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

Consolidated financial statements for 2017 prepared under the International Financial Reporting Standards adopted by the European Union, the Group Management Report and the Audit Report

# Consolidated financial statements for 2017

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

### CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2017 AND 2016

| Thousands of euros | Note | Year-end 2017 | Year-end 2016 (*) |
|---|---|---|---|
| **NON-CURRENT ASSETS:** | | | |
| Intangible assets | | | |
| Goodwill | 14 | 2,488 | 2,697 |
| Other intangible assets | 14 | 13,484 | 15,242 |
| Property, plant and equipment | 15 | 692,673 | 686,299 |
| Biological assets | 16 | 81,692 | 83,411 |
| Other financial assets | | | |
| Hedging derivatives | 19 & 22 | 2,501 | - |
| Other financial assets | 19 & 21 | 4,120 | 11,634 |
| Deferred tax assets | 29 | 59,783 | 69,062 |
| | | **856,741** | **868,345** |
| **CURRENT ASSETS:** | | | |
| Non-current assets held for sale | 17 | - | 6,883 |
| Inventories | 18 | 39,126 | 43,607 |
| Trade and other receivables | 19 & 23 | 106,771 | 80,221 |
| Tax receivables | 29 | 6,945 | 8,811 |
| Income tax receivable | 29 | 1,022 | 1,459 |
| Current financial assets: | | | |
| Hedging derivatives | 19 & 22 | 13,525 | - |
| Other financial assets | 19 & 21 | 6,375 | 9,580 |
| Cash and cash equivalents | 20 | 270,528 | 209,864 |
| Other current assets | | 2,063 | 3,570 |
| | | **446,355** | **363,995** |
| **TOTAL ASSETS** | | **1,303,096** | **1,232,340** |
| **EQUITY:** | | | |
| Share capital | 25 | 221,645 | 225,245 |
| Share premium | 25 | 170,776 | 170,776 |
| Parent company reserves | 25 | 158,479 | 161,269 |
| Parent company retained earnings (prior-year losses) | | (92,436) | (109,117) |
| Reserves in fully-consolidated companies | 25 | 61,210 | 59,615 |
| Interim dividend | 26 | (29,623) | (7,825) |
| Translation differences | | 47 | 86 |
| Own shares - parent company shares | 25 | (4,016) | (11,963) |
| Valuation adjustments | 25 | 51,680 | 27,253 |
| Other equity instruments - shareholder remuneration plan | 4.16 & 11 | 2,783 | 517 |
| Consolidated profit for the year | | 91,786 | 38,475 |
| **Equity attributable to owners of the parent** | | **632,331** | **554,331** |
| **Non-controlling interests** | 25 | **9,903** | **7,234** |
| **TOTAL EQUITY** | | **642,234** | **561,565** |
| **NON-CURRENT LIABILITIES:** | | | |
| Bonds and other marketable securities | 19 & 20 | 293,558 | 243,631 |
| Bank borrowings | 19 & 20 | 101,722 | 132,932 |
| Grants | 27 | 9,196 | 9,671 |
| Hedging derivatives | 19 & 22 | 3,619 | 11,748 |
| Other financial liabilities | 19 & 20 | 19,595 | 39,419 |
| Deferred tax liabilities | 29 | 23,823 | 21,118 |
| Non-current provisions | 28 | 4,167 | 6,167 |
| | | **455,680** | **464,686** |
| **CURRENT LIABILITIES:** | | | |
| Bank borrowings | 19 & 20 | 13,731 | 20,476 |
| Hedging derivatives | 19 & 22 | 2,193 | 14,741 |
| Other financial liabilities | 19 & 21 | 1,457 | 1,305 |
| Trade and other accounts payable | 19 & 24 | 168,636 | 154,169 |
| Income tax payable | 29 | 437 | 117 |
| Taxes payable | 29 | 11,642 | 10,655 |
| Current provisions | 28 | 7,086 | 4,626 |
| | | **205,182** | **206,089** |
| **TOTAL EQUITY AND LIABILITIES** | | **1,303,096** | **1,232,340** |

(*) Restated. Refer to note 3.6

The accompanying notes 1 to 33 and Appendices are an integral part of the consolidated statement of financial position at 31 December 2017

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

### CONSOLIDATED INCOME STATEMENT FOR YEAR-ENDS 2017 AND 2016

| Thousands of euros | Note | 2017 | 2016 (*) |
|---|---|---|---|
| **Continuing operations:** | | | |
| Revenue | 9 | 740,322 | 605,448 |
| Gain/(loss) on hedging transactions | 22 | (465) | 971 |
| Changes in inventories of finished goods and work in progress | 18 | (5,211) | 1,107 |
| Cost of sales | 10 | (285,524) | (268,251) |
| **GROSS PROFIT** | | **449,122** | **339,275** |
| Own work capitalised | 15 & 16 | 4,301 | 6,541 |
| Other operating income | | 5,888 | 5,212 |
| Grants taken to income | 27 | 1,900 | 2,435 |
| Employee benefits expense | 11 | (74,366) | (68,428) |
| Depreciation and amortisation charges | 14 & 15 | (70,412) | (69,728) |
| Depletion of forest reserve | 16 & 17 | (5,025) | (7,151) |
| Impairment of and gains/(losses) on disposals of intangible assets and PP&E | 15, 16, 17 & 28 | 9,060 | 24,034 |
| Other operating expenses | 12 | (170,819) | (159,467) |
| **OPERATING PROFIT** | | **149,649** | **72,723** |
| Finance income | | 1,001 | 285 |
| Change in fair value of financial instruments | 13 & 22 | (1,617) | (414) |
| Other finance costs | 13 | (22,755) | (20,364) |
| Net exchange gains/(losses) | | (6,283) | (1,446) |
| Impairment of and gains/(losses) on disposal of financial assets | | (124) | - |
| **NET FINANCE COST** | | **(29,778)** | **(21,939)** |
| **PROFIT BEFORE TAX** | | **119,871** | **50,784** |
| Income tax | 29 | (26,206) | (12,309) |
| **PROFIT FOR PERIOD FROM CONTINUING OPERATIONS** | | **93,665** | **38,475** |
| **CONSOLIDATED PROFIT FOR THE PERIOD** | | **93,665** | **38,475** |
| Profit/(loss) attributable to non-controlling interests | 25 | 1,879 | - |
| **PROFIT/(LOSS) FOR THE PERIOD ATTRIBUTABLE TO OWNERS OF THE PARENT** | | **91,786** | **38,475** |
| **Earnings/(loss) per share attributable to owners of the parent** | | | |
| Basic | 25 | **0.37** | **0.15** |
| Diluted | 25 | **0.37** | **0.15** |

(*) Restated. Refer to note 3.6

The accompanying notes 1 to 33 and Appendices are an integral part of the consolidated 2017 income statement

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

### CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR YEAR-ENDS 2017 AND 2016

| Thousands of euros | Note | 2017 | 2016 (*) |
|---|---|---|---|
| **CONSOLIDATED PROFIT/(LOSS) FOR THE PERIOD (I)** | | **93,665** | **38,475** |
| **Income and expense recognised directly in equity:** | | | |
| - Cash flow hedges (**) | | 29,791 | (17,262) |
| - Translation differences (**) | | (39) | 999 |
| - Tax effect | | (7,448) | 3,861 |
| **TOTAL INCOME AND EXPENSE RECOGNISED DIRECTLY IN CONSOLIDATED EQUITY (II)** | **25** | **22,304** | **(12,402)** |
| **Amounts transferred to the consolidated income statement** | | | |
| - Cash flow hedges (**) | | 4,212 | (1,031) |
| - Tax effect | | (1,053) | 258 |
| **TOTAL AMOUNTS TRANSFERRED TO PROFIT OR LOSS (III)** | **25** | **3,159** | **(773)** |
| **TOTAL COMPREHENSIVE INCOME/(EXPENSE) (I+II+III)** | | **119,128** | **25,300** |
| Attributable to: | | | |
| Owners of the parent | | **117,249** | **25,300** |
| Non-controlling interests | | **1,879** | **-** |

(*) Restated. Refer to note 3.6

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

The accompanying notes 1 to 33 and Appendices are an integral part of the consolidated 2017 statement of comprehensive income

ENCE ENERGÍA & CELULOSA

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

### CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR YEAR-ENDS 2017 AND 2016

| 2017 (thousands of euros) | Balance at 1/1/2017 | Total recognised income/ (expense) | Appropriation of prior-year profit/(loss) | Dividends distributed | Issuance / (cancellation) of shares | Trading in own shares | Other movements (note 4.16) | Balance at 31/12/2017 |
|---|---|---|---|---|---|---|---|---|
| Issued capital | 225,245 | - | - | - | (3,600) | - | - | 221,645 |
| Share premium | 170,776 | - | - | - | - | - | - | 170,776 |
| Legal reserve | 45,049 | - | - | - | - | - | - | 45,049 |
| Cancelled capital reserve | 6,966 | - | - | - | 3,600 | - | - | 10,566 |
| Capitalisation reserve | - | | 1,848 | - | - | - | - | 1,848 |
| Other reserves | 109,254 | - | 11,601 | (11,578) | (8,552) | 291 | - | 101,016 |
| Parent company retained earnings (prior-period losses) | (109,117) | - | 16,681 | - | - | - | - | (92,436) |
| Reserves in fully-consolidated companies | 59,615 | 1,075 | 520 | - | - | - | - | 61,210 |
| Interim dividend | (7,825) | - | 7,825 | (29,623) | - | - | - | (29,623) |
| Translation differences | 86 | (39) | - | - | - | - | - | 47 |
| Own shares | (11,963) | - | - | - | 8,552 | (605) | - | (4,016) |
| Valuation adjustments | 27,253 | 24,427 | - | - | - | - | - | 51,680 |
| Other equity instruments - shareholder remuneration plan | 517 | - | - | - | - | - | 2,266 | 2,783 |
| Consolidated profit/(loss) for the period | 38,475 | 91,786 | (38,475) | - | - | - | - | 91,786 |
| **Total equity attributable to owners of the parent** | **554,331** | **117,249** | **-** | **(41,201)** | **-** | **(314)** | **2,266** | **632,331** |
| Non-controlling interests | **7,234** | **1,879** | **-** | **-** | **-** | **-** | **790** | **9,903** |
| **Total equity** | **561,565** | **119,128** | **-** | **(41,201)** | **-** | **(314)** | **3,056** | **642,234** |

| 2016 (thousands of euros) | Balance at 1/1/2016 (*) | Total recognised income/ (expense) | Appropriation of prior-year profit/(loss) | Dividends distributed | Issuance / (cancellation) of shares | Trading in own shares | Other movements (note 4.15) | Balance at 31/12/2016 (*) |
|---|---|---|---|---|---|---|---|---|
| Issued capital | 225,245 | - | - | - | - | - | - | 225,245 |
| Share premium | 170,776 | - | - | - | - | - | - | 170,776 |
| Legal reserve | 45,049 | - | - | - | - | - | - | 45,049 |
| Cancelled capital reserve | 6,966 | - | - | - | - | - | - | 6,966 |
| Other reserves | 83,081 | - | 51,251 | (24,886) | - | (192) | - | 109,254 |
| Parent company retained earnings (prior-period losses) | (109,117) | - | - | - | - | - | - | (109,117) |
| Reserves in fully-consolidated companies | 62,564 | 9,600 | (12,347) | - | - | - | (203) | 59,615 |
| Interim dividend | (10,951) | - | 10,951 | (7,825) | - | - | - | (7,825) |
| Translation differences | (1,116) | 999 | - | - | - | - | 203 | 86 |
| Own shares | (3,108) | - | - | - | - | (8,855) | - | (11,963) |
| Valuation adjustments | 51,028 | (23,775) | - | - | - | - | - | 27,253 |
| Other equity instruments - shareholder remuneration plan | - | - | - | - | - | - | 517 | 517 |
| Consolidated profit/(loss) for the period | 49,855 | 38,475 | (49,855) | - | - | - | - | 38,475 |
| **Total equity attributable to owners of the parent** | **570,272** | **25,300** | **-** | **(32,711)** | **-** | **(9,047)** | **517** | **554,331** |
| Non-controlling interests | **-** | **-** | **-** | **-** | **-** | **-** | **7,234** | **7,234** |
| **Total equity** | **570,272** | **25,300** | **-** | **(32,711)** | **-** | **(9,047)** | **7,751** | **561,565** |

(*) Restated. Refer to note 3.6

The accompanying notes 1 to 33 and Appendices are an integral part of the consolidated 2017 statement of changes in equity

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

### CONSOLIDATED STATEMENT OF CASH FLOWS FOR YEAR-ENDS 2017 AND 2016

| Thousands of euros | Note | 2017 | 2016 (*) |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Consolidated profit/(loss) for the period before tax | | 119,871 | 50,784 |
| Adjustments for: | | | |
| Depreciation | 15 | 66,958 | 67,206 |
| Depletion of forest reserve | 16 | 5,025 | 7,151 |
| Amortisation | 14 | 3,454 | 2,522 |
| Changes in provisions and other deferred expense (net) | | 11,582 | 5,742 |
| Impairment of and gains/(losses) on disposals of intangible assets and PP&E | | (8,732) | (24,034) |
| Finance income | | (1,001) | (285) |
| Finance costs | | 29,831 | 22,151 |
| Grants taken to income | 27 | (1,353) | (1,701) |
| | | 105,764 | 78,752 |
| **Changes in working capital:** | | | |
| Inventories | 18 | 4,117 | 807 |
| Trade and other accounts receivables (including from public authorities) | 23 | (25,780) | 37,065 |
| Current financial assets | 21 | 3,266 | (881) |
| Trade payables, other payables and other liabilities | 24 | 11,654 | (11,436) |
| | | **(6,743)** | **25,555** |
| **Other cash flows from operating activities:** | | | |
| - Interest paid | 13 & 20 | (23,958) | (22,193) |
| - Interest received | 13 | 1,001 | 285 |
| - Income tax paid | 29 | (19,630) | (8,313) |
| - Other receipts / (payments) | | - | (2,064) |
| | | **(42,587)** | **(32,285)** |
| **Net cash from operating activities (I)** | | **176,305** | **122,806** |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| **Investments:** | | | |
| Property, plant and equipment and biological assets | 15 & 16 | (50,843) | (61,039) |
| Other intangible assets | 14 | (1,621) | (6,454) |
| Business combinations | 2 | (28,463) | (22,505) |
| Other financial assets | | 7,192 | (7,590) |
| | | **(73,735)** | **(97,588)** |
| Proceeds: | | | |
| Property, plant and equipment and biological assets | 15 & 16 | 3,392 | 38,683 |
| | | **3,392** | **38,683** |
| **Net cash used in investing activities (II)** | | **(70,343)** | **(58,905)** |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| **Proceeds from and payments for equity instruments** | | | |
| Buyback of own equity instruments | 25 | (34,872) | (39,387) |
| Disposal of own equity instruments | 25 | 34,640 | 30,340 |
| | | **(232)** | **(9,047)** |
| **Proceeds from and repayments of financial liabilities:** | | | |
| Proceeds from issuance of bonds and other marketable securities, net of issuance costs | 20 | 48,947 | (369) |
| Increase/(decrease) in bank borrowings, net of issuance costs | 20 | (59,758) | 27,222 |
| Repayment of other borrowings and cancellation of derivatives | 20 | - | - |
| Grants received | 27 | 7 | (416) |
| | | **(10,804)** | **26,437** |
| **Dividends and payments on other equity instruments** | | | |
| Dividends | 26 | (39,837) | (32,711) |
| | | **(39,837)** | **(32,711)** |
| **Net cash used in financing activities (III)** | | **(50,873)** | **(15,321)** |
| **NET INCREASE IN CASH AND CASH EQUIVALENTS (I+II+III)** | | **55,089** | **48,580** |
| Cash and cash equivalents, opening balance | | 209,864 | 159,565 |
| Cash obtained as a result of a business combination | 2 | 5,575 | 1,719 |
| Cash and cash equivalents, closing balance | | 270,528 | 209,864 |

(*) Restated. Refer to note 3.6

The accompanying notes 1 to 33 and Appendices are an integral part of the consolidated 2017 statement of cash flows

# Notes to the 2017 consolidated financial statements

# Contents

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

## Notes to the 2017 consolidated financial statements

### 1. Group information

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 businesses:

**The Pulp Business-**

Encompasses 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 power generation capacity (integrated within the Asturias and Pontevedra factories) is 112 megawatts (MW).

The Group also manages 67,325 hectares of forest in Spain, 44,501 hectares of which it owns.

**Energy Business-**

ENCE has developed and acquired several power generation facilities that are fuelled by biomass obtained from agricultural and forestry sub-products; these plants operate on a standalone basis, separately to the pulp business. Their aggregate power-generating capacity is currently 170 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 |
| Cordoba | 14 | 2031 |
| Cordoba | 13 | 2030 |


**Listing of shares-**

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

## 2. Scope of consolidation and business combinations

### 2.1 Business combinations

**2017 acquisitions**

On 2 August 2017, Ence Energía, S.L.U., a 100%-owned subsidiary of Ence Energía y Celulosa, S.A. and the holding company for the Group's Energy Business, acquired 70% of the share capital of Bioenergía Santamaría, S.A. from EDF Energies Nouvelles for €2,163 thousand, along with the credit claim it held over that investee in the amount (face value) of €26,300 thousand. The transaction gave Ence Energía, S.L.U. control of this entity.

Bioenergía Santamaría, S.A. owns a power plant located in Lucena (Cordoba) which comprises two facilities: a gas-fired CHP plant with installed capacity of 12.8 MW which is used to dry olive pomace, the fuel subsequently use to power the second facility, a 14.3 MW power plant fed with agricultural biomass.

The breakdown of the net assets acquired is as follows:

| Thousands of euros | Note | Carrying amount in target's financial statements(*) |
|---|---|---|
| Property, plant and equipment | 15 | 17,682 |
| Non-current financial investments | | 721 |
| Deferred tax assets | 29 | 2,996 |
| Cash and cash equivalents | | 5,575 |
| Other current assets | | 6,311 |
| **Total assets** | | **33,285** |
| Grants | | 594 |
| Deferred tax liabilities | 29 | 320 |
| Non-current borrowings from group companies | | 26,382 |
| Other current liabilities | | 2,900 |
| **Total liabilities** | | **30,196** |
| **TOTAL NET ASSETS ACQUIRED** | | **3,089** |

(*) Data corresponding to 100% of the acquiree's net assets

In keeping with the accounting standards applicable to business combinations (note 4.1), in order to consolidate this investment 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. The analysis conducted indicated that there were no significant differences between the carrying amounts of the net assets acquired and their fair values. There is no contingent consideration in this acquisition.

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

The transaction costs totalled €0.2 million and have been expensed in the accompanying 2017 consolidated income statement.

**2016 acquisitions**

On 29 December 2016, Ence Energía, S.L.U., a 100%-owned subsidiary of Ence Energía y Celulosa, 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., companies devoted to the generation of power from agricultural biomass, mainly sourced from olives, from Enel Green Power España, S.L. The acquisition price, having factored in the price adjustments associated with the cash and working capital balances on the acquisition date, was €24.8 million.

The allocation of the purchase prices as part of the process of integrating these investments into the Group's financial statements implied the restatement of their productive assets by €10,948 thousand and the recognition of goodwill, assets that will be depreciated/amortised over the plants' remaining regulatory useful lives. 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 €2,737 thousand (note 29).

The breakdown of the net assets acquired was as follows:

| Thousands of euros | Note | Fair value | Carrying amount in target's financial statements(*) |
|---|---|---|---|
| Goodwill | 2 | 2,737 | - |
| Property, plant and equipment | 15 | 24,016 | 13,267 |
| Non-current financial investments | | 1,377 | 1,377 |
| Deferred tax assets | 29 | 587 | 587 |
| Cash and cash equivalents | | 1,719 | 1,719 |
| Other current assets | | 8,984 | 8,985 |
| **Total assets** | | **39,420** | **25,935** |
| Deferred tax liabilities | 29 | 2,998 | 300 |
| Other current liabilities | | 4,309 | 4,309 |
| **Total liabilities** | | **7,307** | **4,609** |
| **NET ASSETS ACQUIRED** | | **32,113** | **21,326** |

(*) Data corresponding to 100% of the acquirees' net assets

The significant costs associated with this transaction amounted to €0.3 million and were expensed in the 2016 consolidated income statement.

## 2.2 Scope of consolidation

The following subsidiaries, effectively controlled by the Parent, are fully consolidated in the accompanying 2017 consolidated financial statements:

**2017**

| Investee | Registered office | Business activity | % ownership interest | Thousands of euros – Investee equity – Capital and other owner contributions | Share premium reserve | Profit (loss) for the year |
|---|---|---|---|---|---|---|
| **Pulp Business-** | | | | | | |
| Celulosas de Asturias, S.A.U. (a) | Celulosas de Asturias, S.A.U. (a) | Pulp production and power generation | 100 | 37,863 | 96,845 | 43,641 |
| Silvasur Agroforestal, S.A.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | Forest land management | 100 | 19,800 | 21,513 | (764) |
| Ibersilva, S.A.U. (a) | Ctra A-5000 Km. 7.5 (Huelva) | Forestry services | 100 | 280 | (93) | 6 |
| Norte Forestal, S.A.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | Forest land management | 100 | 2,464 | 9,725 | (3,416) |
| Ence Investigación y Desarrollo, S.A.U. (a) | Marisma de Lourizán s/n (Pontevedra) | Research into and development of new materials, products and processes | 100 | 6,208 | (3,787) | 37 |
| Iberflorestal, S.A.U. (a) | Lisbon (Portugal) | Purchase-sale of wood | 100 | 6,055 | (4,768) | (848) |
| **Energy Business-** | | | | | | |
| Ence Energía, S.L.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | Holding company and biomass management | 100 | 116,136 | 28,549 | 5,391 |
| Celulosa Energía, S.A.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | Generation and sale of electric energy | 100 | 3,756 | 901 | 4,525 |
| Ence Energía Huelva, S.L.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | Generation and sale of electric energy | 100 | 25,757 | 15,810 | 7,835 |
| Ence Energía Extremadura, S.L.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | Generation and sale of electric energy | 100 | 20,054 | 4,529 | 3,543 |
| Ence Energía Huelva 2, S.L.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | Generation and sale of electric energy | 100 | 3 | - | - |
| Energía de la Loma, S.A. (a) | Villanueva del Arzobispo (Jaen) | Generation and sale of electric energy | 64.07 | 4,167 | 7,061 | 1,574 |
| Energías de la Mancha Eneman, S.A. (a) | Villarta de San Juan (Ciudad Real) | Generation and sale of electric energy | 68.42 | 280 | 9,420 | 3,189 |
| Bioenergía Santamaría, S.A (a) | Camino Viejo de Benamejí, s/n, Lucena (Cordoba) | Generation and sale of electric energy | 70 | 11,992 | (13,044) | 5,161 |

(a) Annual financial statements audited

**2016**

| | | | | Thousands of euros | | |
|---|---|---|---|---|---|---|
| | | | | Investee equity | | |
| Investee | Registered office | Business activity | % ownership interest | Capital and other owner contributions | Share premium reserve | Profit (loss) for the year |
| **Pulp Business-** | | | | | | |
| Celulosas de Asturias, S.A.U. (a) | Celulosas de Asturias, S.A.U. (a) | Pulp production and power generation | 100 | 37,863 | 96,845 | 18,531 |
| Silvasur Agroforestal, S.A.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | 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 | (68) | (25) |
| Norte Forestal, S.A.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | Forest land management | 100 | 2,464 | 12,137 | (2,412) |
| Ence Investigación y Desarrollo, S.A.U. (a) | Marisma de Lourizán s/n (Pontevedra) | Research into and development of new materials, products and processes | 100 | 6,208 | (3,820) | 33 |
| Iberflorestal, S.A.U. (a) | Lisbon (Portugal) | Purchase-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 | 100 | 3,756 | 14,859 | 5,060 |
| Ence Energía, S.L.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | Generation and sale of electric energy | 100 | 116,136 | 39,907 | (3,358) |
| Ence Energía Huelva, S.L.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | Generation and sale of electric energy | 100 | 25,757 | 7,226 | 8,584 |
| Ence Energía Extremadura, S.L.U. (a) | Beatriz de Bobadilla, 14 (Madrid) | Generation and sale of electric energy | 100 | 20,054 | 2,447 | 2,082 |
| Energía de la Loma, S.A. (b) | Villanueva del Arzobispo (Jaen) | Generation and sale of electric energy | 64.07 | 4,167 | 4,214 | 2,847 |
| Energías de la Mancha Eneman, S.A. (b) | Villarta de San Juan (Ciudad Real) | Generation and sale of electric energy | 68.42 | 280 | 7,828 | 1,592 |

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

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

Ence Energía Huelva Dos, S.L.U. was added to the consolidation scope in 2017. This entity was set up in 2009 but it wasn't until 2017 that it embarked on its development work, specifically the planning for construction and subsequent operation of a biomass power generation plant with installed capacity of 40 MW in Huelva (note 15).

## 3. Basis of preparation and consolidation

### 3.1 Basis of preparation

Ence Energía y Celulosa, S.A.'s 2017 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 2017 and of its financial performance and cash flows for the year then ended.

Note 4 summarises the most significant accounting policies and measurement criteria used to prepare the accompanying consolidated financial statements.

The Group's consolidated financial statements for 2017, 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 2016 were ratified at the Annual General Meeting held by the Parent on 30 March 2017.

The euro is the Group's functional and presentation currency. The consolidated financial statements and accompanying notes are therefore expressed 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. 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 2017 and 2016, all the companies comprising the scope of consolidation itemised in note 2 are accounted for using the full consolidation method.

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

The consolidation of the entities comprising the scope of consolidation 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 other investees. The directors have made all the material adjustments needed to adapt these separate financial statements for IFRS and to align their financial information 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 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. None of the Group companies is located in a hyperinflationary economy.

## 3.3 Comparison of information and transaction seasonality

The information provided in these financial statements in respect of 2016 is presented to enable a reader comparison with the equivalent 2017 disclosures.

When making such a comparison, the reader should note the changes in the scope of consolidation disclosed in note 2 and the retroactive application, with effect from 1 January 2016, of IFRS 9 - Financial instruments, which has implied the restatement of the comparative information corresponding to 2016 (refer to note 3.6).

Given the nature of the Group companies' business operations, its transactions are not cyclical or seasonal in nature. 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 2017 and 2016.

## 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 - other than the early adoption of IFRS 9 - Financial instruments (note 3.6) - or corrections of errors affect either the 2017 or the 2016 financial statements.

## 3.6 Early adoption of IFRS 9 - Financial instruments

ENCE has decided to early adopt IFRS 9 - Financial instruments. IFRS 9 introduces new requirements for measuring and classifying financial instruments, for writing down financial assets for impairment and for accounting for hedging derivatives.

The new standard has been applied with retroactive effect from 1 January 2016, triggering the restatement of the comparative financial information.

IFRS 9 does not introduce significant changes with respect to the recognition and derecognition of financial assets compared to IAS 39.

Application of IFRS 9 has implied the following reclassifications of the Group's financial assets, without changing their carrying amounts:

| | IFRS 9 | IAS 39 |
|---|---|---|
| **Financial assets** | | |
| Trade and other receivables | Amortised cost | Loans and accounts receivable/payable |
| Other financial investments | Fair value through profit or loss | Held-to-maturity investments |
| **Financial liabilities** | | |
| Trade and other payables | Amortised cost | Loans and accounts receivable/payable |
| Bonds and other marketable securities | Amortised cost | Loans and accounts receivable/payable |
| Bank borrowings | Amortised cost | Loans and accounts receivable/payable |
| Other financial liabilities | Amortised cost | Loans and accounts receivable/payable |

The "Trade receivables" the Group intends to sell by means of factoring agreements, among other formulae, are classified at 'fair value through profit or loss' (FVPL).

No financial assets were reclassified between the financial asset categories defined above in 2017.

Elsewhere, IFRS 9 introduces a financial asset impairment model based on expected losses (as opposed to the incurred loss approach prescribed in IAS 39) which is applicable, generally, to the assets measured at amortised cost and at fair value through other comprehensive income (FVOCI). The new model contemplates a three-stage approach to impairment loss recognition:

- Assets whose credit quality has not deteriorated since they were initially recognised. Impairment of these assets is based on an allowance for the expected credit loss (ECL) for the next 12 months.

- Assets for which there has been a 'significant increase in credit risk' since their initial recognition. Impairment of these assets is based on an allowance for lifetime ECLs.

- Assets that are credit impaired at the reporting date. Impairment of these assets is based on an allowance for lifetime ECLs.

The Group has analysed the impact of application of the new expected loss impairment model based on the consideration that its financial assets are mainly either (i) trade receivables deriving from the sale of pulp, which are mostly covered by credit insurance policies which cover 90% of the balances pending collection; or (ii) trade receivables deriving from the sale of energy which are ultimately backed the Spanish state. In the wake of this analysis, management concluded that application of this impairment model has not had a significant impact on the accompanying consolidated financial statements.

**Financial liabilities-**

Application of IFRS 9 has not had a significant impact on the classification or measurement of the Group's financial liabilities.

**Hedge accounting-**

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), requiring the use of professional judgement to determine the existence of an economic relationship between the hedged item and hedging instrument. IFRS 9 does not contemplate the possibility of voluntarily terminating hedge accounting.

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 OCI within equity and later reclassified to profit and loss when the hedge is settled.

The financial instruments qualifying as 'hedging instruments' under IAS 39 continue to qualify as such under IFRS 9; this has not changed. The table below itemises the impact on the Group's financial position and earnings of the recognition in equity of the time value of the options written to hedge exposure to the dollar-euro exchange rate arising from pulp sales:

| | Thousands of euros | |
|---|---|---|
| | 01/01/2016 | 31/12/2016 |
| **Profit and loss-** | | |
| Net finance expense (positive \| (negative)) | - | (315) |
| Income tax | - | 79 |
| Profit for the period (positive \| (negative)) | - | (236) |
| | | |
| **Financial position - Equity** | | |
| Equity (increase \| (decrease)) | 2,054 | - |
| Deferred tax assets | 685 | (79) |
| Deferred tax liabilities | (685) | 79 |

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

The following new and amended standards took effect in 2017 and were applied in preparing the accompanying consolidated annual financial statements:

| Standard | Content | Applicable in annual periods beginning on or after |
|---|---|---|
| Amendments to IAS 7 - Disclosure initiative | These amendments introduce additional disclosure requirements with the aim of enhancing the information provided to financial statement users. | 1 January 2017 |
| Amendments to IAS 12 | Recognition of deferred tax assets for unrealised losses. | 1 January 2017 |
| Annual Improvements to IFRSs, 2014-2016 Cycle Clarification of IFRS 12 | Specifically, clarification of the relationship between IFRS 5 and IFRS 12 | 1 January 2017 |

These amendments have not had a significant impact on the accompanying financial statements.

### 3.8 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:

| tandard | Content | Applicable in annual periods beginning on or after |
|---|---|---|
| **New standards-** | | |
| IFRS 15 - Revenue from contracts with customers and related clarifications. | Replaces prevailing 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 | 1 January 2018 |
| IFRS 17 - Insurance contracts | Replaces IFRS 4 and sets out the principles for recognising, measuring, presenting and disclosing insurance contracts | 1 January 2021 |
| IFRS 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 | 1 January 2019 |
| **Amended standards-** | | |
| 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 | 1 January 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 | 1 January 2018 |
| Amendments to IAS 40 - Transfers of investment 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 | 1 January 2018 |
| Annual Improvements to IFRSs, 2014-2016 Cycle | Narrow-scope amendments to a series of standards | 1 January 2018 |
| IFRIC 22 - Foreign currency transactions and advanced consideration | 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 | 1 January 2018 |
| Amendments to IFRS 10 and IAS 28 - Sales or contributions of assets between an investor and its associate 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 |
| IFRIC 23 - Uncertainty over income tax treatments | Clarifies the application of the recognition and measurement requirements in IAS 12 - Income taxes when there is uncertainty over income tax treatments | 1 January 2019 |
| Annual Improvements to IFRSs, 2015-2017 Cycle | Narrow-scope amendments to a series of standards | 1 January 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. Specifically:

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 | 11 | 11 |
| Other leases | 2 | 2 |

The estimated impact on the income statement in 2019 would be 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.

IFRS 15 - Revenue recognition

IFRS 15 replaces IAS 18 in terms of the recognition of revenue in goods and services contracts and IAS 11 with respect to construction contracts. It takes effect on 1 January 2018.

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. The concept of 'control' substitutes the current concept of 'risks and rewards'.

Management has analysed the main contracts with customers on an individual and disaggregated basis. This analysis has factored in the specifics of each contract in relation to the performance obligations assumed by ENCE in each (returns, discounts, etc.). As a result of this analysis, it has concluded that application of this new standard will not have a significant impact on ENCE's consolidated financial statements.

## 4. Summary of significant 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 Business combinations

Business combinations in which the Group acquires control of one or more businesses are accounted for using the acquisition method, in keeping with the provisions of IFRS 3 - Business combinations.

As a general rule, the acquisition method implies recognising, on the acquisition date, the identified assets acquired, liabilities assumed, equity instruments issued and any contingent consideration that depends on future events or delivery of certain conditions, at their acquisition-date fair values, insofar as they can be measured reliably.

Acquisition-related costs are expensed as incurred.

The difference between the consideration transferred and the net assets acquired, coupled with the fair value of any previously held equity interest in the business acquired, is recognised under "Goodwill".

Goodwill is not amortised. Rather, it is tested for impairment annually. The Group recognises a goodwill impairment loss if the recoverable amount, determined on the basis of the present value of the projected future cash flows of the cash-generating units to which each goodwill balance is assigned, discounted at rate that factors in the risks specific to each asset, falls below the initially recognised amount. Goodwill impairment losses cannot be reversed in subsequent years. Goodwill is tested in-house and the related calculation details are provided in note 4.5.

The Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the identifiable net assets acquired. This decision is made on an acquisition-by-acquisition basis. To date the Group has opted to recognise non-controlling interests at their proportionate share of the net assets acquired.

## 4.2 Other 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 those estimated useful lives.

***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 five 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.

### 4.3 Property, plant and equipment

These assets are measured initially at acquisition or production cost, net of any income generated during the testing phase, and are subsequently carried net of accumulated depreciation and any impairment losses, applying the impairment criteria outlined in note 4.5.

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.

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.

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 invoiced 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 20).

Elsewhere, 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 inspection.

The Group depreciates property, plant and equipment using the straight-line method, distributing the cost of the assets over their estimated useful lives, broken down as follows:

| | 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 erected 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 buildings' remaining useful lives, limited by the remaining concession term. 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.

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 4.13). Any subsequent changes in estimated dismantling costs are accounted for by increasing or decreasing the corresponding assets' carrying mounts in the year in which the estimates change. In light of the terms on which the concession for the use of the site on which the Pontevedra complex is located were granted, the number of years for which the concession has been extended and the potential realisable value of the assets at the time of dismantling, management has estimated that dismantling costs will not be material, which is why no provision has been recognised in this respect on the accompanying statement of financial position.

## 4.4 Biological assets

The Group grows several species of trees, mainly the Eucalyptus globulus. The timber is used as the raw material for producing pulp or sold to third parties. 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 the corresponding heading of the statement of financial position (note 4.3).

The Group measures it biological assets at acquisition or production cost, net of forest depletion charges and any impairment losses, as it is not possible to determine their fair value reliably.

There is no 'quoted price' for the Eucalyptus globulus in Spain and the characteristics of the related transactions have not to date enabled the identification of valid market price references. Elsewhere, the use of the alternative methods contemplated in IFRS 13 for determining fair value does not enable a reliable quantification of the fair value of these biological assets due to the vast amount of assumptions and estimates required and their impact on the results of the estimation, among other factors.

ENCE has developed a model for valuing its forest assets based on discounted cash flow methodology which it does not consider sufficiently reliable to use as a proxy for the fair value of its biological assets. However, consistent use of this model over time does provide valuation ranges and enable the identification of trends that are considered when testing its biological assets for potential impairment.

The carrying amounts of biological assets recognised in ENCE's consolidated financial statements for 2017 are not significantly different from the fair values that would result from valuing the assets using discounted cash flow methodology, specifically that outlined in note 4.5, assuming timber purchase prices within a range of €65-70/t.

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 20).

The time elapsing from when a eucalyptus grove is planted in the Iberian Peninsula to when it is economically advisable to extract the stumps and subsequently replant it is approximately 35-40 years. During that period, there is time for three harvests every 10 to 15 years in which time the trees grow to the optimal size and conditions for making pulp. After each harvest shoots grow naturally from the stump, marking the start of the next yield. Against this backdrop, the costs incurred to develop biological assets are grouped into two categories: (i) cycle costs, which include the incurred costs, mainly associated with the plantation process, that will contribute to development of the biological assets over the entire 35-40 year cycle; and (ii) yield/harvest costs, which are those that contribute to development of the biological assets in the harvest in question.

When the plantations are harvested, the value of the forest cover is reduced with a charge to “Biological assets – Depletion of forest reserve” along with recognition of a corresponding expense under “Depletion of forest reserve” in the income statement at incurred production costs. The amount of that charge corresponds to 100% of incurred harvest costs and the proportional share of cycle costs calculated on the basis of the number of harvests per cycle.

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

## 4.5 Impairment of non-financial assets

The Group checks its financial assets for indications of impairment annually. Whenever it detects indications of impairment, it tests them for impairment by estimating their recoverable amount, which is the higher of their fair value less costs to sell and value in use.

If the estimated recoverable amount of an asset is lower than its carrying amount, the latter is written down to the former in the income statement. When an impairment loss subsequently reverts, the carrying amount of the asset 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 the income statement. Goodwill impairment losses cannot be reversed in subsequent reporting periods.

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 ENCE to test for impairment is as follows:

It calculates each cash-generating unit’s recoverable amount, the cash-generating units (CGUs) being each of the Group’s pulp factories and power plants and its biological assets.

Each year, the Group prepares a business plan for each CGU which generally covers a three-year projection period. 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, 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.

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 the energy business, for which cash flows during the construction and operating phases can be estimated with a certain degree of reliability, the recoverable amount is calculated using estimated cash flows projected until the end of the plant’s regulatory useful life. 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 pre-tax discount rate equivalent to the yield on 10-year Spanish government bonds plus 300 basis points is used.

There were no indications that ENCE's cash-generating units were impaired at either year-end 2017 or 2016 with the exception of its biological assets (refer to note 16).

### 4.6 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.

### 4.7 Financial assets and liabilities

ENCE measures its financial instruments in keeping with IFRS 9 - Financial instruments.

**Financial assets**

ENCE classifies its financial assets into the following categories subsequent to initial recognition: 1) at fair value through either other comprehensive income or profit or loss; and 2) at amortised cost.

Classification depends on the business model used by ENCE to manage the financial assets and the characteristics of their contractual cash flows. The Group reclassifies its financial assets if and only if its business model for managing them changes.

*Initial measurement -*

Upon initial recognition, the Group measures its financial assets at fair value, which includes the transaction costs directly attributable to their acquisition. Exceptionally, transactions costs associated with financial assets at fair value through profit or loss are expensed in the income statement.

*Subsequent measurement -*

ENCE classifies its financial assets into the following categories:

i. Amortised cost: assets that are held in order to collect their contractual cash flows and whose contractual cash flows represent solely payments of principal and interest are classified into this category.

   A gain or loss on an investment in a fixed-income instrument measured at amortised cost that is not part of a hedging relationship is recognised in profit or loss in the year in which the asset is derecognised or written down for impairment. Interest income from these financial assets is recognised in finance income as accrued.

ii. Fair value through other comprehensive income: assets that are held in order to achieve an objective by both collecting the contractual cash flows and selling the assets and whose contractual cash flows represent solely payments of principal and interest are classified into this category.

   Gains or losses in these instruments are recognised in "Other comprehensive income", other than impairment losses, interest income and exchange gains or losses, all of which are recognised in profit or loss. When a financial asset is derecognised, the gain or loss previously deferred in "Other comprehensive income" is reclassified from equity to profit or loss, except in the case of equity investments classified in this category. Interest and dividend income from these financial assets and exchange gains and losses are recognised in finance income or cost. Any impairment losses are presented in profit or loss.

iii. Fair value through profit or loss: The financial assets that do not meet the criteria for classification within either of the first two headings are recognised at fair value through profit or loss (FVPL). A gain or loss on a fixed-income investment measured at FVPL that does not form part of a hedging relationship is recognised in profit or loss and presented within operating profit.

*Impairment losses -*

The Group tests its financial assets at amortised cost and at FVOCI for impairment on an expected credit loss basis. Note 6 details how ENCE determines whether a 'significant increase in credit risk' has occurred since initial recognition.

For trade receivables, the Group uses the simplified approach allowed under IFRS 9, which requires the recognition in one step of a loss allowance based on lifetime expected credit losses at the time of initial recognition.

*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 liabilities**

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.).

*Debentures, bonds and bank borrowings*

Loans, bonds and other liabilities are initially recognised at fair value, which usually coincides with the amount of cash received, net of any transaction costs incurred. In subsequent periods, all of these liabilities are measured at amortised cost.

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.

*Trade and other payables*

Trade and other current accounts payable are financial liabilities that do not explicitly accrue interest. They are recognised initially at fair value and measured subsequently at amortised cost.

## 4.8 Derivative financial instruments

The Group's activities expose it mainly to financial and market risks deriving from (i) variability in the dollar/euro exchange rate (which affects its revenue as benchmark pulp prices are quoted internationally in dollars); (ii) other exchange rate fluctuations insofar as they affect currency-denominated sales; (iii) changes in the prices of pulp, fuel-oil, gas and electricity, whether bought or sold; and (iv) movements 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.

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:

1. 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.

2. Cash flow hedges: the effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in "Valuation adjustments" within equity. The gains or losses associated with the ineffective portion are recognised immediately in profit or loss under "Change in the fair value of financial instruments".

   When option contracts are used to hedge forecast transactions, the Group designates only the intrinsic value of the option contract as a hedging instrument. Changes in the time value of options that are related with the hedged item are recognised in "Other comprehensive income".

For these instruments to qualify for hedge accounting they are designated as hedges from the outset and the hedging relationship is documented in detail. The Group establishes its risk management objectives and strategies in entering into hedging transactions at the inception of each hedging relationship and tests its hedges for effectiveness at both inception and regularly throughout the hedging relationship, i.e., it verifies that 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 reasonably offset by the changes in the fair value/cash flows of the hedging instrument.

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.

**Fair value of financial instruments**

The fair value of the various financial instruments is determined in accordance with the hierarchy established in IFRS 13 as follows:

- Level 1 inputs: quoted prices (unadjusted) in active markets for identical assets or liabilities.

- Level 2 inputs: inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly.

- Level 3 inputs: unobservable inputs, namely valuation techniques.

The valuation techniques used vary by instrument type. ENCE uses discounted cash flow analysis to value interest and exchange rate hedges and the Black & Scholes model to value foreign exchange options. It uses 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: Fair value is determined by discounting the instruments' estimated future cash flows. The estimated cash flows from floating-rate instruments are based on quoted swap rates, futures prices and interbank lending rates. The future cash flows estimated are discounted using the zero coupon yield curve, an observable market input. The resulting fair value is adjusted for own and counterparty credit risk.
- Forward currency contracts and tunnels are valued using forward exchange rates for the respective currencies and the associated volatility matrices. The resulting fair value is adjusted for own and counterparty credit risk.
- Commodity swap contracts (over energy prices, etc.) are also measured by discounting futures prices observable in the market for the underlying assets.

The fair values of these financial instruments are obtained from studies compiled by experts in these kinds of instruments using information provided by agencies or official data organisms and they are cross-checked with the financial institutions with which the Group arranges them.

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 2017 or 2016.

## 4.9 Distinction between current and non-current

In the 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.

## 4.10 Inventories

Raw material inventories are measured at acquisition cost, which includes the amount invoiced plus all costs incurred until the goods are located within ENCE's facilities. Inventories of finished products and work in progress are measured at production cost, which 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 writes its inventories down for impairment, with a charge to profit and loss, following the policy outlined in note 4.5. 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 recoverable amount.

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 a grant in the same amount as the balancing entry; the grant is reclassified to profit and loss as the corresponding tonnes of carbon are consumed.

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) acquisition cost in respect of allowances held at year-end or expected to be acquired under available forward purchase agreements; and (ii) the year-end trading price in respect of allowances that ENCE may be short of at year-end.

When trading allowances are delivered to the authorities for the tonnage of carbon emitted, both the inventories and the provision corresponding to their consumption are derecognised.

## 4.11 Share capital, own shares and dividends

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 cost 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.

Interim dividends declared against profits for the year and final dividends are deducted from equity when their payment is authorised.

## 4.12 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.

## 4.13 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 (note 28).

Provisions 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. Provisions are recognised when the liability or obligation arises, with a charge to the relevant heading of the consolidated income statement based on the nature of the liability, discounted to present value. The increase in the carrying amount of provisions due to the passage of time is recognised as borrowing cost as accrued.

In accordance with prevailing labour regulations, ENCE is required to pay benefits to employees whose contracts are terminated under certain circumstances. The provisions recognised in this regard were not significant at either year-end.

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.

## 4.14 Environmental assets and liabilities

Environmental activities are those undertaken with the aim of protecting, enhancing or repairing damage caused to the environment.

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

Capital expenditure deriving from environmental activities is measured at cost and capitalised in the year incurred, following the measurement rules described in sections 4.2 and 4.3 above.

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.

## 4.15 Post-employment benefits

Certain Group companies have defined benefit commitments to employees who have been in active service for more than two years and 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, structured as a group insurance policy, covers beneficiaries’ retirement and the risks of permanent disability and death. ENCE makes defined contributions based on a percentage of plan holder salaries.

Elsewhere, 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 through an insurance company in 2014.

### 4.16 Employee benefits - Long-term bonus plans

At ENCE's Annual General Meeting of 16 March 2016, its 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 consists of a percentage of the beneficiaries' average annual fixed remuneration in 2016-2018 and will vest depending on delivery of three objectives:

- 50% is tied to the level of delivery of the 'synthetic' EBITDA targets (calculated assuming a pulp sales price of €720/tonne and a fixed exchange rate of $1.25/€) set down in the 2016 - 2020 Business Plan for 2018. Delivery of this target can be up to 120%.
- 30% is tied to outperformance by ENCE's shares relative to a basket of pulp sector stocks. Delivery of this target can be up to 120%.
- 20% is tied 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.

The accrual period began on 1 January 2016 and ends on 30 June 2019. To qualify for the benefits, in addition to delivery of the above targets, the beneficiaries must remain in the employment of ENCE at 30 June 2019.

The bonuses will be paid 30% in cash and 70% in Company shares. The CEO and members of the Management Committee who are beneficiaries of the plan have committed to holding a portion of the shares received for at least three years: 67% in the case of the CEO and 50% in the case of the other officers.

During the term of the plan, its fair value, in respect of the portion corresponding to targets tied to the Parent's share price performance, is determined using the Monte Carlo method for quanto basket options, a generally accepted method for valuing financial instruments of this kind (note 4.8). The fair value associated with the EBITDA target is estimated using the most up-to-date information about the outlook for the Group. It is assumed that the target associated with talent management will be delivered in full.

### 4.17 Income and expense recognition

Revenue represents the amounts received or receivable in exchange for the goods delivered and services rendered in the ordinary course of the Group's activities, net of returns and discounts and amounts received but due to third parties, such as value added tax. Revenue is recognised when it can be measured reliably and it is probable that the economic benefits embodied by the transaction will flow to ENCE. It is measured at the fair value of the consideration received or receivable.

Revenue from the sale of goods is recognised when the risks and rewards of ownership of the goods have been transferred to the buyer, which in the case of pulp sales is determined on the basis of the Incoterms (international commerce terms) applied to each transaction.

Revenue from the generation of power includes the pool price received in the market plus the legally-established premiums applicable to power generated from renewable sources and is recognised when it is generated and dispatched to the national power grid.

Revenue from the rendering of services - scantly material for ENCE - 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 is recognised when the right to receive payment is established.

In the power generation business, prevailing regulations establish that any deviations between the variables estimated by the regulator for the purpose of calculating certain generation premiums, most important of which estimated pool prices, and those that ultimately materialise 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 in 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.

### 4.18 Current and deferred income tax

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

The Parent and the rest of the Group subsidiaries 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.

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.

Income tax expense is accounting for using the liability method based on the general balance sheet. This method consists of determining deferred tax assets and liabilities on the basis of differences between the carrying mounts of its assets and liabilities and their tax bases, using the tax rates objectively expected to be prevailing when the assets and liabilities are realised and incurred, respectively. Deferred tax assets and liabilities relating to transactions charged or credited directly in equity are similarly recognised in equity.

Income tax and changes in deferred tax assets and deferred tax liabilities that do not arise from business combinations are recognised in the income statement or within 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.

As a general rule, deferred tax liabilities are recognised for all taxable temporary differences, except where the Parent can control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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.

### 4.19 Related-party transactions

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

### 4.20 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 prevailing 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 each reporting date at prevailing exchange rates are recognised in profit or loss in the reporting period in which they arise.

### 4.21 Statement of cash flows

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

1. Cash flows: inflows and outflows of cash and cash equivalents, the latter understood as short-term (< 3 months), 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.

3. 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.

### 4.22 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".

None of the Group's cash-generating units met the conditions for classification as assets held for sale or discontinued operations at 31 December 2017.

### 4.23 Segment information

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 (note 8) 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 Management Committee and the Board of Directors.

### 4.24 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.

Basic and diluted earnings per share coincided in 2017 and 2016 as there were no instruments convertible into ordinary shares in either period.

## 5. Energy sector regulations

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.

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 reduce other cost items or boost income by an equivalent amount in order to ensure the system's equilibrium. As a result, the possibility of a new tariff deficit is ruled out, to which end the Act introduces 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 2% of estimated system revenue in a given year or the debt accumulated in prior years exceeds 5% of the system revenue estimated for a given year.

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 fail to cover their costs by enough of a margin to compete with the rest of the generation technologies on an even footing, establishing remuneration comprised of:

1. "Remuneration on investment", which is designed to cover any investment costs that cannot be recouped by selling electricity in the market. It is set in euros per MW;

2. "Remuneration on operations", which is designed to cover any shortfall between operating costs and the revenue obtained in the electricity market. It is also set in euros per MW.

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 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 shall 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 table below sets out the remuneration applicable to the facilities managed by ENCE at 31 December 2017:

| Facility | Remuneration on operations (€/MWh) | | | | Remuneration on investments (€/Mw) |
|---|---|---|---|---|---|
| | b.6 | b.8 | gas | c.2 | |
| Energy Business | | | | | |
| 50-MW Huelva | 59.3 | 41.1 | - | - | 270,576 |
| 41-MW Huelva | 66.5 | - | - | - | 253,401 |
| 20-MW Merida | 57.7 | - | - | - | 296,811 |
| 16-MW Jaen | 66.2 | 45.3 | - | - | 266,896 |
| 16-MW Ciudad Real | 66.2 | 45.3 | - | - | 266,896 |
| 14-MW Cordoba - Biomass | 62.5 | 42.7 | - | - | 234,455 |
| 13-MW Cordoba - Gas | - | - | 64.0 | - | 4,634 |
| | | | | | |
| Pulp Business | | | | | |
| 36-MW Navia | 61.0 | 42.0 | - | - | 234,672 |
| 40-MW Navia | - | - | - | 35.2 | 10,671 |
| 35-MW Pontevedra (*) | 60.9 | 41.7 | - | 35.2 | 64,475 |

(*) Uses vapour from the two furnaces that use c.2 and b6/b8 fuel

Elsewhere, the Pulp Business facilities are listed for the 'Interruptibility Service' which consists of reducing their power consumption in response to orders from the system operator. This 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.

In addition, certain power generation facilities within the Energy Business participate in the 'Electricity System Adjustment Services' regulated in the TSO's Operating Procedure No. 7.3.

## 6. Financial risk management

Given the nature of its activities, ENCE is exposed to several financial risks: (i) market risk; (ii) credit risk; and (iii) liquidity risk. The objective when managing risks that could impact its financial statements is to identify, measure, control, mitigate, minimise or transfer those risks.

Through the Audit Committee and 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.

Each corporate department is responsible for identifying, assessing and hedging risks with a financial statement impact. 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.

Next 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, although the availability of these hedging instruments is very limited.

Based on the Group's 2017 revenue, a 5% change in international pulp prices in euros would have an impact on revenue of approximately 3.5%.

***Supply of timber***

Eucalyptus timber 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.

Based on the Group's timber purchases in 2017, a 5% increase in the price per cubic metre of eucalyptus timber for use in the productive process would decrease operating income by approximately €9.3 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 premiums set by the Spanish government (note 5).

Based on the Group's 2017 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 1.4%.

***Environmental regulations***

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 advisability of using such instruments (note 22).

Based on the Group's 2017 revenue, dollar appreciation against the euro of 5% would increase revenue before hedges by approximately 3.5%.

## 6.2 Credit risk

Credit risk is the risk that a counterparty will breach its contractual obligations. Specifically, the Group's exposure to credit risk 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***

In the Pulp Business, ENCE trades with customers with good credit histories and adequate credit ratings and has a Credit Committee that continuously monitors their creditworthiness and exposures per customer.

Moreover, credit risk on pulp sales is covered by an insurance policy that covers approximately 90% of outstanding balances. Credit risk is also mitigated by demanding irrevocable letters of credit.

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

The Group uses the simplified approach to impairment allowed under IFRS 9, which permits the recognition in one step of a loss allowance based on lifetime expected credit losses. To measure expected credit loss it has regrouped its trade receivables based on their shared credit risk characteristics and number of days they are past due. Applying that approach, the allowances for the impairment of trade receivables at 31 December 2017 and 2016 were determined as follows:

- Trade receivables - Pulp Business. Credit risk is concentrated mainly in the portion of the balance that is not covered by the insurance policy, essentially the aggregate annual deductible of €500 thousand and the deductible per customer (maximum of 10%). As a result, management estimates that expected losses will not exceed the aggregate annual deductible, which is the amount that has been provided for.

- Trade receivables - Energy Business. As these balances are ultimately backed by the Spanish state, the expected loss is considered to be nil.

- Other balances. These are typically associated with the sale of forest assets and tend to be insignificant. There is no recent history of significant losses so that provisions for the impairment of receivables are recognised whenever there are indications that they might not be collected; all balances outstanding by more than 6-12 months not covered by the credit insurance policy are written down for impairment.

The ageing analysis of the "Trade and other receivables" past due but not impaired at year-end 2017 and 2016 is provided below:

| | Thousands of euros |
|---|---|
| Less than 90 days | 1,755 |
| 90 - 180 days | 547 |
| More than 180 days | - |
| | **2,302** |

Elsewhere, using the credit ratings assigned by our credit risk underwriter, 58% of the balances outstanding correspond to customers classified as low risk; 23% to customers classified as medium risk; 12% to medium-high risk customers; and 7% to high risk customers.

***Financial assets, Cash and cash equivalents***

To control the credit risk arising from short-term investments and cash balances, ENCE applies corporate criteria which stipulate that counterparties must be banks with high credit ratings and establish maximum investment/deposit limits per entity that are reviewed periodically.

## 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 risk includes the possibility that ENCE will not be able to meet its future or present obligations due to an insufficient availability of liquidity at any given time.

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 solvency and 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 ceiling 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 4-5 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 mainly using bank finance in the Energy Business (note 20). Against this backdrop, the Group actively searches the market for the sources of financing that best suit its business requirements.

Each of ENCE'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 19 - 22 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. Eighty-five per cent of exposures to floating-rate borrowings, which are concentrated mainly in the Energy Business, are hedged using swaps. Moreover, the debt raised in the capital markets carries fixed rates, thereby minimising interest rate risk (notes 20 and 22).

## 7. Critical accounting estimates and judgements

Preparation of the 2017 consolidated financial statements required the use of assumptions and estimates that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues, income and expenses and the corresponding disclosures.

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

- The fair value of certain assets, principally financial instruments (notes 4.8, 19 and 22).
- The impairment tests carried out, particularly with respect to the biological assets (notes 4.5, 14, 15 and 16).
- The useful lives of fixed and intangible assets (notes 4.2 and 4.3)
- The fair value of the net assets acquired in business combinations (note 2).
- Calculation of income tax and the recoverable amount of deferred tax assets (notes 4.18 and 29).
- The assumptions used to calculate certain obligations to employees (note 4.16).
- Calculation of the provisions recognised to cover liabilities arising under lawsuits in progress and bankruptcies (notes 6, 23 and 28).
- The impact of changes in the Spanish energy sector regulatory framework (note 28).

These assumptions and estimates are made considering 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 2017 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.

## 8. 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 encompasses the seven power generation facilities owned by ENCE that are independent of the Pulp Business: the 50-MW Huelva, 41-MW Huelva, 20-MW Merida, 16-MW Ciudad Real and 16-MW Jaen plants and the two new plants acquired in Cordoba in 2017 (notes 1 and 2).

In order to expand the disclosures provided in this note, the appendices include the consolidated statement of financial position at 31 December 2017 and 2016 and the consolidated income statement and consolidated statement of cash flows for the years then ended broken down between the Pulp and Energy businesses.

### 8.1 Operating segment reporting

The table below details the earnings performance by operating segment in 2017 and 2016, based on the management information reviewed regularly by senior management:

| 2017 | Thousands of euros | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Pulp Business | | | | | | | |
| Income statement | Pulp | Forest Management | Forest Services & Other | Adjustments & Eliminations | Total Pulp | Energy Business & Segment | Adjustments & Eliminations | Total |
| **Revenue:** | | | | | | | | |
| Third parties | 605,541 | 2,969 | - | - | 608,510 | 131,812 | - | 740,322 |
| Inter-segment revenue | 1,916 | 5,101 | 850 | (4,736) | 3,131 | 1,231 | (4,362) | - |
| **Total revenue** | **607,457** | **8,070** | **850** | **(4,736)** | **611,641** | **133,043** | **(4,362)** | **740,322** |
| **Earnings:** | | | | | | | | |
| **EBITDA (*)** | **167,287** | **3,867** | **591** | **(1,154)** | **170,591** | **45,435** | **-** | **216,026** |
| **Operatingprofit/(loss)** | **122,169** | **(909)** | **110** | **-** | **121,370** | **28,279** | **-** | **149,649** |
| Finance income | 14,598 | - | - | (3,163) | 11,435 | 534 | (10,968) | 1,001 |
| Finance costs | (17,627) | (3,005) | (158) | 3,163 | (17,627) | (8,096) | 2,968 | (22,755) |
| Hedging derivatives | 2,093 | - | - | - | 2,093 | (3,710) | - | (1,617) |
| Net exchange gains/(losses) | (6,255) | (1) | (14) | - | (6,270) | (13) | - | (6,283) |
| Impairment of financial instruments | - | (124) | - | - | (124) | - | - | (124) |
| Income tax | (25,033) | 738 | (6) | - | (24,301) | (1,905) | - | (26,206) |
| **Profit/(loss) for the year** | **89,945** | **(3,301)** | **(68)** | **-** | **86,576** | **15,089** | **(8,000)** | **93,665** |
| Profit/(loss) attributable to non-controlling interests | - | - | - | - | - | 1,879 | - | 1,879 |
| **Profit/(loss) attributable to equity holders of the parent** | **89,945** | **(3,301)** | **(68)** | **-** | **86,576** | **13,210** | **(8,000)** | **91,786** |
| Capital expenditure | 25,485 | 4,867 | 76 | - | 30,428 | 16,925 | - | 47,354 |
| Accumulated depreciation and depletion of forest reserves | (874,839) | (56,550) | (1,563) | - | (932,952) | (177,714) | 3,404 | (1,107,262) |
| Provision and impairment charges | (46,986) | (23,246) | (2,853) | - | (73,085) | (2,183) | - | (75,268) |

(*) 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.

| 31 December 2017 | Thousands of euros | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Pulp Business | | | | | | | |
| | Pulp | Forest Management | Forest Services & Other | Adjustments & Eliminations | Total Pulp | Energy Business & Segment | Adjustments & Eliminations | Total |
| **Assets** | | | | | | | | |
| Non-current | 770,657 | 169,473 | 4,183 | (132,931) | 811,382 | 259,351 | (273,775) | 796,958 |
| Current | 326,357 | 3,746 | 2,965 | (3,433) | 329,635 | 150,357 | (33,637) | 446,355 |
| **Total assets (a)** | **1,097,014** | **173,219** | **7,148** | **(136,364)** | **1,141,017** | **409,708** | **(307,412)** | **1,243,313** |
| **Liabilities** | | | | | | | | |
| Non-current | 296,480 | 78,501 | 3,192 | (81,527) | 296,646 | 210,387 | (75,176) | 431,857 |
| Current | 192,146 | 1,981 | 1,750 | (3,804) | 192,073 | 46,746 | (33,637) | 205,182 |
| **Total liabilties (a)** | **488,626** | **80,482** | **4,942** | **(85,331)** | **488,719** | **257,133** | **(108,813)** | **637,039** |

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

| 2016 Income statement | Pulp | Forest Management | Forest Services & Other | Adjustments & Eliminations | Total Pulp | Energy Business & Segment | Adjustments & Eliminations | Total |
|---|---|---|---|---|---|---|---|---|
| | Thousands of euros | | | | | | | |
| | Pulp Business | | | | | | | |
| **Revenue:** | | | | | | | | |
| Third parties | 508,153 | 2,934 | 276 | - | 511,363 | 94,085 | - | 605,448 |
| Inter-segment revenue | 2,465 | 7,157 | 511 | (7,240) | 2,893 | 1,899 | (4,792) | - |
| **Total revenue** | **510,618** | **10,091** | **787** | **(7,240)** | **514,256** | **95,984** | **(4,792)** | **605,448** |
| **Earnings:** | | | | | | | | |
| **EBITDA (*)** | **88,350** | **6,925** | **241** | **(99)** | **95,417** | **30,151** | **-** | **125,568** |
| **Operatingprofit/(loss)** | **36,552** | **16,355** | **4** | **(11)** | **52,900** | **19,823** | **-** | **72,723** |
| Finance income | 12,332 | - | 74 | (9,761) | 2,645 | 310 | (2,670) | 285 |
| Finance costs | (17,114) | (4,155) | (150) | 4,383 | (17,036) | (5,998) | 2,670 | (20,364) |
| Hedging derivatives | (414) | - | - | - | (414) | - | - | (414) |
| Net exchange gains/(losses) | 164 | - | (1,616) | - | (1,452) | 6 | - | (1,446) |
| Impairment of financial instruments | (5,264) | (3,419) | 32 | - | (8,651) | (3,658) | - | (12,309) |
| Income tax | **26,256** | **8,781** | **(1,656)** | **(5,389)** | **27,992** | **10,483** | **-** | **38,475** |
| Capital expenditure | 59,310 | 2,587 | 2,418 | | 64,315 | 6,533 | (2,736) | 68,112 |
| Accumulated depreciation and depletion of forest reserves | (790,815) | (55,935) | (1,091) | - | (847,841) | (143,163) | 3,407 | (987,597) |
| Provision and impairment charges | (53,444) | (29,065) | (2,853) | - | (85,362) | (8,742) | - | (94,104) |

(*) 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.

| 31 December 2016 | Pulp | Forest Management | Forest Services & Other | Adjustments & Eliminations | Total Pulp | Energy Business & Segment | Adjustments & Eliminations | Total |
|---|---|---|---|---|---|---|---|---|
| | Thousands of euros | | | | | | | |
| | Pulp Business | | | | | | | |
| **Assets** | | | | | | | | |
| Non-current | 781,377 | 165,928 | 4,623 | (130,284) | 821,644 | 248,044 | (270,405) | 799,283 |
| Current | 256,045 | 6,467 | 3,713 | (4,567) | 261,658 | 134,823 | (32,486) | 363,995 |
| **Total assets (a)** | **1,037,422** | **172,395** | **8,336** | **(134,851)** | **1,083,302** | **382,867** | **(302,891)** | **1,163,278** |
| **Liabilities** | | | | | | | | |
| Non-current | 326,732 | 74,545 | 4,426 | (78,650) | 327,053 | 188,313 | (71,798) | 443,568 |
| Current | 187,306 | 3,065 | 1,708 | (5,170) | 186,909 | 51,671 | (32,491) | 206,089 |
| **Total liabilties (a)** | **514,038** | **77,610** | **6,134** | **(83,820)** | **513,962** | **239,984** | **(104,289)** | **649,657** |

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

The adjustments and eliminations between the various segments and businesses correspond to the elimination of inter-segment balances and transactions.

The Group does not have significant amounts of non-financial assets outside of Spain.

## 8.2 Disclosures by productive plant

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

| 31 December 2017 | Thousands of euros | | | | | | |
|---|---|---|---|---|---|---|---|
| | Pontevedra factory | Navia factory | Corporate | Other (a) | Subtotal | Eliminations | Total |
| **Business metrics:** | | | | | | | |
| Pulp output (ADt) | 434,654 | 523,297 | - | - | 957,951 | - | 957,951 |
| Pulp sales volume (ADt) | 447,487 | 527,816 | - | - | 975,303 | - | 975,303 |
| Energy sales volume (MWh) | 217,441 | 527,884 | - | 885,840 | 1,631,165 | - | 1,631,165 |
| **Continuing operations:** | | | | | | | |
| Revenue | 257,868 | 334,271 | - | 196,334 | 788,473 | (48,151) | 740,322 |
| Cost of sales and other costs | (112,220) | (137,688) | - | (88,453) | (338,361) | 47,161 | (291,200) |
| **GROSS PROFIT** | **145,648** | **196,583** | **-** | **107,881** | **450,112** | **(990)** | **449,122** |
| Employee benefits expense | (18,823) | (21,892) | (26,577) | (7,074) | (74,366) | - | (74,366) |
| Other operating expenses | (52,052) | (56,046) | (7,023) | (44,599) | (159,720) | 990 | (158,730) |
| Overhead passed on | (13,190) | (16,190) | 33,600 | (4,220) | - | - | - |
| **EBITDA (*)** | **61,583** | **102,455** | **-** | **51,988** | **216,026** | **-** | **216,026** |
| Asset depreciation/amortisation and impairment | (10,797) | (32,301) | - | (23,279) | (66,377) | - | (66,377) |
| **OPERATING PROFIT** | **50,786** | **70,154** | **-** | **28,709** | **149,649** | **-** | **149,649** |
| Net finance cost | (8,539) | (6,725) | - | (14,514) | (29,778) | - | (29,778) |
| **PROFIT BEFORE TAX** | **42,247** | **63,429** | **-** | **14,195** | **119,871** | **-** | **119,871** |
| Income tax | (9,236) | (13,867) | - | (3,103) | (26,206) | - | (26,206) |
| **PROFIT/(LOSS) FOR THE YEAR** | **33,011** | **49,562** | **-** | **11,092** | **93,665** | **-** | **93,665** |
| Profit/(loss) attributable to non-controlling interests | | | | 1,879 | 1,879 | | 1,879 |
| **Profit/(loss) attributable to equity holders of the parent** | **33,011** | **49,562** | **-** | **9,213** | **91,786** | **-** | **91,786** |

(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.

(*) 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.

| 31 December 2016 | Thousands of euros | | | | | | |
|---|---|---|---|---|---|---|---|
| | Pontevedra factory | Navia factory | Corporate | Other (a) | Subtotal | Eliminations | Total |
| **Business metrics:** | | | | | | | |
| Pulp output (ADt) | 422,257 | 509,186 | - | - | 931,443 | - | 931,443 |
| Pulp sales volume (ADt) | 414,693 | 508,715 | - | - | 923,408 | - | 923,408 |
| Energy sales volume (MWh) | 194,731 | 484,968 | - | 628,386 | 1,308,085 | - | 1,308,085 |
| **Continuing operations:** | | | | | | | |
| Revenue | 210,337 | 285,716 | - | 162,809 | 658,862 | (53,414) | 605,448 |
| Cost of sales and other costs | (101,400) | (137,685) | (1,975) | (77,414) | (318,474) | 52,301 | (266,173) |
| **GROSS PROFIT** | **108,937** | **148,031** | **(1,975)** | **85,395** | **340,388** | **(1,113)** | **339,275** |
| Employee benefits expense | (23,499) | (24,068) | (12,457) | (8,404) | (68,428) | - | (68,428) |
| Other operating expenses | (50,798) | (51,611) | (10,830) | (33,153) | (146,392) | 1,113 | (145,279) |
| Overhead passed on | **(13,238)** | **(12,278)** | **27,728** | **(2,212)** | - | - | - |
| **EBITDA (*)** | 21,402 | 60,074 | 2,466 | 41,626 | 125,568 | - | 125,568 |
| Asset depreciation/amortisation and impairment | **(9,118)** | **(28,949)** | **(2,466)** | **(12,312)** | **(52,845)** | - | **(52,845)** |
| **OPERATING PROFIT** | 12,284 | 31,125 | - | 29,314 | 72,723 | - | 72,723 |
| Net finance cost | **(3,655)** | **(6,959)** | - | **(11,325)** | **(21,939)** | - | **(21,939)** |
| **PROFIT BEFORE TAX** | 8,629 | 24,166 | - | 17,989 | 50,784 | - | 50,784 |
| Income tax | **(2,090)** | **(5,858)** | - | **(4,361)** | **(12,309)** | - | **(12,309)** |
| **PROFIT/(LOSS) FOR THE YEAR** | **6,539** | **18,308** | - | **13,628** | **38,475** | - | **38,475** |
| Profit/(loss) attributable to non-controlling interests | | | | - | - | | - |
| **Profit/(loss) attributable to equity holders of the parent** | **6,539** | **18,308** | - | **13,628** | **38,475** | - | **38,475** |

(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.

(*) 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.

## 9. Revenue

The breakdown of Group revenue by business in 2017 and 2016 is as follows:

| Thousands of euros | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Pulp Business | Energy Business | Consolidated Group | Pulp Business | Energy Business | Consolidated Group |
| **Business metrics** | | | | | | |
| Pulp sales volume (tonnes) | 975,303 | - | 975,303 | 923,408 | - | 923,408 |
| Energy sales volume (MWh) | 745,325 | 885,840 | 1,631,165 | 679,700 | 628,386 | 1,308,086 |
| **Revenue** | | | | | | |
| Pulp | 515,184 | - | 515,184 | 428,849 | - | 428,849 |
| Electric energy | 76,845 | 131,696 | 208,541 | 66,616 | 94,078 | 160,694 |
| Sales of timber and forestry services | 16,481 | 116 | 16,597 | 15,898 | 7 | 15,905 |
| Inter-segment sales | 3,131 | 1,231 | - | 2,893 | 1,899 | - |
| | **611,641** | **133,043** | **740,322** | **514,256** | **95,984** | **605,448** |

(*) The difference between the figures presented under "Consolidated Group" for 2017 and 2016 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 2017 and 2016 in the amounts of €4,362 thousand and €4,792 thousand euros, respectively.

The revenue associated with the generation of electricity includes an estimate of the 'adjustment for tariff shortfall/surplus' concept contemplated in electricity sector regulations in order to correct the impact of deviations between the variables estimated by the regulator, for the purpose of calculating remuneration on operations, most important of which estimated pool prices, and those that ultimately materialise. This adjustment had the effect of reducing revenue by €7,400 thousand in 2017 (an increase of €9,471 thousand in 2016).

In 2017, the Group companies made sales in currencies other than the euro, mainly US dollars, totalling €243 million (2016: €138.3 million).

### *9.1 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 | 2017 | 2016 |
|---|---|---|
| Germany | 23.4 | 22.9 |
| Spain | 14.6 | 14.3 |
| Italy | 12.6 | 12.9 |
| Poland | 9.0 | 8.3 |
| Turkey | 8.0 | 5.3 |
| France | 6.9 | 6.7 |
| United Kingdom | 3.2 | 3.6 |
| Austria | 2.1 | 5.0 |
| Greece | 2.1 | 1.7 |
| Slovenia | 1.8 | 2.9 |
| Netherlands | 1.2 | 1.4 |
| Other | 15.2 | 15.0 |
| | **100** | **100** |

(*) Breakdown made on the basis of the location of each customer's registered office

Two customers accounted for sales volumes that represented over 10% of Group revenue from pulp sales.

## 10. Cost of sales

Consumption of raw materials and other consumables breaks down as follows in 2017 and 2016:

| Thousands of euros | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Pulp Business | Energy Business | Consolidated Group | Pulp Business | Energy Business | Consolidated Group |
| Purchases | 222,073 | 37,604 | 256,965 | 216,011 | 23,184 | 235,704 |
| Change in raw materials and other inventories | 1,696 | (1,441) | 256 | 367 | 2,218 | 2,585 |
| Other external expenses | 24,366 | 5,587 | 28,303 | 27,378 | 3,878 | 29,962 |
| | **248,135** | **41,750** | **285,524** | **243,756** | **29,280** | **268,251** |

(*) The difference between the figures presented under “Consolidated Group” for 2017 and 2016 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 2017 and 2016 in the amounts of €4,361 thousand and €4,785 thousand euros, respectively.

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

## 11. Employee benefits expense

The breakdown of the employee benefits expense incurred in 2017 and 2016 is provided below:

| Thousands of euros | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Pulp Business | Energy Business | Consolidated Group | Pulp Business | Energy Business | Consolidated Group |
| Wages and salaries | 48,220 | 5,282 | 53,502 | 48,272 | 2,875 | 51,147 |
| Social security | 11,500 | 1,243 | 12,743 | 11,095 | 654 | 11,749 |
| Contributions to pension plans (note 4.15) | 1,736 | 132 | 1,868 | 1,672 | 86 | 1,758 |
| Other benefit expense | 1,185 | 47 | 1,232 | 1,285 | 24 | 1,309 |
| | 62,641 | 6,704 | 69,345 | 62,324 | 3,639 | 65,963 |
| Long-term remuneration plans | 3,976 | 342 | 4,318 | 929 | 55 | 984 |
| Termination benefits | 675 | 28 | 703 | 1040 | 441 | 1,481 |
| | **67,292** | **7,074** | **74,366** | **64,293** | **4,135** | **68,428** |

### 11.1 Headcount figures

The average Group headcount in 2017 and 2016:

| | Average headcount during the year | | | | | |
|---|---|---|---|---|---|---|
| | 2017 | | | 2016 | | |
| Job category | Men | Women | Total | Men | Women | Total |
| Executives | 6 | 1 | 7 | 6 | 1 | 7 |
| Individual job contracts | 226 | 73 | 299 | 221 | 64 | 285 |
| Collective bargaining agreements | 417 | 60 | 477 | 404 | 55 | 459 |
| Temporary workers | 84 | 42 | 126 | 102 | 38 | 140 |
| | **733** | **176** | **909** | **733** | **158** | **891** |

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

| | Year-end headcount | | | | | |
|---|---|---|---|---|---|---|
| | 2017 | | | 2016 | | |
| Job category | Men | Women | Total | Men | Women | Total |
| Executives | 6 | 2 | 8 | 7 | 1 | 8 |
| Individual job contracts | 235 | 79 | 314 | 220 | 68 | 288 |
| Collective bargaining agreements | 425 | 64 | 489 | 408 | 59 | 467 |
| Temporary workers | 81 | 40 | 121 | 82 | 32 | 114 |
| | **747** | **185** | **932** | **717** | **160** | **877** |

At year-end 2017, 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. Three of the directors represent legal person directors.

## 11.2 Long-term remuneration plans

ENCE's shareholder-ratified “Long-term bonus plan for 2016-2018” aims to align the management team with delivery of the targets set by the Board of Directors for the term of the remuneration plan and to help retain talent (note 4.16).

The bonuses consist of a percentage of the beneficiaries' average annual fixed remuneration in 2016-2018 and will be paid 30% in cash and 70% in Company shares.

The maximum payout under the plan, considering the current 75 beneficiaries and assuming 100% target delivery, amounts to €8,595 thousand. Of this total, 58% corresponds to members of the Management Committee.

The charge accrued in 2017 in this respect amounted to €4,318 thousand (€984 thousand in 2016) and is recognised under: i) “Other equity instruments” in the consolidated statement of financial position for the portion to be settled in shares, in the amount of €3,023 thousand before the related tax effect (€689 thousand in 2016); and ii) “Non-current provisions” in the consolidated statement of financial position (note 28) for the portion to be settled in cash, in the amount of €1,295 thousand (€295 thousand in 2016).

## 12. Other operating expenses

The breakdown of this consolidated income statement heading in 2017 and 2016 was as follows:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| Thousands of euros | Pulp Business | Energy Business | Consolidated Group | Pulp Business | Energy Business | Consolidated Group |
| External services | 125,897 | 28,510 | 149,420 | 117,722 | 24,620 | 128,845 |
| Use of emission allowances (note 18) | 1,897 | 220 | 2,117 | 1,600 | 5 | 1,605 |
| Taxes other than income tax and other management charges | 3,218 | 1,502 | 4,720 | 3,174 | 295 | 3,469 |
| Electricity generation levy | 5,482 | 8,544 | 14,026 | 4,687 | 6,609 | 11,296 |
| Change in trade and other provisions | 312 | 224 | 536 | (257) | 45 | (212) |
| Impact of the closure of the Huelva factory (note 28) | - | - | - | 145 | - | 145 |
| Other non-recurring charges | - | - | - | 10,127 | 4,244 | 14,319 |
| | **136,806** | **39,000** | **170,819** | **137,198** | **35,818** | **159,467** |

(*) The difference between the figures presented under "Consolidated Group" for 2017 and 2016 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 2017 and 2016 in the amounts of €4,987 thousand and €13,549 thousand euros, respectively.

In 2016, "Other non-recurring charges" included €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. This heading also included the costs of promoting new projects, non-recurring consultancy fees incurred as part of the plant efficiency projects and the impact of non-recurring equipment breakdowns in 2016.

### 12.1 External services

The breakdown of "External services" in 2017 and 2016 is as follows:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| Thousands of euros | Pulp Business | Energy Business | Consolidated Group | Pulp Business | Energy Business | Consolidated Group |
| Transport, freight and business expenses | 34,321 | 191 | 34,512 | 32,787 | 80 | 32,867 |
| Utilities | 37,949 | 1,261 | 39,209 | 31,409 | 708 | 32,117 |
| Repairs and upkeep | 13,689 | 11,756 | 25,445 | 14,801 | 6,449 | 21,250 |
| Rent and royalties | 6,174 | 548 | 6,596 | 4,652 | 394 | 4,972 |
| Insurance premiums | 3,212 | 839 | 4,051 | 2,934 | 466 | 3,400 |
| Independent professional services | 6,075 | 747 | 6,822 | 3,863 | 278 | 4,141 |
| Banking and similar services | 956 | 217 | 1,173 | 1,084 | 70 | 1,154 |
| Advertising, publicity and public relations (note 25) | 3,118 | 3 | 3,121 | 658 | - | 658 |
| Research and development costs | 665 | - | 665 | 1,576 | - | 1,576 |
| Other services | 19,738 | 12,948 | 27,826 | 23,958 | 16,175 | 26,710 |
| | **125,897** | **28,510** | **149,420** | **117,722** | **24,620** | **128,845** |

(*) The difference between the figures presented under "Consolidated Group" for 2017 and 2016 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 2017 and 2016 in the amounts of €4,987 thousand and €13,497 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 2017, this policy cost the Group €28 thousand euros.

### 12.2 Audit fees

The fees paid for financial statement audit work and other services to the Group's auditor, Pricewaterhousecoopers Auditores, S.L., and entities related to the latter in 2017 and 2016 are shown in the next table:

| Thousands of euros | 2017 | 2016 |
|---|---|---|
| Audit services | 164 | 143 |
| Other services (*) | 2 | 17 |

(*) In 2017 and 2016, this concept included other services related with the audit: (i) the review over the internal control over financial reporting system; and (ii) the provision of a report containing the financial ratios needed to comply with covenants under financing agreements.

In addition, the network to which the auditor belongs invoiced the Group €12 thousand for audit services performed outside of Spain and €88 thousand for other services.

### 12.3 Leases

At year-end, 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 | 31/12/2017 | 31/12/2016 |
|---|---|---|
| Within one year | 2,113 | 2,160 |
| Between one and five years | 6,053 | 7,000 |
| More than five years | 9,650 | 10,118 |
| | **17,816** | **19,278** |

At year-end 2017, the Group managed 22,824 hectares of forest assets earmarked for the production of biological assets under leases and via consortia (25,303 hectares at year-end 2016). 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 15.2).

## 13. Finance costs

The breakdown of this consolidated income statement heading in 2017 and 2016 was as follows:

| Thousands of euros | 2017 Pulp Business | 2017 Energy Business | 2017 Consolidated Group | 2016 Pulp Business | 2016 Energy Business | 2016 Consolidated Group |
|---|---|---|---|---|---|---|
| High-yield bond | 13,440 | - | 13,440 | 13,438 | - | 13,438 |
| Project finance facilities | - | 2,389 | 2,389 | - | 3,068 | 3,068 |
| Credit, factoring and reverse factoring lines | 2,132 | 601 | 2,733 | 1,575 | - | 1,575 |
| Fees for undrawn facilities and other charges | 2,127 | 467 | 2,594 | 1,900 | 521 | 2,421 |
| Capitalised borrowing costs (note 16) | (72) | - | (72) | (79) | - | (79) |
| Inter-business finance costs | - | 2,968 | - | 202 | 2,468 | - |
| Other | - | - | - | - | - | - |
| | 17,627 | 6,425 | 21,084 | 17,036 | 6,057 | 20,423 |
| Non-recurring costs associated with refinancing work: | | | | | | |
| Fair value of IR swaps reclassified to profit or loss | - | 3,631 | 3,631 | - | - | - |
| Derecognition of arrangement fees | - | 1,554 | 1,554 | - | - | - |
| | - | 5,185 | 5,185 | - | - | - |
| Derivatives: | | | | | | |
| Settlement of IR swap | - | 117 | 117 | - | (59) | (59) |
| Fair value of currency and other hedges | (2,093) | 79 | (2,014) | 414 | - | 414 |
| | (2,093) | 196 | (1,897) | 414 | (59) | 355 |
| | **15,534** | **11,806** | **24,372** | **17,450** | **5,998** | **20,778** |

(*) The difference between the figures presented under “Consolidated Group” for 2017 and 2016 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 2017 and 2016 in the amounts of €2,967 thousand and €2,670 thousand euros, respectively.

The bank debt funding the Energy Business was refinanced on 24 November 2017 (note 20) as a result of which the project finance facilities that had been financing the 50-MW Huelva and 20-MW Merida biomass power plants and the two loans arranged to fund the acquisition of Energía de la Loma, S.A. and Energías de la Mancha ENEMAN, S.A. were prepaid. As a result, the debt arrangement fees pending reclassification to profit or loss at the time of the refinancing - in the amount of €1,554 thousand euros - were written off.

This transaction also included the restructuring of the interest-rate swaps arranged to hedge the related exposure to 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 (€3,631 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") (notes 20 and 22).

## 14. Goodwill and other intangible assets

The reconciliation of the carrying amounts of the various components of intangible assets and accumulated amortisation in 2017 and 2016 is as follows:

| 2017 | Thousands of euros<br>Balance at 01/01/2017 | Additions/ (charges) | Transfers (note 15) | Balance at 31/12/2017 |
|---|---|---|---|---|
| Goodwill | 2,697 | 40 | - | 2,737 |
| Software | 19,060 | 513 | 751 | 20,324 |
| Development costs | 17,092 | 141 | 1,199 | 18,432 |
| Prepayments | 1,448 | 942 | (1,855) | 535 |
| Other intangible assets | 3,167 | - | - | 3,167 |
| **Total cost** | **43,464** | **1,636** | **95** | **45,195** |
| Software | (11,171) | (2,517) | - | (13,688) |
| Development costs | (9,437) | (911) | - | (10,348) |
| Other intangible assets | (1,317) | (21) | - | (1,338) |
| **Total amortisation** | **(21,925)** | **(3,449)** | **-** | **(25,374)** |
| Goodwill | - | (249) | | (249) |
| Development costs | (2,854) | - | - | (2,854) |
| Other intangible assets | (746) | - | - | (746) |
| **Total impairment** | **(3,600)** | **(249)** | **-** | **(3,849)** |
| **Carrying amount** | **17,939** | **(2,062)** | **95** | **15,972** |

| 2016 | Thousands of euros<br>Balance at 01/01/2016 | Changes in scope (note 2) | Additions/ (charges) | Transfers (notes 15 & 18) | Balance at 31/12/2016 |
|---|---|---|---|---|---|
| Goodwill | - | 2,697 | - | - | 2,697 |
| Software | 17,510 | - | 31 | 1,519 | 19,060 |
| Emission allowances (note 18) | 1,303 | - | - | (1,303) | - |
| Development expenses | 12,340 | - | 2,418 | 2,334 | 17,092 |
| Prepayments | 2,366 | - | 2,765 | (3,683) | 1,448 |
| Other intangible assets | 2,092 | - | 1,075 | - | 3,167 |
| **Total cost** | **35,611** | **2,697** | **6,289** | **(1,133)** | **43,464** |
| Software | (9,019) | - | (2,152) | - | (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)** |
| Goodwill | (2,854) | - | - | - | (2,854) |
| Other intangible assets | (746) | - | - | - | (746) |
| **Total impairment** | **(3,600)** | **-** | **-** | **-** | **(3,600)** |
| **Carrying amount** | **12,613** | | | | **17,939** |

The Group did not capitalise any own work within intangible assets in 2017. In 2016, it capitalised investments of €2,025 thousand.

The Group continues to strategically upgrade the IT systems supporting its key business processes framed by the SAP platform.

In 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 related investment amounted to €2,009 thousand.

At 31 December 2017 and 2016, there were fully-amortised intangible assets still in use with an original cost of €16,669 thousand.

### 14.1 Goodwill

The goodwill recognised at 31 December 2017 in the amount of €2,488 thousand arose on the acquisition by ENCE of interests in Energía de la Loma, S.A. and Energías de la Mancha ENEMAN, S.A., the cash-generating units to which it has been allocated.

The goodwill will be amortised over the remaining regulatory useful lives of the power plants to which it has been allocated. That goodwill balance has been written down for impairment by €249 thousand to reflect the one-year reduction in those plants' regulatory useful lives. Factoring in that impairment charge, the recoverable amounts of the cash-generating units to which the goodwill has been allocated are in line with their carrying amounts.

## 15. Property, plant and equipment

The reconciliation of the carrying amounts of the various components of property, plant and equipment and accumulated depreciation in 2017 and 2016 is as follows:

| | Thousands of euros | | | | | | |
|---|---|---|---|---|---|---|---|
| 2017 | Balance at 01/01/2017 | Changes in consolidation scope (note 2) | Additions/ (charges) | Derecognitions or decreases | Transfers to held for sale (note 17) | Transfers (note 14) | Balance at 31/12/2017 |
| Forest land | 82,865 | - | 955 | (97) | 130 | - | 83,853 |
| Other land | 9,422 | 821 | - | (64) | - | 354 | 10,533 |
| Buildings | 107,679 | 936 | 92 | (299) | - | 3,183 | 111,591 |
| Plant and equipment | 1,400,642 | 27,485 | 1,980 | (842) | 37,453 | 19,302 | 1,486,020 |
| Other PP&E | 43,377 | 9,169 | 598 | - | - | 4,131 | 57,275 |
| Prepayments and PP&E in progress | 17,598 | 28 | 38,397 | 5 | - | (27,067) | 28,961 |
| **Cost** | **1,661,583** | **38,439** | **42,022** | **(1,297)** | **37,583** | **(97)** | **1,778,233** |
| Buildings | (60,787) | (276) | (1,768) | 209 | - | (4,360) | (66,982) |
| Plant and equipment | (832,973) | (18,549) | (61,637) | 512 | (30,300) | 4,362 | (938,585) |
| Other PP&E | (25,551) | (1,932) | (3,558) | - | - | - | (31,041) |
| **Depreciation** | **(919,311)** | **(20,757)** | **(66,963)** | **721** | **(30,300)** | **2** | **(1,036,608)** |
| Land and buildings | (1,985) | - | - | - | - | - | (1,985) |
| Plant and equipment | (52,409) | - | - | 10,039 | (3,018) | - | (45,388) |
| Other PP&E | (1,579) | - | - | - | - | - | (1,579) |
| **Impairment** | **(55,973)** | **-** | **-** | **10,039** | **(3,018)** | **-** | **(48,952)** |
| **Carrying amount** | **686,299** | | | | | | **692,673** |

| 2016 | Thousands of euros | | | | | | |
|---|---|---|---|---|---|---|---|
| | Balance at 01/01/2016 | Changes in consolidation scope (note 2) | Additions/ (charges) | Derecognitions or decreases | Transfers to held for sale (note 17) | Transfers (note 14) | Balance at 31/12/2016 |
| Forest land | 82,867 | - | - | - | (2) | - | 82,865 |
| Other land | 8,108 | 146 | 1,159 | - | - | 9 | 9,422 |
| Buildings | 96,875 | 4,749 | 522 | (33) | 34 | 5,532 | 107,679 |
| Plant and equipment | 1,034,869 | 62,434 | 7,066 | (6,758) | 245,171 | 57,860 | 1,400,642 |
| Other 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** | **68,045** | **58,446** | **(7,178)** | **261,872** | **(892)** | **1,661,583** |
| Buildings | (58,632) | - | (2,168) | 13 | - | - | (60,787) |
| Plant and equipment | (556,142) | (43,966) | (60,905) | 3,885 | (176,567) | 722 | (832,973) |
| Other 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) | - | - | - | - | - | (1,985) |
| Plant and equipment | (8,334) | - | (10,714) | 22,571 | (55,932) | - | (52,409) |
| Other PP&E | (1,579) | - | - | - | - | - | (1,579) |
| **Impairment** | **(11,898)** | **-** | **(10,714)** | **22,571** | **(55,932)** | **-** | **(55,973)** |
| **Carrying amount** | **641,930** | | | | | | **686,299** |

## 15.1 Additions

The Group invested in its productive facilities in both the Pulp and Energy Businesses with a view to making its production processes more efficient, boosting power generation and making them more environmentally friendly. This capital expenditure breaks down as follows by facility:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Pulp Business: | | |
| Pontevedra | 14,399 | 22,378 |
| Navia | 10,068 | 33,060 |
| Other | 1,263 | - |
| Energy Business: | | |
| 40-MW Huelva (*) | 9,600 | - |
| 16-MW Ciudad Real | 755 | - |
| 16-MW Jaen | 673 | - |
| 50-MW Huelva | 667 | 814 |
| 41-MW Huelva | 1,835 | 1,682 |
| Other | 2,762 | 512 |
| | **42,022** | **58,446** |

(*) Plant under construction

Through Ence Energía Hueva Dos, S.L.U., on 8 November 2017, the Group signed an EPC contract for the construction of a 40-megawatt renewable energy power plant fuelled by biomass. The plant is located in

Huelva and it is expected to be commissioned during the second half of 2019. Investment in this project is expected to total €89 million, €60 million of which will be financed by a syndicated bank loan (note 20).

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.

Capital commitments

At year-end 2017, the Group had contractually committed to capital expenditure at its factories of €25.3 million, €2.5 million of which will be earmarked to its Energy Business, with the remaining €22.8 million going to the Pulp Business.

## 15.2 Public-domain concession - Pontevedra Pulp Mill

The Pontevedra factory is located on public-domain coastal land for which ENCE holds the corresponding domain concession, to which end it is subject to the legal regime contemplated in Law 2/2013, of 29 May 2013, on coastal protection and sustainability and amending the Coastal Act, and the General Coast Regulations enacted by means of Royal Decree 876/2014 (10 October 2014).

That concession 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 conditional upon ENCE making certain investments totalling €61 million at the facility between 2017 and 2019, as follows:

1. Investments of €30.2 million earmarked to increasing the mill's capacity and making it more efficient.
2. Investments of €27 million 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. Investments of €4 million for designing and executing a landscaping project for the factory in Lourizán.

Of this total, €19.3 million has already been invested, while the Group is contractually committed to investing another €12.1 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 32), along with other commitments such as the installation of three bioenergy centres and one biomass CHP facility in Galicia entailing an estimated investment of up to €94 million.

## 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:

| Thousands of euros | 2017 | 2016 |
|---|---|---|
| Buildings | 35,052 | 29,976 |
| Machinery & equipment | 394,162 | 370,578 |
| Tools | 1,456 | 1,301 |
| Furniture & fittings | 4,932 | 4,772 |
| Other | 75,176 | 5,072 |
| | **510,778** | **411,699** |

## 15.4 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 €13,517 thousand (€13,876 thousand at 31 December 2016), amounted to €40,615 thousand at year-end (€41,690 thousand at 31 December 2016) and is included in “Valuation adjustments” in equity.

## 15.5 Discontinuation of a business - Pulp production in Huelva

The decision taken at the end of 2014 to cease pulp production at the Huelva industrial complex has meant that some of its industrial assets are no longer used for productive purposes.

The recoverable amount of these assets at year-end 2017, determined by means of an appraisal conducted by a prestigious independent expert, was €14,622 thousand (€16,919 thousand at 31 December 2016). For accounting purposes, those assets were presented at 31 December 2017 at a cost of €294,496 thousand net of accumulated depreciation of €239,859 thousand and net of impairment losses of €41,282 thousand.

At the time of discontinuation of this activity, the Group embarked on an active sale process, to which end it reclassified them as "non-current assets held for sale". Since then, some of these assets have been sold; the remainder were reclassified in 2017 and 2016 out of "Non-current assets held for sale" and into "Property, plant and equipment", despite the fact that the sale process remains active (note 17).

In keeping with IFRS 5, upon reclassification these assets were measured at their carrying amount prior to classification as non-current assets held for sale and adjusted for the depreciation charges that would have been recognised had the assets not been so classified. This accounting treatment has implied additional depreciation charges in 2017 and 2016 of €2,091 thousand and €14,262 thousand, respectively, as well as the reversal of impairment losses in the same amounts.

## 15.6 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 and their insurance advisors believe that the coverage provided by these policies at the reporting date is sufficient.

## 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 2017 and 2016 is as follows:

| Thousands of euros | 31/12/2017 | 31/12/2016 |
|---|---|---|
| Forest cover - Pulp Business | 81,497 | 82,768 |
| Forest cover - Energy Business | 195 | 643 |
| | **81,692** | **83,411** |

The movement in this heading 2017 and 2016:

| 2017 | Thousands of euros | | | | |
|---|---|---|---|---|---|
| | Balance at 01/01/2017 | Additions/ (charges) | De-recognitions | Transfers | Balance at 31/12/2017 |
| **Pulp Business:** | | | | | |
| Forest cover | 158,956 | 3,431 | (14,400) | - | 147,987 |
| Depletion of forest reserve | (45,464) | (4,033) | 4,449 | - | (45,048) |
| Provision for impairment | (30,724) | (256) | 9,538 | - | (21,442) |
| | **82,768** | **(858)** | **(413)** | **-** | **81,497** |
| **Energy Business** | | | | | |
| Forest cover | 5,347 | 265 | (4,160) | - | 1,452 |
| Depletion of forest reserve | (897) | (764) | 1,429 | - | (232) |
| Provision for impairment | (3,807) | - | 2,782 | - | (1,025) |
| | **643** | **(499)** | **51** | **-** | **195** |
| | **83,411** | | | | **81,692** |

| 2016 | Thousands of euros | | | | |
|---|---|---|---|---|---|
| | 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) |
| | **87,230** | **(3,950)** | **(512)** | **-** | **82,768** |
| **Energy Business:** | | | | | |
| 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** |

In 2017, the Group planted 292 hectares of land (2016: 251 hectares) and carried out forest preservation and protection work encompassing 2,299 hectares (2014: 2,199 hectares). The Group has derecognised the forest cover affected by the fires of October 2017; however, this did not have a significant impact on the accompanying financial statements.

## 16.1 Breakdown of forest cover

An analysis of the Group's forest cover at year-end 2017 and 2016 is provided below:

| 2017 | Spain & Portugal | | | |
|---|---|---|---|---|
| | Pulp | | Energy crops | |
| Age (years) | Productive hectares | Carrying amount in € '000 | Productive hectares | Carrying amount in € '000 |
| > 17 | 1,263 | 3,262 | - | - |
| 14 - 16 | 1,240 | 4,349 | - | - |
| 11 - 13 | 10,103 | 34,294 | - | - |
| 8 - 10 | 12,517 | 30,495 | - | - |
| 4 - 7 | 14,636 | 23,162 | 1,430 | 1,035 |
| 0 - 3 | 11,295 | 7,377 | 591 | 185 |
| Impairment of biological assets | - | (21,442) | - | (1,025) |
| | **51,054** | **81,497** | **2,021** | **195** |

| 2016 | Spain & Portugal | | | |
|---|---|---|---|---|
| | Pulp | | Energy crops | |
| Age (years) | Productive hectares | Carrying amount in € '000 | Productive hectares | Carrying amount in € '000 |
| > 17 | 915 | 2,343 | - | - |
| 14 - 16 | 966 | 3,935 | - | - |
| 11 - 13 | 8,887 | 30,833 | - | - |
| 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** |

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 2017 corresponding to forest plantation, preservation and silviculture services received amounted to €3,768 thousand (€3,298 thousand in 2016).

The Group also capitalised €72 thousand of borrowing costs under forest cover in 2017 (€79 thousand in 2016); this addition is accounted for in the consolidated income statement as a reduction in “Other finance costs” (note 13).

### 16.3 Derecognitions and impairment

At 31 December 2017, the Group recognised impairment losses against its biological assets totalling €22,467 thousand (€46,532 thousand at year-end 2016).

These assets were tested for impairment using the methodology and assumptions outlined in notes 4.4. and 4.5; this exercise yielded a net realisable value that was below the carrying amount of these assets, justifying the related impairment charges.

An increase in market timber prices of 1% would have the effect of reducing the impairment charges recognised by approximately €2.3 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 2017 and 2016 is as follows:

| Thousands of euros - 2017 | Balance at 01/01/2017 | Assets consumed and other | Sales | Transfers (note 15) | Impairment | Balance at 31/12/2017 |
|---|---|---|---|---|---|---|
| Huelva industrial complex (note 15) | 4,262 | - | (29) | (4,135) | (98) | - |
| Forest land and cover | 2,621 | (228) | (2,263) | (130) | - | - |
| **Total** | **6,883** | **(228)** | **(2,292)** | **(4,265)** | **(98)** | **-** |

| Thousands of euros - 2016 | Balance at 01/01/2016 | Assets consumed and other | Sales | Transfers (note 15) | Impairment | Balance at 31/12/2016 |
|---|---|---|---|---|---|---|
| Huelva industrial complex (note 15) | 26,207 | - | (346) | (20,700) | (899) | 4,262 |
| Forest land and cover | 24,131 | (316) | (21,194) | - | - | 2,621 |
| **Total** | **50,338** | **(316)** | **(21,540)** | **(20,700)** | **(899)** | **6,883** |

**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.

It completed this process in 2017 with the sale of 165 hectares for €2,162 thousand.

In 2016, it sold 1,736 hectares for €37,494 thousand, generating a gain of €16,297 thousand, which was recognised under “Impairment of and gains/(losses) on disposals of intangible assets and PP&E” in the 2016 income statement.

## 18. Inventories

The breakdown of the Group’s inventories at 31 December 2017 and 2016 is as follows:

| Thousands of euros | 31/12/2017 | 31/12/2016 |
|---|---|---|
| Timber | 16,084 | 17,394 |
| Other raw materials | 1,771 | 859 |
| Spare parts (*) | 7,593 | 6,978 |
| Greenhouse gas emission allowances | 1,713 | 1,263 |
| Finished goods and work in progress | 11,336 | 16,547 |
| Prepayments to suppliers | 629 | 566 |
| | **39,126** | **43,607** |

(*) Presented net of impairment allowances of €13,653 thousand and €14,884 thousand at 31 December 2017 and 2016, respectively.

There are no restrictions on title to inventories.

At 31 December 2017, the Group had entered into agreements with suppliers for the purchase, during the next three years, of 3.4 million tonnes of biomass for use at the power plants constituting the Energy 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 2017 and 2016 is provided in the next table:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Number of allowances | Thousands of euros | Number of allowances | Thousands of euros |
| Opening balance | 101,389 | 1,263 | 122,605 | 1,303 |
| Changes in consolidation scope (note 2) | 34,815 | 204 | - | - |
| Allocations (note 27) | 89,558 | 547 | 91,287 | 734 |
| Delivered (*) | (163,626) | (1,586) | (162,503) | (1,564) |
| Purchased | 81,000 | 1,285 | 50,000 | 790 |
| **Closing balance** | **143,136** | **1,713** | **101,389** | **1,263** |

(*) 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 89,558 tonnes of carbon emissions, valued at €547 thousand, in 2017 (91,287 tonnes valued at €734 thousand in 2016).

“Current provisions” on the liability side of the consolidated statement of financial position includes €2,136 thousand in this respect at 31 December 2017 (€1,605 thousand at year-end 2016) corresponding to the liability derived from the consumption of 184,409 tonnes of carbon in 2017 (163,626 tonnes in 2016) (note 28).

Elsewhere, the Group has contractually committed to the forward purchase of allowances covering a total of 470,000 tonnes of carbon at a price of €15.97/tonne and exercisable in 2018 and 2019. It is estimated that part of the allowance purchases committed to, approximately 63 thousand allowances, will not be consumed within the term of the current 2013-2020 Plan, to which end these allowances have been measured at market value. This has entailed the recognition of a €491 thousand provision within "Non-current provisions" on the accompanying consolidated statement of financial position (with a charge to "Other operating expenses" in the income statement) (year-end 2016: €2,190 thousand) (note 28).

## 19. Financial instruments by category

The table below reconciles the Group’s financial instruments by category and the consolidated statement of financial position headings:

| 2017<br>Thousands of euros | Note | Amortised cost | Fair value through other comprehensive income | Fair value through profit or loss | Total at 31/12/2017 |
|---|---|---|---|---|---|
| Derivatives | 22 | - | 14,344 | 1,682 | 16,026 |
| Trade and other receivables | 23 | 105,852 | - | 919 | 106,771 |
| Other financial investments | 21 | 8,016 | - | 2,479 | 10,495 |
| Cash and cash equivalents | 20 | 270,528 | - | - | 270,528 |
| **Total financial assets** | | **384,396** | **14,344** | **5,080** | **403,820** |
| Derivatives | 22 | - | 5,812 | - | 5,812 |
| Trade and other payables | 24 | 168,636 | - | - | 168,636 |
| Bonds and other marketable securities | 20 | 293,558 | - | - | 293,558 |
| Bank borrowings | 20 | 115,453 | - | - | 115,453 |
| Other financial liabilities | 21 | 21,052 | - | - | 21,052 |
| **Total financial liabilities** | | **598,699** | **5,812** | **-** | **604,511** |

| 2016<br>Thousands of euros | Note | Amortised cost | Fair value through other comprehensive income | Fair value through profit or loss | Total at 31/12/2016 |
|---|---|---|---|---|---|
| Derivatives | 22 | - | - | - | - |
| Trade and other receivables | 23 | 79,451 | - | 770 | 80,221 |
| Other financial investments | 21 | 12,513 | - | 8,701 | 21,214 |
| Cash and cash equivalents | 20 | 209,864 | - | - | 209,864 |
| **Total financial assets** | | **301,828** | **-** | **9,471** | **311,299** |
| Derivatives | 22 | - | 26,075 | 414 | 26,489 |
| Trade and other payables | 24 | 154,169 | - | - | 154,169 |
| Bonds and other marketable securities | 20 | 243,631 | - | - | 243,631 |
| Bank borrowings | 20 | 153,408 | - | - | 153,408 |
| Other financial liabilities | 21 | 40,724 | - | - | 40,724 |
| **Total financial liabilities** | | **591,932** | **26,075** | **414** | **618,421** |

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 (note 4.8).

The fair value of the Group's financial assets and liabilities is not significantly different from their carrying amounts. Note that the bonds issued by ENCE in 2015 were trading at 106.41% of par at 31 December 2017.

## 20. Borrowings and cash and cash equivalents

The breakdown of the Group's drawn borrowings at 31 December 2017 and 2016 is as follows:

| | 31/12/2017 | | 31/12/2016 | |
|---|---|---|---|---|
| Thousands of euros | Current | Non-current | Current | Non-current |
| Borrowings - Pulp Business | | | | |
| High-yield bond | - | 250,000 | - | 250,000 |
| Loans | 4,286 | 21,429 | 4,286 | 25,714 |
| Arrangement costs | - | (5,390) | - | (6,369) |
| Accrued interest payable and other | 2,415 | - | 2,352 | - |
| | **6,701** | **266,039** | **6,638** | **269,345** |
| Borrowings - Energy Business | | | | |
| Notes issued | - | 50,000 | - | - |
| Loans | 7,000 | 83,000 | 1,001 | 13,999 |
| Project finance facilities | - | - | 12,753 | 94,984 |
| Arrangement costs | - | (3,759) | - | (1,765) |
| Accrued interest payable and other | 30 | - | 84 | - |
| | **7,030** | **129,241** | **13,838** | **107,218** |
| | **13,731** | **395,280** | **20,476** | **376,563** |

The breakdown of bank borrowings at 31 December 2017 and 2016 corresponding to loans and discounting facilities, classified by their respective maturities, is as follows:

| | | | Maturity | | | | |
|---|---|---|---|---|---|---|---|
| Year-end 2017 – Thousands of euros | Limit | Balance drawn | 2018 | 2019 | 2020 | 2021 | Beyond |
| Borrowings - Pulp Business | | | | | | | |
| High-yield bond | 250,000 | 250,000 | - | - | - | - | 250,000 |
| Revolving credit facility | 90,000 | - | - | - | - | - | - |
| Other loans | 25,714 | 25,714 | 4,286 | 19,286 | 2,143 | - | - |
| Arrangement fees | - | (5,390) | (1,005) | (1,063) | (1,125) | (1,190) | (1,007) |
| Accrued interest payable and other | - | 2,415 | 2,415 | - | - | - | - |
| | **365,714** | **272,739** | **5,696** | **18,223** | **1,018** | **(1,190)** | **248,993** |
| Borrowings - Energy Business | | | | | | | |
| Notes | 50,000 | 50,000 | - | - | - | - | 50,000 |
| Revolving credit facility | 20,000 | - | - | - | - | - | - |
| Loans | 150,000 | 90,000 | 7,000 | 14,000 | 17,000 | 26,000 | 26,000 |
| Arrangement fees | - | (3,759) | (414) | (531) | (565) | (486) | (1,764) |
| Accrued interest payable and other | - | 30 | 30 | - | - | - | - |
| | **220,000** | **136,271** | **6,616** | **13,469** | **16,435** | **25,514** | **74,236** |
| | **585,714** | **409,010** | **12,312** | **31,692** | **17,453** | **24,324** | **323,229** |

| Year-end 2016 – Thousands of euros | Limit | Balance drawn | Maturity 2017 | 2018 | 2019 | 2020 | Beyond |
|---|---|---|---|---|---|---|---|
| Borrowings - Pulp Business | | | | | | | |
| High-yield bond | 250,000 | 250,000 | - | - | - | - | 250,000 |
| Revolving credit facility | 90,000 | - | - | - | - | - | - |
| Loans | 30,000 | 30,000 | 4,286 | 4,286 | 19,286 | 2,142 | - |
| Arrangement fees | - | (6,369) | - | (1,005) | (1,063) | (1,125) | (3,176) |
| Accrued interest payable and other | - | 2,352 | 2,352 | - | - | - | - |
| | **370,000** | **275,983** | **6,638** | **3,281** | **18,223** | **1,017** | **246,824** |
| Borrowings - Energy Business | | | | | | | |
| Loans | 15,000 | 15,000 | 1,001 | 1,159 | 3,409 | 3,409 | 6,022 |
| Project Finance | 107,737 | 107,737 | 12,753 | 13,425 | 13,590 | 13,587 | 54,382 |
| Arrangement fees | - | (1,765) | - | (338) | (294) | (249) | (884) |
| Accrued interest payable and other | - | 84 | 84 | - | - | - | - |
| | **122,737** | **121,056** | **13,838** | **14,246** | **16,705** | **16,747** | **59,520** |
| | **492,737** | **397,039** | **20,476** | **17,527** | **34,928** | **17,764** | **306,344** |

In addition, the Group has receivables factoring facilities with a limit of €85,000 thousand (note 23) and reverse factoring lines with a limit of €125,000 thousand (note 24).

## 20.1 Borrowings - Pulp Business

**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 bonds were issued under New York state law and are traded on the Luxembourg Euro MTF exchange. They were issued to refinance the Company's 2013 bond issue.

The 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. 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.

**Loans**

In 2015, ENCE arranged two loans to fund some of the investments carried out at the Navia factory (Asturias) related with capacity additions:

- On 23 April 2015, it arranged a €15 million loan repayable in a single bullet payment on 24 March 2019. That loan accrues interest at Euribor plus 2.1%.

- On 15 July 2015, it arranged a €15 million loan repayable on 30 June 2020. This loan has a two-year grace period after which it has to be repaid in equal instalments during the remaining three years. That loan accrues interest at a fixed rate of 2.1%.

Several Group companies belonging to the Pulp Business are guarantors on these loans.

## 20.2 32.2 Energy Business

On 25 November 2017, Ence Energía, S.L., the holding company for ENCE's Energy Business, arranged a senior loan with a syndicate of 12 banks and one Spanish insurance company with a drawdown limit of €170 million. That loan is structured into four tranches:

| | Thousands of euros | | | Interest |
|---|---|---|---|---|
| | Drawn | Undrawn | Maturity | rate (*) |
| Tranche 1 | 84,000 | 84,000 | Dec 2024 | 1.75%-3.25% |
| Tranche 2 | 6,000 | 6,000 | Dec 2025 (**) | 3.45% |
| Tranche 3 (***) | 60,000 | - | Dec 2024 | 1.75%-3.25% |
| Tranche 4 | 20,000 | - | Dec 2024 | 1.25%-2.75% |
| | **170,000** | **90,000** | | |

(*) Euribor plus a spread that varies in accordance with leverage in the Energy Business
(**) Due in a single bullet on the date indicated.
(***) The proceeds will be used to build a new power plant in Huelva with installed capacity of 40 MW (note 15). Drawdowns are expected to begin during the first half of 2018.

Against the backdrop of this facility, ENCE also placed €50 million of notes in a private placement which was subscribed by a fixed-income fund. These notes are due in a single instalment in 2025 and accrue interest at 6-month Euribor plus a spread of 3.45%. Those notes have been admitted to trading on the Frankfurt exchange (Freiverkehr).

This financing is secured mainly by pledges over the shares in ENCE Energía Huelva, S.L.U., ENCE Energía Extremadura, S.L.U., Ence Energía Huelva 2 S.L.U, Celulosa Energía S.L.U., Bioenergía Santamaría S.L.U., Energías de la Mancha ENEMAN, S.A. and Energía de La Loma S.A., as well as their current and future assets and credit claims. The Pulp Business is accordingly not part of the guarantee arrangement.

The financing 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 solvency and profitability financial ratios determined on the basis of the annual consolidated financial statements of Ence Energía, S.L. and a requirement to maintain a minimum biomass stock buffer, factoring in supply agreements, equivalent to three months' consumption. The covenants also stipulate a minimum cash sweep in the Energy

Business of €34.3 million, including any amounts drawn down under tranche 4, as well as certain restrictions regarding the payment of dividends and ability to secure additional financing.

The commissions paid in 2017 to arrange this funding totalled €3,754 thousand.

Based on internal analysis, it was concluded that this financing meets the requirements for recognition as new financing rather than the modification of existing financial liabilities.

In order to hedge the risk deriving from this floating-rate facility, ENCE has restructured the hedge agreements it had arranged for the purposes of its project finance facilities. The new interest-rate swaps cover 85% of the financing drawn down and lock in an average rate of 1.87% (note 22).

**Financing cancelled**

The proceeds from this new financing were used to prepay the financing in place until then, as follows:

- The syndicated loan in the form of a project finance facility in the amount of €135,018 thousand. That facility was structured into two tranches of €96,531 thousand and €38,487 thousand, which were assigned to the 50-MW Huelva and 20-MW Merida power plants, respectively. It was due on 30 December 2024 and accrued interest at a floating rate benchmarked to Euribor plus a spread ranging between 2.50% and 3.00%, depending on the years elapsing from the loan's arrangement. The arrangement fees paid in 2015 in connection with this facility amounted to €2,540 thousand.

  The main collateral securing this loan was a pledge over the shares of ENCE Energía, S.L.U. and its active subsidiaries and over their current and future assets and credit claims. In parallel, ENCE Energía, S.L.U. had 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 keep the plants operational and available. The facility similarly included certain obligations, mainly related to the disclosure of specific business and financial information, compliance with certain financial ratios, the requirement to maintain a specific volume of felled biomass stock, and cash sweeps, the earmarking of surplus cash to the early repayment of the loan, etc. The covenants also imposed certain restrictions, mainly on the distribution of dividends and the raising of new financing.

- Two separate €7,500 thousand loans due 29 December 2021 and 2023, respectively, carrying interest at Euribor plus spreads of 1.9% and 2.25%, respectively. They were secured by the shareholdings acquired by the Energy Business in Energías de la Mancha ENEMAN, S.A. and Energía de la Loma, S.A.

## 20.3 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 0.01% in 2017 (0.06% in 2016).

The Group had €270,528 thousand of cash and cash equivalents at 31 December 2017 (€167,294 thousand of which corresponding to the Pulp Business and €103,234 thousand to the Energy Business).

In assessing the availability of the Group's cash, readers should note that the financing taken on by the Energy Business requires it to maintain a minimum cash balance of €14,300 thousand, a sum that could rise to €34,400 thousand depending on the extent to which it uses the credit facility contemplated in tranche 4.

The year-end 2017 statement of financial position includes €4,138 thousand of cash denominated in US dollars (year-end 2016: €6,892 thousand).

# 21. Other financial assets and liabilities

## 21.1 Other financial assets

The reconciliation of the carrying amount of this consolidated statement of financial position heading at the beginning and end of 2017 and 2016 is as follows:

| Thousands of euros | Year-end 2017 | | Year-end 2016 | |
|---|---|---|---|---|
| | Current | Non-current | Current | Non-current |
| Adjustments for tariff shortfall/surplus (note 23) | - | 2.479 | - | 10.044 |
| Collateral under hedges and future purchase of emission allowances (notes 22 and 18) | 4.028 | - | 8.466 | - |
| ENCE's share liquidity agreement (note 25) | 1.248 | - | 41 | - |
| Deposits, guarantees and other | 1.099 | 1.641 | 1.073 | 1.590 |
| | **6.375** | **4.120** | **9.580** | **11.634** |

## 21.2 Other financial liabilities

The amount recognised under this heading on the accompanying consolidated statement of financial position corresponds mainly to loans obtained from public organisms, usually at below-market or even zero rates. The proceeds so obtained have been used to finance projects undertaken by the Group to expand and upgrade the productive capacity of its pulp plants, as well as its research and development work.

The breakdown by maturity at year-end 2017 and 2016 is as follows:

| Thousands of euros | 31/12/2017 | 31/12/2016 |
|---|---|---|
| 2017 | - | 1,305 |
| 2018 | 1,457 | 1,213 |
| 2019 | 1,185 | 1,213 |
| 2020 | 3,340 | 6,060 |
| 2021 | 3,392 | 6,111 |
| 2022 and beyond | 12,025 | 25,368 |
| Unwind of discount | (347) | (546) |
| | **21,052** | **40,724** |

In 2016, ENCE was awarded three loans against the backdrop of its so-called Re-industrialisation and Manufacturing Competitiveness Stimulus Programme for a total amount of €33,925 thousand. The proceeds are being used 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. Some of the investments to be financed from these funds have been postponed and it is likely that ENCE will not therefore meet the project deadline requirements laid down in the terms of the grant, which is why it opted to repay €18.8 million of the funds received in 2017.

Elsewhere, in 2017, ENCE was awarded two 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 €18,673 thousand. The proceeds are being used to finance certain investments at the Navia pulp mill. The loans were drawn down in January 2018. They are repayable over a 10-year term and bear interest at a fixed rate of 2.2%. There is a three-year grace period.

## 22. Derivative financial instruments

In keeping with the financial 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 2017 and 2016 (showing the fair value of the derivatives at year-end), is provided in the next table:

| | Non-current assets | | Current assets | | Non-current liabilities | | Current liabilities | |
|---|---|---|---|---|---|---|---|---|
| Thousands of euros | 31/12/2017 | 31/12/2016 | 31/12/2017 | 31/12/2016 | 31/12/2017 | 31/12/2016 | 31/12/2017 | 31/12/2016 |
| Cash flow hedges: | | | | | | | | |
| Energy sale hedges | - | - | - | - | - | - | - | 1,525 |
| IR swap | | | | | 5,608 | 7,756 | 2,193 | 2,729 |
| IR swap arrangement fee | - | - | - | - | (1,989) | - | - | - |
| Currency hedges | 2,501 | - | 13,525 | - | - | 3,992 | - | 10,487 |
| **Total** | **2,501** | **-** | **13,525** | **-** | **3,619** | **11,748** | **2,193** | **14,741** |

These financial instruments have been measured subsequent to initial recognition by reference to observable market data (note 19), either directly (i.e., prices), or indirectly (i.e. inputs derived from prices).

The changes in the fair value of the derivatives designated as hedging instruments that were reclassified to profit or loss in 2017 and 2016 are shown below:

| Thousands of euros - Profit/(Loss) | 2017 | 2016 |
|---|---|---|
| Impact on operating profit | | |
| Energy sale hedges | (2,411) | 1,630 |
| Currency hedges | 1,946 | (659) |
| Impact on net finance costs | | |
| IR swap | (3,747) | 60 |
| **Total** | **(4,212)** | **1,031** |

In addition, a residual portion of the derivatives arranged do not qualify for hedge accounting, so that they are measured directly at fair value through profit or loss. These non-hedge derivatives implied a gain of €2,014 thousand in 2017, which is recognised under "Change in the fair value of financial instruments" in the income statement.

### 22.1 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 breakdown of these options at 31 December 2017 is as follows:

| Underlying | Maturity | Strike price Call | Strike price Put | Notional amount (USD m) |
|---|---|---|---|---|
| EUR/USD | 1Q18 | 1.111 | 1.174 | 82.2 |
| EUR/USD | 2Q18 | 1.079 | 1.156 | 82.1 |
| EUR/USD | 3Q18 | 1.104 | 1.160 | 82.2 |
| EUR/USD | 4Q18 | 1.119 | 1.160 | 82.2 |
| | | | | **328.7** |
| EUR/USD | 1Q19 | 1.123 | 1.154 | 38.5 |
| EUR/USD | 2Q19 | 1.171 | 1.208 | 5.5 |
| | | | | **44.0** |

The contracts outstanding at 31 December 2017 cover approximately 50% and 7% of forecast pulp sales in 2018 and 2019, respectively.

These instruments presented a positive fair value of €16,026 thousand at 31 December 2017.

Considering the hedges arranged at year-end 2017, dollar depreciation of 5% relative to the spot price as at 31 December 2017 would imply a cash inflow of €26,579 thousand in 2018. In contrast, dollar appreciation against the euro of 5% would imply a cash outflow of €11,711 thousand in 2018.

## 22.2 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). None was outstanding at 31 December 2017. The commodity swaps outstanding at 31 December 2016:

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

## 22.3 Interest rate swaps:

The interest rate derivatives arranged by the Group and outstanding at year-end 2017 and 2016 are shown below:

| Thousands of euros | Fair value | Notional amount at year-end: 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|
| 2017 | 7,801 | - | 134,725 | 151,300 | 146,200 | 126,650 | 104,550 | 82,450 |
| 2016 | 10,485 | 82,420 | 71,691 | 60,819 | 49,950 | 38,322 | - | - |

The interest-rate swaps arranged, all of which are associated with the Energy Business's financing, qualified for hedge accounting at both year-ends.

The debt associated with the Energy business was refinanced on 24 November 2017 (note 20). The interest-rate swaps arranged to hedge the refinanced debt were cancelled and new swaps were arranged, tailored for the new facility's repayment regime. The new hedges cover 85% of the balances already drawn or expected to be drawn in the future. The cancellation costs were included in the new hedges' settlement interest rate.

This triggered the discontinuation of the hedge accounting applied up until that juncture. As a result, the fair value loss on those instruments (€3,631 thousand), which was recognised in equity at the time, was reclassified to profit and loss (the loss is recognised under "Change in the fair value of financial instruments") (notes 13 and 20).

The new interest rate swaps have been designated as hedges of the new facility as from that date.

Considering the hedges arranged at 31 December 2017, a 10% increase in the Euribor forward curve would imply a cash inflow of €27 thousand in 2018. In contrast, a 10% decline in the Euribor interest rate curve would result in a cash outflow of the same magnitude in 2018.

## 23. Trade and other receivables

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

| Thousands of euros | 31/12/2017 | 31/12/2016 |
|---|---|---|
| Trade receivables: | | |
| Pulp | 67,070 | 47,431 |
| Energy | 35,797 | 29,803 |
| Other items | 3,451 | 4,126 |
| Sundry receivables | 3,701 | 1,998 |
| Provision for impairment | (3,248) | (3,137) |
| | **106,771** | **80,221** |

The credit period on pulp sales averages between 60 and 65 days, a five-day improvement from 2016. The fair value of pulp receivables does not differ significantly from their carrying amount.

At year-end, the Group had €32.3 million of US dollar-denominated accounts receivable (year-end 2016: €6.8 million).

### 23.1 Balances receivable associated with the Energy Business

The regulatory changes introduced in the Spanish energy sector have included, among other measures, the obligation on the part of all parties receiving remuneration from the system operator to finance the electricity tariff deficit. The Group's share of the financing of the tariff deficit pending collection at 31 December 2017 amounted to €12,098 thousand (€8,935 thousand at year-end 2016).

The headings "Other non-current financial investments" and "Trade and other receivables" on the accompanying consolidated statement of financial position also include the Group's credit claim vis-a-vis the sector regulator, the CNMC, 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 the 'Adjustments for tariff shortfall/surplus' concept (notes 5 and 9). This balance breaks down as follows:

| Thousands of euros | 31/12/2017 | 31/12/2016 |
|---|---|---|
| Other non-current financial investments: | | |
| Period 2014-2016 | 10,112 | 10,000 |
| 2017 estimate | (7,633) | - |
| Energy customers (current): | | |
| Period 2014-2016 | 968 | 855 |
| | **3,447** | **10,855** |

As provided for in that piece of legislation, the balance corresponding to the 2014-2016 regulatory stub period will be collected, as a general rule, over the remaining useful lives, for regulatory purposes, of the power generation and co-generation plants, earning interest at a rate of 7.398%.

### 23.2 Factoring facilities

The Group has drawn down €49,287 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 €85,000 thousand at 31 December 2017 (€47,198 thousand and €70,000 thousand, respectively, at 31 December 2016). The Group pays interest equivalent to 3-month Euribor plus a spread ranging between 0.8% and 1.2% on the receivables discounted under these agreements.

## 24. Trade and other accounts payable

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 | 31/12/2017 | 31/12/2016 |
|---|---|---|
| Trade and other payables | 147,898 | 129,768 |
| Payable to fixed-asset suppliers | 12,453 | 16,963 |
| Employee benefits payable | 8,285 | 7,438 |
| | **168,636** | **154,169** |

The average payment period on goods and services purchased ranges between 65 and 70 days. The fair value of trade payables does not differ significantly from their carrying amount.

The Group had drawn down €67,005 thousand under non-recourse reverse factoring agreements with an aggregate limit of €125,000 thousand at 31 December 2017 (€56,503 thousand and €105,000 thousand, respectively, at 31 December 2016). The reverse factoring agreements arranged by ENCE do not contemplate the provision of guarantees.

At 31 December 2017, the Group had €50 thousand of US dollar-denominated accounts payable (year-end 2016: €144 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 2017 and 2016 and the amounts outstanding at year-end (excluding intra-group transactions and payments to fixed asset suppliers):

| | 2017 | 2016 |
|---|---|---|
| Average supplier payment term (days) | 63 | 67 |
| Paid transactions ratio (days) | 64 | 69 |
| Outstanding transactions ratio (days) | 49 | 41 |
| | Thousands of euros | |
| Total payments made | 524,664 | 509,762 |
| Total payments outstanding by more than the legally-stipulated term | 44,101 | 38,970 |

# 25. Equity

## 25.1 Share capital

The share capital of ENCE Energía y Celulosa, S.A. at 31 December 2017 was represented by 246,272,500 fully subscribed and paid bearer shares, each with a par value of €0.90.

The table below depicts the Company's shareholder structure at 31 December 2017 and 2016:

| | % | |
|---|---|---|
| Shareholder | 31/12/2017 | 31/12/2016 |
| D. Juan Luis Arregui / Retos Operativos XXI, S.L. | 27.96 | 26.65 |
| D. Víctor Urrutia / Asúa Inversiones, S.L. | 6.34 | 6.23 |
| Corporación Financiera Alcor, S.A / Imvernelin Patrimonio S.L. | 4.97 | 5.49 |
| D. Jose Ignacio Comenge / Mendibea 2002, S.L. | 5.68 | 5.59 |
| Norges Bank | 3.09 | - |
| Treasury stock | 0.61 | 2.2 |
| Members of Company's Board of Directors -shareholding <3% | 0.50 | 0.49 |
| Free float | 50.85 | 53.35 |
| **Total** | **100** | **100** |

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.

**Capital reduction**

The Company's Board of Directors agreed on 26 April 2017 to execute the capital decrease ratified at the Annual General Meeting held on 30 March 2017, reducing share capital by 3,600,000 euros by cancelling 4 million own shares, with a unit par value of €0.90, held as treasury stock.

The capital reduction falls under the scope of the Share Buyback Programme authorised by the Board of Directors on 23 June 2016 with the aim of remunerating shareholders by reducing the Parent's share capital. That programme had materialised in the acquisition 4 million shares for €8,552 thousand.

For the purposes of the capital reduction, the Company has created a reserve for cancelled shares, with a charge against unrestricted reserves, of €3,600,000, which is subject to the same requirements as are set forth for reducing capital, pursuant to article 335.c of Spain's Corporate Enterprises Act.

### 25.2 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.

### 25.3 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.

### 25.4 Reserves in fully-consolidated companies

The next table breaks down “Equity – Reserves in fully-consolidated companies” by company at 31 December 2017 and 2016:

| Thousands of euros | 31/12/2017 | 31/12/2016 |
|---|---|---|
| Pulp Business: | | |
| Celulosas de Asturias, S.A.U. | 125,232 | 125,232 |
| Norte Forestal, S.A.U. | 3,338 | 4,972 |
| Silvasur Agroforestal, S.A.U. | 7,566 | 1,458 |
| Iberflorestal, S.A.U. | (5,500) | (4,721) |
| Ibersilva, S.A.U. | (18,172) | (18,115) |
| Ence Investigación y Desarrollo, S.A.U. | (5,124) | (5,157) |
| Maderas Aserradas del Litoral, S.A. | (5,315) | (5,363) |
| Las Pléyades, S.A. (SAFI) | 1,902 | 1,945 |
| Sierras Calmas, S.A. | 5,838 | 5,900 |
| Energy Business | | |
| Celulosa Energía, S.A.U. | 25,852 | 24,809 |
| ENCE Energía, S.L.U. | (42,483) | (29,413) |
| ENCE Energía Huelva, S.L.U. | (11,317) | (19,789) |
| ENCE Energía Extremadura, S.L.U. | (12,519) | (14,556) |
| Consolidation and other adjustments | (8,088) | (7,587) |
| | **61,210** | **59,615** |

(*) Dividends paid out are considered additions to reserves at the receiving companies.

The balance of reserves in consolidated companies that is restricted stood at €15,454 thousand at year-end (year-end 2016: €12,412 thousand) and corresponds mainly to the legal reserves endowed by the various Group companies.

## 25.5 Proposed appropriation of the Parent's profit

The Company's directors have resolved to submit the following appropriation of the Parent's 2017 profit of €69,813 thousand for shareholder approval at the upcoming Annual General Meeting (note that consolidated profit amounted to €91,786 thousand):

| | **Thousands of euros** |
|---|---|
| **Basis of appropriation:** | |
| Profit/(loss) for the year | 69,813 |
| **Appropriation:** | |
| Interim dividend - paid out in August 2017 (note 26) | 14,935 |
| Interim dividend - paid out in December 2017 (note 26) | 14,688 |
| Final dividend (*) | 16,254 |
| Capitalisation reserve | 2,695 |
| Retained earnings (prior-year losses) | 21,241 |

(*)Maximum dividend. The amount not distributed on account of own shares held as treasury stock will be earmarked to "Voluntary reserves".

## 25.6 Earnings per share

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

| Earnings per share | 2017 | 2016 |
|---|---|---|
| Group profit/(loss) attributable to owners of the parent (€ 000) | 91,786 | 38,475 |
| Weighted average number of ordinary shares outstanding during the year | 247,543,733 | 250,272,500 |
| **Basic earnings per share (euros)** | **0.37** | **0.15** |
| **Diluted earnings per share (euros)** | **0.37** | **0.15** |

## 25.7 Parent Company shares

The reconciliation of "Own shares" at the beginning and end of 2017 and 2016 is as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | No. of shares | Thousands of euros | No. of shares | Thousands of euros |
| Opening balance | 5,508,463 | 11,963 | 1,406,466 | 3,108 |
| Purchases | 10,010,217 | 34,957 | 16,560,137 | 39,387 |
| Shares cancelled | (4,000,000) | (8,552) | - | - |
| Sales | (10,022,618) | (34,436) | (12,458,140) | (30,532) |
| **Closing balance** | **1,496,062** | **3,932** | **5,508,463** | **11,963** |

The own shares held by the Company at 31 December 2017 represent 0.6% of its share capital (2.2% at year-end 2016) and are carried at €1,346 thousand (€4,958 thousand at 31 December 2016). These shares were acquired at an average price of €2.68 per share. The own shares held as treasury stock are intended for trading in the market and for delivery as part of the "Long-term 2016-2018 bonus plan" (notes 4.16 and 11).

ENCE has a liquidity agreement with a financial broker the object of which is to foster the frequency and regularity with which the Company's shares are traded, within the limits established at the Annual General Meeting and prevailing legislation, specifically, CNMV Circular 1/2017 on liquidity agreements.

## 25.8 Valuation adjustments

"Valuation adjustments" within equity includes the impact of the changes in the fair value of the Group's hedging derivatives (note 22) 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 €40,615 thousand at year-end 2017 (€41,690 thousand at year-end 2016). The latter reserve is freely distributable.

The breakdown of "Valuation adjustments" in respect of hedging transactions is provided below:

| | 31/12/2017 | | | 31/12/2016 | | |
|---|---|---|---|---|---|---|
| Thousands of euros | Fair value | Tax effect | Adjustment in equity | Fair value | Tax effect | Adjustment in equity |
| IR swap | 409 | 102 | 307 | (3,662) | (916) | (2,746) |
| Currency hedges | 14,344 | 3,586 | 10,758 | (14,064) | (3,516) | (10,548) |
| Energy sales hedges | - | - | - | (1,524) | (381) | (1,143) |
| | **14,753** | **3,688** | **11,065** | **(19,250)** | **(4,813)** | **(14,437)** |

## 25.9 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 2017 and 2016 is as follows:

**2017**

| Company | Balance at 01/01/2017 | Profit/(loss) attributable to NCI | Adjustment to acquisition price | Changes in consolidation scope (note 2) | Balance at 31/12/2017 |
|---|---|---|---|---|---|
| Energía de la Loma, S.A. | 4,122 | 566 | (88) | - | 4,600 |
| Energías de la Mancha Eneman, S.A. | 3,112 | 1,007 | (49) | - | 4,070 |
| Bioenergía Santamaría, S.A. | - | 306 | - | 927 | 1,233 |
| **Total** | **7,234** | **1,879** | **(137)** | **927** | **9,903** |

**2016**

| Company | Balance at 01/01/2016 | Profit/(loss) attributable to NCI | Adjustment to acquisition price | Changes in consolidation scope (note 2) | Balance at 31/12/2016 |
|---|---|---|---|---|---|
| Energía de la Loma, S.A. | - | - | - | 4,122 | 4,122 |
| Energías de la Mancha Eneman, S.A. | - | - | - | 3,112 | 3,112 |
| **Total** | **-** | **-** | **-** | **7,234** | **7,234** |

# 26. Shareholder remuneration

ENCE's dividend policy contemplates the distribution to its shareholders of an amount equivalent to approximately 50% of profit for the year, structured into two interim dividends, one approved at the end of the first half and the other in November, and a final dividend, to be put before the its shareholders for approval at the Annual General Meeting.

This dividend policy is conditional upon delivery of the financial discipline criteria laid down in the Business Plan as well as the Company's legal and contractual obligations.

The next table itemises the dividends declared in 2017:

| | Dividend per share | Thousands of euros |
|---|---|---|
| Final - 2016 earnings | 0.0473 | 11,578 |
| Interim - 2017 earnings - July | 0.0610 | 14,935 |
| Interim - 2017 earnings - November | 0.0600 | 14,688 |
| | | **41,201** |

At the Annual General Meeting held on 30 March 2017, the shareholders of Ence Energía y Celulosa, S.A. ratified the motion to pay a final dividend against 2016 profits in the amount of €0.047 per Ence Energía y Celulosa, S.A. share. The dividend, which totalled €11,578 thousand, was paid out on 18 April 2017. The Company had already paid out an interim dividend from 2016 profits of €0.032 per share as per a board resolution dated 22 November 2016.

At a meeting held on 26 July 2017, the Board of Directors of the Parent resolved to pay an interim dividend from 2017 profits of €0.061 per share (before withholdings), in cash. This dividend entailed the payment of €14,935 thousand and was paid out on 6 September 2017.

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 30 June 2017:** | |
| Cash | 140,536 |
| | **140,536** |
| Interim dividend payment (maximum amount) | (15,023) |
| Forecast net cash flows until date of approval of interim dividend | - |
| **Forecast liquidity as of date of approval of interim dividend** | **125,513** |
| Forecast cash receipts until 30 June 2018 | |
| Cash flows from operating activities (proceeds net of payments) | 36,359 |
| Dividends received | 50,000 |
| Forecast cash outflows until 30 June 2018 | |
| Capital expenditure & income tax | (32,839) |
| Financing transaction (payments of interest and repayment of principal) | (18,501) |
| **Forecast liquidity as of 30 June 2018** | **160,532** |

Elsewhere, at a meeting held on 22 November 2017, the Board of Directors of the Parent resolved to pay a second interim dividend from 2017 profits of €0.06 per share (before withholdings), similarly in cash. This dividend entailed the payment of €14,688 thousand and was paid out on 14 December 2017 (note 1).

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 2017:** | |
| Cash | 105,631 |
| | **105,631** |
| Interim dividend payment (maximum amount) | (14,776) |
| Forecast net cash flows until date of approval of interim dividend | - |
| **Forecast liquidity as of date of approval of interim dividend** | **90,855** |
| Forecast cash receipts until 31 October 2018 | |
| Cash flows from operating activities (proceeds net of payments) | 68,129 |
| Dividends received | 67,000 |
| Forecast cash outflows until 31 October 2018 | |
| Capital expenditure & income tax | (52,009) |
| Financing transaction (payments of interest and repayment of principal) | (23,501) |
| **Forecast liquidity as of 31 October 2017** | **150,474** |

## 27. Grants

The reconciliation of the carrying amount of this consolidated statement of financial position heading at the beginning and end of 2017 and 2016 is as follows:

| Thousands of euros | Subsidised loans (note 21) | Grants relating to assets | Emission allowances (note 18.1) | Other | Total |
|---|---|---|---|---|---|
| **Balance at 01/01/2016** | **773** | **10,481** | **-** | **-** | **11,254** |
| Additions, new grants (*) | - | 118 | - | - | 118 |
| Emission allowances granted | - | - | 734 | - | 734 |
| Reclassified to profit or loss | (227) | (1,474) | (734) | - | (2,435) |
| **Balance at 31/12/2016** | **546** | **9,125** | **-** | **-** | **9,671** |
| Additions, new grants (*) | - | - | - | | - |
| Changes in consolidation scope | - | 792 | - | - | 792 |
| Emission allowances granted | - | - | 547 | - | 547 |
| Reclassified to profit or loss | (186) | (1,167) | (547) | - | (1,900) |
| Other | - | - | - | 86 | 86 |
| **Balance at 31/12/2017** | **360** | **8,750** | **-** | **86** | **9,196** |

(*) Net of expenses incurred in obtaining them

The Group has been granted non-repayable grants by several public bodies 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 21).

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

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

## 28.1 Provisions and impairment charges

The reconciliation of the opening and closing balances of current and non-current provisions in 2017 and 2016 is as follows:

| | Thousands of euros | | | | |
|---|---|---|---|---|---|
| 31 December 2017 | Balance at 01/01/2017 | Additions/ (charges) | Derecognitions or decreases | Transfers | Balance at 31/12/2017 |
| **Non-current:** | | | | | |
| Employee commitments (note 11.2) | 295 | 1,295 | - | - | 1,590 |
| Emission allowances (note 18) | 1,605 | - | (1,605) | - | - |
| Onerous contracts (note 18) | 2,190 | - | (1,699) | - | 491 |
| Discontinuation of pulp production in Huelva | 453 | - | - | - | 453 |
| Other | 1,624 | 591 | (582) | - | 1,633 |
| | **6,167** | **1,886** | **(3,886)** | **-** | **4,167** |
| **Current** | | | | | |
| Emission allowances (note 18) | - | 2,136 | - | 215 | 2,351 |
| Discontinuation of pulp production in Huelva | 4,626 | 1,466 | (1,357) | - | 4,735 |
| | **4,626** | **3,602** | **(1,357)** | **215** | **7,086** |

| | Thousands of euros | | | | |
|---|---|---|---|---|---|
| 31 December 2016 | Balance at 01/01/2016 | Additions/ (charges) | Derecognitions or decreases | Transfers | Balance at 31/12/2016 |
| **Non-current:** | | | | | |
| Employee commitments (note 11.2) | 2,063 | 295 | - | (2,063) | 295 |
| Emission allowances (note 18) | 1,604 | 1,605 | (1,604) | - | 1,605 |
| Onerous contracts (note 18) | 1,908 | 282 | - | - | 2,190 |
| Discontinuation of pulp production in Huelva | 1,494 | - | (1,041) | - | 453 |
| Other | 2,191 | 583 | (1,150) | - | 1,624 |
| | **9,260** | **2,765** | **(3,795)** | **(2,063)** | **6,167** |
| **Current** | | | | | |
| Employee commitments (*) | - | - | (2,063) | 2,063 | - |
| Discontinuation of pulp production in Huelva | 6,306 | 766 | (2,446) | - | 4,626 |
| | **6,306** | **766** | **(4,509)** | **2,063** | **4,626** |

(*) 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.

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. At 31 December 2017, the Group continued to record provisions totalling €5,188 thousand to cover the estimated costs associated with the commitments assumed with third parties.

## 28.2 Guarantees extended to third parties

At 31 December 2017, several financial institutions had extended the various Group companies guarantees for an aggregate amount of approximately €52,485 thousand (€45,437 thousand at 31 December 2016), as broken down in the table below.

| | Thousands of euros |
|---|---|
| Processing of grid access for power plants | 10,952 |
| Subsidised loans (note 21) | 10,511 |
| Factoring facilities | 6,000 |
| Irrigation association works | 5,074 |
| Tax claims (note 28.3) | 4,517 |
| Forest project performance | 3,166 |
| Pontevedra concession | 3,050 |
| Electricity market payment guarantee | 3,607 |
| Environmental | 1,512 |
| Payments to suppliers | 833 |
| Other | 3,263 |
| | **52,485** |

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

## 28.3 Contingent assets and liabilities

At year-end 2017, 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 accompanying financial statements:

Energy sector regulations in Spain – Energy crops

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 recognise provisions to cover the costs of unwinding the related lease agreements and other associated costs.

On 14 and 31 July 2014, several Group companies filed a claim against the Spanish state, specifically seeking an award of €69,813,419 for damages caused by the retroactive application of the new regulatory regime applicable to the generation of power using biomass obtained from energy crops. The claim was substantiated with an expert report. It was presented as an open-ended claim and the award sought will be increased over time 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.

Having concluding the dismantling work, the same independent expert was commissioned to issue a second expert report, in which it estimates the damages at €60,329,791. That second expert report was present to the authorities on 5 December 2017.

The administration has yet to rule on the claim seeking damages from the state.

Energy sector regulations in Spain – Recovery of lignin

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 black liquor, 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 black liquor 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.

The lawsuit brought before the Supreme Court questions the accuracy of the Royal Decree insofar as it fails to assign any value to black liquor fuel. The amount being sought has not been quantified.

The parties having presented their conclusions in writing, it was agreed as a final discovery measure, by Order 16/10/17, to require the energy market regulator, the CNMC, and the Spanish Ministry of Energy, Tourism and Digital Agenda to report - in relation to the parameters assigned to the facility types 1035 and 1036 in Annex VIII of Ministerial Order IET/1045/2014 - on the technical reasons for justifying their black liquor assessment in light of its biomass properties.

On 16 January 2018, ENCE presented its pleadings with respect to the report prepared by IDEA (acronym in Spanish for the energy savings and diversification institute) and presented by the Ministry.

The appeal is in turn pending ruling.

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.

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 de Pontevedra*, before the National Appellate Court (Chamber for Contentious Administrative Proceedings), giving rise to two separate proceedings. 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 January 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 the Town Council of Pontevedra and two environmentalist associations: Green Peace Spain and *Asociación pola Defensa da Ría de Pontevedra*.

Those challenges have given rise to four consecutive court proceedings before the the National Appellate Court (Chamber for Contentious Administrative Proceedings), two of which have since been rolled into one, leaving three. ENCE has appeared in court in all the cases in its capacity as co-defendant, arguing the legality of the actions of the Ministry in extending the concession. The proceedings remain ongoing. The concession extension resolution was also challenged by another association, *Salvemos Pontevedra*; however, as far as ENCE is aware, that association has not taken the initial dismissal of its case to the court level.

The resolution of these matters is not expected to have a significant impact on these financial statements.

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-payment interest 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, which is still pending resolution.

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.

## 29. Tax matters

The balances receivable from and payable to the tax authorities at year-end 2017 and 2016 are shown below:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | 31 December 2017 | | 31 December 2016 | |
| | Taxes receivable | Taxes payable | Taxes receivable | Taxes payable |
| **Non-current:** | | | | |
| Deferred tax assets | 59,783 | - | 69,062 | - |
| Deferred tax liabilities | - | 23,823 | - | 21,118 |
| **Total** | **59,783** | **23,823** | **69,062** | **21,118** |
| **Current:** | | | | |
| Income tax receivable and VAT payable | 6,282 | 3,278 | 8,135 | 2,922 |
| Current tax on profits for the year | 1,022 | 437 | 1,459 | 117 |
| Electricity levy | - | 4,178 | 217 | 4,519 |
| Sundry taxes receivable from and payable to the tax authorities | 663 | 4,186 | 459 | 3,214 |
| **Total** | **7,967** | **12,079** | **10,270** | **10,772** |

## 29.1 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 statutory income tax rate in Spain is 25%.

**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%.

***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.

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

The reconciliation of accounting profit/(loss) to tax income/(tax expense) in 2017 and 2016 is provided below:

| | Thousands of euros | |
|---|---|---|
| | **2017** | **2016** |
| **Profit before tax (*)** | 119,871 | 51,098 |
| Permanent differences: | | |
| Arising in profit or loss | 192 | 144 |
| Arising in equity | (81) | (22) |
| Capitalisation reserve | (2,695) | (1,848) |
| Temporary differences: | | |
| Arising during the year | 10,459 | 14,303 |
| Arising in prior years | (12,129) | (17,286) |
| Consolidation adjustments | 8,679 | 14,415 |
| Utilisation of tax losses | (30,318) | (15,435) |
| **Taxable income/(tax loss)** | **93,978** | **45,369** |

(*) 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 29.4.

"Consolidation adjustments" mainly reflect the impact of the forest cover revalued in 2004 (notes 16 and 25) in respect of the land sold in 2017 and 2016 as well as elimination of the impacts of first-time application of IFRS 9 - Financial instruments, which are not contemplated under Spanish accounting and tax regulations.

## 29.3 Reconciliation of accounting profit and tax expense

The reconciliation of accounting profit/(loss) to tax income/(tax expense) in 2017 and 2016 is provided below:

| | Thousands of euros | |
|---|---|---|
| | **2017** | **2016** |
| **Profit before tax (*)** | 119,871 | 51,098 |
| Permanent differences arising in profit or loss | 192 | 144 |
| Capitalisation reserve | (2,695) | (1,848) |
| Elimination of the accounting profit of entities not resident in Spain | 944 | 937 |
| Consolidation adjustments and eliminations | 663 | 1,592 |
| **Taxable income/(tax loss)** | **118,975** | **51,923** |
| **Tax payable before deductions** | **29,744** | **12,981** |
| Deductions and adjustments in respect of prior year | (3,555) | (890) |
| Tax corresponding to entities not resident in Spain | 17 | 218 |
| **Income tax expense** | **26,206** | **12,309** |

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

The breakdown of tax expense / (income) in 2017 and 2016:

| | Thousands of euros | |
|---|---|---|
| | **2017** | **2016** |
| Current tax and other | 25,789 | 11,563 |
| Deferred tax | 417 | 746 |
| **Income tax expense** | **26,206** | **12,309** |

## 29.4 Recognised deferred tax assets and liabilities

The reconciliation of the related consolidated statement of financial position headings at the beginning and end of 2017 and 2016 is as follows:

## *Deferred tax assets*

| 2017 | Thousands of euros | | | | | |
|---|---|---|---|---|---|---|
| | Balance at 31/12/2016 | Increases | Decreases | Transfers & other | Additions to scope (note 2) | Balance at 31/12/2017 |
| **Deferred tax assets recognised in profit or loss:** | | | | | | |
| Non-current asset depreciation | 7,267 | 25 | (913) | 18 | 515 | 6,912 |
| Non-current asset impairment | 12,682 | 896 | (2,274) | - | - | 11,304 |
| Provisions | 602 | 617 | (58) | (24) | - | 1,137 |
| Employee commitments | 694 | 1,103 | (50) | 275 | - | 2,022 |
| Current-asset impairment | 714 | - | (590) | (1) | - | 123 |
| Non-resident companies and consolidation adjustments | 1 | 1,076 | (4) | | - | 1,073 |
| Additions to consolidation scope | 587 | - | - | (587) | - | - |
| Unused tax losses | 40,735 | - | (7,295) | (155) | 2,483 | 35,768 |
| Unused tax credits | 969 | 2,860 | (3,165) | 883 | - | 1,547 |
| | **64,251** | **6,577** | **(14,349)** | **409** | **2,998** | **59,886** |
| **Deferred tax assets recognised in equity:** | | | | | | |
| Hedging derivatives (note 22) | 4,205 | 81 | (102) | (4,288) | - | (103) |
| | **4,205** | **81** | **(102)** | **(4,288)** | **-** | **(103)** |
| **Total** | **68,456** | | | | | **59,783** |

| 2016 | Thousands of euros | | | | |
|---|---|---|---|---|---|
| | Balance at 1/1/2016 | Increases | Decreases | Transfers & other | Balance at 31/12/2016 |
| **Deferred tax assets recognised in profit or loss:** | | | | | |
| Non-current asset depreciation | 8,175 | - | (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 | - | (1,457) | (90) | - |
| Non-resident companies and consolidation adjustments | 132 | 55 | (187) | 1 | 1 |
| Additions to consolidation scope | - | - | - | 587 | 587 |
| Unused tax losses | 44,578 | - | (3,859) | 16 | 40,735 |
| Unused tax credits | 3,109 | - | (3,076) | 936 | 969 |
| | **70,895** | **3,631** | **(11,630)** | **1,355** | **64,251** |
| **Deferred tax assets recognised in equity:** | | | | | |
| Non-current asset impairment | | - | - | - | - |
| Hedging derivatives (note 22) | 621 | 4,288 | (79) | (19) | 4,811 |
| | **621** | **4,288** | **(79)** | **(19)** | **4,811** |
| **Total** | **71,516** | | | | **69,062** |

The opening and closing 2016 balances have restated with respect to the 2016 financial statements as a result of the early application of IFRS 9 (note 3.6).

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 approximately 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. Tax assets recognised in respect of unused tax credits, meanwhile, must be utilised within 15 years.

**Deferred tax liabilities**

| 2017 | Thousands of euros | | | | | |
|---|---|---|---|---|---|---|
| | Balance at 31/12/2016 | Increases | Decreases | Transfers & other | Additions to scope (note 2) | Balance at 31/12/2017 |
| **Deferred tax liabilities recognised in profit or loss:** | | | | | | |
| Accelerated depreciation | 1,651 | - | (189) | - | - | 1,462 |
| Additions to consolidation scope (note 2) | 2,997 | - | (260) | (2,737) | - | - |
| Consolidation and other adjustments | 1,781 | 1,077 | (311) | 2,737 | 303 | 5,587 |
| | **6,429** | **1,077** | **(760)** | **-** | **303** | **7,049** |
| **Deferred tax liabilities recognised in equity:** | | | | | | |
| Revaluation of forest land (notes 16 & 22) | 13,876 | - | (358) | - | - | 13,517 |
| Hedging derivatives (note 22) | 144 | 3,492 | (189) | (176) | - | 3,271 |
| Consolidation and other adjustments | 63 | 505 | (1,096) | 515 | - | (13) |
| | **14,083** | **3,997** | **(1,644)** | **339** | **-** | **16,775** |
| **Total** | **20,512** | **5,074** | **(2,403)** | **338** | **303** | **23,823** |

| 2016 | Thousands of euros | | | | |
|---|---|---|---|---|---|
| | Balance at 1/1/2016 | Increases | Decreases | Transfers & other | Balance at 31/12/2016 |
| **Deferred tax liabilities recognised in profit or loss:** | | | | | |
| Accelerated depreciation | 1,838 | - | (187) | - | 1,651 |
| Additions to consolidation scope (note 2) | - | - | - | 2,997 | 2,997 |
| Other | 1,781 | - | - | - | 1,781 |
| | **3,619** | **-** | **(187)** | **2,997** | **6,429** |
| **Deferred tax liabilities recognised in equity:** | | | | | |
| Revaluation of forest land (notes 15 y 21) | 17,076 | - | (3,200) | - | 13,876 |
| Hedging derivatives (note 21) | 516 | 365 | (268) | 137 | 750 |
| Consolidation and other adjustments | 34 | 722 | (807) | 114 | 63 |
| | **17,626** | **1,087** | **(4,275)** | **251** | **14,689** |
| **Total** | **21,245** | | | | **21,118** |

## 29.5 Unrecognised deferred tax assets

The Group did not recognise certain deferred tax assets in 2017 and 2016, mainly corresponding to tax losses generated in Uruguay, in the amount of €4 million, and in Portugal, in the amount of €3 million.

### 29.6 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 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.

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

### 30.1 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, 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 2017 and 2016 in their capacity as directors:

| | | Thousands of euros | | |
|---|---|---|---|---|
| 2017 – Director | Class | Fixed remuneration | Per diems & other | Total |
| Juan Luis Arregui Ciarsolo | Proprietary | 134 | 95 | 229 |
| Retos Operativos XXI, S.L. | Proprietary | 44 | 31 | 75 |
| Pedro Barato Triguero | Independent | 44 | 275 | 319 |
| Fernando Abril-Martorell Hernández | Other external | 44 | 59 | 103 |
| José Guillermo Zubía Guinea | Independent | 44 | 78 | 122 |
| José Carlos de Álamo Jiménez | Independent | 44 | 57 | 101 |
| Pascual Fernández Martínez | Proprietary | 44 | 45 | 89 |
| Isabel Tocino Biscarolasaga | Independent | 44 | 42 | 86 |
| Javier Echenique Landiribar | Other external | 44 | 51 | 95 |
| Víctor de Urrutia Vallejo | Proprietary | 44 | 35 | 79 |
| Mendibea 2002, S.L. | Proprietary | 44 | 33 | 77 |
| Luis Lada Díaz | Independent | 44 | 35 | 79 |
| Ignacio de Colmenares Brunet | Executive | 44 | - | 44 |
| | | **662** | **836** | **1,498** |

| 2016 – Director | Class | Thousands of euros Fixed remuneration | 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 | Independiente | 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 | - | 40 |
| | | **658** | **548** | **1,206** |

The non-executive directors only receive the fixed remuneration and *per diems* 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 75). 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 2017 or 2016.

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

## 30.2 Key management personnel and their pay

The list of key management personnel in 2017 is as follows:

| Name | Position |
|---|---|
| Ignacio de Colmenares y Brunet | Chief Executive Officer |
| Jaime Argüelles Álvarez | Pulp Operations Officer |
| Jordi Aguiló Jubierre | Independent Energy Plants Officer |
| Alvaro Eza Bernaola | Supply Chain Officer |
| María José Zueras Saludas | Human Capital Officer |

| | |
|---|---|
| Alfredo Avello de la Peña | Finance and Corporate Development Officer |
| Luis Carlos Martínez Martín | Communication and Institutional Relations Officer |
| Reyes Cerezo Rodríguez-Sedano (*) | General Secretary |
| Javier Arregui Abendivar (**) | New Power Plant Development and Forest Assets Officer |

(*) At a Board meeting held on 26 July 2017, the directors approved the addition of Reyes Cerezo, who serves as General Secretary, to the Management Committee.

(**) At a Board meeting held on 20 December 2017 the directors agreed to reorganise the Management Committee following the appointment of Javier Arregui Abendivar as the natural person representative of Turina 2000, S.L. His duties have been divided between the Supply Chain, Independent Energy Plants and Finance and Corporate Development Departments.

The total remuneration accrued by the members of the Management Committee in 2017, 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 €4,388 thousand (2016: €4,055 thousand). The Vice-Chairman and CEO and key management personnel are beneficiaries of the "Long-term bonus plan of ENCE, Energía y Celulosa, S.A. for 2016-2018" (notes 4.16 and 11). In 2016, as part of their performance-based pay, they also received variable remuneration totalling €894 thousand in connection with the "Long-term bonus plan of ENCE, Energía y Celulosa, S.A. for 2013-2016".

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 CEO, by virtue of his service agreement, and the members of the Management Committee, receive certain company benefits, including mixed savings, life and accident insurance coverage (which can be substituted by a contribution to ENCE's Joint Contribution Pension Plan). In terms of the savings portion of the policy, the CEO and other members of the Management Committee contribute 1% of their 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 fixed monthly remuneration; in the event the contingencies result from an accident, they would receive a lump sum equivalent to 70 months' pay. In addition, the Company offers the members of its Management Committee an annual medical check-up.

### 30.3 Additional considerations

The composition of the Board of Directors of ENCE Energía y Celulosa, S.A. changed as follows in 2017: Turina 2000, S.L., represented by Javier Arregui Abendivar, joined the board, while Pascual Fernández Martínez stepped down.

In 2016, Luis Lada Díaz joined the board as an independent director and Gustavo Matías Clavero stepped down.

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.

## 31. Related-party transactions

The Company entered into the following transactions with related parties in 2017 and 2016:

| Related party | Item | Thousands of euros 2017 | 2016 |
|---|---|---|---|
| Grupo Foresta | Purchase of biomass | 163 | 171 |

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

## 32. Environmental management

ENCE is Europe's leading producer of eucalyptus pulp, Spain's number-one producer of renewable power from biomass and the leading end-to-end and responsible manager of forest land and crops in Spain.

As a company firmly committed to sustainability and its surroundings, ENCE conducts its business under an integrated productive model articulated around the most stringent and widely-regarded international sustainability and corporate responsibility criteria. ENCE's integrated productive model spans the cultivation of trees, the generation of energy from renewable sources and the production of natural pulp, all of which framed by economic, social and environmental sustainability criteria designed to ensure an orientation around results, mutually-beneficial relations with suppliers, forest owners, customers and other stakeholders and due management of the Company's environmental impacts.

ENCE implemented its total quality management (TQM) model as the means to cultural and management practice transformation in 2011. Thanks to the involvement of senior management, ENCE has developed a proprietary management excellence model which has been implemented on the basis of a continuous improvement approach with a focus on maximising efficiency and competitiveness by addressing matters related to quality, health and safety, environmental protection and pollution prevention as one.

The TQM model is structured around three key lines of initiative ("Managing improvement", "Managing processes" and "Managing day-to-day activities") which make the model easier to understand and implement. The model further establishes a series of fundamental improvement targets that are clearly focused on the environment:

33. Reducing odour pollution
34. Improving the quality of wastewater
35. Boosting energy efficiency
36. Reducing the consumption of raw materials
37. Cutting waste generation

In addition, at its Operations Centres in Pontevedra, Navia and Huelva, ENCE has developed an integrated management system with the overriding goal of ensuring that all of the Company's activities are carried out under the scope of the management policy established by senior management and the defined targets and goals are met. This integrated system is certified by an accredited organism which audits it annually. The management system is articulated around processes that are identified and evaluated in order to facilitate control tasks and their continuous improvement.

The integrated management system complies with the following international standards:

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

The 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.

ENCE's environmental management policy is based on compliance with prevailing legislation and regulations. All of its operations centres hold the integrated environmental permits required for the pursuit of their industrial activities, as required under Spanish Law 16/2002 on the Integrated Prevention and Control of Contamination. The goal of these permits is to prevent, or at least reduce, and control air, water and soil contamination with a view to protecting the environment as a whole. To this end, the permits encompass a series of authorisations with respect to emissions, liquid discharges, waste management and soil and underground water protection. Against this backdrop, the permits set emission limits for each facility based on best available techniques and oversight and control plans in respect of all relevant environmental parameters.

However, ENCE's environmental management strategy seeks to go beyond mere compliance with prevailing legislation. ENCE wants to set an example with its environmental management. 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 plan-do-check-act (PDCA) and standardise-do-check-act (SDCA) 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 by the Group in recent years, underpinned by implementation of the best available techniques (BAT) and best environmental practices (BEP) defined in two BREFs: the 'Best Available Techniques Reference Document for the pulp and paper industry, 2014' and the 'Best Available Techniques Reference Document for large combustion plants, 2017', both of which approved by the European Parliament's ENVI Committee.

By way of example of what can be achieved by means of environmental excellence, the pulp produced in Pontevedra and Navia has carried the Nordic Swan seal (the official Scandinavian ecolabel, created in 1989 by the Nordic Council of Ministers representing Sweden, Denmark, Finland, Iceland and Norway) certifying compliance with the most stringent environmental standards since 2014. The goal of this ecolabel is to help consumers take environmentally-friendly purchasing decisions.

Obtained following a rigorous assessment of the environmental impact of the Company's products throughout their entire life cycle, this ecolabel promises compliance with the seal's stringent requirements in the areas of climate change mitigation, energy efficiency and resource consumption (water, chemical products and raw materials).

## 32.1 Pulp Business

### Pontevedra Operations Centre

"**Zero odours**" is ENCE's priority goal for Pontevedra, one on which it is working tirelessly. To this end, and to improve the facility's environmental performance, it has completed phase two of the Environmental Reliability Plan designed to prevent fallout from air emissions. That plan is articulated around three fundamental cornerstones:

- Improving operating procedures and standardising processes to make them robust and minimise their environmental impact.
- Improving equipment reliability, implementing maintenance routines designed to prevent error.
- Developing an investment plan for the replacement of equipment that is getting close to the end of its useful life and for equipment identified as critical, installing redundant equipment.

Application of this plan, coupled with the improvements eked our thanks to the standardise-do-check-act (SDCA) daily routine and the plan-do-check-act (PDCA) improvement cycle, have driven a 25% drop in odour, measured in minutes, at channelled sources and a drop of 17% in the case of minutes from diffuse sources compared to 2016.

This means that the number of odorous episodes has declined by over 99% since this project was launched in 2010.

The odour impact index, used to track progress on the odour reduction project, monitors, in addition to the number of minutes of odour episodes at channelled and diffuse sources, the perception of the smell from the industrial activity in the surrounding areas, this having fallen by 46% from 2016.

As for liquid discharges, process improvements and controls have delivered excellent results. The discharge readings are the best in the factory's history and cement the Pontevedra Operations Centre's position as a sector benchmark in this respect. For example, chemical oxygen demand was 3.65 kg/ADt, which is over 80% below the threshold recommended in the pulp and paper BAT reference document. Suspended solids are similarly improving, with the facility outperforming the BREF recommendations by 70% in this respect.

Aware of the issues posed by the low reserves caused by the scarcity of rainfall in Galicia, measures were introduced to reduce water consumption last September and since October, water consumption has been cut by over 10% compared to the first nine months of the year.

However, ENCE has set its sights on making the Pontevedra Operations Centre a global benchmark for innovation in this field, to which end it continues to work on its “New Water Cycle” project. This goal of the project, which is the first of its kind in the pulp industry, is to develop a new wastewater treatment facility to complement the existing one; the new facility will enable the reuse of treated wastewater so as to potentially reduce the amount of water taken from the Lérez River and the volume of wastewater discharged into the bay by up to 90%.

As for air emissions, 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 to reduce emissions in the recovery furnace and lime kilns. These figures mean that the Pontevedra factory is compliant with the BREF benchmark ranges that will become applicable from the last quarter of 2018.

A series of projects designed to improve the complex's environmental performance were executed in 2017. Among these initiatives, which entailed investment of €2.5 million in total, it is worth highlighting the installation of a closure system for the collection and treatment of the fog from the wastewater treatment facility with the aim of reducing odour; installation of a new press filter which has reduced the generation of dregs substantially; the fitting of new monitors in order to continually monitor air emissions; and execution of phase one of the noise reduction plan, which delivered a 15-decibel reduction in levels at the noise-generating points.

The investment projects carried out in 2017 also included completion of all of the work contemplated for phase one of the landscape integration project.

Lastly, true to its environmental pledge, the Pontevedra Operations Centre publishes daily environmental performance indicators on its website (www.encepontevedra.com) 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 €2,217 thousand in 2017 (€5,210 thousand in 2016).

***Pontevedra Environmental Pact***

ENCE and the environment department of the 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 area.

Under the pact, ENCE has committed to:

- Introducing 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.
- Fostering job creation by using regional forest resources.
- Creating a a research centre focused on the generation of specialist jobs and helping to refurbish a building to house this centre.
- Installing a biomass-fuelled co-generation plant and three bioenergy centres.
- Negotiating a collaboration agreement, which was 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 by 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 the refurbishment 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 the 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 extension agreement 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.

**Navia Operations Centre**

The integrated management system at the Navia complex was consolidated with renewal of its environmental and quality management certifications in accordance with the new versions of the UNE-EN-ISO 14001 and UNE-EN-ISO 9001 standards, respectively. Adaptation of the ISO standards for the criteria introduced in 2015 implies progress on adapting the integrated management system for risk assessment analysis in all areas of the Company's management as the initial premise for implementing change.

In 2017, the project for upgrading and fine-tuning the facility's technology, initiated in 2015, continued to yield encouraging results. This initiative encompasses technical improvements to a significant number of productive processes, delivering an aggregate increase in capacity of 40,000 ADt. The following optimisation initiatives stand out:

- Optimisation of the expansion of the facility for treating diluted odorous gases which has delivered a 95% reduction in odour with repercussions outdoors compared to 2016, underpinned by an exhaustive study of the Centre's diffuse sources of odour.
- A new debarking and chipping line which has added flexibility and capacity to the timber processing phase (including planks longer than 5 metres), increasing the availability of raw material.

Other environmental upgrade work such as the operational fine-tuning of the lime kilns with the aim of reducing particle emissions and the number of operational incidents by over 50%. Improvements were also made to the electrostatic precipitators in the recovery and biomass furnaces.

Work was performed to reduce noise emissions from the new facilities, focusing particularly on the timber facilities.

Operational control was perfected, attaining optimal ratios of 95%, paving the way for process stability and reduced operating costs.

Optimisation of the treatment facility implied a considerable improvement in wastewater quality. Suspended solids dropped by 20%. Wastewater chemical oxygen demand readings also continued to improve in 2017, declining 23% year-on-year to 3.6kg/ADt.

The readings for 2017 put Navia at the forefront of environmental compliance in the areas in which the sector has the greatest impact, namely odour, the impact of which, measured using the odour impact index, declined by 73% from 2016. So does the quality of its wastewater, which comfortably outperfoms the limits stipulated in its environmental permit.

Environmental capital expenditure at the Navia factory totalled €1,185 thousand in 2017 (€2,400 thousand in 2016).

**Forestry**

ENCE maintained its position and role as the leading private forest manager and a key dealer in timber-based products in Spain throughout 2017. It reinforced its position as benchmark buyer of agricultural biomass for conversion into energy.

From the organisational standpoint, the work of defining strategy and implementing techniques and the operational control and oversight tasks are carried out by corporate professionals with the required expertise from the headquarters in Madrid and the various bases located close to the production and management centres.

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). In relation to agricultural biomass, in 2017, ENCE presented a 10-Point Declaration on the Sustainability of Biomass which will now have to be translated into a universe of indicators to guarantee sustainable management from source right throughout the productive process. 2018 will be marked by implementation of the requirements stipulated in the latest versions of the ISO quality and environmental management standards. These initiatives should serve as a driver for encouraging the sector to adopt these standards, lifting the number of ISO-certified suppliers accordingly (currently, close to 11% of the service providers working with ENCE in forestry activities are certified under the ISO quality standard, with 8% certified under its environmental management standard; these figures drop to 4.7% and 3.7%, respectively, in the case of timber suppliers).

This environmental sustainability approach is an element of the broader corporate social responsibility strategy. The procurement of timber and biomass, whether from directly managed forests, standing timber purchases, purchased from suppliers or agricultural biomass, generates income and jobs in rural communities, providing economic structure in areas in which raw material production activities constitute one of the main ways of earning a living. ENCE contributes to this wealth generation not only by carrying out its direct management business but also by providing tools for technical and social development of these rural communities: financing schemes for groups; nursery discounts; transfer of know-how to forest owners and companies; training and education, etc., all with the aim of accelerating genuine sector development framed by the Group's environmental and social policies.

All of these activities are compliant with prevailing laws and regulations. Indeed, ENCE is a sector benchmark in terms of compliance with labour, technical and regulatory requirements, particularly in the timber market, which puts it in a position to assure that all of the the activities performed by it and its partners are compliant with the European due diligence regulation with respect to the legal origin of timber (EUTR).

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 86% and 8%, at year-end 2017. It is particularly worth highlighting ENCE's widespread efforts to promote dual certification (PEFC+FSC): similarly since 2011, the percentage of incoming timber that boasts dual certification has risen from 0% at both mills to 84% at Navia and 77% at Pontevedra.

The optimisation of the acreage managed by ENCE enabled the production of 155,078 tonnes of timber (debarked) and 143,102 tonnes of forestry biomass in 2017, implying an investment of close to €3.7 million in these assets as a whole, €1.46 million of which corresponding to the generation of income and royalties and €2.24 million to forestry care and infrastructure upgrade work and reforestation. All of ENCE's proprietary forestry management activity was audited during the first half 2017 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 robust technical management at the national level but also as a source of timber, for the large part doubly certified.

ENCE also contributes to the generation of rural wealth by means of its timber purchases. In 2017, it purchased standing timber from a total of 2,225 forest owners, purchasing an average of €13,102 per owner. Twenty-six per cent of the owners sold their timber to ENCE through an association. In procuring timber, ENCE fosters purchasing from small-sized suppliers (< 3,000$m^3$, debarked), which represent 92% of the total by number and 63% of the total by incoming volumes.

The R&D effort in the forestry arena is framed by the Forest Improvement Programme the Group has been working on for decades. The goals of this programme include developing and reproducing on a commercial scale genetically enhanced material and designing forest treatments and management models that increase the productivity and profitability of eucalyptus plantations and improve their phytosanitary condition. Among the most noteworthy initiatives carried out in 2017, it is worth highlighting the reproduction on an experimental scope of the genetically enhanced E. nitens x globulus hybrid which, alongside all of the other elite material developed under the scope of this programme, has been planted in nine experimental plots to evaluate and characterise its improved traits. Important progress was also made on enhancing the technology used to biologically control the Gonipterus pest by standardising the production of its parasitoid, the Anaphes nitens, in biofactories, and studying the Anaphes inexpectatus parasitoid in the lab. The results so far point to significant room for improving biological control of this pest as a result of the compatibility and complementarity of the two parasitoids.

Not only does ENCE's forest management division produce timber for sale to third parties, it is an active generator of income and of intangible environmental and social benefits. Against this backdrop, in 2017, ENCE collaborated on the definition of an Environmental Services Payment standard (under the FSC framework), which is scheduled to be pilot-tested during the first half of 2018. Certification of these services will permit identification of potential ways of adding value to the production of raw materials in forested estates. The resulting assessment of ecosystem services could top up income for owners who implement sustainable management policies.

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

- The landscape integration project at ENCE's factory in Pontevedra, pursuant to the tender called to this end and with the aim of using a range of solutions (architectural formulae, green walls, among others) to make the factory blend into its surroundings in a manner that is more pleasing on the eye.

- Rollout of the RENOVA project, designed to make use of every last bit of the tree, in this instance by using eucalyptus stumps to produce pulp.

- Project for the recovery of eucalyptus plantations affected by fire or managerial shortcomings which consists of taking charge of their management through felling and development during that time of the necessary remedial actions, restoring the existing plantations' productive capacity, framed by efficiency and profitability criteria and adequate forestry care. By the end of 2017, agreements had been reached covering an additional 300 hectares and the Group continues to prepare quotes for an additional 1,590 hectares, out of a total of 6,400 hectares evaluated since the project got underway.

- Continuation of the cross-border work between the Spanish-Portuguese teams for the exchange of know-how and strategies in the effort to combat the Gonipterus pest and the biological treatment of over 22,700 hectares during the autumn, bringing the total treated in 2017 to 47,972 hectares, which is 30% more than in 2016. The level of damage caused by this pest within the area covered by the treatment has been inventoried and analysed and the results indicate that the treated plantations grow 2.7 times faster than their untreated counterparts. ENCE presented at the PLURIFOR conference in Aveiro, in the section dealing with pest risks, sharing its know-how in the biological treatment of Gonipterus.

- Consolidation of the two biofactories set up in Huelva and Pontevedra in 2016 to research the Anaphes nitens egg parasitoid, specifically to demonstrate to the sector the viability of integrated pest control efforts framed by efficiency criteria. The improvement and standardisation of the parasitoid production process at biofactories has enabled a 37% reduction in treatment costs with respect to 2016. In addition, the Group concluded the lab work researching the complementarity and compatibility of the Anaphes inexpectatus parasitic wasp with a view to registering it as a biological pest control organism.

- Improvements in the supply of Eucalyptus globulus plants to the sector and increase in sales of cloned plants of 39% compared to 2016 as part of the strategy of transferring technology to the sector, which includes the provision of technical advice to owners with respect to selecting the best materials for planting and recommendations regarding the best forestry care solutions for each situation.

- The project dubbed "Improved ownership accreditation" designed to pinpoint the location of mature eucalyptus plantations in Galicia and Asturias in order to inform their owners of their value and possibly present bids, getting them into the market.

- The project dubbed "Unlocking value in forest tracts" designed to try to verify ownership accreditation in Galicia and Asturias by helping owners meet the related requirements.

- Agricultural biomass supply project at the energy plants in southern Spain designed to foster the recovery of waste, and not only forest waste but above all agricultural waste, preventing it from being burned, thereby unlocking value from this byproduct while helping to generate carbon-neutral power.

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, as well as fostering communication and debate in general on relevant forestry matters with the rest of the sector, the public authorities and civil society.

In 2017, 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 figures remain very impressive, with 2,420,073$m^3$ of certified timber going through its factories in 2017.

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 110 km in 2017, and from 103km, to 100 km and to 97 km in Navia over the same timeframe. As for the companies working on forest logistics tasks, the number of trucks stood at 196 in the northern region, rendering the fleet in use highly flexible and well-diversified. In addition, the first trucks fuelled by liquid natural gas (LNG) were incorporated into the fleet, thus reducing emissions and injecting efficiency into the transportation of timber to the productive facilities. Elsewhere, geolocation technology is being used when assigning vehicles, which is delivering a substantial improvement in the process of allocating and controlling transportation loads.

On the safety front, the Group continues to foster implementation of a safety culture by the firms it works with by means of initiatives on the ground related with employee health and safety awareness-raising by means of seminars, talks and oversight of critical interventions such as manual felling. Lastly, it is worth highlighting the technical improvements proposed during the year in the area of communication with forest workers in the field and tools to assist manual felling such as hydraulic and mechanical wedges.

## 32.2 Energy Business

### Huelva Operations Centre

The volume of energy exported to the grid by the Huelva factory increased by 2% in 2017 thanks to higher output and a shorter annual stoppage at the 41-MW Huelva plant.

All of this facility's wastewater readings in 2017, both the volume discharged and the main indicators tracking the quality of the effluents discharged, remained below the thresholds stipulated in the environmental permit and were down year-on-year. Most notably, enhanced management of the effluent treatment system drove a reduction in suspended solids of over 50%.

As for air pollution, having modified the electro-filter at the biomass furnace at the 41-MW facility during the annual maintenance stoppage of 2016, these readings remained below the limits established in the facility's environmental permit.

One of the biggest challenges tackled in 2017 was the increase in the fractionation of biomass originating from agricultural sub-products; this biomass contains a higher percentage of nitrate and thus presents greater potential for the emission of nitrogen oxides. Process enhancements and standardisation delivered emissions readings that were similar to those obtained in 2016.

Among the priority areas of attention, projects were implemented to improve air quality and reduce noise levels, specifically action plans designed to mitigate diffuse particle emissions and preparation of a facility noise map which has enabled identification of the key sources of noise and formulation of a host of measures for improving noise levels at the 50-MW Huelva facility.

In relation to waste generation and management, the ash from the biomass furnaces was used to make technical flooring, consolidating this strategy for recovering this waste.

With the goal of fostering circular economy projects, research into alternative uses for waste continues with a view to enabling its classification and use as sub-product.

Lastly, with respect to the dismantling of the pulp production facilities, the process of dismantling the buildings and facilities in the timber area is complete, while the dismantling of the facilities and equipment in the central, biological treatment and causticising areas of the factory is in the final stages; note that a new 40-MW plant is to be built in the cleared biological treatment and causticising areas.

### Merida Operations Centre

In 2017, operations at the Merida went according to plan and the production targets set for the year were met. The wastewater and air emissions readings remained at all times within the limits established in the facility's environmental permit.

One of the biggest challenges tackled in 2017 was the increase in the fractionation of biomass originating from agricultural sub-products. This biomass, with its higher nitrate content, could well have implied a significant increase in NOx emissions. Improvements introduced to process controls, coupled with the adequate classification of the various classes of biomass, enabled identification of the optimal mix for input into the furnace, thanks to which the nitrogen oxide emissions readings were kept flat year-on-year.

During the annual maintenance stoppage, as demanded by the Guadiana Water Confederation and with the authorisation of the regional government of Extremadura, the transformer station located close to the Guadiana River was moved and the work to upgrade the biomass storage facility adjoined to the energy plant was completed; authorisation to commission this new depot was received during the second half. This new facility will enable the storage of an additional 7,000 tonnes of biomass.

The Environmental Monitoring Programme to Control Risks to Fauna remained ongoing 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, the plant continues to collaborate with other companies in the region on the LIFE ICIRBUS Circular Economy project, researching how to recover the ash produced in the furnace. Phase three of this project was completed in 2017 to field-test the fertilisers developed by trialling the new materials obtained from the addition of the plant's ash.

### La Loma & Enemansa Operations Centres

Over the course of 2017, operations at the La Loma and Enemansa plants went according to plan and the production targets set for the year were met.

The process of integrating these two plants into ENCE's work procedures and systems, initiated following their acquisition in December 2016, concluded during the second half of 2017. The integration process is delivering positive results thanks to the improvements and upgrades implemented at both facilities during the year, particularly during the annual stoppages. The projects included:

- Mill system improvements
- Alignment with ENCE's health and safety standards
- Enhanced ash unloading installations at both plants
- Better air condenser vacuum system
- Noise blower system at Enemansa
- Plant access road upgraded to take 40 tonne loads
- Upgrade of slag and chip collection
- Replacement of furnace grid
- Renewal of fire protection equipment
- Gasoil burner parts
- Renewal of the chip feeding system at Enemansa

In addition, progress was made on the management front by working on the development and implementation of the Group's TQM and environmental management model.

An environmental action plan has been articulated around a series of projects designed to improve the both plants' environmental performance. That plan, which entails capex totalling €0.5m, includes the following features:

- Installation of evaporation pools in Enemansa
- Improved emissions control systems
- Reliability of environmental KPI measurement
- Enhanced reverse osmosis in Enemansa

As for air emissions, all readings were below the limits stipulated in the integrated environmental permit, which means both plants are currently compliant with the BREF benchmark ranges.

Both plants have applied to have the Spanish ministry of the environment have their slag and ash waste declared sub-products.

In addition, the plant in La Loma has been authorised by the regional government to market its ash and slag for the manufacture for fertilisers, thus marking progress on the path towards creating a circular economy.

### Lucena Operations Centre

The acquisition of EDF's stake in Bioenergía Santamaría, S.A. in Lucena (Cordoba) in August 2017 has increased installed capacity in ENCE's Energy business by 19% to 170 MW.

The Lucena plant has started the work of adapting to the ENCE Group's work methods. Since its acquisition it has been operating normally and delivering its output targets and has not reported any incidents.

Certain facility upgrades have already been implemented, notable among which:

- Installation of steam blowers to increase plant availability.
- Installation of a cleaning system to improve functioning time between stoppages.
- Alignment with ENCE's health and safety standards.

On the emissions front, a study was conducted to analyse how to cut emissions to comply with BREF particle emission requirements. As a result of that work, a project has been designed for the expansion and improvement of the scrubbing devices which will be carried out in 2018.

### 32.3 The sustainability of biomass as fuel

The generation of power from low-carbon biomass generates one thousand times fewer carbon emissions than a coal-fired plant and 400 times fewer than a CCGT plant. It further prevents the uncontrolled burning of agricultural waste (which has significant environmental ramifications) and helps to keep forests clear, reducing the incidence of forest fires by up to 70%. Moreover, it is an indigenous, renewable and programmable (does not depend on the wind, sun or rain) fuel such that imports of fossil fuels are reduced while creating more - sustainable - jobs than its alternatives: 30 direct, indirect and induced jobs per MW, according the calculations presented in the Biomass Spain 2015 report issued by APPA, Spain's renewable energy business association.

ENCE is Spain's number-one producer of renewable power from forestry and agricultural biomass, Europe's leading producer of eucalyptus pulp and the leading end-to-end and sustainable manager of forest land and crops in Spain.

Against this backdrop, on 12 July 2017, ENCE published its 10-Point Declaration on the Sustainability of Biomass as a Fuel. This is a pioneering initiative in the Spanish business landscape and is designed to underpin the Company's commitment to using biomass sustainably and caring for the environment in making use of this renewable source of energy.

With this initiative, ENCE is seeking to look into what the future holds in store for biomass and to guarantee all of its stakeholders that it will use biomass sustainably and respect the natural resources involved without fail.

ENCE drew from the biomass sustainability criteria established by some of Europe's leading environmentalist organisations in formulating its declaration. ENCE's commitments are articulated around respect for its natural surroundings and materialise in the following pledges:

1. Respect for the natural environment: Management of biomass will respect at all times the ability to renew biomass resources and soil quality and will not harm the natural surroundings.

2. Compatibility with sustainable farming and forestry practices: ENCE's business activities will be conducted in a manner that is compatible with best agricultural and forestry practice guides, no matter the crop or species used.

3. No burning of round wood: ENCE will not use round wood with a diameter of more than 10cm or wood deriving from farmed invasive species as fuel.

4. Respect for the priority uses of biomass: The biomass used by ENCE will not compete with other potential sustainable and priority uses of biomass (food, construction, furniture, etc.).

5. No use of biomass that competes with food: ENCE will not use biomass that comes from energy crop plantations on land apt for farming and producing food crops.

6. Exclusive use of surplus agricultural biomass: ENCE will only use surplus agricultural biomass and biomass that does not imply reducing the amount earmarked to feeding livestock.

7. Respect for the law and human rights: The harvesting of biomass will be performed at all times in keeping with prevailing legislation, human rights and community interests.

8. Use of best available technologies: ENCE will use best available techniques when transporting and storing biomass and generating power from it with a view to minimising its environmental impact and maximising energy efficiency.

9. Minimisation of carbon emissions: ENCE will analyse its total carbon footprint, considering the sum of greenhouse gas emissions throughout the product's entire life cycle, and will limit the distances travelled to harvest agricultural and forestry waste.

10. Maximisation of energy efficiency: ENCE will champion enhanced energy performance by developing and deploying technology that leverages the residual useful heat generated at its plants for use in other local industries and for other purposes.

## 33. Events after the reporting date

No significant events have taken place since 31 December 2017, other than those already disclosed herein, that would imply modifying the accompanying consolidated financial statements.

# Appendices

# Statement of financial position at 31 December 2017 and 31 December 2016 and income statement and statement of cash flows for the years then ended for the PULP and ENERGY businesses

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

### CONSOLIDATED STATEMENT OF FINANCIAL POSITION BY BUSINESS AT 31 DECEMBER 2017 AND 2016

| | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| Thousands of euros | Pulp Business | Energy Business | Adjustments & Eliminations | CONSOLIDATED TOTAL | Pulp Business | Energy Business | Adjustments & Eliminations | CONSOLIDATED TOTAL |
| **NON-CURRENT ASSETS:** | | | | | | | | |
| Intangible assets | 13,154 | 2,818 | - | 15,972 | 15,204 | 2,735 | - | 17,939 |
| Property, plant and equipment | 438,392 | 254,281 | - | 692,673 | 451,359 | 234,940 | - | 686,299 |
| Biological assets | 81,497 | 195 | - | 81,692 | 79,038 | 4,373 | - | 83,411 |
| Non-current investments in group companies | | | | - | | | | - |
| Equity instruments | 198,599 | - | (198,599) | - | 198,599 | - | (198,599) | - |
| Loans to group companies | 75,176 | - | (75,176) | - | 71,804 | 1 | (71,805) | - |
| Other financial assets | | | | | | | | |
| Hedging derivatives | 2,501 | - | - | 2,501 | - | - | - | - |
| Other financial assets | 2,063 | 2,057 | - | 4,120 | 5,640 | 5,994 | - | 11,634 |
| Deferred tax assets | 47,272 | 12,511 | - | 59,783 | 57,780 | 11,283 | (1) | 69,062 |
| | **858,654** | **271,862** | **(273,775)** | **856,741** | **879,424** | **259,326** | **(270,405)** | **868,345** |
| **CURRENT ASSETS:** | | | | | | | | |
| Non-current assets held for sale | - | - | - | - | 6,487 | 396 | - | 6,883 |
| Inventories | 28,640 | 10,486 | - | 39,126 | 35,363 | 8,244 | - | 43,607 |
| Trade and other receivables | | | | | | | | |
| Trade receivables, third parties | 97,598 | 5,472 | - | 103,070 | 73,597 | 4,625 | - | 78,222 |
| Trade receivables, related parties | 4,828 | 28,809 | (33,637) | - | 9,721 | 22,797 | (32,518) | - |
| Other receivables | 3,377 | 324 | - | 3,701 | 1,943 | 56 | - | 1,999 |
| Government and authorities | 6,097 | 848 | - | 6,945 | 8,477 | 302 | 32 | 8,811 |
| Income tax receivable from tax authorities | 355 | 667 | - | 1,022 | 912 | 547 | - | 1,459 |
| Current financial assets: | | | - | | | | - | |
| Derivatives | 13,525 | - | - | 13,525 | - | - | - | - |
| Other financial assets | 6,369 | 6 | - | 6,375 | 9,575 | 5 | - | 9,580 |
| Cash and cash equivalents | 167,294 | 103,234 | - | 270,528 | 112,098 | 97,766 | - | 209,864 |
| Other current assets | 1,552 | 511 | - | 2,063 | 3,485 | 85 | - | 3,570 |
| | **329,635** | **150,357** | **(33,637)** | **446,355** | **261,658** | **134,823** | **(32,486)** | **363,995** |
| **TOTAL ASSETS** | **1,188,289** | **422,219** | **(307,412)** | **1,303,096** | **1,141,082** | **394,149** | **(302,891)** | **1,232,340** |

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

### CONSOLIDATED STATEMENT OF FINANCIAL POSITION BY BUSINESS AT 31 DECEMBER 2017 AND 2016

| | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| Thousands of euros | Pulp Business | Energy Business | Adjustments & Eliminations | CONSOLIDATED TOTAL | Pulp Business | Energy Business | Adjustments & Eliminations | CONSOLIDATED TOTAL |
| **EQUITY:** | | | | | | | | |
| Share capital | 221,645 | 116,136 | (116,136) | 221,645 | 225,245 | 116,136 | (116,136) | 225,245 |
| Share premium | 170,776 | 74,463 | (74,463) | 170,776 | 170,776 | 82,463 | (82,463) | 170,776 |
| Parent company reserves | 158,479 | - | | 158,479 | 161,269 | | | 161,269 |
| Reserves in fully-consolidated companies | 113,102 | (5,980) | (45,912) | 61,210 | 121,990 | (19,819) | (42,556) | 59,615 |
| Valuation adjustments | 51,374 | 306 | | 51,680 | 30,262 | (3,009) | | 27,253 |
| Parent company retained earnings (prior-year losses) | (92,436) | (45,912) | 45,912 | (92,436) | (109,117) | (42,556) | 42,556 | (109,117) |
| Profit/(loss) for the year | 86,576 | 13,210 | (8,000) | 91,786 | 27,992 | 10,483 | - | 38,475 |
| Interim dividend | (29,623) | - | - | (29,623) | (7,825) | - | - | (7,825) |
| Translation differences | 47 | - | - | 47 | 86 | - | - | 86 |
| Own shares - parent company shares | (4,016) | - | - | (4,016) | (11,963) | | - | (11,963) |
| Other equity instruments - shareholder remuneration plan | 2,574 | 209 | | 2,783 | 488 | 29 | | 517 |
| **Equity attributable to owners of the parent** | **678,498** | **152,432** | **(198,599)** | **632,331** | **609,203** | **143,727** | **(198,599)** | **554,331** |
| **Non-controlling interests** | | **9,903** | | **9,903** | | **7,234** | | **7,234** |
| **TOTAL EQUITY** | **678,498** | **162,335** | **(198,599)** | **642,234** | **609,203** | **150,961** | **(198,599)** | **561,565** |
| **NON-CURRENT LIABILITIES:** | | | | | | | | |
| Bonds and other marketable securities | 244,610 | 48,948 | - | 293,558 | 243,631 | - | - | 243,631 |
| Bank borrowings | 21,429 | 80,293 | - | 101,722 | 25,714 | 107,218 | - | 132,932 |
| Grants | 7,274 | 1,922 | - | 9,196 | 8,454 | 1,217 | - | 9,671 |
| Derivative financial instruments | - | 3,619 | - | 3,619 | 3,992 | 7,756 | - | 11,748 |
| Other financial liabilities | 19,595 | - | - | 19,595 | 39,419 | - | - | 39,419 |
| Deferred tax liabilities | 21,072 | 2,751 | - | 23,823 | 17,914 | 3,204 | - | 21,118 |
| Non-current provisions | 3,738 | 429 | - | 4,167 | 5,845 | 322 | - | 6,167 |
| Non-current borrowings from group companies | - | 75,176 | (75,176) | - | 1 | 71,800 | (71,801) | - |
| | **317,718** | **213,138** | **(75,176)** | **455,680** | **344,970** | **191,517** | **(71,801)** | **464,686** |
| **CURRENT LIABILITIES:** | | | | | | | | |
| Bank borrowings | 6,701 | 7,030 | - | 13,731 | 6,713 | 13,763 | - | 20,476 |
| Derivative financial instruments | 3 | 2,190 | - | 2,193 | 11,663 | 3,078 | - | 14,741 |
| Other financial liabilities | 1,457 | - | - | 1,457 | 1,305 | - | - | 1,305 |
| Trade and other payables | | | | | | | | |
| Trade payables, third parties | 140,838 | 27,798 | - | 168,636 | 132,552 | 21,617 | | 154,169 |
| Trade payables, related parties | 28,808 | 4,829 | (33,637) | - | 22,800 | 9,722 | (32,522) | - |
| Income tax payable | 25 | 412 | - | 437 | 117 | (4) | 4 | 117 |
| Other payables to public authorities | 7,590 | 4,052 | - | 11,642 | 7,133 | 3,495 | 27 | 10,655 |
| Current provisions | 6,651 | 435 | - | 7,086 | 4,626 | - | - | 4,626 |
| | **192,073** | **46,746** | **(33,637)** | **205,182** | **186,909** | **51,671** | **(32,491)** | **206,089** |
| **TOTAL EQUITY AND LIABILITIES** | **1,188,289** | **422,219** | **(307,412)** | **1,303,096** | **1,141,082** | **394,149** | **(302,891)** | **1,232,340** |

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

### CONSOLIDATED INCOME STATEMENT BY BUSINESS FOR 2017 AND 2016

| | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| Thousands of euros | Pulp Business | Energy Business | Adjustments & Eliminations | CONSOLIDATED TOTAL | Pulp Business | Energy Business | Adjustments & Eliminations | CONSOLIDATED TOTAL |
| **Continuing operations:** | | | | | | | | |
| Revenue | 611,641 | 133,043 | (4,362) | 740,322 | 514,256 | 95,984 | (4,792) | 605,448 |
| Gain/(loss) on hedging transactions | (358) | (107) | - | (465) | (224) | 1,195 | - | 971 |
| Changes in inventories of finished goods and work in progress | (5,211) | - | - | (5,211) | 1,107 | - | - | 1,107 |
| Cost of sales | (248,136) | (41,750) | 4,362 | (285,524) | (243,756) | (29,280) | 4,785 | (268,251) |
| **GROSS PROFIT** | **357,936** | **91,186** | **-** | **449,122** | **271,383** | **67,899** | **(7)** | **339,275** |
| Own work capitalised | 3,732 | 569 | - | 4,301 | 5,602 | 939 | - | 6,541 |
| Other operating income | 11,317 | (442) | (4,987) | 5,888 | 17,586 | 1,168 | (13,542) | 5,212 |
| Grants taken to income | 1,704 | 196 | - | 1,900 | 2,336 | 99 | - | 2,435 |
| Employee benefits expense | (67,292) | (7,074) | - | (74,366) | (64,293) | (4,135) | - | (68,428) |
| Depreciation and amortisation charges | (54,379) | (16,033) | - | (70,412) | (56,739) | (12,989) | - | (69,728) |
| Depletion of forest reserve | (4,034) | (991) | - | (5,025) | (5,976) | (1,175) | - | (7,151) |
| Impairment of and gains/(losses) on disposals of intangible assets and PP&E | 9,192 | (132) | - | 9,060 | 20,198 | 3,836 | - | 24,034 |
| Other operating expenses | (136,806) | (39,000) | 4,987 | (170,819) | (137,197) | (35,819) | 13,549 | (159,467) |
| **OPERATING PROFIT/(LOSS)** | **121,370** | **28,279** | **-** | **149,649** | **52,900** | **19,823** | **-** | **72,723** |
| **Finance income:** | | | | | | | | |
| From interests in equity instruments in group companies | 8,000 | - | (8,000) | - | - | - | - | - |
| From marketable securities & other financial instruments: | | | | - | | | | - |
| Related parties | 2,968 | - | (2,968) | - | 2,468 | 202 | (2,670) | - |
| Third parties | 467 | 534 | - | 1,001 | 177 | 108 | - | 285 |
| **Finance costs** | | | | - | | | | - |
| Related-party borrowings | - | (2,968) | 2,968 | - | (202) | (2,468) | 2,670 | - |
| Third-party borrowings | (17,627) | (5,128) | - | (22,755) | (16,834) | (3,530) | - | (20,364) |
| Change in fair value of financial instruments | 2,093 | (3,710) | - | (1,617) | (414) | - | - | (414) |
| Exchange differences | (6,270) | (13) | - | (6,283) | (1,452) | 6 | - | (1,446) |
| Impairment of and gains/(losses) on disposal of financial assets | (124) | - | - | (124) | - | - | | - |
| **NET FINANCE COST** | **(10,493)** | **(11,285)** | **(8,000)** | **(29,778)** | **(16,257)** | **(5,682)** | **-** | **(21,939)** |
| **PROFIT/(LOSS) BEFORE TAX** | **110,877** | **16,994** | **(8,000)** | **119,871** | **36,643** | **14,141** | **-** | **50,784** |
| Income tax | (24,301) | (1,905) | | (26,206) | (8,651) | (3,658) | | (12,309) |
| **PROFIT/(LOSS) FOR THE PERIOD FROM CONTINUING OPERATIONS** | **86,576** | **15,089** | **(8,000)** | **93,665** | **27,992** | **10,483** | **-** | **38,475** |
| **CONSOLIDATED PROFIT FOR THE PERIOD** | **86,576** | **15,089** | **(8,000)** | **93,665** | **27,992** | **10,483** | **-** | **38,475** |
| Profit/(loss) attributable to non-controlling interests | - | 1,879 | - | 1,879 | - | - | - | - |
| **PROFIT/(LOSS) FOR THE PERIOD ATTRIBUTABLE TO OWNERS OF THE PARENT** | **86,576** | **13,210** | **(8,000)** | **91,786** | **27,992** | **10,483** | **-** | **38,475** |

**CONSOLIDATED STATEMENT OF CHANGES IN CASH FLOW BY BUSINESS FOR 2017 AND 2016**

| | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| Thousands of euros | Pulp Business | Energy Business | Adjustments & Eliminations | CONSOLIDATED TOTAL | Pulp Business | Energy Business | Adjustments & Eliminations | CONSOLIDATED TOTAL |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | | | | | | |
| Consolidated profit/(loss) for the period before tax | 110,877 | 16,994 | (8,000) | 119,871 | 36,643 | 14,141 | - | 50,784 |
| Adjustment for: | | | | | | | | |
| Depreciation and amortisation | 59,567 | 15,870 | - | 75,437 | 64,799 | 12,080 | - | 76,879 |
| Changes in provisions and other deferred expense (net) | 10,804 | 778 | - | 11,582 | 3,031 | 2,711 | - | 5,742 |
| Impairment of and gains/(losses) on disposals of intangible assets and PP&E | (9,085) | 353 | - | (8,732) | (20,198) | (3,836) | - | (24,034) |
| Finance income | (3,435) | (534) | 2,968 | (1,001) | (1,360) | (310) | 1,385 | (285) |
| Finance costs | 20,993 | 11,806 | (2,968) | 29,831 | 17,537 | 5,999 | (1,385) | 22,151 |
| Grants taken to income | (1,157) | (196) | - | (1,353) | (1,602) | (99) | - | (1,701) |
| | **77,687** | **28,077** | **-** | **105,764** | **62,207** | **16,545** | **-** | **78,752** |
| **Changes in working capital:** | | | | | | | | |
| Inventories | 5,611 | (1,494) | - | 4,117 | (1,386) | 2,193 | - | 807 |
| Trade and other receivables | (17,934) | (7,846) | - | (25,780) | 16,483 | 20,582 | - | 37,065 |
| Short-term investments | 3,266 | - | - | 3,266 | (881) | - | - | (881) |
| Trade payables, other payables and other liabilities | 9,396 | 2,258 | - | 11,654 | (15,003) | 3,567 | - | (11,436) |
| | **339** | **(7,082)** | **-** | **(6,743)** | **(787)** | **26,342** | **-** | **25,555** |
| **Other cash flows from operating activities:** | | | | | | | | |
| - Interest paid | (16,474) | (10,452) | 2,968 | (23,958) | (14,667) | (8,911) | 1,385 | (22,193) |
| - Interest received | 3,435 | 534 | (2,968) | 1,001 | 1,360 | 310 | (1,385) | 285 |
| - Income tax received (paid) | (14,476) | (5,154) | - | (19,630) | (7,247) | (1,066) | - | (8,313) |
| - Other receipts / (payments) | - | - | - | - | (2,064) | - | - | (2,064) |
| | (27,515) | (15,072) | - | (42,587) | (22,618) | (9,667) | - | (32,285) |
| **Net cash from operating activities (I)** | 161,388 | 22,917 | (8,000) | 176,305 | 75,445 | 47,361 | - | 122,806 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | | | | | | |
| **Investments:** | | | | | | | | |
| Property, plant and equipment and biological assets | (39,141) | (15,222) | 3,520 | (50,843) | (57,971) | (5,804) | 2,736 | (61,039) |
| Intangible assets | (1,253) | (368) | - | (1,621) | (6,423) | (31) | - | (6,454) |
| Business combinations | - | (28,463) | - | (28,463) | - | (22,505) | - | (22,505) |
| Other financial assets | 2,531 | 4,661 | - | 7,192 | (3,296) | (4,294) | - | (7,590) |
| | **(37,863)** | **(39,392)** | **3,520** | **(73,735)** | **(67,690)** | **(32,634)** | **2,736** | **(97,588)** |
| **Proceeds**: | | | | | | | | |
| Property, plant and equipment and biological assets | 3,392 | **3,520** | **(3,520)** | **3,392** | 38,592 | - | - | 38,592 |
| | **3,392** | **3,520** | **(3,520)** | **3,392** | **41,419** | **-** | **(2,736)** | **38,683** |
| **Net cash used in investing activities (II)** | **(34,471)** | **(35,872)** | **-** | **(70,343)** | **(26,271)** | **(32,634)** | **-** | **(58,905)** |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | | | | | | |
| **Proceeds from and payments for equity instruments** | | | | | | | | |
| Buyback of own equity instruments | (34,872) | - | - | (34,872) | (39,387) | - | - | (39,387) |
| Disposal of own equity instruments | 34,640 | - | - | 34,640 | 30,340 | - | - | 30,340 |
| | **(232)** | **-** | **-** | **(232)** | **(9,047)** | **-** | **-** | **(9,047)** |
| **Proceeds from and repayments of financial liabilities:** | | | | | | | | |
| Group companies and associates | (7,491) | 7,491 | - | - | (20,744) | 20,744 | - | - |
| Proceeds from issuance of bonds and other marketable securities, net of issua | - | 48,947 | - | 48,947 | (369) | - | - | (369) |
| Increase/(decrease) in bank borrowings, net of issuance costs | (24,140) | (35,618) | - | (59,758) | 32,316 | (5,094) | - | 27,222 |
| Repayment of other borrowings and cancellation of derivatives | - | - | - | - | - | - | - | - |
| Grants received | (23) | 30 | - | 7 | (416) | - | - | (416) |
| | **(31,654)** | **20,850** | **-** | **(10,804)** | **10,787** | **15,650** | **-** | **26,437** |
| **Dividends and payments on other equity instruments** | | | | - | | | | |
| Dividends | (39,837) | (8,000) | 8,000 | (39,837) | (32,711) | - | - | (32,711) |
| | **(39,837)** | **(8,000)** | **8,000** | **(39,837)** | **(32,711)** | **-** | **-** | **(32,711)** |
| **Net cash used in financing activities (III)** | **(71,723)** | **12,850** | | **(50,873)** | **(30,971)** | **15,650** | **-** | **(15,321)** |
| **NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS (I+II+III)** | **55,194** | **(105)** | | **55,089** | **18,203** | **30,377** | **-** | **48,580** |
| Cash and cash equivalents, opening balance | 112,098 | 97,766 | - | 209,864 | 93,895 | 65,670 | - | 159,565 |
| Cash obtained as a result of a business combination | - | 5,575 | - | 5,575 | | 1,719 | - | 1,719 |
| Cash and cash equivalents at end of year | 167,293 | 103,235 | - | 270,528 | 112,098 | 97,766 | - | 209,864 |

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

Group management report for the year ended 31 December 2017, specifically including the information required for the non-financial statement and the required diversity disclosures

# Contents

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

## Group management report for the year ended 31 December 2017, specifically including the information required for the non-financial statement and the required diversity disclosures

### 1. Introduction

This Management Report has been drawn up in keeping with the terms of article 49 of Spain's Code of Commerce, as worded by Spanish Law 16/2007 (of 4 July 2007), revising and adapting the accounting aspects of company law to harmonise them with the EU-endorsed standards, article 262 of the Spanish Corporate Enterprises Act and the recommendations issued by the Spanish securities market regulator, the CNMV, in its "Guide for the preparation of management reports for listed companies".

Note additionally that the Management Report contains the non-financial statement drawn up to meet the requirements introduced by Spanish Royal Decree-Law 18/2017, passed on 25 November 2017, which amends the Code of Commerce, the consolidated text of the Corporate Enterprises Act enacted by means of Royal Legislative-Decree 1/2010, and Spain's Audit Act (Law 22/2015) with respect to non-financial and diversity disclosures. It was also drawn up taking into consideration the guidelines on non-financial reporting issued by the European Commission (2017/C 215/01) in response to Directive 2014/95/EU. Lastly, it takes into account the contents of version G4 of the Global Reporting Initiative's sustainability reporting guidelines, which are similarly used to articulate the annual Corporate Social Responsibility Report which this year complements and provides further details about the matters touched upon in this Management Report.

### 2. Governance 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 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 Operations Officer, the Energy Officer, the Supply Chain Officer, the Chief Finance & Corporate Development Officer, the Human Capital Officer, the Communication and Institutional Relations Officer and the General Secretary. These officers report directly to the 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. Indeed, the Company is the sole director of its Group companies, other than those in which there are non-controlling interests.

In 2016, Ence Energía, S.L.U., 100%-owned by Ence Energía y Celulosa, S.A., acquired 60.07% of Energía la Loma, S.A. and 68.42% of Energías de la Mancha ENEMAN, S.A. from the ENEL Group. On 2 August 2017, Ence Energía, S.L.U. closed the acquisition of 70% of Bioenergía Santamaría, S.A. from EDF EN IBERIA, S.A.

These three companies are governed by a board of directors and the non-controlling shareholder is represented on two of them.

## 3. Group activity

ENCE has articulated its activities around two core businesses: the production of pulp, which represented 79% of Group EBITDA in 2017, and the generation of energy from renewable sources at standalone power plants, which accounted for the remaining 21%.

### 3.1. Pulp production:

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 co-generation of energy at the plants involved in the productive process, as well as the supply of timber from the plantations managed by the Company.

Pulp is the basic raw material used to manufacture the various kinds of paper that form part of our everyday lives. More specifically, it 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.

### 3.2. Renewable power generation:

The Energy Business 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 seven such plants: two in the Huelva industrial complex, with capacity of 50 MW and 41 MW, respectively, one in Merida (20 MW), one in Ciudad Real (16 MW), one in Jaen (16 MW) and a complex in Cordoba with two separate facilities (with capacity of 14 MW and 13 MW). In addition, ENCE has begun construction of a new 40-MW independent plant in the Huelva industrial complex which is expected to be commissioned towards the end of 2019.

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 leading generator of biomass-fuelled renewable energy, with installed capacity of 112 MW integrated within the pulp plants and another 170 MW distributed between seven standalone plants located in Andalusia, Extremadura and Castile la Mancha. Moreover, ENCE is the leading player in the end-to-end and responsible management of forest land and crops in Spain.

### 3.3. 2016-2020 Business Plan

ENCE presented its **2016-2020 Business Plan** to the investment community in November 2015 with the stated target of virtually doubling Group EBITDA and reducing its cyclicality over that timeframe by investing over €650 million between its two businesses: Pulp and Energy. Subsequently, in March 2017, it presented a plan update for the Pulp Business, reducing its capex target for this business by €50 million.

Almost half of targeted investment, €288 million, will be earmarked to the Pulp Business with the goals of (i) driving environmental excellence and reinforcing safety at the Navia and Pontevedra mills; and (ii) continuing to enhance the efficiency of the productive process, bringing the cash cost down to €325/tonne by 2020.

To this end, the Business Plan contemplates a staggered 25% increase in annual production to 1,120,000 tonnes by 2020 via the elimination of bottlenecks and the introduction of productivity enhancements at the mills.

**Bussines Plan Summary - Pulp Bussines** (with a $/t 720 price and $1.25 exchange rates)

| | 2015 a | 2016 a | **2017 e** | **2018 e** | **2019 e** | **2020 e** | **Total** |
|---|---|---|---|---|---|---|---|
| **Capex (Mn €)** | 30 | 37 | 41 | 71 | 82 | 27 | **288** |
| **Production destined for sales (000, t)** | 898 | 931 | 972 | 991 | 1,040 | **1,120** | |
| **Cash cost (€/t)** | 358 | 357 | 339 | 337 | 329 | **325** | |

The other half of the capital expenditure envisaged in the Business Plan - €325 million - will be earmarked to development of the renewable power generation business with the goal of lifting EBITDA to €78 million by 2020, from €30 million in 2015, by increasing installed capacity and boosting efficiency by means of diversification of the sources of biomass used in our plants marked by a shift towards agricultural sub-products, which in 2015 represented just 14% of the total.

It is important to underscore that the Business Plan stipulates that all of these investments must be compatible with maintaining a conservative financial profile, i.e., keeping leverage at all times below 2.5x in the Pulp Business and 5x in the Energy Business.

Since setting the plan in motion, the Company has added 40,000 tonnes of capacity at the Navia mill (on a staggered basis during the maintenance stoppages of 2016 and 2017), such that pulp sales increased to 975,000 tonnes in 2017.

The cash cost has trended in line with the guidance provided in the Business Plan for a scenario contemplating constant prices of $720/t and an exchange rate of €/$1.25. The difference between the targeted cash cost of

€339/t and the reported cost of €350/t in 2017 is entirely attributable to higher pulp prices and lower exchange rates that those modelled.

For every €50/t change in pulp prices, €3/t automatically goes to or is borne by the Company's timber suppliers. This mechanism helps to keep our cost structure flexible in any price scenario.

In the Energy business, annualised EBITDA already topped €50m in 2017. This significant growth was driven by the acquisition of three biomass plants in Spain with aggregate capacity of 59 MW, coupled with the savings eked out by the strategy of diversifying into agricultural biomass, which already accounts for 60% of the mix.

In December 2016, ENCE closed the acquisition of Enel Green Power's interests in two separate 16-MW biomass-fuelled renewable power plants located in Enemasa (Ciudad Real) and La Loma (Jaen) and in August 2017 it closed the acquisition of a 27.1-MW biomass-fuelled renewable energy plant in Lucena (Cordoba) from EDF EN IBERIA, S.A.

The next steps in the Pulp business entail the addition of 30,000 tonnes of new capacity at the Pontevedra facility in March 2018, followed by another 40,000 tonnes in 2019, and expansion of the Navia facility by 80,000 tonnes in April 2019.

In the Energy Business, we have already begun construction of the new 40-MW biomass power plant in Huelva, due to be commissioned at the end of 2019 and expected to contribute approximately €11m to EBITDA in its first year in operation.

In parallel, we continue to analyse investment alternatives in Spain and Europe, specifically the acquisition of biomass plants, with a view to lifting EBITDA in this business from €45m in 2017 to €78m.

ENCE is already working on a new Business Plan that will continue to generate value for our shareholders, environmental excellence for our surroundings and safety for our employees and facilities beyond 2020.

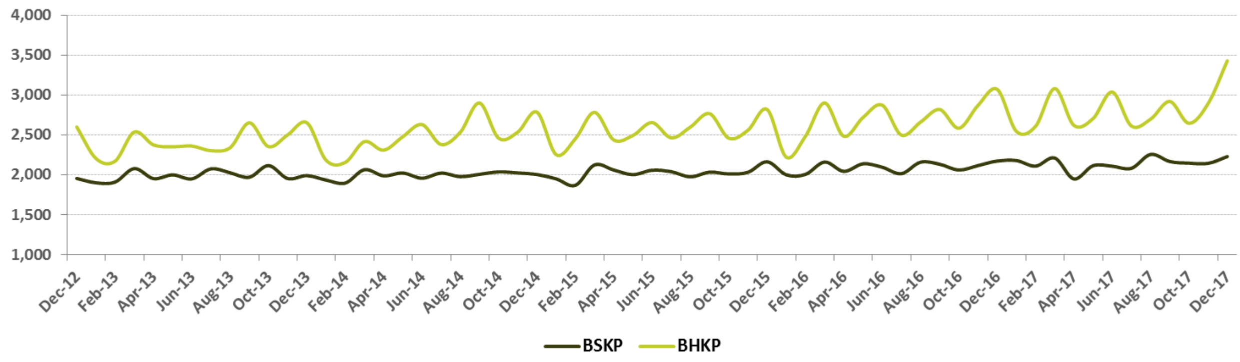
## 4. Pulp Business

### Pulp market trends and outlook

Growth in global demand for short-fibre pulp continued throughout 2017, with global shipments rising 5% year-on-year (equivalent to 1.6 million tonnes).

China remains the main driver of growth in global demand for short-fibre pulp, having registered demand growth of 13% in 2017, followed by other emerging markets, where demand firmed by 3%. This sharp growth in demand for short-fibre pulp is being shaped by growing consumption of tissue paper on the back of rapid urban development and growing standards of living in these countries, as well as the rollout of more stringent environmental protection standards in China.

**Monthly demand for pulp during the last five years (millions of tonnes)**




Source: PPPC (G-100)

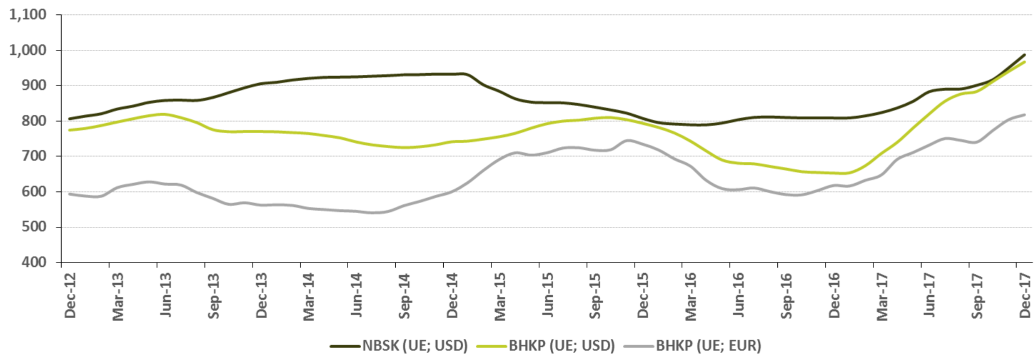
On the other hand, as we had already indicated, the growth in supply via new short-fibre capacity has proven substantially lower than initially anticipated by sector analysts as a result of a more gradual than expected start-up of APP's new mill in Indonesia and the intense pace of mergers and capacity conversions in Asia.

This has been compounded by operating problems at some mills during the year, notably at the CMPC mill in Brazil. These problems are commonplace in an industry in which the overall capacity utilisation rate stands at over 90%.

As a result, the price of short-fibre pulp (BHKP) in Europe continued to climb all year long, reaching $979/t by the end of December. This trend is expected to continue throughout 2018. By January short-fibre prices had reached $1,000/t and ENCE has already announced a fresh increase in the price of its pulp to $1,020/t for February.

Continued sharp growth in global demand, coupled with the lack of major short-fibre capacity addition plans, foreshadows a period of high pulp prices for at least the next three years.

**Pulp prices in Europe during the last five years**




Source: FOEX

## Pulp sales

Pulp sales volumes rose by 5.6% in 2017, shaped by growth of 2.8% in output and the reduction of 17,351 tonnes of inventories.

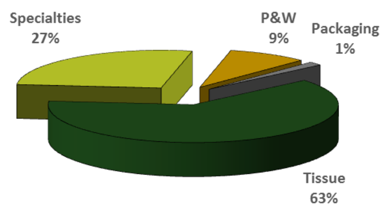
| | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| **Pulp sales (t)** | **255,401** | **259,529** | *(1.6%)* | **239,034** | *6.8%* | **975,302** | **923,408** | *5.6%* |
| Average selling price (€/t) | 581.5 | 439.3 | *32.4%* | 543.2 | *7.1%* | 528.2 | 464.4 | *13.7%* |
| **Pulp sales revenues (€Mn)** | **148.5** | **114.0** | *30.3%* | **129.8** | *14.4%* | **515.2** | **428.8** | *20.1%* |

The volume of pulp inventories declined by 35% in 2017 to end the year at a low of 33,000 tonnes.

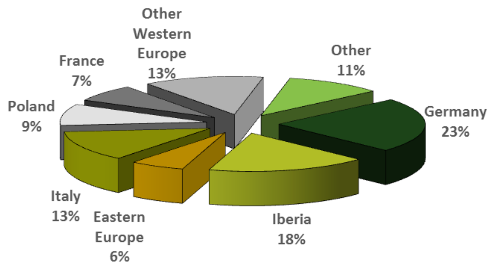
The growth in sales volumes, coupled with a 13.7% recovery in average sales prices, drove revenue from pulp sales 20.1% higher to €515.2m.

The tissue paper segment remains the main end use given to the pulp sold by ENCE, accounting for 63% of revenue from pulp sales in 9M17, followed by the specialty paper segment, at 27%. 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.

**Breakdown of revenue by end product**




**Breakdown of revenue by geographic market**




Most of the pulp produced by ENCE is sold in Europe, namely 89% of revenue from pulp sales in 2017. Germany and Spain/Portugal accounted for 23% and 18% of total revenue, respectively, followed by Italy, Poland and France, at 13%, 9% and 7%, respectively. Western Europe accounted for 13% of the total, with the rest of Eastern Europe representing 6%.

## Pulp output and cash cost

| | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| Navia pulp production | 142,780 | 141,262 | *1.1%* | 133,501 | *7.0%* | 523,297 | 509,186 | *2.8%* |
| Pontevedra pulp production | 115,149 | 110,343 | *4.4%* | 113,396 | *1.5%* | 434,654 | 422,257 | *2.9%* |
| **Pulp production (t)** | **257,929** | **251,605** | *2.5%* | **246,898** | *4.5%* | **957,951** | **931,443** | *2.8%* |

Pulp production increased by 2.8% year-on-year in 2017. Production at the Navia mill increased by 2.8%, compared to growth of 2.9% at the Pontevedra mill.

As is customary, the Pontevedra mill was stopped for maintenance for nine days in March and the Navia mill was halted for 12 days in June, which was three days longer than usual due to the clean-up of the pipeline into the Navia estuary.

During the maintenance stoppage in Pontevedra, the company eked out energy efficiency gains and prepared for the addition of 30,000 tonnes of capacity during the stoppage scheduled for March 2018. In addition, it reinforced the complex's environmental excellence and continued to make progress on its Zero Odour programme by introducing several improvements to the facility's digesters and furnaces that will boost the quality of gas condensation and controls.

During the maintenance stoppage at Navia, this facility's environmental excellence was similarly reinforced, emphasising the reduction of odours but also making the cooking process more efficient. It also conducted an ad-hoc clean-up of the pipeline discharging into the Navia estuary.

| Figures in €/t | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| Wood cost | 196.5 | 189.3 | *3.8%* | 192.1 | *2.3%* | 192.7 | 190.7 | *1.0%* |
| Conversion costs | 105.6 | 101.7 | *3.9%* | 104.0 | *1.5%* | 102.9 | 111.7 | *(7.9%)* |
| Commercial and logistic costs | 30.7 | 29.3 | *4.8%* | 28.6 | *7.3%* | 29.4 | 29.0 | *1.3%* |
| Overheads | 24.8 | 20.7 | *20.2%* | 25.3 | *(2.0%)* | 24.6 | 25.3 | *(2.7%)* |
| **Total cash cost** | **357.6** | **340.9** | *4.9%* | **350.0** | *2.2%* | **349.6** | **356.7** | *(2.0%)* |

The cash cost amounted to €349.6/t in 2017, down €7.1/t year-on-year despite the increase of €12/t in timber prices, which are now indexed to the trend in pulp prices.

The reduction was brought about thanks to investments in efficiency improvements and capacity additions in prior quarters, coupled with savings in overhead and other timber costs.

The €12/t increase in timber prices in 2017 as a result of benchmarking to pulp prices was largely offset by savings achieved in certification costs, shortening of the supply distance, price differentiation with respect to other less productive eucalyptus species such as the *nitens* and new initiatives such as the promotion of forest owner associations (*cotos redondos*).

The trend in the cash cost is similar quarter-on-quarter: the increase of €4.40/t in timber prices is the result of two increases during the last quarter as a result of pulp price benchmarking. In addition, conversion costs increased quarter-on-quarter due largely to the increase in the prices of the chemical products used, such as caustic soda.

| | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| Wood cost €/m3 | 65.5 | 63.6 | *2.9%* | 64.2 | *2.0%* | 64.5 | 64.4 | *0.0%* |
| Timber consumption (m3) | 718,967 | 696,040 | *3.3%* | 699,716 | *2.8%* | 2,857,483 | 2,824,973 | *1.2%* |
| Big suppliers | 26% | 24% | | 26% | | 25% | 29% | |
| Small suppliers | 48% | 44% | | *47%* | | 48% | 43% | |
| Standing timber acquired directly from land owners | 26% | 31% | | *27%* | | 27% | 26% | |
| Owned timber | *0%* | 1% | | *0%* | | 0% | 1% | |

Given that timber prices are now adjusted automatically as a function of increases or decreases in pulp prices, in order to track delivery of the Business Plan targets it is necessary to adjust the reported 2017 cash cost for the difference between the pulp price of $720/t modelled in our Business Plan and actual prices in 2017. Pro forma for that adjustment, the reported cash cost is in line with the target.

## Revenue from the sale of energy ties to the Pulp Business

As an integral part of its pulp production process, ENCE uses the lignin and forest biomass 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 net cost is included in the above-mentioned conversion costs within the cash cost metric.

| | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| Navia energy sales | 142,906 | 143,028 | *(0.1%)* | 139,616 | *2.4%* | 527,884 | 484,967 | *8.8%* |
| Pontevedra energy sales | 58,110 | 55,223 | *5.2%* | 58,539 | *(0.7%)* | 217,441 | 194,732 | *11.7%* |
| **Energy sales linked to the pulp process (MWh)** | **201,016** | **198,251** | *1.4%* | **198,155** | *1.4%* | **745,325** | **679,699** | *9.7%* |
| Average selling price - Pool + Ro (€/MWh) | 93.1 | 113.8 | *(18.2%)* | 84.7 | *9.8%* | 89.4 | 82.8 | *7.9%* |
| Investment remuneration (€Mn) | 2.6 | 2.6 | *(1.0%)* | 2.6 | - | 10.2 | 10.4 | *(1.0%)* |
| **Revenues from energy sales linked to pulp (€Mn)** | **21.3** | **25.1** | *(15.4%)* | **19.4** | *9.9%* | **76.8** | **66.6** | *15.4%* |

The generation of energy in connection with pulp production increased by 9.7% in 2017, 2016 output having been affected by the incident affecting the turbine rotor in Pontevedra during the first quarter.

Average sales prices meanwhile jumped 7.9%, due mainly to growth in pool prices to €52.1/MWh, compared to €39.7/MWh in 2016. On top of this, the plants' remuneration for operations (Ro) parameter increased following the recent update of the parameters applicable for 2017-2019.

Erring on the side of caution, ENCE adjusts average pool prices monthly as a function of the limits set by the regulator (regulatory collar); this prudent accounting treatment led to the recognition of a provision of €3m in 2017 which has been recognised as a reduction in the average sales price. In 2016, however, the Company made positive adjustment of €3.9m in this respect, in the fourth quarter.

In total, revenue from energy sales in the Pulp Business, factoring in remuneration for investment - unchanged - increased by 15.4% in 2017 to €76.8m.

## Pulp Business - earnings analysis

| Figures in €Mn | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| **Total net revenue** | **175.5** | **144.4** | *21.5%* | **150.9** | *16.3%* | **611.6** | **514.3** | *18.9%* |
| **EBITDA** | **55.9** | **29.4** | *90.2%* | **45.4** | *23.1%* | **170.6** | **95.4** | *78.8%* |
| *EBITDA margin* | *32%* | *20%* | *0.6 p.p.* | *30%* | *1.8 p.p.* | *28%* | *19%* | *9.3 p.p.* |
| Amortization | (15.8) | (12.5) | *26.7%* | (13.6) | *16.4%* | (54.4) | (56.7) | *(4.2%)* |
| Forest depletion | (1.4) | (2.1) | *(31.0%)* | (0.1) | *n.s.* | (4.0) | (6.0) | *(32.5%)* |
| Impairment of and gains/(losses) on fixed-asset disposal | 3.5 | 1.2 | *191.9%* | 1.5 | *124.2%* | 9.2 | 20.2 | *(54.5%)* |
| **EBIT** | **42.2** | **16.1** | *162.7%* | **33.3** | *26.6%* | **121.4** | **52.9** | *129.4%* |
| *EBIT margin* | *24%* | *11%* | *1.2 p.p.* | *22%* | *2.0 p.p.* | *20%* | *10%* | *9.6 p.p.* |
| Net finance costs | (3.3) | (3.7) | *(10.7%)* | (3.8) | *(12.8%)* | (14.2) | (14.4) | *(1.4%)* |
| Other financial results | (0.8) | (0.3) | *159.9%* | (0.1) | *n.s.* | 3.7 | (1.9) | *n.s.* |
| **Profit before tax** | **38.0** | **12.0** | *216.8%* | **29.4** | *29.3%* | **110.9** | **36.6** | *202.6%* |
| Income tax | (8.5) | (3.0) | *183.9%* | (6.8) | *25.2%* | (24.3) | (8.7) | *180.9%* |
| **Net Income** | **29.5** | **9.0** | *227.8%* | **22.6** | *30.6%* | **86.6** | **28.0** | *209.3%* |

EBITDA in the Pulp Business amounted to €170.6m in 2017, up 78.8% from 2016, thanks to the 13.7% increase in average sales prices, growth of 5.6% in pulp sales volumes and a 2% reduction in the cash cost.

Depreciation charges were 4.2% lower at €54.4m, shaped by the recognition in 2016 of outstanding depreciation charges in respect of the industrial complex in Huelva which was reclassified from assets held for sale to property, plant and equipment.

Since then, depreciation of these assets has been largely offset by the reversal of the impairment provision recognised against these assets within depreciation charges and gains on asset disposals. In 2016, the above heading also included €16.3m of gains on estate sales.

Net finance costs were virtually flat year-on-year at €14.2m, while 'other finance income/costs' reflects the collection of an €8m dividend from the Energy business in 2Q17, offset by net exchange losses.

First-time application of IFRS 9 in 2017 recommends retrospective application to 2016 of the new accounting treatment applicable to the time value of hedging derivatives. As a result, time value changes originally recognised in other finance income/costs in 2016 are now presented in equity.

In all, the Pulp Business reported bottom-line growth of 209.3% to €86.6m in 2017, compared to €28m in 2016.

## Pulp Business - cash flows

Net cash flows from operating activities amounted to €153.4m in 2017, up 97.9% from 2016, as a result of the EBITDA growth of 78.8%.

| Figures in €Mn | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| **EBITDA** | **55.9** | **29.4** | *90.2%* | **45.4** | *23.1%* | **170.6** | **95.4** | *78.8%* |
| Non cash expenses / (incomes) | 4.2 | 1.6 | *159.4%* | 3.3 | *25.5%* | 9.6 | 2.5 | *290.4%* |
| Other charges / (payments) | 0.7 | (3.1) | *n.s.* | 0.0 | *n.s.* | 0.3 | (1.1) | *n.s.* |
| Change in working capital | 17.6 | 14.7 | *19.6%* | (5.5) | *n.s.* | 0.3 | (0.8) | *n.s.* |
| Income tax received/(paid) | (12.4) | (6.6) | *88.3%* | - | *n.s.* | (14.5) | (7.2) | *99.8%* |
| Interest paid | (7.6) | (5.9) | *27.9%* | 0.6 | *n.s.* | (13.0) | (13.3) | *(2.0%)* |
| **Net cash flow from operating activities** | **58.4** | **30.2** | *93.6%* | **43.9** | *33.1%* | **153.4** | **75.4** | *103.3%* |

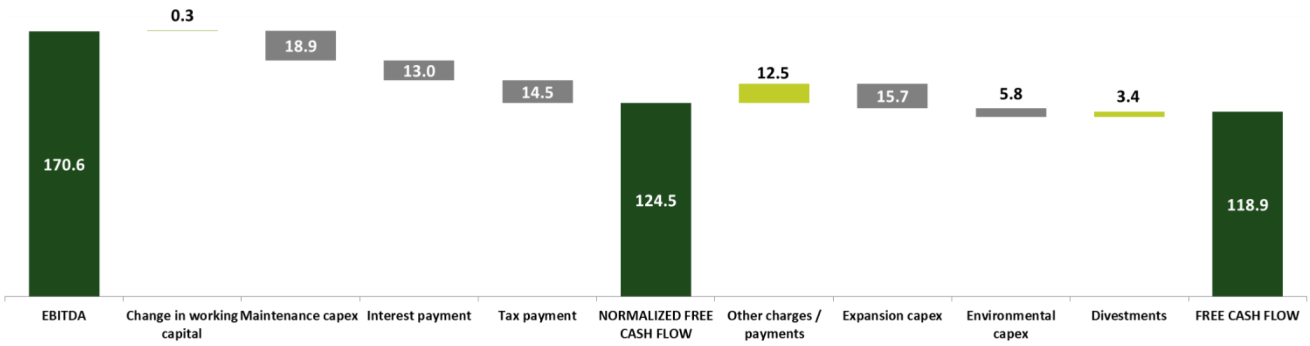
Working capital was virtually flat in 2017 (-€0.3m) as the increase in trade payables and decrease in inventories offset the growth in trade receivables, driven mainly by the recovery in net sales prices.

| Figures in €Mn | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| Inventories | 1.0 | 6.3 | *(85.0%)* | (0.9) | *n.s.* | 5.6 | (1.4) | *n.s.* |
| Trade and other receivables | 2.9 | 7.9 | *(63.2%)* | (2.4) | *n.s.* | (17.9) | 16.5 | *n.s.* |
| Current financial and other assets | 2.4 | 1.1 | *126.6%* | 0.9 | *158.1%* | 3.3 | (0.9) | *n.s.* |
| Trade and other payables | 11.3 | (0.6) | *n.s.* | (3.1) | *n.s.* | 9.4 | (15.0) | *n.s.* |
| **Change in working capital** | **17.6** | **14.7** | *19.6%* | **(5.5)** | *n.s.* | **0.3** | **(0.8)** | *n.s.* |

Net cash flows used in investing activities totalled €34.5m, including the collection of €3.4m corresponding to the sale of the last 165 hectares of forest plantations agreed in December 2016 and of certain industrial assets related with the Huelva complex. In 2016, the Group collected €41.4m from asset disposals, mainly from the sale of 1,736 hectares of forest crops.

| Figures in €Mn | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| Maintenance capex | (8.1) | (6.8) | *19.2%* | (2.6) | *211.7%* | (18.9) | (21.1) | *(10.5%)* |
| Environmental capex | (1.6) | (1.7) | *(9.0%)* | (1.2) | *25.6%* | (5.8) | (7.5) | *(22.4%)* |
| Efficiency and expansion capex | (4.7) | (6.1) | *(23.5%)* | (2.0) | *132.0%* | (15.7) | (35.8) | *(56.2%)* |
| Financial investments | 0.9 | (4.3) | *n.s.* | 0.9 | *2.0%* | 2.5 | (3.3) | *n.s.* |
| **Investments** | **(13.5)** | **(19.0)** | *(28.9%)* | **(5.0)** | *169.5%* | **(37.9)** | **(67.7)** | *(44.1%)* |
| Disposals | 0.2 | 16.5 | *(98.6%)* | 0.5 | *(55.7%)* | 3.4 | 41.4 | *(91.8%)* |
| **Net cash flow from investing activities** | **(13.3)** | **(2.5)** | *439.0%* | **(4.5)** | *195.1%* | **(34.5)** | **(26.3)** | *31.2%* |

Maintenance capex totalled €18.7m in 2017. Environmental capital expenditure - €5.8m - was earmarked to multiple initiatives designed to reinforce the factories' environmental excellence, emphasising the reduction of odours and noise, and to the start of the landscaping project in Pontevedra. Investments in efficiency and growth - €15.7m - corresponded primarily to payments for investments made in 2016 in connection with the capacity added in Navia.




As a result, normalised free cash flow in the Pulp Business amounted to €124.5m in 2017, while free cash flow net of efficiency, growth and environmental capex totalled €118.9m.

## 5. Energy Business

### Electricity market trends

| | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| Average pool price (€/MWh) | 57.5 | 56.6 | *1.7%* | 48.5 | *18.6%* | 52.1 | 39.7 | *31.2%* |

**Pool prices during the last five years (€/MWh) - 30-day average**


Average mainland pool prices increased by 31.2% from 2016 due mainly to the 47.5% drop in hydro output with the slack being picked up by the coal- and gas-fired fossil fuel plants. This situation was exacerbated by a 7.2% spike in demand for electricity in January due to a cold spell.

## Energy sales

| | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| Huelva 50 MW | 91,532 | 100,850 | *(9.2%)* | 97,793 | *(6.4%)* | 326,355 | 337,194 | *(3.2%)* |
| Huelva 41 MW | 27,452 | 50,684 | *(45.8%)* | 43,895 | *(37.5%)* | 173,841 | 154,314 | *12.7%* |
| Mérida 20 MW | 34,723 | 43,330 | *(19.9%)* | 41,982 | *(17.3%)* | 134,488 | 136,878 | *(1.7%)* |
| Ciudad Real 16 MW | 23,071 | - | | 24,995 | *(7.7%)* | 90,743 | - | |
| Jaén 16 MW | 16,974 | - | | 19,012 | *(10.7%)* | 77,059 | - | |
| Córdoba 27 MW | 49,234 | - | | 32,429 | *51.8%* | 81,663 | - | |
| **Energy sales (MWh)** | **242,985** | **194,864** | *24.7%* | **260,106** | *(6.6%)* | **884,149** | **628,386** | *40.7%* |
| Average selling price - Pool + Ro (€/MWh) | 114.9 | 125.6 | *(8.5%)* | 98.9 | *16.1%* | 106.3 | 106.1 | *0.2%* |
| Investment remuneration (€Mn) | 10.2 | 7.3 | *39.7%* | 10.0 | *2.7%* | 39.0 | 29.3 | *33.3%* |
| **Revenues (€Mn)** | **38.3** | **31.8** | *20.5%* | **36.5** | *5.0%* | **133.0** | **96.0** | *38.6%* |

Energy sales volumes increased by 40.7% in 2017 to 884,149 MWh, boosted by the addition of the two 16-MW biomass plants acquired in December 2016 in Ciudad Real and Jaen and the 27-MW plant acquired in Cordoba last August.

It is worth highlighting the 12.7% increase in production at the 41-MW Huelva plant, having been stopped for longer than usual in 2Q16 for a turbine overhaul. This effect was offset by a lower utilisation rate in the fourth quarter.

Elsewhere, the high electricity prices observed in 4Q16 enabled the 50-MW Huelva and 20-MW Merida plants to operate above their annual ceiling of 6,500 equivalent hours.

Average sales prices were broadly flat year-on-year in 2017. The growth in average mainland pool prices was offset by the impact of the first-time consolidation of the three plants acquired during the past year, which have below-average remuneration for operations (Ro) parameters, and by the accounting treatment for the regulatory collar.

Erring on the side of caution, ENCE adjusts average pool prices monthly as a function of the limits set by the regulator (regulatory collar); this prudent accounting treatment led to the recognition of a provision of €4.2m in 2017 which has been recognised as a reduction in the average sales price. In 2016, however, the Company made positive adjustment of €3.9m in this respect, in the fourth quarter.

Lastly, remuneration for investment increased by 33.3% in 2017 to €39m, similarly due to the first-time consolidation of the three recently-acquired plants.

In total, the Energy business reported topline growth of 38.6% in 2017, posting revenue of €133m.

## Energy Business - earnings analysis

| Figures in €Mn | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| **Total net revenue** | **38.3** | **31.8** | *20.5%* | **36.5** | *5.0%* | **133.0** | **96.0** | *38.6%* |
| **EBITDA** | **12.4** | **12.8** | *(2.6%)* | **14.4** | *(13.4%)* | **45.4** | **30.2** | *50.7%* |
| *EBITDA margin* | *32%* | *40%* | *(7.7) p.p.* | *39%* | *(6.9) p.p.* | *34%* | *31%* | *2.7 p.p.* |
| Amortization | (4.3) | (3.1) | *38.2%* | (4.1) | *4.6%* | (16.0) | (13.0) | *23.4%* |
| Forest depletion | - | (0.1) | *(100.0%)* | (0.8) | *(100.0%)* | (1.0) | (1.2) | *(15.7%)* |
| Impairment of and gains/(losses) on fixed-asset disposals | - | 3.2 | *(100.0%)* | (0.1) | *(100.0%)* | (0.1) | 3.8 | *n.s.* |
| **EBIT** | **8.1** | **12.8** | *(36.7%)* | **9.4** | *(13.5%)* | **28.3** | **19.8** | *42.7%* |
| *EBIT margin* | *21%* | *40%* | *(19.1) p.p.* | *26%* | *(4.5) p.p.* | *21%* | *21%* | *0.6 p.p.* |
| Net finance costs | (3.1) | (1.5) | *102.0%* | (1.4) | *113.4%* | (7.6) | (5.7) | *32.9%* |
| Other financial results | (3.6) | 0.0 | *n.s.* | (0.0) | *n.s.* | (3.7) | 0.0 | *n.s.* |
| **Profit before tax** | **1.4** | **11.3** | *(87.8%)* | **7.9** | *(82.5%)* | **17.0** | **14.1** | *20.2%* |
| Income tax | 2.0 | (2.8) | *n.s.* | (2.0) | *n.s.* | (1.9) | (3.7) | *(47.9%)* |
| **Net Income** | **3.4** | **8.5** | *(60.0%)* | **5.9** | *(42.9%)* | **15.1** | **10.5** | *44.0%* |
| Non-controlling interests | (0.6) | - | *n.s.* | (0.5) | | (1.9) | - | *n.s.* |
| **Atributable Net Income** | **2.8** | **8.5** | *(66.9%)* | **5.4** | *(48.5%)* | **13.2** | **10.5** | *26.0%* |

EBITDA in the Energy Business increased by 50.7% to €45.4m in 2017, driven mainly by the above-mentioned growth of 38.6% in revenue as well as biomass cost savings attained thanks to the strategy of diversifying into agricultural biomass initiated in 2015; this source currently accounts for 57% of all biomass.

The growth was accentuated by the adverse accounting effect in 2016 (€2.9m, recognised in 2Q16) of the classification of the Huelva 41-MW plant as a hybrid plant (85%-biomass; 15%-lignin).

Below the EBITDA line, it is worth highlighting the 23.4% increase in depreciation charges, due mainly to the first-time consolidation of the three plants acquired over the past 12 months.

The increase in finance costs reflects €1.5m of expenses associated with the debt restructuring work undertaken in this business in the fourth quarter. 'Other finance income/costs' also includes a charge of €3.6m in connection with the cancellation of the interest rate hedges arranged over the restructured debt. Note that neither item implied an outflow of cash.

As a result, net profit attributable of owners of the parent amounted to €13.2m in the Energy business (net profit attributable to non-controlling shareholders, related to the three plants acquired, amounted to €1.9m), marking growth of 26% over 2016 net profit.

## Energy Business - cash flows

Net cash flows from operating activities totalled €22.9m, compared to €47.4m in 2016, due mainly to growth in the working capital requirement, which more than offset the growth in EBITDA.

| Figures in €Mn | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| **EBITDA** | **12.4** | **12.8** | *(2.6%)* | **14.4** | *(13.4%)* | **45.4** | **30.2** | *50.7%* |
| Non cash expenses / (incomes) | (0.9) | (0.0) | *n.s.* | 0.2 | *n.s.* | 0.6 | (0.1) | *n.s.* |
| Other charges / (payments) | (0.2) | (0.5) | *(64.8%)* | (0.3) | *(44.7%)* | (0.9) | 0.7 | *n.s.* |
| Change in working capital | 4.4 | 14.4 | *(69.1%)* | (7.2) | *n.s.* | (7.1) | 26.3 | *n.s.* |
| Income tax received/(paid) | (4.2) | (0.9) | *341.6%* | 0.3 | *n.s.* | (5.2) | (1.1) | *383.5%* |
| Interest paid | (5.0) | (3.5) | *41.5%* | (0.7) | *n.s.* | (9.9) | (8.6) | *15.3%* |
| **Net cash flow from operating activities** | **6.6** | **22.1** | *(70.2%)* | **6.7** | *(1.2%)* | **22.9** | **47.4** | *(51.7%)* |

In 2017, the movement in working capital implied a cash outflow of €7.1m, mainly as a result of the €7.8m increase in trade receivables as a result of the sharp growth in the volume of energy sold. In addition, the biomass inventories balance increased by €1.5m.

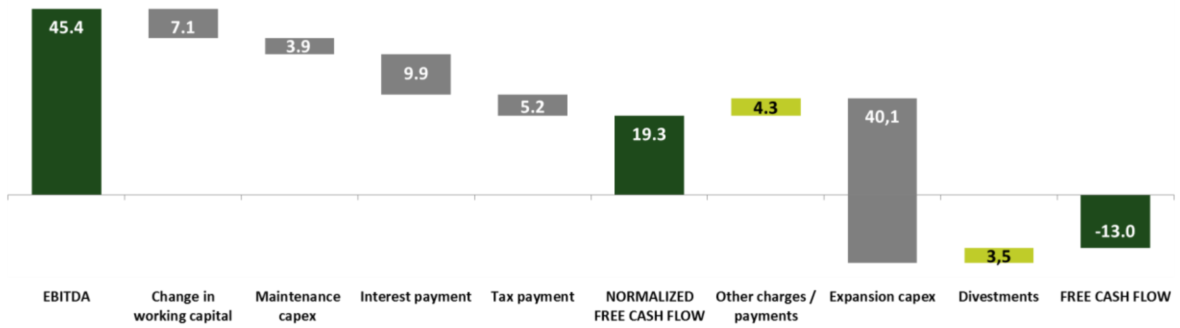
In 2016, the movement in working capital had implied a cash inflow of €26.3m, due to the collection of balances due from the electricity system totalling €28.8m during the second half of the year.

| Figures in €Mn | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| Inventories | 1.3 | 1.5 | *(10.0%)* | (0.3) | *n.s.* | (1.5) | 2.2 | *n.s.* |
| Trade and other receivables | 1.3 | 12.0 | *(89.4%)* | (7.0) | *n.s.* | (7.8) | 20.6 | *n.s.* |
| Trade and other payables | 1.8 | 0.9 | *95.1%* | 0.2 | *n.s.* | 2.3 | 3.6 | *(36.7%)* |
| **Change in working capital** | **4.4** | **14.4** | *(69.1%)* | **(7.2)** | *n.s.* | **(7.1)** | **26.3** | *n.s.* |

Net cash flows used in investing activities totalled €35.9m and included the €28.5m payment for the 27-MW plant acquired in Cordoba in August. The remaining investments in efficiency and expansion work corresponded to the first payments for the construction of a new 40-MW plant in Huelva, which is expected to be commissioned by the end of 2019.

| Figures in €Mn | 4Q17 | 4Q16 | Δ% | 3Q17 | Δ% | 2017 | 2016 | Δ% |
|---|---|---|---|---|---|---|---|---|
| Maintenance capex | (1.4) | (3.4) | *(60.2%)* | (1.1) | *19.6%* | (3.9) | (5.8) | *(32.0%)* |
| Efficiency and expansion capex | (9.4) | (22.5) | *(58.3%)* | (30.0) | *(68.7%)* | (40.1) | (22.5) | *78.2%* |
| Financial investments | 2.0 | (4.4) | *n.s.* | 1.6 | *24.7%* | 4.7 | (4.3) | *n.s.* |
| Investments | **(8.8)** | **(30.3)** | *(71.1%)* | **(29.5)** | *(70.3%)* | **(39.4)** | **(32.6)** | *20.8%* |
| Disposals | 3.5 | - | *n.s.* | - | *n.s.* | 3.5 | - | *n.s.* |
| **Net cash flow from investing activities** | **(5.2)** | **(30.3)** | *(82.7%)* | **(29.5)** | *(82.2%)* | **(35.9)** | **(32.6)** | *10.0%* |

The net cash inflow of €4.7m from financing activities mainly reflects the €4.2m accounting provision recognised during the reporting period to adjust average pool prices for the limits set by the regulator (regulatory collar).




In total, the Energy Business generated €19.3m of normalised free cash flow in 2017. Free cash flow after efficiency & growth capex, however, was negative: -€13m.

## 6. Liquidity and capital resources

### Pulp Business

Net debt in the Pulp Business declined by €75m from year-end 2016 to €120.1m.

The Pulp Business paid out €31.7m of dividends, net of dividends received, in 2017. This figure includes payment of the final dividend against 2016 profits in 2Q17 in the amount of €11.6m, collection of an €8m dividend from the Energy business, also in 2Q17, and payment of two interim dividends against 2017 profits in the third and fourth quarters in an aggregate amount of €28.1m.

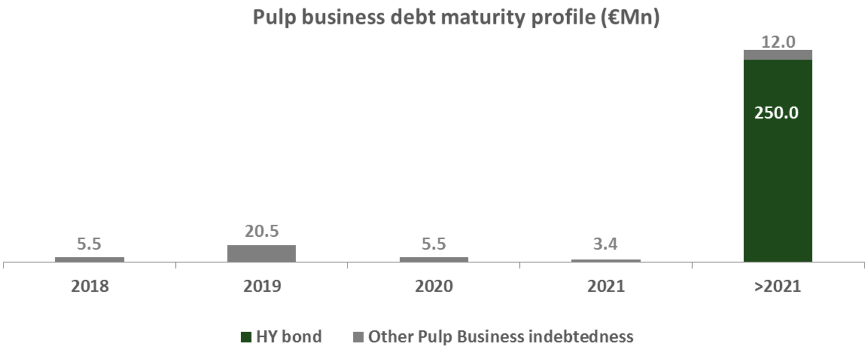
The movement in borrowings from the Energy Business implied a cash outflow of €7.5m, mainly related to the passing on of overhead that is still pending collection.

Lastly, the reduction in short-term investments and non-cash finance costs had the effect of pushing net debt €4.7m higher.

| Figures in €Mn | Dec-17 | Dec-16 | Δ% | Sep-17 | Δ% |
|---|---|---|---|---|---|
| Long term financial debt | 285.6 | 308.7 | *(7.5%)* | 287.7 | *(0.7%)* |
| Short-term financial debt | 8.2 | 8.0 | *1.8%* | 31.5 | *(74.1%)* |
| **Gross financial debt** | **293.8** | **316.8** | *(7.3%)* | **319.2** | *(8.0%)* |
| Cash and cash equivalents | 167.3 | 112.1 | *49.2%* | 161.6 | *3.5%* |
| Short-term financial investments | 6.4 | 9.6 | *(33.5%)* | 8.8 | *(27.8%)* |
| **Pulp business net financial debt** | **120.1** | **195.1** | *(38.4%)* | **148.8** | *(19.3%)* |

The gross debt of €293.8m at year-end corresponds mainly to the €250m of corporate bonds due 2022, the outstanding balance of €26m on two bilateral loans due in 2019 and 2020 taken on to finance the capacity expansion work undertaken in Navia, and a series of loans totalling €21m 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. Debt arrangement fees are deducted from gross borrowings on the balance sheet.

At year-end 2017, the business had cash and cash equivalents of €173.7m in addition to an undrawn €90m credit facility.




## Energy Business

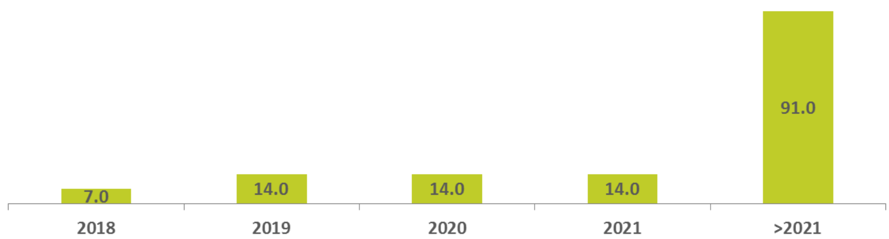
Net debt in the Energy Business increased by €9.8m from year-end 2016 to €33m.

In addition to the negative free cash flow of €13m, the Energy Business paid an €8m dividend to the Pulp Business in the second quarter, offset by a net cash inflow of €7.5m on account of cash movements between the two businesses, mostly related to the reinvoicing of overhead; lastly, the business consolidated cash of €5.6m belonging to the 27-MW Cordoba plant acquired in 3Q17. Lastly, non-cash finance costs drove net debt €1.8m higher.

| Figures in €Mn | Dec-17 | Dec-16 | Δ% | Sep-17 | Δ% |
|---|---|---|---|---|---|
| Long term financial debt | 129.2 | 107.2 | *20.5%* | 99.9 | *29.4%* |
| Short-term financial debt | 7.0 | 13.8 | *(48.9%)* | 14.8 | *(52.3%)* |
| **Gross financial debt** | **136.3** | **121.0** | *12.6%* | **114.7** | *18.8%* |
| Cash and cash equivalents | 103.2 | 97.8 | *5.6%* | 80.0 | *29.0%* |
| Short-term financial investments | 0.0 | 0.0 | *20.0%* | 0.0 | - |
| **Energy business net financial debt** | **33.0** | **23.2** | *42.4%* | **34.7** | *(4.7%)* |

The gross borrowings of €136.3m correspond to the new €150m syndicated loan agreement due 2024 arranged on 24 November 2017, which had been drawn down by €90m at year-end, and €50m of bonds due 2025. Debt arrangement fees are deducted from gross borrowings on the balance sheet.

**Energy debt maturity profile (€Mn)**




At year-end 2017, the business had cash and cash equivalents of €103.2m, in addition to an undrawn €20m credit facility.

## 7. The team

### *Recruitment*

The recruitment process is a priority component of the Group's human resources management and the recruiting process is 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 2017, we continues to boost staff expertise at the Navia and Pontevedra Operations Centres and in the Energy Operations area, hiring highly-qualified professionals with experience in the both the pulp and biomass power generation sectors with the goal of aligning all efforts around delivery of the Business Plan targets. Specifically, we hired five new professionals in Pontevedra, 11 in Navia, three in Energy Operations and five between the corporate Sales, Procurements and General Secretariat Departments.

Also in 2017, an average of 53 new graduates participated in ENCE's Talent Programme, 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.

Moreover, 11 talented young graduates from the 2016 edition of the programme were hired in 2017.

***Workplace climate/motivation***

Management believes it is important to know what ENCE’s employees think and feel and to 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, in December 2016 it set the Workplace Climate Study in motion. The survey was launched on 9 January 2017 and the results were reported during the first quarter and announced in April.

Throughout the rest of 2017 work began on action plans based on the results of the survey, focusing on initiatives related with leadership at ENCE. Specifically, eight working groups were set up, made up of employees from all of the firm's areas and businesses, who then focused on diagnosing the current situation with a view to identifying the needs and areas for improvement across the lines of initiative contemplated in the project.

These teams are currently in the process of finalising their work and are due to propose specific actions addressing all aspects of relevance to improving the workplace climate at ENCE.

Specific communication campaigns were also carried out to make sure everyone at the Company was familiar with the project.

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 Human Resources 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:

1. Employee of the week
2. Publication of an employee newsletter
3. Prize ceremony in the presence of executives
4. TQM prize events
5. Annual prize for the best embodiment of ENCE's values
6. Annual prizes for standard-setters

### *Workplace health and safety*

Employee safety and health in the workplace is one of ENCE's strategic human resource management priorities. We strive 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 our daily activities and all of our operations under the slogan, "safety is the top priority".
- Leading by example and the palpable commitment of management and the entire chain of command.
- Systematic evaluation of facility risk factors and risky conduct as the first step in preventing accidents.

  Registration and analysis of all workplace accidents and incidents occurring at our places of work, learning lessons and providing resources and action for preventing recurrence.
- Correction of all unsafe actions taking a "zero tolerance" approach.
- Investment in continuous employee safety training.
- Selection of safety-certified suppliers and subcontractors, monitoring of ongoing compliance with ENCE's safety rules and harmonisation of their safety management through use of the tools we use.
- 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, hence, 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. This tool allows us to pinpoint ways in which we can improve our management and demonstrate our commitment to safety. 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 to evaluate our performance.

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 organisation'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, already certified, passed the OHSAS 18001 audit without incident.
- Completion in 2017 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 2018.
- Updating of the work permit system at the Group level, contemplating environmental aspects as well as adding five specific permits to complement the general work permit.

These new permits simplify the permitting process and make it easier to identify workplace risks and safety measures for work associated with specific risks.

- Implementation of the 2017 Safety Improvement Plan, with virtually all the initiatives contemplated executed. A new Safety Improvement Plan for 2018, with more ambitious targets and true to the commitment to continuous improvement, has already been devised.
- All the work classified as 'particularly risky' was performed accident free. Improvements are being readied for 2018 for all phases of preparation and execution of these tasks with the support and advice of a highly-reputed external safety consultant.
- Accident rates improved from prior years, hitting all-time records in several workplaces. Moreover, these rates 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 commitment to the organisation's strategic goals.

Training is an important aspect of the Strategic Human Resources Plan, which contemplates the following corporate training initiatives in addition to each Operations Centre's specific training plans:

The initiatives undertaken in 2017 can be classified into the following topics: workplace health and safety; Sigma 6, environmental management, management skills and technical expertise, broken down as follows:

| CORPORATE TRAINING PLAN | Nº of hours' training per employee | Expected number of participants in 2017 |
|---|---|---|
| ENCE leadership development n-4 | 28 | 106 |
| Phase 2 of Driving your development: Skills n-2/n-3 | 16 | 55 |
| Phase 2 of Driving your development: Mentoring | 8 | 7 |
| Quality conversations in performance management. 'Let's talk' project | 8 | 117 |
| Technical operations training programme | 28 | 240 |
| Technical maintenance training programme | 32 | 120 |
| Pulp workplace health management skills plan | 20 | 444 |
| Forestry workplace health management skills plan | 20 | 122 |
| Black Belt training | 144 | 10 |
| Green Belt training | 40 | 2 |
| Yellow Belt training | 16 | 140 |
| Green Belt training on process quality control management | 16 | 16 |
| Green Belt training focused on equipment reliability | 16 | 10 |

In 2017, ENCE imparted 17,821 hours of training in total; this translates into 16 hours of training per employee.

### *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 2017:

| 2017 | Highlights by geographic workplace: |
|---|---|
| **Madrid Offices** | Union elections were held for the works committee for the Madrid Central Offices on 9 March. Outcome: 5 members of *Comisiones Obreras* (4 under collective bargaining agreements and 1 under an individual contract). The committee for negotiating the collective bargaining agreement for the Madrid Central Offices was set up in May and the agreement was signed on 21 July |
| **Biomass plant in Huelva** | An agreement was signed regarding payment of the electricity premium on 17 May 2017. There were no other incidents worthy of mention during the rest of the year |
| **Huelva Offices** | Union elections were held to appoint the staff representative on 11 September. The Comisiones Obreras candidate prevailed. |
| **Operations Centre Navia** | Event to acknowledge the production record attained in August 2017 |
| **Navia Offices** | A new collective bargaining agreement is currently under negotiation |
| **Operations Centre Pontevedra** | The board for negotiating the collective bargaining agreement at the Operations Centre was set up in January and the 2017-2020 Pontevedra Operations Centre agreement was signed on 23/06/2017. |
| **Pontevedra Offices** | The board for negotiating the collective bargaining agreement at the Pontevedra Offices was set up in March and the agreement was signed in July. |

## 8. 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:

1. 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.
2. 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.
3. 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 corporate crime risk map; this map identifies the organisation's activities that are susceptible to criminal conduct which must be prevented.
4. 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.

5. 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 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 Group, understood as each and every one of the companies in which Ence Energía 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 contemplates threats to the various types of objectives established by the organisation. Specifically it refers to objectives classified as:

1. Strategic
2. Operational
3. Financial Information and Reporting
4. Compliance

The risks addressed by the ERM model are in turn classified as follows:

1. Environmental Risks
2. Risks associated with Decision-Making Information
3. Financial Risks
4. Organisational Risks
5. Operational Risks
6. Corporate Crime Risks
7. Tax Risks

In keeping with ENCE's Risk Management and Control Policy, the Company has a methodology for assigning specific risk appetite thresholds depending on the activities involved. 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.

1. ENCE takes a zero-tolerance stance on any situation which could compromise the health or safety of its employees.
2. Its 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.
3. ENCE 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.

4. ENCE's appetite for situations related to product research, development and innovation can be described as moderate, the aim being to provide solutions that fully satisfy its customers' needs so that the Company remains a benchmark in the pulp market.
5. In addition, aware of prevailing economic complexity, 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 appetite for speculative financial trades is low.
6. 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 appetite 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 the Company's earnings.

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.

The Group has currently hedged approximately 50% of estimated 2018 sales and approximately 25% of first-quarter 2019 sales under different forward currency contracts.

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 2018, that covers, depending on the country in which the customer is located, between 80% and 90% of the 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.

To mitigate this risk, ENCE also has a Credit Committee which is tasked with continuously monitoring outstanding receivables balances and available insurance coverage.

d) LIQUIDITY AND CAPITAL RISK

Adverse conditions in the debt and equity 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 ceiling 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 4-5 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 financing and raising money from institutional investors 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 state, regional and/or local tax authorities could make further changes to current tax regulations, such as changes/reforms to corporate and/personal income tax , that could directly affect ENCE and its earnings.

To mitigate this risk, ENCE has a team of in-house specialists who work together with external tax advisors and experts and have established internal rules for tax compliance and guidelines for minimising exposure to risk in this respect. However, because this is an exogenous risk factor, 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 various Operations Centres' targets and the mills' and energy plants' installations, machinery and equipment could become impaired.

In order to manage the risks that could jeopardise delivery 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 that 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 enhancing productive processes and maintaining a customer complaints/claims management system. In 2017, ENCE continued to raise the profile of and assign new resources to its Customer Service Department. In addition, it shored up its salesforce quantitatively and qualitatively with a view to identifying customers' specific needs in order to factor them into the Company's product range.

***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 chemical products, fuel, gas, industrial supplies and spare parts, 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 Corporate Supply Chain Department periodically monitor the performance of its main suppliers with a view to taking 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 addition, ENCE 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, generating costs deriving from contract non-performance and ultimately adversely impacting the Company's earnings. These events can also trigger the cancellation of orders by our customers thereby increasing stock levels. To minimise this risk, the Pulp Business 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, the activities performed by ENCE in both its Pulp and Energy Businesses are 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.

ENCE mitigates this risk by reducing the impact its operations have on the environment by means of its integrated quality, environment and safety management system which is certified under the UNE-EN-ISO 14001 environmental management standard, by means of education about how to prevent environmental risks, writing insurance policies, conducting audits and implementing inspection, oversight and control measures, framed by a preventative approach. Note that in 2017, the Group also continued to invest to make its facilities more environmentally-friendly.

***Objective: Business Continuity***

The Pontevedra factory is located on public-domain coastal land for which ENCE holds the corresponding domain concession, to which end it is subject to the legal regime contemplated in Law 2/2013, of 29 May 2013, on coastal protection and sustainability and amending the Coastal Act, and the General Coast Regulations enacted by means of Royal Decree 876/2014 (10 October 2014).

The Spanish Ministry of Agriculture, Food and the Environment has extended the Company's concession for the use of the land on which the Pontevedra complex is located for 50 plus 10 years, the additional 10 years of which are subject to the performance by ENCE of specific works in the energy efficiency, water savings and environmental performance areas. Failure to comply with the terms and conditions stipulated in the commitments enshrined in the Ministerial Order of 26 January 2016 extending the concession could imply the loss of that additional 10-year period.

This resolution has also been challenged firstly through administrative channels and subsequently in court by the Town Council of Pontevedra and two environmentalist associations: Green Peace Spain and *Asociación pola Defensa da Ría de Pontevedra*. Their challenges have given rise to four separate consecutive court proceedings before the Appellate Court's Chamber for Contentious Administrative Proceedings. ENCE has appeared in court in all the cases in its capacity as co-defendant, arguing the legality of the actions of the Ministry in extending the concession. These proceedings remain ongoing.

ENCE engages continuously with the various authorities with a view to correctly executing the various agreed-upon investments, as well as a host of initiatives and projects in the local community.

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 upholding its workplace safety plans, which include an action plan for preventing/reducing accidents that is based primarily on employee training initiatives, process upgrades, regular compliance audits 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 EU-endorsed Best Available Techniques Reference Document (BREF) for the sector took effect in 2017. Companies have until 2020 to fully adapt to the new requirements. The BREF requirements are more stringent than the prior requirements in terms of production and emissions depending on process types, geographic location and local environmental conditions, triggering the need for new environmental 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 environmental investments required at all of the Operations Centres to adapt to the new regulations were analysed and approved by ENCE's Investment Committee in 2017.

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 Corporate 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 2017 a number of internal policies and procedures were formulated and implemented to mitigate the organisation's exposure to specific corporate crime 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 ENCE's 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 a zero risk tolerance approach in this arena.

# 9. Non-financial statement

## About this chapter

The goal of this non-financial statement is to report on environmental, social, employee and human rights issues of relevance to the Company. It is important to note that in respect of matters relating to respect for human rights, the Company's role is limited to managing its employees properly and ensuring enforcement of their fundamental rights under the scope of ENCE's Human Resources Strategic Plan, Equality Plan, Remuneration Policy, Harassment Prevention Policy, as well as numerous other initiatives described in the corresponding section.

The information provided in this chapter will be expanded upon in the Corporate Social Responsibility Report which ENCE has been publishing annually since 2005 and which will be uploaded onto the corporate website in due course.

## Business model

ENCE is a benchmark player in the European eucalyptus pulp market and the leading producer of power from biomass in Spain. Its business model is articulated around responsible end-to-end management of timber, respect for the environment and its sustainability and a commitment to respect people, their safety and their development. Its strategic objectives, explicitly laid down in the 2016-2020 Business Plan, include increasing its pulp production and power generation capacity, rationalising production costs and minimising the environmental impacts of its business activities with a view to virtually doubling EBITDA and reducing its cyclicality by 2020.

## 9.1 Business lines

ENCE carries out three core lines of business - forestry management, the production of pulp and the generation of power from renewable sources - all of which framed by an environmental perspective, identifying impacts and taking action to mitigate them.

**Forestry**

Management of forest tracts and plantations, caring for and maintaining them in order to extract timber and biomass, coupled with applied research into species yields, constitute ENCE's key activities in the forestry segment. Of the area under management in 2017 - 67,595 hectares (69,869 hectares in 2015 and 68,979 hectares in 2016) - 71% was earmarked to the production of timber for pulp and 5% to the production of biomass. The remaining 23% - around 16,000 hectares - was earmarked to the protection and conservation of ecosystems.

This line of business also involves the purchase of timber from third parties, as not all the timber consumed by ENCE is sourced from directly managed forest land. ENCE's activity as a timber buyer (which it can buy as standing timber or straight from suppliers) moved 2.9 million cubic metres of timber in 2017 (2.7 million in 2015 and 2016). As for biomass, some 1.2 million tonnes were supplied to all of its plants.

**Pulp**

ENCE's main business line is the production of pulp. It is the leading producer and number-two player by market share. In 2017, production totalled 957,951 tonnes (898,166 tonnes in 2015 and 931,443 tonnes in 2016), 55% of which was produced at the Navia mill (elemental chlorine free or ECF pulp), with the remaining 45% made at the Pontevedra complex (total chlorine free or TCF pulp).

Europe, home to the world's most demanding customers, was the destination for 84.7% of total sales. ENCE has been increasing its presence in the faster-growing segments (tissue paper and specialty papers, which account for 63% and 27% of total sales, respectively) and scaling it back in the segments in decline. These numbers dovetail with the sales mix ENCE has been pursuing in recent years with the aim of boosting sales profitability and reinforcing its sales strategy, in line with the Business Plan targets.

**Energy**

ENCE is Spain's largest producer of renewable energy from biomass with installed capacity of over 280 MW across its current ower plants. In 2017, it produced 1,671 million GWh of energy and sales totalled 1,548 million GWh (1,421 and 1,326 million GWh in 2015 and 1,403 and 1,308 million GWh in 2016, respectively).

ENCE's power plants are duly registered with the renewable energy regime regulated by Spanish Royal Decree 413/2014.

In addition to generating power, ENCE carries out the management activities related with the purchase and sale of electricity, energy business planning and control, plant operation and management, regulatory oversight (Spanish and international regulations) and new project studies and development.

For further information about ENCE's business model and the business environment in 2017, refer to sections titled “Group information”, “Pulp Business” and “Energy Business”.

### Management of non-financial aspects

ENCE articulates its stakeholder commitments around its Corporate Social Responsibility Policy which in turn applies the principles set down in its Code of Conduct. These two sets of guidelines form the backbone of the Company's business ethics and culture.

## 9.2 Corporate Social Responsibility Policy

In its capacity as a prominent and environmentally-aware player in the eucalyptus pulp market and biomass renewable power segment and a committed and responsible manager of forest plantations, ENCE has been systematically deploying initiatives designed to orient its business activities around the principles of economic, environmental, labour and social sustainability, all underpinned by a desire to stay close to its communities and their problems and, in short, to improve the well-being of the people who live in them.

ENCE's commitments to its stakeholders are articulated in its Corporate Social Responsibility Policy, which was approved by the Board of Directors in 2015, duly exercising its non-delegable powers and in line with the recommendations issued in the Good Governance Code approved by Spain's securities market regulator with respect to corporate social responsibility. This policy is designed to ensure implementation of and compliance with these pledges. These commitments reflect how ENCE views its stakeholders. The policy seeks to facilitate efficient and satisfactory relations with the Company's various stakeholders by establishing channels for the exchange of information and as the basis of a mutually-beneficial relationship. The goals of this policy are to:

- Contribute to improving individual well-being
- Foster economic and social development in ENCE's business communities
- Create sustainable value for ENCE's shareholders, people, forest owners, customers, suppliers, influencers, communities and surroundings

ENCE's Corporate Social Responsibility Policy enables it to identify the Company's stakeholders and establish the relationships and commitments to be pursued with each. Below is a list of ENCE's stakeholders and the main pledges made to each:

| Stakeholder | Commitment |
|---|---|
| **Shareholders and investors** | The duties of transparency, accountability and share price maximisation |
| **People** | Career development, quality work, workplace health and safety and job satisfaction |
| **Customers** | Quality, confidence and satisfaction |
| **Strategic partners and suppliers (incl. forest owners)** | Confidence, transparency and collaboration |
| **Government and authorities** | Confidence, transparency and contribution |
| **Community and environment** | Creation of sustainable value |
| **Influencers** | Transparency and collaboration |

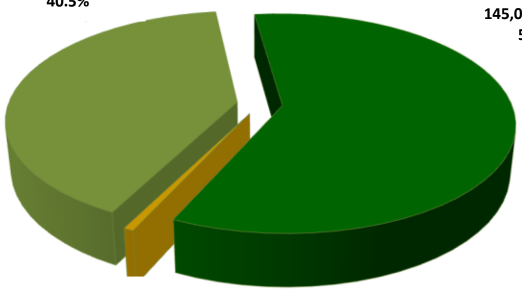
## 9.3 Commitment to shareholders and investors

ENCE is committed to creating value for its shareholders and investors, framed by a strong transparency pledge. It adopts specific procedures to guarantee the accuracy of the information it discloses so that shareholders, institutional investors, research analysts and proxy advisors can base their decisions on accurate knowledge and a proper understanding of the Company's business strategies and management performance.

**Ownership structure**

ENCE's share capital consists of 246,272,500 shares with a unit par value of €0.90. They are represented by book entries and all carry identical voting and dividend rights. 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 and FTSE4Good stock indices.

At year-end 2017, almost 40.5% of the Company's shares were held by members of ENCE's Board of Directors and 0.6% were held as treasury stock.




The rest of the shares, the free float, were held primarily by international institutional investors, followed by Spanish institutional investors and retail investors.

**Respect for shareholder rights**

In recent years, ENCE has been systematically developing initiatives designed to guarantee that its activities are pursued in strict compliance with applicable regulations and standards, including generally accepted accounting principles, and that it has in place the internal controls and procedures needed to ensure that the financial and accounting reports it issues comply with prevailing legislation, regulations and stock market requirements.

ENCE's Board of Directors is responsible for management and oversight at the highest level of the information provided to the Company's shareholders, the institutional investor community and other market members such as financial brokerages, asset managers and share depositaries, financial analysts, the rating agencies, news agencies, proxy advisors, etc., and to the market in general, safeguarding, protecting and facilitating their ability to exercise their rights, all framed by protection of the corporate interest, in keeping with the following general principles:

- Transparency, integrity, timeliness, equality and symmetry with respect to information disclosures.
- Equal treatment of all shareholders in the same position insofar as unaffected by non-compete obligations or conflicts of interest in terms of acknowledging their rights and facilitating their exercise. Protection of the legitimate rights and interests of all shareholders.
- Promotion of the provision of regular and ongoing information to the Company's shareholders and not solely on the occasion of calls to general meetings, providing them with effective channels so they are regularly apprised of the Company's performance.
- Development of information tools that make the most of emerging technologies.
- Compliance with the law and ENCE's corporate governance rules and its principles for cooperating transparently with the authorities, regulatory bodies and competent authorities.
- Compliance with the rules and regulations governing the use of inside and price-sensitive information, shareholder relations and communication with the securities markets laid down in both generally applicable legislation and ENCE's body of internal rules and regulations (Board Regulations, Internal Securities Markets Code of Conduct and the Code of Conduct).

**Communication with shareholders and investors**

ENCE applies these principles in the various channels for communicating and engaging with shareholders, investors, the financial analyst community and proxy advisors through which it provides them with information and, to the extent possible, a reasonable response to their demands.

Each of these channels has its own characteristics in terms of format, frequency and intensity of use. They range from channels that are available permanently, such as dedicated e-mail accounts and the corporate website, to sporadic forums, such as meetings and presentations, to more *ad-hoc* events.

The communication channels most relevant to ENCE's effort to communicate with its shareholders, institutional investors and proxy advisors are the following:

**THE ANNUAL GENERAL MEETING**

The Annual General Meeting is the most important forum for shareholder participation. The Board of Directors strives to encourage informed and responsible participation at the Annual General Meeting and takes all the measures and safeguards it deems opportune in order to help ensure that the duties vested in the shareholders in general meeting under prevailing legislation and ENCE's corporate governance system are performed as intended.

Pursuant to the provisions of article 539.2 of the consolidated text of Spain's Corporate Enterprises Act, ENCE sets up an online shareholder forum within its corporate website to facilitate communication among its shareholders prior to celebration of each Annual General Meeting.

**COMISIÓN NACIONAL DEL MERCADO DE VALORES (CNMV)**

For ENCE, the most important channel for communicating with shareholders, institutional investors, financial analysts, proxy advisors and the financial markets in general is the CNMV due to the reach and public disclosure attained - immediately - by the price-sensitive notices filed with the securities market regulator and published on its website; these notices can similarly be accessed from the corporate website (www.ence.es) via a specific link.

In 2017, ENCE reported 33 price-sensitive developments via the regulator's website.

**CORPORATE WEBSITE**

ENCE's corporate website (www.ence.es) is a crucial tool for establishing smooth, updated and comprehensive communication between the Company and its shareholders, institutional investors, financial analysts and the financial markets in general. ENCE uses the investors tab on its corporate website to channel information of potential interest to these stakeholders, favouring this channel because the information can be disseminated instantly yet accessed subsequently, with the aim of reinforcing transparent relations between ENCE, the financial markets and the public in general.

In 2017, the investors tab of the website received a monthly average of 1,535 visits.

The quarterly results presentations are broadcast live by a platform hired by ENCE to this end; this format gives interested parties the chance to ask questions about the presentations. Similarly, ENCE strives to provide direct access via its website to the recording of each presentation.

- ENCE presented its 4Q16 earnings results on 28 February 2017 on a conference call joined by 55 shareholders, investors, research analysis and other market agents.
- ENCE presented its 1Q17 earnings results on 27 April 2017 on a conference call joined by 45 shareholders, investors, research analysis and other market agents.
- ENCE presented its 2Q17 earnings results on 26 July 2017 on a conference call joined by 27 shareholders, investors, research analysis and other market agents.
- ENCE presented its 3Q17 earnings results on 2 November 2017 on a conference call joined by 38 shareholders, investors, research analysis and other market agents.

**INVESTOR RELATIONS DEPARTMENT**

The Investor Relations Department is responsible for attending continually and individually to queries fielded from shareholders, institutional investors and financial analysts via e-mail (dedicated inbox: ir@ence.es), phone or by any other means.

ENCE also organises regular meetings with these stakeholders with the aim of making sure they have the best and most updated public information about the Company.

In 2017, the Investor Relations Department contacted a total of 343 institutional investors by means of its participation in:

- 10 roadshows with equity investors
- Two roadshows with fixed-income investors
- 10 equities conferences
- Three fixed-income conferences
- Four post-results breakfast events
- Meetings/conference calls at the corporate HQ

The Investor Relations Department's mandate includes staying in close and direct contact with the various research houses that cover the Company's stock and the rating agencies that assign credit ratings to the Company as issuer and to its specific fixed-income issues.

The following analysts, with which the Investor Relations Department is in constant contact, currently cover the Company:

- Ahorro Corporación
- BPI – Caixa
- Banco Santander
- Mirabaud
- Bankinter
- Fidentiis
- JB Capital
- Alantra
- BBVA
- Haitong Kepler

- Banco Sabadell
- GVC Gaesco-Beka
- Intermoney
- Link Securities

**Share price performance and dividend payments**

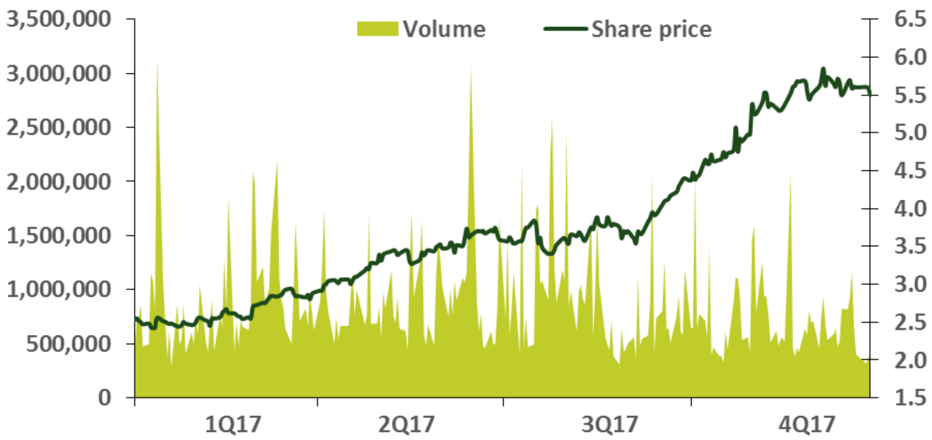
ENCE issued €250m of 5.37% bonds due 1 November 2022 on 30 October 2015. The coupon is payable twice-yearly. The first call date is 1 November 2018. The bonds are traded on the EuroMTF exchange in Luxembourg.

Both Moody's and S&P updated their ratings in 2017.

| | Rating | Outlook | Date |
|---|---|---|---|
| **Moody's** | Ba3 | Stable | 11/10/2017 |
| **S&P** | BB- | Stable | 06/04/2017 |

The bondholder report was updated in April to include the 2016 results. That report is available on our website and on that of the Luxembourg stock exchange, on which they are traded.

ENCE's share price ended 2017 at €5.50, which implies an equity market value of €1.36 billion, having gained 119.1% during the year, buoyed by execution of the Business Plan, which is translating into sharp growth and margin expansion in both the Pulp and Energy Businesses. During the same period, the Company's sector peers saw their share prices increase by 26.7% on average (*).




*Source: Bloomberg*

| | 1Q17 | 2Q17 | 3Q17 | 4Q17 |
|---|---|---|---|---|
| **Share price at the end of the period** | 2.89 | 3.59 | 4.40 | 5.50 |
| **Market capitalization at the end of the period** | 711.7 | 884.1 | 1083.6 | 1354.5 |
| **Ence quarterly evolution** | 15.1% | 24.2% | 22.6% | 25.0% |
| **Daily average volume (shares)** | 883,525 | 938,535 | 927,095 | 723,124 |
| **Peers quarterly evolution *** | 1.9% | 5.3% | 18.7% | 6.8% |

*(*) Altri, Navigator, Fibria and Suzano.*

| | 1Q17 | 2Q17 | 3Q17 | 4Q17 |
|---|---|---|---|---|
| **Share price at the end of the period** | 107.14 | 107.15 | 107.62 | 106.41 |
| **Yield to worst at the end of the period*** | 2.42% | 1.90% | 0.76% | 0.83% |

*(*) The yield calculated by Bloomberg assumes that the bonds will be refinanced in November 2018.*

In 2017, ENCE earmarked €40 million to shareholder remuneration, implying a dividend yield of 3% (calculated in respect of the year-end share price).

The Board of Directors approved the dividend policy applicable from 2017 on 26 July 2017. The new policy consists of paying out a dividend per share roughly equivalent to 50% of earnings per share every year in three annual instalments: two interim dividends, one approved at the end of the first half and the other in November of each year, and a final dividend, to be put before the Company's shareholders for approval at the Annual General Meeting.

Ence made its first and second interim dividend payments against 2017 profits on 6 September and 14 December 2017 in the amounts of €0.061 and €0.06 per share, respectively (amounts stated before withholdings).

The final dividend from 2016 profits (€0.0473 per share before withholdings) was paid out on 18 April 2017.

**Governance structure**

The Annual General Meeting is ENCE's highest decision-making body with respect to the matters falling within its remit and it represents all of its shareholders. It is regulated by the Bylaws and General Meeting Rules. The last Annual General Meeting took place on 30 March 2017. The key matters addressed included the examination and approval of the financial statements and management report, the discharge of the board's performance, the re-election of some of the directors, the reduction of share capital and cancellation of own shares and the new wording given to articles 5 and 6 of the Bylaws.

ENCE reduced its share capital in 2017 as duly registered with the Madrid Companies Register on 11 May. The Company's share capital was reduced by cancelling 4 million own shares held as treasury stock in the wake of the share buyback programme carried out in 2016. As a result, the Company's share capital is now made up of 246,272,500 shares with a unit par value of €0.90, represented by book entries and all belonging to a single class.

The Board of Directors is the Company's highest governance body and is mandated with representing the Company, governing it and supervising its management in all matters other than those reserved for approval by the shareholders in general meeting. It is made up of 13 directors, 38.46% of whom are independent, 38.46%

of whom are proprietary, 15.38% of whom are classified as 'other external', the CEO, who is in turn the vice-chairman, and a non-member secretary. In 2017, the Board of Directors met on 11 occasions. The issues it dealt with included analysis of the information reported by its various committees, the ratification of the pertinent resolutions on the basis of their proposals and recommendations, approval of the dividend policy, approval of the interim financial statements, oversight of the Company's financial and cost structure, oversight of its tax and CSR strategy and of execution of its Business Plan, approval of strategic investments and operations and implementation of the resolutions adopted at the Annual General Meeting.

Directors are selected following rigorous evaluation by the Appointments and Remuneration Committee, whose mission is to ensure equal opportunities in term of gender, providing guidelines for how to achieve the gender mix target, and also to guarantee that the selection procedures are unbiased so as to prevent discrimination on grounds of gender, in keeping with the director selection policy.

To ensure it carries out its duties as efficiently as possible, the Board has the following committees:

- The Executive Committee, in which the Board of Directors has permanently delegated all of powers that are not reserved to the Board under law, the Bylaws or the Board Regulations. In 2017 it was made up of seven directors and met on 10 occasions.

- The Audit Committee is broadly responsible for ensuring financial transparency and assessment of the risks that could affect the Company. It is also tasked with ensuring enforcement of the Company's corporate governance rules and reporting to the Board on the Corporate Social Responsibility Policy. In 2017 it was made up of five non-executive directors, the majority of whom independent, and met five times.

- The Appointments and Remuneration Committee is the Board committee tasked primarily with director appointment, evaluation and remuneration. In 2017 it was made up of five non-executive directors, most of whom independent, and met on seven occasions.

- The Forestry and Regulatory Policy Advisory Committee is the Board committee mandated with reporting to and advising the Board on forest regulation, sustainability and planning matters. In 2017 it was made up of seven directors and met four times.

The Company also has a Management Committee on which the CEO and the heads of the various business areas and corporate departments sit.

**ERM system**

ENCE's Board of Directors, with the help of the senior management team, defines the Company's risk management policies as a function of the risk factors to which it is exposed and establishes the internal control systems. The Internal Audit Department verifies adequate implementation of these principles and policies. In addition, ENCE has a Compliance and Crime Prevention Committee, which reports to the Audit Department and is responsible for defining and updating the corporate crime risks to which the Company is exposed. Management and all ENCE employees contribute actively to this process, which is implemented transparently right across the Company.

The enterprise risk management (ERM) system identifies, assesses, prioritises, addresses and monitors situations that could pose a threat to the Company's activities and objectives. Correct implementation of the ERM system enables the Company to maximise the positive impacts of its activities, while minimising risks and negative impacts. The main risks identified by ENCE are decision-making risks, financial risks, organisational risks and environmental risks.

The ERM system is reviewed regularly in order to introduce prevailing best practices in this arena at the general and industry levels.

For more information about risk management at ENCE, refer to the section titled "Key risks and sources of uncertainty".

**Code of Conduct**

The Board of Directors approved the Company's Code of Conduct in October 2015. It encompasses the principles ENCE has committed to voluntarily and consolidates its standing as a socially responsible organisation, while guaranteeing compliance with the corporate governance recommendations issued by the CNMV. It lays down the guidelines regarding workplace conduct in the areas of environmental care, community relations, employee safety, discrimination, harassment, conflicts of interest, corruption, information transparency and integrity, fraud prevention, confidentiality and competition, among others.

The Audit Committee, by means of a Whistle-blowing Channel which any of the people bound by the Code of Conduct can use to report potential non-compliance with the law or Company rules, is tasked with oversight of its enforcement. In 2017, the Company received two complaints through this channel; they were processed without incident and the cases were resolved without major implications.

The Code of Conduct is available for consultation at the following link: https://www.ence.es/es/código-de-conducta.html.

**Corporate Crime Prevention and Detection Protocol**

The Group has implemented an action plan which has materialised in a generic white-collar crime prevention and detection protocol which complies with the requirements laid down in recent Spanish legislation amending the Criminal Code in this arena. The protocol encompasses a series of specific measures and controls for each possible crime. The Ethics and Crime Compliance Committee is responsible for supervising, controlling and updating remedy plans, measures and controls under the umbrella of the protocol.

This committee, which reports to the Board's Audit Committee, is vested with far-reaching autonomous powers and control authority and mandated first and foremost with controlling prevention, supervision and protocol reviews. Its duties are set down in the procedure regulating its *modus operandi* and include:

- Defining and updating ENCE's corporate crime risk map; this map identifies the organisation's activities that are susceptible to criminal conduct which must be prevented.
- Supervising, controlling and evaluating how the Corporate Crime Prevention and Detection Protocol is functioning, in coordination with the direct owners of the crime prevention controls in place at the Company.
- Identifying control weaknesses and areas for improvement, promoting plans for remedying them and updating or modifying the measures and controls that constitute ENCE's Corporate Crime Prevention and Detection Protocol.
- Analysing and updating the risks and controls that could affect ENCE's departments.
- Reporting to the Audit Committee regularly on the results of its assessments of the Protocol.

The Ethics and Crime Compliance Committee comprises the Internal Audit Director, who chairs it, the General Secretary, who acts as secretary, the Human Resources Officer, the Energy Officer and the Pulp Operations Officer. The Internal Audit Director reports to the Audit Committee quarterly on the work performed to apply and monitor the controls defined in the Company's corporate crime prevention protocol, on recommended action plans and the level of implementation of any such recommendations. In turn, the Chairman of the Audit Committee reports on these activities to the Board of Directors.

The Ethics and Crime Compliance Committee draws up an activities report annually which is provided to the Audit Committee and forms the basis of proposals for improving and updating the Crime Prevention Protocol as necessary.

## 9.4 Commitment to employees

ENCE's commitment to its employees is underpinned by different policies and initiatives designed to facilitate their application and effectiveness and foster better employee relations and a safe working environment. In 2017, ENCE's headcount averaged 909 (843 in 2015 and 891 in 2016). In the last year, ENCE reinforced its team of technical experts and highly qualified personnel with 24 new hires.

**Management priorities**

In 2016, it approved a Strategic Human Resources Plan, which runs to 2020 and is aimed at establishing management priorities for the professional and personal development of ENCE's employees. The specific goals are to develop leadership skills and a participative management model, boost a range of skills, attract and retain talent, set competitive remuneration, evaluate job performance, frame labour relations by dialogue and trust, in short increase the Company's commitment to its professionals and recognise their achievements and results.

Training is a crucial component of this Plan, which defines the corporate training plans that complement the Operations Centres' specific plans addressing health and safety, TQM and other management tools, environmental issues, leadership skills and other areas of technical and managerial expertise. In 2017 it imparted a total of 17,821 hours of training, which implies 16 hours per employee (19 in 2015 and 33 in 2016). ENCE also runs a Talent Programme, thanks to which 53 young graduates were given the chance to start their careers with work practice at several areas of the Company in 2017. Fifty-five graduates had participated in the 2016 edition of this programme with 11 of them ultimately taking up employment at ENCE.

**Equal opportunities plan**

Through its Ethics Code, ENCE promotes equal opportunities and rejects all forms of discrimination. These commitments are articulated in an Equality Plan which specifically promotes gender equality. Over 19% of the headcount is female (18% in 2015 and 2016).

**Remuneration policy**

ENCE offers competitive remuneration based on market criteria and non-discrimination. Employees also enjoy a host of social benefits.

The ratio between the starting salary and the minimum wage stipulated in Spanish legislation is over 130%.

**Prevention of harassment**

The Ethics Code also embodies ENCE's rejection of all forms of harassment and stresses prevention, specifically committing to prevent, avoid, remedy and penalise harassment. These commitments are enshrined in a Harassment Prevention Policy and a Workplace and Sexual Harassment Prevention Protocol. The Company did not receive any reports of harassment via its whistle-blowing channel in 2017.

**Internal communication**

The Strategic Human Resources Plan is supported by an Internal Communication Plan, which is evaluated and supervised by the Management Committee. It informs everyone at the Company about the cultural change sought and makes them fully aware of their mission and contribution, ENCE's values and strategy, thus engaging them in the cultural change.

The Management Committee undertook several initiatives in 2017 in order to deliver the targets laid down in the Internal Communication Plan.

**Workplace health and safety**

A core component of ENCE's commitment to its employees relates to their health and safety at work. This commitment is set down in the Health & Safety Policy which is in turn distilled in a management system. Given its business activity, the safety targets set by the Company are ambitious and demonstrate a high level of commitment. ENCE's occupational health and safety management system is OHSAS 18001-certified. Thanks to this system, which complies with applicable legislation and fosters a culture of prevention, workplace accident rates have been falling, by 34% year-on-year in 2017 and by 6.3% year-on-year in 2016.

For more information about human resource management at ENCE, refer to the section titled "The team".

## 9.5 Commitment to customers

ENCE factors its customers' needs into all of its activities, taking action when required to meet their demands and in this manner build long-term relationships with them.

In 2012, the Company implemented a benchmark customer relationship system which enables the registration of any incidents that may occur and due processing of complaints and claims. However, the system is not intended to serve as a complaints management tool but rather a proactive system through which ENCE visits its customers periodically and invites them to come and get to know its business and demanding systems up close. In 2017 the Company visited more than 250 customers (427 in 2015 and over 230 in 2016).

To manage claims and gather customer feedback, ENCE prepares 8D reports in which it describes the problem, the containment plans, analyses the root causes, corrective action, etc. Elsewhere, is uses the Voice of Customer system to measure its customers' satisfaction. Two customer visits were organised in 2017 during which interviews were conducted addressing six major topics.

In 2017, ENCE developed a Customer Extranet which will provide streamlined information of interest to this stakeholder group and will be fully operational in 2018.

Also in 2017, ENCE took advantage of its close customer relationships to develop 'special personalised products. ENCE has put in place an industrial marketing team which is working to make sure these new products satisfy our customers and enhance profitability. With the support of this team we have also begun work on a project for persuading our customers to use ENCE's pulp as a substitute for the long-fibre pulp they use.

## 9.6 Commitment to partners and suppliers

The relationship with partners and suppliers is underpinned by trust and transparency, as stipulated in the Code of Conduct, to which end the Company strives to establish responsible bonds and contribute to mutual development and growth, focusing particularly on local suppliers.

ENCE's goal is to work with outsourced forest harvesters, preferably based locally or in the immediate vicinity of the harvesting work. The planning professionals organise the work on the basis of proximity, subject to availability. They attempt to strike a balance between hiring small, local players that create jobs in the rural community and larger firms capable of taking on larger-scale work.

In all instances, security requirements are a must, irrespective of the amount of equipment and workers involved.

In 2017, the Company's forest harvesting work was performed by small teams hired locally, most of which with just the one piece of equipment and fewer than five workers.

**Direct purchases from forest owners and small suppliers**

ENCE buys timber directly from forest owners and small suppliers. By entering into agreements with the various groups, it establishes guidelines for collaborating on key matters for the forestry sector.

In 2017, ENCE purchased timber from 5,590 forest owners (16% of total timber purchases were made through forest associations). Forty-eight per cent of purchase volumes corresponded to small suppliers, 99% of which based in Galicia and Asturias, where the Company has its mills, thus promoting supply proximity.

**Promotion of best practices and training**

However, when it comes to purchasing timber, ENCE takes other factors into consideration, specifically promoting best practices on the part of third parties, educating eucalyptus forest owners and helping them to certify their sustainable management. These initiatives tackle issues such as plant location, timber prices and the keys to exemplary plantations. As a result, of ENCE's 241 suppliers in 2017, 142 boasted dual certification, 19 had PEFC chain of custody certification only and eight had FSC certification only.

## 9.7 Commitment to the community and its surroundings

The Company is aware of the impacts its activity can have, particularly on the environment, which is why it has taken multiple measures to mitigate these impacts, relying on best available techniques to do so.

A number of mechanisms have been put in place to meet the demands of its surroundings. The Total Quality Management (TQM) model implemented in 2011 is a cultural and management practices transformation model which seeks excellence and involves senior management as the means to continuous improvement. It is articulated around specific environmental objectives: reducing odour impacts; improving wastewater quality; improving energy efficiency; reducing raw material consumption; and reducing waste generation.

ENCE also has an integrated environmental management system which encompasses all of the Company's activities and is certified by an accredited organisation which conducts annual audits. The system has been implemented at the Huelva, Navia and Pontevedra Operations Centres and complies with the following international standards: the UNE-EN-ISO 9001:2008 quality management standard, the UNE-EN-ISO 14001:2004 environmental management standard and the OHSAS 18001:2007 workplace health and safety standard. The three factories also participate in the Community eco-management and audit scheme (EMAS) governed by Regulation (EC) No. 1221/2009.

**Sustainable forest management**

ENCE is one of the biggest purchasers of timber in Spain and, as stated in its Code of Conduct and Corporate Social Responsibility Policy, it articulates this activity around sustainability. In terms of its forest management activities, these pledges have materialised in implementation of a Forest Management System, a transparent, efficient and responsible system centred on rationale use of all the goods and services offered by forest land, meaning not only what they have to offer productively but also their ecological and social attributes. ENCE works under the scope of a Management Plan centred on rationale use of all the goods and services offered by forest land, meaning not only what they have to offer productively but also their ecological and social values. Under the umbrella of this System, ENCE prepares Technical Forest Management Plans, Technical Forest Development Plans and Ongoing Forest Inventory Plans.

ENCE's stringent forest management standards are evident in the fact that in 2017, of the total area under management, 82% was PEFC-certified and 78% was FSC-certified (82% and 55% in 2015 and 85% and 69% in 2016, respectively).

In the areas and habitats subject to some form of protection requirements, ENCE takes action to improve their conservation status and develop preventative measures. In 2017, over 6,200 hectares of the forest land managed by ENCE qualified as high conservation value forest (HCVF), presenting one or more of the classification attributes stipulated by the FSC. In addition, another 11,189 hectares were official protected nature reserves, a designation assigned by the various competent Spanish authorities.

As ENCE does not obtain all of its timber from directly-managed forest land, supplying its factories also with timber purchased from third parties, the traceability of the wood it buys is another core component of ENCE's forest management work. ENCE has established a timber supplier evaluation system, by means of which it analyses various aspects of their activities (origin, government permits, etc.). These suppliers are subject to a programme of periodic audits designed to guarantee compliance with the stipulated criteria. ENCE also has a traceability regime, which encompasses the suppliers evaluated.

**10-Point Declaration on the Sustainability of Biomass as a Fuel**

In July 2017, ENCE presented its 10-Point Declaration on the Sustainability of Biomass as a Fuel, through which it commits to use this resource sustainably and to care for the environment in the process. By means of this initiative, ENCE aims to shape the future of biomass power generation by promoting its responsible and sustainable use, underpinned by the use of best available techniques and practices at its power plants.

ENCE has defined 10 principles related with respect for natural surroundings, compatibility with agricultural and forestry practices and other uses of biomass, limitations on the kind of timber that can be used, respect for land apt for growing food, compliance with prevailing legislation and minimisation of environmental impacts. ENCE is committed to upholding these principles in its Energy Business and implement measures to control their enforcement.

The 10-Point Declaration on the Sustainability of Biomass as a Fuel can be consulted at the following link: https://www.ence.es/es/decálogo-para-la-sostenibilidad-de-la-biomasa-como-combustible.html.

**Environmental Pact between ENCE and the regional government of Galicia**

Against the backdrop of its engagement with the authorities, on 28 June 2016, ENCE entered into an Environmental Pact with the regional government of Galicia. The key terms of that pact are itemised in note 32 of the accompanying financial statements.

**Management of environmental impacts of the productive process**

ENCE's environmental management policy is based on compliance with prevailing legislation and regulations. All of its Operations Centres hold the integrated environmental permits required for the pursuit of their industrial activities. The goal of these permits is to prevent, or at least reduce, and control air, water and soil contamination with a view to protecting the environment as a whole. To this end, the permits encompass a series of authorisations with respect to emissions, liquid discharges, waste management and soil and underground water protection. Against this backdrop, the permits set emission limits for each facility based on best available techniques and oversight and control plans in respect of all relevant 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. To this end, under the scope of the total quality management (TQM) model, it has developed the operating standards needed to optimally control and manage potential environmental fallout. Improved process control thanks to the plan-do-check-act (PDCA) and standardise-do-check-act (SDCA) 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 by the Company in recent years, underpinned by implementation of the best available techniques (BAT) and best environmental practices (BEP) defined in two BREFs: the 'Best Available Techniques Reference Document for the pulp and paper industry, 2014' and the 'Best Available Techniques Reference Document for large combustion plants, 2017', both of which approved by the European Parliament's ENVI Committee.

***Materials and waste***

ENCE uses a range of raw materials and auxiliary products in its productive process. The main raw material required to make pulp is timber. Most of the other materials consumed are chemical products. Pursuant to Regulation (EC) No. 1907/2006 concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH), ENCE checks that the chemical products it uses comply with this regulation before using them, even performing this check for products that do not require this clearance. ENCE participates in several registered substance consortia in order to update the registry in the event of changes in their composition or new identified uses. The raw material used by the power generation plants is biomass sourced from forestry and agricultural waste, as well as olive pomace, a sub-product obtained at olive oil plantations.

The waste generated by the manufacture of pulp primarily includes dregs (inert elements derived from the green liquor clarification process), ash in the biomass furnace and bioslurry at the wastewater treatment facility. At its biomass plants, the most important source of waste is the ash generated in the furnaces. ENCE minimises the generation of waste throughout the entire productive process by using sub-products, such as biomass, to harness energy. The dregs and ashes are used to produce cement and soil improvers.

***Energy and emissions***

ENCE is aware of the importance of its energy consumption, the vast majority of which takes the form of fuel and electricity. To minimise energy usage in its productive processes it has taken initiatives such as the installation of frequency inverters, highly energy-efficient equipment and presses for drying biomass, which combined have delivered a considerable improvement in the energy efficiency of its biomass.

To control emissions, the key sources of emissions - the recovery furnace and lime kilns, among others - have been fitted with automatic metering systems, which are connected up to a control system. ENCE has also taken specific measures to reduce its emissions, such as the installation of electrostatic precipitators and scrubbers.

Below are the key emissions readings in relation to the benchmark indicators (permits and BREF):

| | PONTEVEDRA | | | | | | NAVIA | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | BREF | AAI | 2014 | 2015 | 2016 | 2017 | BREF | AAI |
| **RECOVERY FURNACE** | | | | | | | | | | | | |
| Particles ($mg/Nm^3$) | 21 | 19 | 12 | 10 | 10-40 | 150 | 22 | 24 | 29 | 23.8 | 10-40 | 50 |
| $SO_2$ ($mg/m^3$) | 28 | 24 | 14 | 19 | 5-50 | 200 | 51 | 15 | 9 | 15.8 | 5-25 | 200 |
| TRS ($mg/Nm^3$) | 1.9 | 3.04 | 2.09 | 0.76 | 1-5 | - | - | - | - | - | 1-5 | - |
| $SH_2$ ($mg/Nm^3$) | 1 | 1.6 | 1.1 | 0.4 | - | 5 | 0.7 | 0.7 | 0.4 | 0.5 | - | 8 |
| NOx ($mg/Nm^3$) | 185 | 188 | 186 | 190 | 120-200 | 260 | 221 | 192 | 158 | 153.7 | 120-200 | 300 |
| **LIME FURNACES** | | | | | | | | | | | | |
| Particles ($mg/Nm^3$) | 11 | 9 | 8 | 5 | 10-30 | 50 | 21 | 27 | 29 | 22.3 | 10-30 | 50 |
| $SO_2$ ($mg/m^3$) | 14 | 10 | 10 | 10 | 5-70 | 300 | 92 | 43 | 42 | 43.1 | 5-70 | 1200 |
| TRS ($mg/Nm^3$) | 3.2 | 2.42 | 1.98 | 0.88 | 1-10 | - | - | - | - | - | 1-10 | - |
| $SH_2$ ($mg/Nm^3$) | 2.1 | 2.2 | 1.8 | 0.8 | - | 5 | 1.4 | 1.5 | 1 | 0.5 | - | 8 |
| NOx ($mg/Nm^3$) | 142 | 167 | 139 | 170 | 100-200 | 380 | 348 | 315 | 248 | 364.2 | 100-350 | 600 |

| | PONTEVEDRA | | | | | | NAVIA | | | | | | HUELVA 40 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | BREF | AAI | 2014 | 2015 | 2016 | 2017 | BREF | AAI | 2014 | 2015 | 2016 | 2017 | BREF | AAI |
| **BIOMASS FURNACE** | | | | | | | | | | | | | | | | | | |
| Particles ($mg/Nm^3$) | 19 | 25 | 26 | 32 | - | 100 | 47 | 25 | 14 | 13 | 2-12 | 20 | 62 | 64 | 23 | 20 | 2-15 | 30 |
| $SO_2$ ($mg/m^3$) | 259 | 219 | 261 | 250 | - | 1,700 | 82 | 40 | 33 | 20 | 10-70 | 200 | 5 | 2 | 13 | 147 | 15-100 | 200 |
| NOx ($mg/Nm^3$) | 385 | 426 | 469 | 448 | - | 600 | 141 | 177 | 201 | 197 | 50-180 | 250 | 76 | 230 | 257 | 237 | 70-225 | 300 |
| CO (ppm) | 122 | 89 | 104 | 91 | - | 616 | - | - | - | - | - | - | - | - | - | - | - | - |

| | HUELVA 50 | | | | | | MERIDA | | | | | | LA LOMA | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | BREF | AAI | 2014 | 2015 | 2016 | 2017 | BREF | AAI | 2014 | 2015 | 2016 | 2017 | BREF | AAI |
| **BIOMASS FURNACE** | | | | | | | | | | | | | | | | | | |
| Particles ($mg/Nm^3$) | 1 | 3 | 2 | 3 | 2-12 | 20 | 5 | 6 | 4 | 3 | 2-15 | 50 | - | - | 6 | 10 | 2-15 | 50 |
| $SO_2$ ($mg/m^3$) | 7 | 10 | 25 | 47 | 10-70 | 200 | 23 | 16 | 8 | 14 | 15-100 | 200 | - | - | 2 | 4 | 15-100 | 200 |
| NOx ($mg/Nm^3$) | 154 | 150 | 167 | 187 | 50-180 | 250 | 238 | 230 | 210 | 249 | 70-225 | 400 | - | - | 618 | 79 | 70-225 | 300 |
| CO (ppm) | - | - | - | - | - | - | - | - | - | - | - | - | - | - | 9 | 256 | 30-250 | 1445 |

| | ENEMANSA | | | | | | LUCENA | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | BREF | AAI | 2014 | 2015 | 2016 | 2017 | BREF | AAI |
| **BIOMASS FURNACE** | | | | | | | | | | | | |
| Particles ($mg/Nm^3$) | | | - | 1 | 2-15 | 30 | | | - | 9 | 2-15 | 50 |
| $SO_2$ ($mg/m^3$) | | | - | 105 | 70-225 | 200 | | | - | 15 | 15-100 | 200 |
| NOx ($mg/Nm^3$) | | | - | 192 | 30-250 | 300 | | | - | 184 | 70-225 | 300 |
| CO (ppm) | - | - | - | - | - | 350 | | | - | 70 | 30-250 | 250 |

***Water and wastewater***

The water used at the production and operations centres is taken from surface sources, the requirements for which are established in the corresponding environmental permits. Throughout the entire process, ENCE strives to implement measures designed to foster efficient water consumption as well as its reuse, for example by means of dry debarking and condensate stripping. The use of water in the productive process results in the generation of discharges, mainly as a result of the pulp cooking, washing, bleaching and drying processes.

Below are the key indicators in relation to the benchmark indicators (permits and BREF):

| | PONTEVEDRA | | | | | | NAVIA | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | Bref | AAI | 2014 | 2015 | 2016 | 2017 | Bref | AAI |
| Volume discharged (m3/tAD) | 32.2 | 31.1 | 32 | 28.9 | 25-50 | 37 | 33.2 | 34.4 | 33 | 33.8 | 25-50 | 45 |
| Suspended solids (kg/tAD) | 0.42 | 0.53 | 0.54 | 0.44 | 0,3 - 1,5 | 2 | 1.1 | 1.15 | 1.2 | 0.97 | 0,3 - 1,5 | 2 |
| DQO (kg/tAD) | 4.47 | 4.50 | 4.18 | 3.65 | 7-20 | 7 | 5.8 | 4.89 | 4.7 | 3.57 | 7-20 | 15 |
| DBO (mg/L) | 9.8 | 9.3 | 9 | 8 | 25 | 48 | 27 | 24 | 21 | 16.4 | 25 | 100 |
| AOX (kg/tAD) | < 0,0004 | < 0,0003 | < 0,0003 | 0.0003 | 0 | 0 | 0.05 | 0.07 | 0.03 | 0.03 | 0 | 0 |
| Nitrógeno total (kg/tAD) | 0.21 | 0.22 | 0.25 | 0.21 | 0,05-0,25 | 1 | 0.17 | 0.14 | 0.0627 | 0.1 | 0,05-0,25 | s/e |
| Fósforo total (kg/tAD) | 0.011 | 0.012 | 0.011 | 0.009 | 0,02-0,11 | 0 | 0.033 | 0.036 | 0.019 | 0.039 | 0,02-0,11 | s/e |

| | HUELVA | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | Bref | AAI |
| Volume discharged ($m^3$/h) | 588 | 232 | 227 | 160 | | |
| Suspended solids (mg/l) | 26 | 13 | 20 | 7 | 5-30 | 150 |
| DQO (mg/l) | 40 | 15 | 12 | 11 | 30-150 | - |
| AOX (mg/l) | 0.04 | 0.08 | 0.10 | 0.08 | | 9 |
| Nitrógeno total (mg/l) | 2.5 | 1.8 | 1.2 | 1.2 | 1-50 | 8 |
| Fósforo total (mg/l) | 0.2 | 0.5 | 0.8 | 1.0 | | 4 |
| COT (mg/l) | 14 | 4 | 5 | 4 | | 150 |

| | MERIDA | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | Bref | AAI |
| pH | 7.8 | 7.7 | 8.0 | 8.0 | | 6-9 |
| Conductividad | 854 | 1,062 | 1,082 | 1,023 | | 1,200 |
| Suspended solids (mg/L) | 10 | 12 | 12 | 5 | 5-30 | 20 |
| Cloruros (mg/L) | 114 | 149 | 152 | 153 | 500-1000 | 200 |
| Sulfatos (mg/L) | 242 | 243 | 205 | 205 | 300-1500 | 300 |
| DBO (mg/L) | < 5 | < 5 | 5 | 4 | | 10 |
| Nitrógeno total (mg/L) | < 5 | < 5 | 6 | 5 | 1-50 | 25 |
| Nitratos (mg/L) | 24 | 7 | 18 | 12 | | 25 |
| Fósforo total (mg/L) | 0.48 | 0.41 | 0.57 | 0.34 | | 3 |

| | LA LOMA | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | Bref | AAI |
| pH | - | - | - | 8.1 | - | 6-9 |
| Conductivity (µS/cm) | - | - | - | 776 | - | 2,000 |
| Suspended solids (mg/l) | - | - | - | 3.4 | 10-30 | 35 |
| DBO (mg/L) | - | - | - | 6 | - | 25 |
| DQO (mg/l) | - | - | - | 17.0 | 60-150 | 125 |
| AOX (mg/L) | - | - | - | - | - | 0.15 |
| Cloro libre residual (mg/L) | - | - | - | 0.10 | - | 0.30 |
| Fósforo total (mg/l) | - | - | - | 1.0 | - | 2 |
| Toxicity | - | - | - | 2 | - | 12 |
| Temperatura (°C) | - | - | - | 20 | - | 25 |

| | LUCENA | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | Bref | AAI |
| Conductivity (µS/cm) | - | - | - | 1,366 | - | 2,000 |
| Suspended solids (mg/l) | - | - | - | 8.4 | - | 35 |
| DBO (mg/L) | - | - | - | 9 | - | 25 |
| DQO (mg/l) | - | - | - | 29 | - | 125 |

***Odour and noise***

Noise and odour also feature among the significant impacts of its business activities. To minimise these ramifications, ENCE recently expanded the facility for the treatment of diluted odorous gases at the Navia Operations Centre.

In terms of noise, the Company recently completed phase one of the noise mitigation plan, which falls under the umbrella of the Pontevedra Operations Centre's Environmental Reliability Plan. These measures have reduced noise levels by 15 decibels at the noise-generation sources. At the Navia Operations Centre, all of the investments planned for eliminating high-pitch sounds and soundproofing the new timber line have been made. Lastly, at the Merida Operations Centre a plan for improving noise emissions by installing acoustic insulation and replacing mechanical parts in the cooling towers has also been successfully executed.

Below are the key indicators tracking odour levels:

| | PONTEVEDRA | | | NAVIA | | |
|---|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2015 | 2016 | 2017 |
| Odour impact index | 0.62 | 0.31 | 0.17 | - | 3 | 0.7 |
| Stationary sources | 647 | 459 | 344 | 426 | 856 | 359 |
| Diffuse sources | 678 | 345 | 288 | 20,659 | 27,091 | 797 |
| Total minutes | 1,325 | 804 | 632 | 21,085 | 27,947 | 1,156 |

Below are the key noise readings in relation to the benchmark indicators (environmental permits):

| | PONTEVEDRA | | | | | NAVIA | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | AAI | 2014 | 2015 | 2016 | 2017 | AAI |
| Daytime | 61.0 | 62.1 | 62.8 | 63.5 | 70 | 61.3 | 60.7 | 60.6 | 60.0 | 55 |
| Afternoon | 60.0 | 61.1 | 62.2 | 61.7 | 70 | - | - | - | - | - |
| Night-time | 55.9 | 57.0 | 59.7 | 57.9 | 60 | 60.4 | 59.3 | 59 | 59.8 | 45 |

| | HUELVA | | | | | MERIDA | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | AAI | 2014 | 2015 | 2016 | 2017 | AAI |
| Daytime | - | 68.0 | 67.4 | 65.1 | 75 | 66.4 | 66.4 | 59.2 | 58.9 | 65 |
| Afternoon | - | - | - | - | - | - | - | - | - | - |
| Night-time | - | 59.7 | 59.2 | 57.0 | 70 | 57.0 | 57.0 | 56.6 | 51.0 | 55 |

At the recently-acquired La Loma and Enemansa power plants, work is underway to develop a specific action plan for reducing noise levels.

More information about ENCE's environmental management is available in note 31 of the accompanying consolidated financial statements.

## 9.8 Commitment to governments and regulators

ENCE evidences its commitment to society and its surroundings by engaging directly and continuously with the authorities of relevance to its sector (such as the Spanish Ministry of Industry, the General Directorate of Energy Policy and Mining and various regional and local governments, among others). Active communication with the various authorities is fundamental to building mutual understanding and enhanced social, environmental and economic well-being in the regions in which it does business.

In addition to its dialogue with the authorities, the Company contributes by complying scrupulously with its tax obligations. In 2017, ENCE's business implied a total direct tax outlay of €60 million, broken down as follows:

| | Thousands of euros | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Pontevedra | Huelva | Navia | Mérida | Jaén | Ciudad Real | Córdoba | Madrid & other | Total |
| Corporate income tax (*) | 7,223 | 2,814 | 13,320 | - | 395 | 1,063 | 358 | - | 25,173 |
| Electricity generation levy | 1,555 | 5,674 | 4,202 | 1,453 | 825 | 926 | 1,736 | - | 16,371 |
| Contributions to the Social Security | 4,652 | 1,172 | 4,757 | - | 9 | 23 | 251 | 1,039 | 11,903 |
| Other taxes | 1,696 | 53 | - | 1 | 28 | 35 | - | - | 1,813 |
| Environmental levies | 928 | 340 | 309 | - | 14 | - | 40 | - | 1,631 |
| Business activity tax | 317 | 552 | 214 | 15 | 21 | 13 | 20 | - | 1,152 |
| Other | 701 | 565 | 279 | 4 | 17 | 10 | 472 | - | 2,048 |
| | **17,072** | **11,170** | **23,081** | **1,473** | **1,309** | **2,070** | **2,877** | **1,039** | **60,091** |

*(*) Factoring in tax reimbursements*

In addition, ENCE's business activities make an important contribution as a result of the tax the Group collects, such as VAT and personal income tax withholdings, for the revenue services in the areas in which it operates. These indirect taxes amounted to €59 million in 2017, broken down as follows:

| | Thousands of euros | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Pontevedra | Huelva | Navia | Mérida | Jaén | Ciudad Real | Córdoba | Madrid & other | Total |
| Withholdings | 3,998 | 983 | 4,327 | 2 | 13 | 20 | 334 | 7691 | 17,368 |
| IVA (*) | - | 7,472 | 24,375 | 2,159 | 1014 | 1276 | 2,341 | 117 | 38,754 |
| Social Security contributions- employees | 926 | 224 | 977 | - | 3 | 4 | 45 | 220 | 2,399 |
| | **4,924** | **8,679** | **29,679** | **2,161** | **1,030** | **1,300** | **2,720** | **8,028** | **58,521** |

*(*) Factoring in tax reimbursements*

ENCE is fully committed to complying with all its tax obligations under prevailing legislation, articulated around a transparent model based on ethical tax practices. To this end, ENCE bases its engagement with the various tax authorities on the principles of good faith, collaboration and mutual trust. The Group attempts to prevent tax lawsuits by prioritising an interpretative approach to the tax regulations established by these authorities.

## 10. 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.

## 11. Research, development and innovation (R&D&i)

Sustainability and continuous improvement are two of the cornerstones underpinning the Group's activities and its R&D effort is of vital importance to delivering these strategic goals. In 2017, 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 enhance the properties of its pulp, such as its dimensional stability, smoothness, opacity and the stability of its whiteness.

Focused on continuous process improvement, the Company also tested the use of surfactants during cooking, bleaching catalysts with peroxide and bleaching enzymes and studied how to optimise chip thickness.

The NOVACELL Project was rolled out, spearheaded by ENCE with the participation of several sector players, public centres and the University of Valladolid. The goal of this project is to develop viable methods for obtaining nanocellulose materials from kraft pulp and adapting it for applications of interest in the chemicals, plastics-composites production, paper, packaging, cosmetics and water treatment sectors. This project is supported by the CDTI, the acronym in Spanish for the centre for the development of industrial technology.

Two projects are underway for the assessment of dry rolled timber using vibroacoustic and microwave absorption property measurement methods.

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, concluded in 2017, having begun in 2013. Its goal was to design, optimise and scale a new multi-stage process for the production of second-generation liquid biofuels from lignocellullosic biomass at a competitive price and using next-generation nanocatalysts. The ultimate aim being to prepare biofuels of similar composition and properties to those obtained from gasoline.

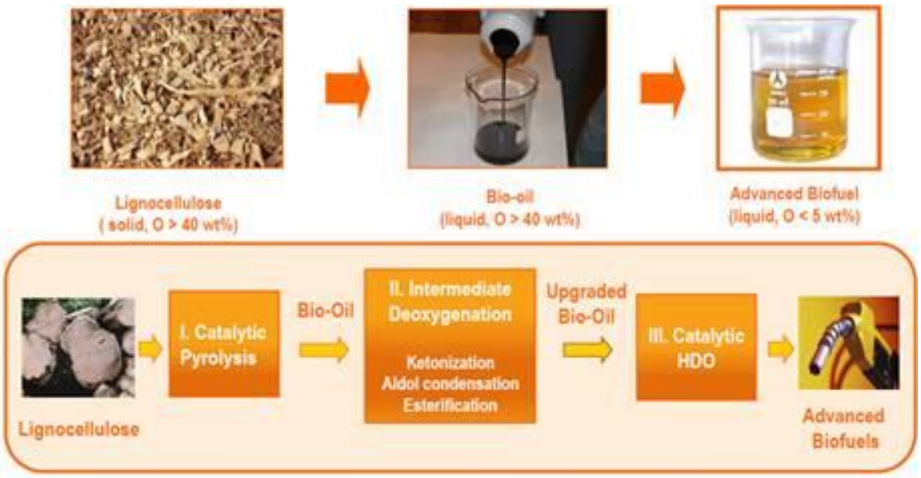



FIGURE 1.2. LIGNOCELLULOSE CASCADE DEOXYGENATION PROCESS FOR 2nd GENERATION BIOFUELS PRODUCTION.

ENCE headed up the biomass selection and classification work (WP1) and participated in the biofuel classification tests (WP7) and in the process design and commercial-scale viability test (WP9). It also participated in the innovation and management committees.

The INNVENTIA project also concluded in 2017. Initiated in 2015, ENCE participated in the pre-competitive research and the research into functional applications. As part of the pre-competitive research work, the worldwide lignin business and production volumes were analysed. Methods for classifying and purifying lignin were also developed. This research area also included economic studies regarding the market for the identified functional applications.

The functional application research work focused on the production of valid resins for the manufacture of chipboard. Another line of research looked at activated carbon and activated carbon fibres for use in the energy storage field (H2, electricity, etc.). Carbon nanofibres were also developed from different kinds of lignin (SKL, HKL).

Work continued in 2017 on the KL-Vanillin project which is aimed at extracting various substances of interest from lignin, such as vanillin and its associated compounds.

In 2017, the LIGNO-SPREAD (2015-2018) project addressed the use of lignin produced by ENCE in various products of interest: flocculants, surfactants (detergents), forest paths and coverings, insulation panel foam and foam for car seats.

A technical and economic study was also conducted to research implementation of LIGNOBOOST technology at the Pontevedra operations centre.

The LIGNOPRIZED (2016-2020) project is focused on expanding the field of application of black liquors and the lignin they contain. Black liquor was sent to the partners that are going to develop the corresponding technology and precipitated and clean lignin was sent to the partners that are going to work on its modification and transformation. Precipitation techniques (use of ceramic membranes and selective precipitation) were also studied.

In the forestry area, the R&D work carried out in 2017 was framed by the Continuous Improvement Plan established by ENCE over three decades ago. This Plan encompasses three improvement programmes: the genetic enhancement programme; the silviculture programme and the pest and disease control programme. The specific projects implemented under the umbrella of this Plan in 2017 included:

- The Gonipterus Project - improving the phytosanitary properties of its Eucalyptus globulus plantations by combating the Gonipterus platensis (eucalyptus tree weevil).
- The Micos Project - investigating new clones that tolerate Mycosphaerella and Gonipterus.
- The Hybrids Project - selection of new genotypes created from the controlled crossing of specimens in order to assess generic traits that can be exploited for business purposes.
- The Agricultural Biomass Project - enhanced use of agricultural biomass waste by developing specific harvesting and logistics processes.

Under the scope of the Gonipterus Project, it is worth highlighting improvements made to the process of reproducing the parasitoids in biofactories, delivering a significant reduction in costs (of 36%), while enabling the biological treatment of an area spanning over 24,000 hectares. Both factors - cost and coverage volumes - are crucial to the sustainability of biological treatments as a benchmark form of pest control in the future. The developments and results were compiled and tabulated for the second year in a row and the results of the biological treatment campaign were analysed and evaluated in detail. Also under the scope of this project, the first lab tests using the Anaphes inexpectatus parasitoid were completed; these certified its suitability as a Gonipterus pest control agent, one that it compatible with and complements the treatments already being carried out using the Anaphes nitens.

The new experiments being developed in the genetic enhancement arena resulted in the installation of new test plots planted with trees modified to tolerate the Gonipterus plague and Micosphaerella disease. In the latter instance, a tolerant clone has been pre-evaluated and its reproduction initiated on a pilot scale. New hybrid materials were also obtained by crossing the E. nitens and E. globulus species in a controlled environment using elite specimens from each. These materials' ability to root is currently being evaluated with a view to subsequently analysing the ability to reproduce these clones.

Significant milestones were obtained in the Agricultural Biomass Project, including those related with the use of corn biomass, improvements in the process of collecting straw and leveraging its energy potential and successful finalisation of the operational plant supply schematic. These results were obtained following comprehensive analysis of available collection technology, as well as efficiency and effectiveness studies. The study was completed using the results obtained for the multi-product harvesting systems (grain + straw) using the CornRower II (New Holland®) and other prototypes developed as part of the project. Under the umbrella of this same project, work began on studying and improving the processes used to harness other sources of agricultural biomass, including vine shoots, citric and olive tree pruning waste, cotton, sunflowers and rice.

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. Against this backdrop it is worth highlighting the fact that the supply of genetically-enhanced Eucalyptus globulus through our nurseries increased by 39% in 2017.

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. Last year the Company entered into a collaboration agreement with the University of Extremadura (specifically the construction department and materials research unit) to carry out a project titled “Classification of the Sub-products Deriving from Biomass-fuelled Power Plants”. Lastly, the technical team participated in a series of congresses, know-how sharing seminars and symposiums at the national and international levels.

## 12. Own shares

The disclosures regarding the acquisition and sale of own shares in 2017 are provided in note 25.7 to the accompanying consolidated financial statements.

## 13. Other information

### Corporate governance

The Annual Corporate Governance Report is attached to this Management Report. (See Spanish version)

### Alternative performance measures

ENCE presents its results in accordance with generally accepted accounting principles, specifically IFRS. In addition, this report provides certain other complementary metrics that are not defined or specified in IFRS and are used by management to track the Company's performance. The alternative performance measures (APMs) used in this report are defined, reconciled and explained below:

**CASH COST**

The production cost per tonne of pulp produced, or cash cost, is the key measure used by management to measure its efficiency as a pulp maker.

Cash cost includes all of the expenses incurred to produce pulp: timber, conversion costs, corporate overhead, sales and marketing expenses and logistics costs. It excludes fixed-asset depreciation and forest depletion charges, impairment charges and gains/losses on non-current assets, finance costs/income, income tax and certain operating expenses which management deems to be non-recurring, such as *ad-hoc* consultancy projects, ENCE's long-term remuneration plan and the termination benefits agreed with staff.

As a result, the difference between the average sales price and the cash cost applied to the total sales volume in tonnes yields a figure that is a very close proxy for the EBITDA generated by the Pulp Business.

**EBITDA**

EBITDA measures operating profit before depreciation, amortisation and forest depletion charges, non-current asset impairment charges and gains or losses on non-current assets.

EBITDA provides an initial approximation of the cash generated by the Company's operating activities, before interest and tax payments, and is a measure that is widely used in the capital markets to compare the earnings performances of different companies.

**NORMALISED FREE CASH FLOW**

ENCE reports normalised free cash flow within the cash flow metrics for each of its two business units as the sum of EBITDA, the change in working capital, maintenance capital expenditure, net interest payments and income tax payments.

Normalised free cash flow provides a proxy for the cash generated by the Company's operating activities before collection of proceeds from asset sales; this cash represents the amount available for investments other than maintenance capex, for shareholder remuneration and for debt repayment.

**MAINTENANCE, EFFICIENCY & GROWTH AND ENVIRONMENTAL CAPEX**

ENCE provides the breakdown of its capital expenditure related cash outflows for each of its business units, distinguishing between maintenance, efficiency & growth and environmental capex.

Maintenance capex are recurring investments designed to maintain the capacity and productivity of the Company's assets. Efficiency & growth capex, meanwhile, are investments designed to increase these assets' capacity and productivity. Lastly, environmental capex covers investments made to enhance quality standards, occupational health and safety and environmental performance and to prevent contamination.

ENCE's 2016-2020 Business Plan includes a schedule of the amounts it expects to invest annually in efficiency & growth and environmental capex in order to attain the strategic targets set. The disclosure of capex cash flows broken down by area of investment facilitates oversight of execution of the published 2016-2020 Business Plan.

**FREE CASH FLOW**

ENCE reports free cash flow as the sum of its net cash flows from operating activities and its net cash flows from investing activities.

Free cash flow provides information about the cash generated by the Group's operating activities that is left over after its investing activities for the remuneration of shareholders and repayment of debt.

**NET DEBT**

The borrowings recognised on the balance sheet include bonds and other marketable securities, bank borrowings and other financial liabilities. They do not however include the measurement of financial derivatives.

Net debt is calculated as the difference between current and non-current borrowings on the liability side of the balance sheet and the sum of cash and cash equivalents and short-term financial investments on the asset side.

Net debt provides a proxy for the Company's indebtedness and is a metric that is widely used in the capital markets to compare the financial position of different companies.