace Safety Observations that help ensure consistent safety attitudes and behaviours by identifying safe and unsafe practices, correcting the latter and communicating them firm-wide. There are also Standard Operating Procedures that establish how to correctly perform tasks and prevent mistakes or unsafe practices. Workplace safety inspections and audits are also carried out regularly.

Ence has an OHSAS 18001-certified occupational health and safety management system that enables it to reduce accident rates and increase productivity, comply with health and safety legislation and foster a culture of safety by integrating prevention into the Company's overall system and getting all employees engaged in the quest to continually improve the firm's health and safety record.

It is worth highlighting the following milestones in this respect:

- All the Operations Centres passed the OHSAS 18001 without a single incident.
- Completion in 2016 of the training modules contemplated in the Skills Training Plan, work that is set to continue with the Workplace Health and Safety Training Plan for 2017.
- Updating of the work permit system at the Group level adding five specific permits to complement the general work permit.
  - These specific permits simplify the permitting process and make it easier to identify workplace risks and preventative measures particular to specific kinds of work.
- Implementation of the 2016 Safety Improvement Pian, with virtually all the initiatives contemplated executed. A new Improvement Pian for 2017 is in the process of being formulated.
- All the work classified as 'particularly risky' was performed accident free.
- Accident rates in 2015 and 2016 were stable at levels that are below the sector average.

#### Training

The overriding goal of the professional training programme is to encourage personal and professional development at all levels with a view to improving employee integration in the Company and employee commitment to the organisation's strategic goals.

Training is an important aspect of the Strategic HR Plan, which contemplates the following corporate training initiatives in addition to the each Operations Centre's specific training plans:

The most noteworthy training initiatives developed by Ence in 2016 were the following:



# Workplace health and safety

Training designed to promote and embed safe conduct at all levels of the organisation under the scope of the Workplace Health and Safety Training Plans for 2016 and 2017, in 2016 this effort already implied a substantial increase in training hours for staff covered by collective bargaining agreements

# The TQM model and management tools

This idea behind this type of training is to orient management around the customer with a view to increasing customer satisfaction and delivering continuous improvement in operating efficiency and the ability to use the available management tools optimally

# Environmental training

The aim of the environmental training initiatives is to raise employee awareness of the need to care for and respect the environment and to use limited resources responsibly

## Development of leadership skills

Here the aim is to nudge the firm towards a more participative management style. Management skills training is targeted at individuals holding key positions, professionals who manage teams and people singled out for career development programmes.

# Technical and management skills training

The purpose of these courses is to equip workers with process and technology related skills specific to their trade or area of expertise and the knowledge they need to grow in their respective professions (hydraulics and pneumatics, mechanical instrument, process knowledge and skills, etc.) Among the initiatives carried out in this category in 2016, the technical training plan for operations and maintenance and the Green Belt and Project Management training sessions stand out

2016 CORPORATE TRAINING PLAN	No of training hours/person	No of participants I		
Leadership development plan: driving your career development	20	48		
Championing change programme	4	103		
Operations & Maintenance programme	28	363		
Workplace health management skills programme	20	403		
Green Belt training	40	53		
Black Belt training	144	20		
Green Belt training - Executive Committee	24	9		
Project Management programmes	84	18		

In 2016, Ence imparted 29,341 hours of training in total; this translates into 35.10 hours of training per employee.

# Diversity

The Equality Plan promotes effective application of the principle of non-discrimination between men and women, guaranteeing the same job and career development opportunities for both genders at all levels of the organisation. Although Ence belongs to a sector in which female representation has traditionally been low, at year-end 2016, 18.67% of the workforce was female (year-end 2015: 17.67%).

As part of its policy for preventing harassment, Ence has pledged to prevent, avoid, remedy and discipline potential instances of harassment as part of its non-negotiable commitment to guaranteeing the dignity, integrity and non-discriminatory treatment of all employees and equal opportunities for all. In 2016, not a single workplace harassment case had to be investigated.



The Group's remuneration policy is likewise designed to guarantee non-discrimination in pay, compensating employees competitively based on market criteria and a variable component based on objective job performance evaluation informed by equality and efficiency criteria.

#### Management-employee relations

Management-employee relations are based on dialogue and joint responsibility, the idea being to foster a labour relations climate that is propitious to working towards efficiency and productivity gains.

The highlights in this arena in 2016:

# The biomass power plants in Hueiva

An agreement regulating certain aspects of the manner of settling the electricity premium in 2016 was signed during the first quarter. In May, 87 employees were transferred to Ence Energía S.L. and the State Collective Agreement for the Pulp, Paper and Board Sector for 2015-2018 was published.

#### **Navia Operations Centre**

Union elections were held in the Forestry division in May to select the person to represent office staff in Navia. Two meetings also took place, one in Madrid and one in Pontevedra, to address workplace climate issues, as well as two meetings/workshops with employees from the division to analyse and formulate an action plan.

#### Pontevedra Operations Centre

Several meetings were held in 2016 with the Works Committee to discuss the facility action plan in light of the concerns sparked by the lack of investment in the causticising area.

### Pontevedra Offices

Partial union elections were held in 2016 as a result of which the number of representatives on the works committee was increased from five to nine.

#### Liquidity

# **Pulp Business**

Net cash flows from operating activities totalled €75.4 million in 2016. It is worth highlighting the drop in interest expense in the wake of the bond restructuring work undertaken in 2015.

Figures In €Mn	4716	3T16	Δ%	4T15	Δ%	2016	2015	Δ%
Adjusted EBITDA	29,5	23.4	26 5%	60.8	(51.4%)	104.0	169.6	(38.7%)
Non cash expenses / (Incomes)	1.6	1.6	(0.1%)	(1.0)	ns	2.5	2.6	(5.2%)
Other Incomes / (payments)	(3.1)	(2.2)	40.8%	(3.2)	(4.0%)	(9.7)	(9.5)	1 6%
Change in working capital	14.7	(6.7)	n.s.	3.9	278 6%	(0.8)	(29.0)	(97.3%)
Income tax received/(paid)	(6.6)	₩	n.s.	(7.1)	(6.6%)	(7.2)	(7.8)	(7 195)
Interest paid	(6.7)	0.3	n.s.	(20.9)	(67.8%)	(13.3)	(39.7)	(66.5%)
Net cash flow from operating activities	29.5	16.4	79.5%	32.5	(9.3%)	75.4	86.1	(12 4%)

The working capital requirement increased by just €0.8 million in 2016, having increased by €28.9 million in 2015.



Figures in €Mn	4716	3T16	Δ%	4T15	Δ%	2016	2015	Δ%
Inventories	6.3	(5.8)	11.5	(2.8)	n.s.	(1.4)	(2.9)	(52.0%)
Trade and other receivables	7.9	8.8	(9.8%)	0.9	ns.	16.5	(15.2)	ns
Current financial and other assets	1.1	0.6	ns	(0.9)	(0.6%)	(0.9)	(0.2)	437.2%
Trade and other payables	(0.6)	(10.3)	(94.0%)	6.7	n.s.	(15.0)	(10.8)	39.1%
Change in working canital	14.7	(6.7)	n.s.	3.9	278.6%	(8.0)	(29.0)	(97.3%)

Net cash used in investing activities amounted to €26.3 million: capital expenditure totalling €67.7 million was partially offset by the collection of proceeds of €41.4 million from asset sales.

						2040	2015	401
Figures in €Mn	4Q16	3Q16	Δ%	40,15	Δ%	2016	2015	Δ%
Maintenance capex	(6.8)	(5.9)	15.8%	(8.3)	(18.0%)	(21.1)	(22.0)	(4.2%)
Environmental capex	(1.7)	(2.9)	(40.5%)	(0.4)	319 5%	(7.5)	(5.4)	38.2%
Efficiency and expansion capex	(6.1)	(9.3)	(33.5%)	(8.7)	(29.0%)	(35.8)	(26.4)	35.3%
Financial investments	(4.3)	0.0	n.s.	0.0	n.s.	(3.3)	(0.1)	n.s.
Investments	(19.0)	(18.0)	5.5%	(17.4)	9.4%	(67.7)	(54.0)	25,4%
Disposals	13.7	17.6	(22.0%)	24.4	(43.8%)	41.4	32.3	28 4%
Net cash flow from Investing activities	(5,3)	(0.4)	n.s.	7.0	n.s	(26.3)	(21.7)	21.0%

Maintenance capex amounted to €21.1 million (in line with €22 million in 2015), while environmental capex totalled €7.5 million (vs. €5.4 million in 2015), earmarked primarily to upgrade work at the Pontevedra complex.

Investments in efficiency and expansion work totalled €35.8 million in 2016, mainly related to the successive efficiency improvements and 20,000-tonne capacity expansions carried out at Navia in each of June 2015 and June 2016.

This heading also includes financial investments of €3.3 million, corresponding to the present value of the difference between the pool price estimated by the regulator and the actual pool price observed between 2014 and 2016, which will be collected over the facilities' remaining useful lives for regulatory remuneration purposes, capitalised at 7.4%.

Elsewhere, in 2016, the Group closed the sale of 1,736 hectares of estates; the proceeds, already collected, totalled €38.7 million. This virtually completes the orderly sale of the forest land owned in Huelva, a process embarked on at the end of 2014 after pulp production at that complex was discontinued. The remaining €2.7 million of proceeds from asset sales (total: €41.4 million) correspond to the internal transfer of certain industrial assets to the Energy business in the fourth quarter.

#### **Energy Business**

Net cash flow from operating activities increased from €24.5 million in 2015 to €47.4 million in 2016, driven by the growth in adjusted EBITDA and a lower working capital requirement.

Figures in €Mn	4016	3Q16	Δ%	4Q15	Δ%	2016	2015	Δ%
Adjusted EBITDA	32.7	9.3	35.6%	(2.3)	n.s.	34.0	31.2	9 0%
Non cash expenses / (Incomes)	(0.0)	0.4	ns.	(0.0)	(21 3%)	(0.1)	(0.6)	(84.9%)
Other incomes / (payments)	(0.4)	(1.0)	(58 6%)	(0.7)	(38.2%)	(3.2)	(0.7)	379.0%
Change in working capital	14.4	16.3	(11 6%)	(0.7)	ns	26.3	(6.5)	ns.
Income tax received/(pald)	(0.9)	-	n.s.	(1.5)	(35 9%)	(1.1)	8.5	ns
Interest paid	(3.6)	(0.6)	n.s.	(1.9)	85.6%	(8.6)	(7.5)	15.3%
Net cash flow from operating activities	22.1	24.5	(10.0%)	(7.1)	n.s.	47.4	24.5	93.1%

The change in working capital implied a cash inflow of €26.3 million in 2016, compared to a cash outflow of €6.5 million in 2015, thanks to the collection of balances due from the Spanish electricity system in the amount of €28.8 million, as anticipated, in 2016.



Figures in €Mn	4Q16	3Q16	∆%	4Q15	Δ%	2016	2015	Δ%
Inventories	1,5	0.5	188.0%	(0.6)	n.s.	2.2	(1.2)	n.s.
Trade and other receivables	12.0	13.5	(11.2%)	3.4	255.9%	20.6	(6.8)	n.s.
Trade and other payables	0.9	2.3	(58 9%)	(3.4)	n.s	3.6	1.6	128 1%
Change in working capital	14.4	16.3	(11.6%)	(0.7)	ns	26.3	(6.5)	n.s.

Net cash flows used in investing activities amounted to €32.7 million, marking year-on-year growth of 29%. This figure includes a payment of €22.5 million in December 2016 to acquire interests of 68.4% and 64.1% In two biomass power plants located in Ciudad Real and Jaen, respectively, each with installed capacity of 16 MW.

Figures In €Mn	4Q16	3Q16	∆%	4Q15	Δ%	2016	2015	Δ%
Maintenance capex	(3.4)	(1.3)	161.8%	(1.1)	204.9%	(5,9)	(5.3)	11 7%
Efficiency and expansion capex	(22.5)		ns		ns.	(22.5)	-	ns
Financial Investments	(4.4)	į.	n.s.		n s	(4.3)		ns
nvestments	(30.3)	(1.3)	ns.	(1.1)	ns	(32.7)	(5.3)	ns
Disposals			n.s.		n s.		,,	ns
Net cash flow from investing activities	(30.3)	(1.3)	n.s.	(1.1)	ns	(32.7)	(5.3)	ns

Maintenance capex totalled €5.9 million, compared to €5.3 million in 2015, and includes €2.7 million from the Pulp business in the fourth quarter.

This heading also includes financial investments of €4.3 million, corresponding to the present value of the difference between the pool price estimated by the regulator and the actual pool price observed between 2014 and 2016, which will be collected over the facilities' remaining useful lives for regulatory remuneration purposes, capitalised at 7.4%.

# Key risks and sources of uncertainty

Ence's enterprise risk management (ERM) system is a process that is embedded within the organisation and is designed to identify, assess, prioritise, address and monitor situations that pose a threat to the Company's activities and objectives. Various areas of the Company participate in the process, each with specific responsibilities which, combined, constitute the end-to-end system;

Each year, Ence identifies and evaluates new risks and monitors developments with respect to risks identified in prior years and those that have dissipated during the year. The purpose of this monitoring and control process is to ensure execution and effectiveness of the agreed-upon action plans and guarantee continuous supervision of the Company's key risk factors. Ence's risk control and management process assigns the following specific roles and responsibilities:

- The risk management officers are tasked with executing the action plans and establishing the controls needed to provide the agreed-upon response to the risks identified within their respective purviews.
- Throughout the year the Internal Audit Department closely monitors the level of progress on executing the risk mitigation plans and is the body responsible for providing the Audit Committee with regular updates on these matters.
- Ence has a Compliance and Crime Prevention Committee, which reports to the Board's Audit Committee and is responsible for defining and updating Ence's crime risk map; this map identifies the organisation's activities that are susceptible to criminal conduct which must be prevented.
- The Audit Committee is in charge of proposing the risk mitigation plans (risk controls and action plans) assigned to the various identified risks to the Board of Directors. It also conducts periodic oversight of the level of execution of the various action plans and the effectiveness of the controls put in place with a view to managing the risks to which the organisation is exposed.



Lastly, the Board of Directors is responsible for ensuring the integrity and overseeing the correct working of Ence's ERM system, monitoring to this end both the risks identified and the controls and action plans agreed to manage the threats to delivery of the Company's strategic objectives.

This general modus operandi ensures that all those participating in executing, reporting, monitoring, controlling and supervising the risk management measures taken are duly coordinated.

Ence's ERM system takes into consideration the possible threats to delivery of the strategic objectives of all of the Ence Group's businesses (pulp, energy and forestry) as well as other activities undertaken by the organisation's various support areas.

This system encompasses the entire Ence Group, understood as each and every one of the companies in which Ence Energia y Celulosa, S.A. holds, directly or indirectly, a majority shareholding, a majority of the voting rights or in which it has appointed or has the power to appoint the majority of the members of their boards of directors, giving it effective control over the investee.

The ERM system is designed to identify, assess, prioritise, address and monitor situations that pose a threat to the Company's activities and objectives. It contemplates threats to the various types of objectives established by the organisation. Specifically it refers to objectives classified as:

- M Strategic
- Operational
- Financial Information and Reporting
- Compliance

The risks addressed by the ERM model are in turn classified as follows:

- Environmental Risks
- Risks associated with Decision-Making Information
- Financial Risks
- Organisational Risks
- Operational Risks
- Criminal Risks
- Tax Risks

Ence uses specific methodology to assign risk tolerance thresholds to the various risks identified depending on the activities performed. Its risk tolerance levels are contingent upon ensuring that rewards and potential risks are fully understood before decisions are made, to which end it establishes reasonable risk management measures as required.

Ence analyses each situation based on the risk-reward trade-off. This analysis contemplates multiple factors including strategy, stakeholder expectations, prevailing legislation, the environment and third-party relations.

- Ence takes a zero-tolerance stance on any situation which could compromise the health or safety of its employees.
- Ence's approach is to minimise its exposure to situations related with compliance with the laws and regulations applicable to Company, particularly in respect of the impact of its operations on the environment or its facilities' surroundings, the Group's reputation in the eyes of others and business sustainability.



- The Company has a team of external advisors and expert in-house staff who lay down the guidelines for ensuring compliance with tax requirements so that it assumes no risk whatsoever in this arena.
- Ence's tolerance for situations related to product research, development and innovation can be described as moderate, the aim being to provide solutions that full satisfy its customers' needs so that the Company remains a benchmark in the pulp market.
- In addition, aware of prevailing economic troubles, Ence is committed to the pursuit of financial discipline such that it can control the organisation's overall debt and maintain enough liquidity to ensure its ability to service its payment obligations and fund its priority investments. Against this backdrop, its risk tolerance threshold for speculative financial trades is low.
- Nevertheless, a significant percentage of Ence's transactions are exposed to the exchange rate between the dollar and the euro. Ence, knowledgeable of the prevailing economic situation and trends in the rate of exchange between these two currencies, has defined a low risk tolerance strategy in this arena, managing its currency exposure rigorously in keeping with the guidelines set by the Executive Committee of the Board of Directors and the Finance Department, as warranted.

The chief risks to delivery of the organisation's fundamental objectives and the associated response plans for mitigating their potential impact are detailed in this section:

#### Objective: Financial discipline

In complex economic environments, such as that in which Ence does business and operates, demands in terms of business profitability and development tend to increase. Against this backdrop, Ence is aware of the need to impose financial discipline so that it is capable of maintaining the ability to finance potential investments within reasonable leverage thresholds. Delivery of this objective is exposed to the following risk factors:

### a) PULP PRICE VOLATILITY

Pulp prices are formed in an active market. Trends in pulp prices have a significant influence on Ence's revenue and profits. Global pulp prices have been volatile in recent years, fluctuating significantly over short periods of time, as a result of continual imbalances between supply and demand in the pulp and paper industries. A significant decline in the price of one or more pulp products could have an adverse impact on the organisation's revenue, cash flows and net profit.

To mitigate this risk factor, first and foremost, Ence goes to lengths to reduce its production costs. In addition, Ence has a Global Risk Committee (Derivatives Committee) which is tasked with continually monitoring the pulp market on account of its highly cyclical nature. This Committee is in constant contact with financial entities with the aim of arranging, if necessary and the prices are right, financial hedges and/or futures in order to mitigate potential fallout from pulp price volatility.

# b) EXCHANGE RATE VOLATILITY

Revenue from the sale of pulp is exposed to the trend in the dollar/euro exchange rate. Insofar as the Company's cost structure is denominated in euros, potential changes in the rate of exchange between the two currencies can have an adverse effect on revenue.

The Global Risk Committee, also the main body tasked with controlling this risk factor, monitors the currency markets and the trend in the dollar/euro exchange rate periodically with the aim of arranging financial hedges to mitigate currency exposure if necessary.

# c) TRADE CREDIT RISK, PULP BUSINESS

In the pulp market is it possible that the odd customer, due to the adverse performance of its own business, could delay or fail to make payments on the terms agreed on orders fulfilled by Ence.



Ence has a credit insurance policy, which has been renewed until 31 December 2017, that covers, depending on the country in which the customer is located, between 80% and 90% of balances receivable. This insurance policy assigns credit limits according to the creditworthiness of the customer and covers virtually all of the Group's pulp sales. Under the policy, pulp customer-specific credit limits cannot be overstepped.

Ence mitigates this risk factor through its Global Risk Committee which actively monitors trends and developments in the pulp market and across its customer base.

#### d) LIQUIDITY AND CAPITAL RISK

Adverse conditions in the debt and capital markets could make it hard or impossible for the Group to raise the funding needed in the course of its business operations or to execute its 2016-2020 Business Plan.

This is one of the risk factors monitored most closely by the Ence Group. To mitigate this risk, it has established a series of key financial targets:

- 1. Guaranteed business continuity in any pulp price scenario.
- 2. Support for the growth plans in the various business segments by means of a solid capital structure and adequate liquidity level.
- 3. Leverage targets (based on net debt) tailored for each business unit's revenue volatility profile. Against this backdrop, the leverage cap set for the Pulp Business is 2.5 times recurring EBITDA, the latter derived using mid-cycle pulp prices and average exchange rates. The leverage cap established for the Energy Business is 5 times.
- 4. Diversified and tailored sources of financing for each business. At present, this means tapping the capital markets opportunely for the Pulp Business and using bank-provided project finance in the Energy Business.

Each of the Group's two businesses is financed and managed separately and optimally in light of their unique characteristics. The debt of each is non-recourse to that of the other and there are no cross-guarantees.

The Group's Finance Department draws up a financial plan annually that addresses all financing needs and how they are to be met. Funding needs for the most significant cash requirements, such as forecast capital expenditure, debt repayments and working capital requirements, as warranted, are identified sufficiently in advance.

There are also policies establishing the maximum amount of equity that can be committed to projects under development before the associated long-term financing has been arranged.

#### e) REGULATORY CHANGES (INCLUDING TAX REGULATIONS)

It is feasible that the authorities will make further changes to current tax regulations that could directly affect Ence and its earnings, such as corporate and/personal income tax changes or reforms.

To mitigate this risk, Ence has a team of advisors and experts who, together with the Company's inhouse tax experts, have drafted internal rules for tax compliance and guidelines for minimising exposure to risk in this respect. However, because this is an exogenous risk factor over which Ence has little influence, the teams follow the main tax-related developments closely in order to be ready to react whenever they may materialise.



# Objective: Enhancing the Company's Productive Capacity

Ence uses the most environmentally-friendly technology possible in all its production processes and uses total quality management (TQM) methodology to boost its competitive positioning and the quality of its products. However, the Group's maintenance, refurbishment and investment plans could affect the correct operation, performance and/or useful lives of its pulp-making machinery and equipment and its productive facilities.

This target is exposed to factory obsolescence risk. In the absence of an investment and maintenance plan to address facility obsolescence, the firm cannot guarantee delivery of the factories' targets and the mills' pulpmaking installations, machinery and equipment could become impaired.

In order to manage the risks falling under the umbrella of this strategic objective, Ence works to reduce the relative age of its machinery, equipment and facilities by means of three specific lines of initiative: (i) review of the public works supporting its facilities, disposing of idle equipment; (ii) new investments to address any areas for improvement detected; and (iii) the design of maintenance programmes to guarantee efficient production.

# Objective: New Product Development

Ence attempts to differentiate its products from those of its competitors while building a globally recognised brand in parallel. Here the main risks include the risk of not being able to stock the products its customers are looking for or not being able to meet customers' expectations in terms of quality.

The strategy adopted to satisfy customers' needs is to reduce risk by means of a customer complaints/claims management system. In 2016, Ence continued to raise the profile of and assign new resources to its Customer Service Department. In addition, it shored up its salesforce in number and in terms of skills with a view to identifying customers' specific needs in order to factor them into the Company's product range.

Ence attempts to maximise its products' added value by using certified timber. Here the threat is a shortfall of certified timber of the standard generally accepted in the global pulp market, mainly timber certified in accordance with the Forest Stewardship Council (FSC) standard.

With respect to the availability of FSC-certified wood, Ence mitigates this risk by means of adequate control over supplier management, increased purchases of standing timber, and articulation within Ence of a sustainability department focused on helping third parties to get their timber certified.

### Objective: Minimising the Cash Cost

In the volatile environment in which Ence does business, given the intrinsic characteristics of its businesses and the prevailing economic crisis, the Company has set itself the priority of making its operations more efficient by minimising its cash cost.

Several situations could threaten delivery of this objective: inflation in the cost of acquiring chemicals, fuel, gas or industrial supplies, logistics and transportation costs, strike action, the economic fallout from sector and environmental regulations and technological developments on the part of its competitors. Meanwhile, the price of timber can also fluctuate as a result of changes in the balance of supply and demand in the regions in which the factories are located.

Ence attempts to mitigate the risk of price changes by having the Procurements Department periodically monitor the performance of its main suppliers with a view to taking the corresponding action (search for alternative products, identification of more competitive goods and services, enhancement of the firm's bargaining power and additions to the pool of suppliers) in the event of significant incidents. The risk of a shortfall of timber supply in the regions in which the Group's factories are located is managed mainly by means of reliance on alternative markets, usually with higher logistics costs, an increased market presence via standing timber purchases, contingency plans and inventory buffers to guarantee business continuity.



To mitigate the risk of third-party strikes that could affect Ence, the Group has drawn up supplier communication plans that anticipate these situations so as to enable timely identification of alternatives. A specific joint management-work policy has been defined to address the risk of strike action by carriers. Meanwhile, management and control has been enhanced by means of the provision of mobile computer devices to carriers.

The primary measure taken to reduce the potential cost of specific environmental regulations is to remain in ongoing contact and dialogue with the main stakeholders (mainly the various government offices and sector/environmental associations) with a view to ensuring adequate oversight of the Group's environmental permits and the corresponding paperwork.

Lastly, in order to control the risk of the development of superior technology by its competitors, management closely follows what its rivals are doing on the technology front, learning about emerging technologies and production process improvements with a view to assessing their suitability/feasibility for the Company. Ence's technical experts likewise work continually on alternatives for incorporation into its productive processes with a view to further differentiating its product from that of its competitors.

# Objective: Increasing Ence's Market Share

One of Ence's priorities is to increase the market share commanded by its pulp products, namely to sell higher volumes of pulp to a greater number of customers. However, certain developments could threaten delivery of this objective, such as a deterioration in contractual sales terms, a shift in customers' production mixes, a contraction in demand for its products and evolving market preferences.

Ence's Marketing Plan is designed to reinforce the presence and positioning of the Company's products in the European market and materialises in initiatives aimed at: (i) increasing the customer base in order to reduce concentration risk; (ii) differentiating Ence's products by means of plans to enhance the properties and qualities of its pulp; and (iii) improving customer service.

In parallel, management continually monitors market trends in respect of pulp preferences. In addition, the production and sales teams work closely with Ence's customers to ensure that the pulp it sells meets or surpasses their needs.

### Objective: Streamlining of Post-Production Logistics

Once the product is ready, it is crucial to deliver it to the end customer as cost-effectively as possible and on the contractual terms established in the related sales agreements. Two specific situations could threaten delivery of this objective: stockouts and shipping costs.

End product stockouts can occur as a result of *ad-hoc* technical incidents in the productive process (breakdowns, bottlenecks, etc.) resulting in lower than initially-planned product availability. This situation can lead to the failure to deliver within the agreed-upon deadlines, causing damage to the end customer and to Ence's reputation, as well as generating costs deriving from contract non-performance. Moreover, it can lead to order cancellations, thereby increasing stock levels. To minimise this risk, the business unit reviews the production, sales and logistics plans as a whole in order identify potential shortfalls and devote the resources needed to address them. Sales and end product stock levels are also monitored by means of the corresponding scorecards and supervision of trends in key production and logistics variables.

### Objective: Minimising the Impact of our Operations on the Environment

Generally speaking, Ence's pulp business is carried out in industrial facilities in which a number of different raw materials and pieces of machinery and equipment interact in a manner that generates risks that are intrinsic to all industrial activities.



Ence is firmly committed to minimising all risky activities that could have adverse ramifications for its natural surroundings, the environment or the communities where it does business. The main threats to delivery of this objective include potential accidental emissions of contaminating particles, possible accidental spills and potential noise or aesthetic contamination as a result of its industrial activities.

The Company is strategically committed to reducing the environmental impact of its business operations by means of its enterprise risk management model. In 2016, the Group continued to invest to make its facilities more environmentally-friendly.

# Objective: Business Continuity

One of Ence's key objectives is that of maintaining its business operations and availing of all the measures needed to guarantee the continuity of these operations and all supporting activities. Generally speaking, the main threats in this respect include natural catastrophes and disasters, adverse meteorological conditions (drought, frost, etc.), unexpected geological conditions and other factors of a physical nature, fires, floods or any other emergency situation that could affect Ence's productive and storage facilities.

Because of the diverse range of risks in this arena, Ence takes individual actions to address each risk factor with a view to preventing them from materialising and/or mitigating their impact in the event they do: fire safety training, insurance policies, regular audits, preventative inspections, surveillance and control of business operations and a corporate policy for controlling the main pests to which the Group's biological assets are exposed.

As for international expansion projects, the potential risks to business continuity relate to political, economic and regulatory uncertainty in the markets in which Ence wants to establish a presence, as well as risks related to the supply of biomass.

Ence analyses all international expansion projects extremely thoroughly at all levels, drawing up risk maps in order to identify and assess the situations that could pose a threat to the Company's activities and objectives and establishing actions plans to mitigate or eliminate the risks so identified.

### Objective: Guaranteeing Worklife Quality and Workplace Health and Safety

Ence is aware of the importance of providing a workplace that guarantees the best conditions in terms of occupational health and safety, guided by stringent compliance with prevailing legislation in Spain. Certain situations could pose a threat to delivery of this objective as some jobs come with intrinsic risks, with the attendant health or safety ramifications for the employees performing them.

To minimise this risk the Group has accident prevention plans predicated on safety training, the maintenance of integrated health and safety management systems and certification to benchmark standards such as ISO, OSHAS and FSC. In parallel, it has drawn up contingency plans for specific situations to ensure safety compliance in the field.

Ence is firmly committed to maintaining its accident prevention plans, including an action plan for preventing/reducing accidents that is based primarily on employee training initiatives, process upgrades and adequate oversight of the plans' effectiveness and any associated requirements. Lastly, there are plans to roll out overall equipment effectiveness (OEE) initiatives to make harvesting safer and more cost effective.

# Objective: Regulatory and Reporting Compliance

The new pulp and paper sector Best Available Techniques References (BREF) documents are expected to take effect in 2017. Adopters have one more year for full adaptation to the new regulations. It is expected that the new BREF requirements will be more stringent in terms of production and emissions in light of process types, geographic location and local environmental conditions, triggering the need for new investments and control systems.



The strategy employed by Ence to tackle this risk factor is two-fold. Firstly, Ence staff have reached out to the government, key sector associations and other stakeholders and participated in establishing the definitive standard requirements so that all the players' views could be taken into account.

In parallel, the most important investments required to adapt to the new regulations have been analysed and approved and are reflected in the organisation's current industrial investment Plan.

In addition, following effectiveness of Spanish Law 1/2015 (of 30 March 2015), amending the Criminal Code and regulating in greater detail the criminal liability of legal persons, in 2015, Ence implemented a Crime Detection and Prevention Risk Management and Control System which includes a plethora of measures and controls designed to prevent or at least mitigate to the extent possible the risk of commission of any form of crime at the organisation and ensure the lawfulness of all actions taken by the Company's staff and executives in the course of discharging their professional duties.

Following on from this, in 2016 a number of internal policies and procedures were formulated and implemented to mitigate the organisation's exposure to specific criminal risks.

### Objective: Tax Risk Control

The Audit Committee monitors the Company's tax-related risks with a view to assisting the Board with its task of determining tax risk management and control policy.

Ence has a dedicated tax division and receives specific tax counselling to ensure its in-house guidelines guarantee compliance with prevailing tax regulations, framed by zero risk tolerance in this arena.

# **Events after the reporting date**

No events have occurred between the reporting date and the date of authorising these consolidated financial statements for issue that have not been disclosed therein.

# **R&D** activities

Sustainability and continuous improvement are two of the cornerstones underpinning the Ence Group's activities and its R&D effort is of vital importance to delivering these strategic goals. In 2016, the Group carried out research work on the forestry, industrial (production of pulp and energy) and environmental fronts.

In the industrial arena, it executed projects designed to deliver continuous improvement of the pulp production process, including an analysis of the use of surfactants and catalysts in the cooking sequence, studies into how to optimise splinter thickness, the use of enzymes in the bleaching process and the use of alternative complexing agents, as well as work on the product property front, looking at how to make it smoother and increase its dimensional stability and the stability of its whiteness.

Work began on the study to determine the size and impact of the installation of a lignin plant. Execution of the LIGNO-SPREAD project researching recovery of lignin derived from black liquor in the paper sector in new competitive and environmentally-sustainable products and the CASCATBEL project researching the CASCade deoxygenation process using tailored nanoCATalysts for the production of BiofuELs from lignocellullosic biomass under the scope of the seventh European Framework Programme, continued. Meanwhile, work began on a new project called LIGNOPRIZED looking at lignin biorefining processes for the production of value-added products. Note that the CASCATBEL, LIGNO-SPREAD and LIGNOPRIZED projects are being spearheaded by Ence and are aligned with the strategy of reconverting production plants into biorefineries.

The Group completed Project FARO, which entailed a far-reaching review of operating processes in the pulp business, in 2016. It was advised on this process by a first-class sector consultancy firm. Under the scope of this



project, important progress was made on plant availability by means of enhanced operational controls and improved management of certain aspects unrelated to the process. In addition, innovative measurement systems were introduced to generate reliable readings in areas of critical importance in terms of costs.

On the environmental management front, the treatment of TCF discharges was studied using pilot facilities. The goal of this project, which entails reverse osmosis separation processes, is to reduce the DQO load and water consumption by reusing filtered and purified water.

in the forestry area, Ence focused its R&D efforts on the following initiatives:

- Improving the phytosanitary properties of its Eucalyptus Globulus plantations by combating the Gonipterus platensis (eucalyptus tree weevil). PROJECT GONIPTERUS.
- Evaluation of new clones that are tolerant of Gonipterus and Mycospherella.
- Selection of new genotypes created from controlled crossing of specimens in order to assess generic traits that can be exploited for business purposes.
- Improvement of the nursery plant breeding process.
- Enhanced use of agricultural biomass waste by developing specific harvesting and logistics processes. The Agricultural Blomass Project.

All these initiatives were undertaken under the umbrella of Ence's Continuous improvement Plan established over three decades ago, the legacy of which positions the Group optimally to tackle these challenges and demands. This Plan encompasses three improvement programmes: the genetic enhancement programme; the silviculture programme and the pest and disease control programme.

As part of the pest and disease control programme, it is worth singling out Project GONIPTERUS, which is aimed at better controlling the Gonipterus platensis by means of Anaphes nitens (this pest's specific parasite). Two biofactories were set up in early 2016, one in Pontevedra and one in Huelva, with the aim of making the Anaphes nitens production process more efficient by investigating and improving every step of the process; the resulting cost reductions are promising in terms of application and effectiveness of the biological control of the Gonipterus platensis in Eucalyptus globulus plantations. In addition, in 2016, 16,000 hectares of plantations were treated with biological pest controls twice, during the spring and summer harvests, with another 5,400 hectares receiving just one treatment.

Also as part of the effort to fight the Gonipterus pest, authorisation was obtained from the Ministry to research the use of another parasite, Anaphes inexpectatatus, which is currently being tested in a laboratory environment. The goal is to identify this parasite's biological cycle and the optimal conditions for its reproduction at an industrial scale.

Elsewhere, as part of the Genetic Improvement work, the Company is evaluating a range of genetic materials that are tolerant of the Gonipterus pest and Mycosphaerella disease taken from specimens selected for presenting these genetic traits of interest. These materials are being tested and evaluated in different field tests with a view to verifying these virtues in different climate, soil and terrain conditions.

Research continues in parallel into the selection of new cloned materials deriving from controlled crosses of specimens presenting compelling traits in terms of timber quality, growth, etc.

As for the nursery breeding process, work continues to improve plant quality in response to customer needs and demands. The results to date are better-quality plants bred at lower cost.

Another Important line of initiative relates to the use of agricultural biomass, an area in which the Company is innovating in terms of the related harvesting and logistics processes. Against this backdrop, Ence R&D



participated in the development of a prototype machine for harvesting and threshing corn straw together with another manufacturer, Moresil. It also collaborated with CIEMAT (acronym in Spanish for the Centre for Energy, Environmental and Technological Research) on an end-to-end assessment of impact and categorisation of foreign bodies (inert solids) in straw.

The Company is also evaluating a new corn harvesting and threshing system made by New Holland, the CornRower II.

The two projects in progress with Huelva University continued: "Selection, reproduction and evaluation of Camaldulensis eucalyptus clones for use in highly productive energy crops in Extremadura" and "Study of the productive potential of Eucalyptus hybrids using ferti-irrigation, water rationalisation methods and sap analysis"

Ence R&D actively collaborates with associations and forest owners on the resolution of phytosanitary and silvicultural problems related with eucalyptus plantations, advising them on matters as varied as eucalyptus species and strain selection, land preparation, planting methods and all the forestry care work required to enhance productivity

In addition, Ence R&D collaborates with the regional governments of Galicia and Asturias on the biological control of the Gonipterus pest as well as with other research and technology centres such as the 'Do Areeiro' plant pathology centre and SERIDA.

# Purchase-sale of own shares

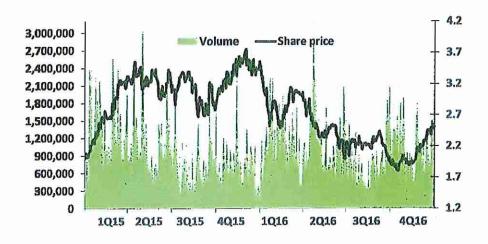
The disclosures regarding the acquisition and sale of own shares in 2016 are provided in note 21.7 to the accompanying consolidated financial statements.

### Miscellaneous information

### Share price performance

Ence's share price corrected by 28.2% in 2016, affected by the drop in pulp prices, ending the year at €2.51, down from €3.50 at year-end 2015.

During the same period, the Company's sector peers saw their share prices correct by 22.0% on average(\*).





#### Source: Thomson Reuters

<u> </u>	1015	2015	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16
Share price at the end of the period	3,32	3.07	2.90	3.50	2.97	2.15	1.94	2.51
Market capitalization at the end of the period	830.4	767.1	724.5	874.7	742.1	538.1	485.5	628.2
Ence quarterly evolution	65.2%	(7.6%)	(5.5%)	20.7%	(15.2%)	(27.5%)	(9.8%)	29.4%
Daily average volume (shares)	1,350,917	1,115,543	805,633	772,161	1,147,192	1,185,453	834,452	1,081,146
Peers quarterly evolution *	41.4%	(6.9%)	10.9%	12.2%	(26.1%)	(19.1%)	2.156	31.5%

(\*) Altri, Navigator, Fibria and Suzano.

The Company's shares have been traded on the Spanish stock exchanges and on the continuous market since it was privatised in 2001 and are part of the Ibex Small Cap, Ibex Top Dividendo and FTSE4Good stock indices.

#### **Dividend payments**

In recent years, the Group policy's has been to distribute a stable dividend, adjusting it upwards or downwards depending on evolving circumstances.

### Credit ratings management

In addition to having its shares publicly traded, the Group has issued €250 million of 5.375% 7-year bonds which at year-end 2016 were trading at 105.52% of par.

In conjunction with this issue, two international credit ratings agencies issued an opinion on the creditworthiness of the Group as a whole and of its bond issue. The current issuer and issue credit ratings assigned by Standard&Poors and Moody's are BB-/BB- and Ba3/B1, respectively.

# Corporate governance

The Annual Corporate Governance Report is part of the Group Management Report and can be downloaded from the securities market regulator's website (www.cnmv.es).

