

# Integrated Report / February 2015



# Integrated Report / February 2015

**Iberdrola's Public Information**

To provide our shareholders, employees, customers, suppliers, and society in general with trustworthy and relevant information regarding the Company's performance and its strategic lines for the coming years.

**Annual Information**

- **Integrated Report**  
Prepared based on the recommendations of the International Integrated Reporting Council (IIRC).
- **Financial Report**  
Prepared according to international financial reporting standards and externally audited.
- **Corporate Governance Report**  
Prepared according to the form provided by the National Securities Market Commission of Spain.
- **Sustainability Report**  
Prepared according to the Global Reporting Initiative (GRI) guidelines and externally assured.
- **Report of the Consultative Committees of the Board of Directors**  
Prepared according to Iberdrola internal standards.
- **Director Remuneration Report**  
Prepared according to Iberdrola internal standards.
- **Report on Compliance with the Code for the Separation of Activities**  
Prepared according to Iberdrola internal standards.

**Additional Information**

- **Quarterly Results Report**
- **IBE Watch Fact Sheet**
- **Quarterly Shareholder Bulletin**
- **Innovation Report**
- **Biodiversity Report**
- **Greenhouse Gas Report**

Information on the Corporate Website  
[www.iberdrola.com](http://www.iberdrola.com)

- **About Us**
- **Reputation and Sustainability**
- **Press Room**
- **Shareholders and Investors**
- **Customers**
- **Suppliers**
- **Networks**



This icon refers to the pages of this report where related information can be found. It also gives information on other specific reports where more information of interest can be accessed.



Access the 2014 annual reports and get further information on the Iberdrola group by scanning the corresponding QR code using your smartphone or tablet.

# Your energy, our energy.

## Comfort for homes

Our goal is to offer a reliable, high-quality, and environmentally-friendly energy supply.

## Sustainability for the future

Drive the economic and social development of the communities in which we are present.

## Innovation for infrastructure

Improve the well-being of people.

## Competitiveness for companies

Create sustainable value for our shareholders, employees, customers, and suppliers.

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\$M = millions of dollars.

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Ignacio S. Galán  
Chairman of Iberdrola

## **“We will continue maximising our economic and social contribution and impact in the communities in which we operate”.**

Dear friends:

I am pleased to present to you, for the second consecutive year, Iberdrola's *Integrated Report*, which sets forth the most significant future risks and opportunities for the company, as well as the strategy we have designed to face them, whilst maximising our positive impacts on stakeholders and in all of the societies in which we operate. For that reason, Iberdrola will continue to engage in business in accordance with a sustainable business model, based on the long term, geographic diversification, a focus on regulated activities, the quality of our assets, efficiency, and financial strength. We will do so whilst making a special effort in the ongoing promotion of ethics, transparency, good governance, innovation, and inclusion. Our goal is to continuing sharing our capabilities with all of society, and to generate trust through continuous dialogue and engagement with our stakeholders.

With this model, we hope to continue being one of the leading utilities worldwide, which currently produces and supplies electricity –cleanly, reliably, and responsibly– to approximately one hundred million people, primarily in the United Kingdom, the United States of America, Mexico, Brazil, and Spain, whilst fostering their economic and social development at the same time.

For that purpose, we expect to continue progress in achieving the goals that we set out in the *Outlook 2014-2016*. One example of our path to compliance is the results obtained in 2014, during which gross operating income (EBITDA) increased by 3.1% compared to the previous year –to the sum of 6,965 million euros– while net profit came to 2,327 million euros, in both cases surpassing the estimates we had made and which we made public on Investor Day in February 2014.

We also expect to continue building our financial strength, as we did last year, when we reduced debt by more than 1,492 million euros, to 25,344 million euros\*, which allowed us to reduce the net debt/EBITDA ratio to 3.6x, from 4x in 2013. This meant a big step towards our goal of bringing net debt to 25,000 million euros by year-end 2016 and of achieving a net debt/ EBITDA ratio below 3.5x. All of this will allow us to continue maintaining our commitment to shareholder compensation, which in 2014 was 0.27 euro per share, reaching a total shareholder return\*\* of 30.1% for the year.

### **Economic and social contribution and impact**

At the same time, we are continuing to maximise our economic and social impact in the communities in which we operate by means of investments worth 11,200 million euros through 2016 (some 3,000 million euros in 2014), mainly for electricity transmission and distribution networks, and clean energy; and procurement in an amount of more than 5,000 million euros annually.

Furthermore, we will continue contributing to public coffers with a volume of direct taxes that last year amounted to 5,500 million euros (10,500 million\*\*\* if we add indirect and induced contributions). We



will also continue our wager on the maintenance and creation of stable high-quality employment, especially among younger persons. Today, Iberdrola gives direct, indirect, or induced employment to 350,000\*\*\* people all over the world.

The management of human capital will continue to be a priority for the company, in areas such as: training (with more than a million annual hours for employees (3% of working hours) and an international youth scholarship programme); professional promotion; and equality (progressive equivalence between men and women in the workforce).

We will also continue encouraging the reconciliation of family and professional life; international mobility; and job safety (with a goal of 0 accidents). Our objective is to continue increasing team pride and employee satisfaction, which during the last labour climate survey received a rating of approximately 8 out of 10.

Furthermore, R&D+i at Iberdrola (to which we allocated 170 million euros in 2014 alone) will continue to be focused on efficiency, sustainability, and the development of new products and services. We expect to continue to be at the head of the most innovative utilities in Europe, as the European Commission has recently certified.

In addition –as I already mentioned– we are going to further intensify our policy of dialogue and engagement with our stakeholders: employees, customers, suppliers, and especially our shareholders: more than 600,000 –many of them pensioners. Along these lines, our investors will continue to be at the centre of our Corporate Governance System, which we will continue to conform to the best domestic and international practices to strengthen our leadership in this area. At the same time, ethics and compliance will continue to be absolutely priority aspects at Iberdrola, both for our internal management and throughout the supply chain.

### Care for the environment

As regards our contribution to caring for the environment, even though our emissions per kWh are already 30% less than the average for the European electricity sector, we have set goals for a 30% reduction in the intensity of our emissions by 2020 as compared to 2007, and to be carbon

## “We will even further intensify our policy of dialogue and engagement with our stakeholders”.

neutral by 2050. Together with this, we will continue minimising the environmental impact of our facilities and launching initiatives to support the biodiversity of our surroundings, such as with bird protection. Finally, we will continue with our commitment to support art and culture, through illumination, restoration, exhibitions, etc. And we will especially drive our social action programmes directed towards improving the quality of life for persons in situations of vulnerability or social exclusion, as we have been doing in recent years. One example of this is the *Electricity for All Programme (Programa electricidad para todos)*, which was launched in 2014 to strengthen activities promoting access to electricity in emerging and developing countries. Our challenge in future years will be to continue staying at the forefront of the leading sustainability indices, such as *Dow Jones Sustainability*, *FTSE4Good*, *Oekom* and *Carbon Disclosure*, among others.

This way, we can continue to create value for all of our stakeholders – our shareholders, employees, customers, suppliers... – and contribute to progress in all of the territories in which we operate. Because Iberdrola serves society and, more importantly, the well-being of people.

\* As adjusted by the dividend paid in December.

\*\* Total shareholder return (TSR): includes the dividends received by the shareholders and the increase in price of the shares.

\*\*\* Annual impact estimated by Analistas Financieros Internacionales (AFI), based on Iberdrola's business during the 2009-2013 period.

# Iberdrola today

Lempster Wind Farm in New Hampshire  
/ United States of America

1

# 1.1 Iberdrola today

## Our activities

- Production of electricity from renewable and conventional sources.
- Purchase/sale of electricity and gas on wholesale markets.
- Transmission and distribution of electricity.
- Supply of electricity, gas, and related energy services.
- Other activities, mainly linked to the energy sector.

**Iberdrola is one of the leading electric companies in the world.**

## What we are

The process of internationalisation carried out in recent years has made the Iberdrola of today one of the leading electric companies, and among the largest utilities in the world by stock market capitalisation.

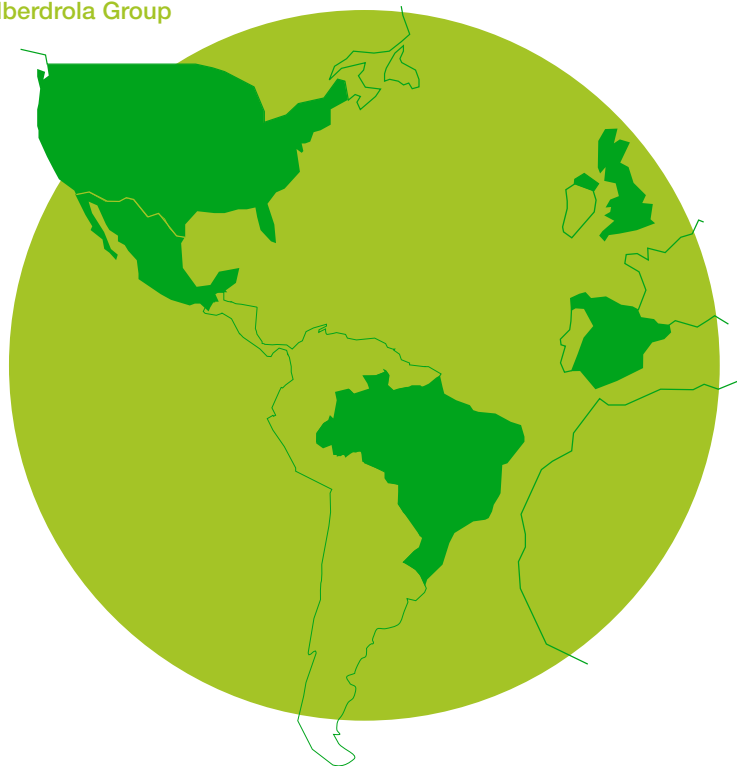
The corporate and governance structure is described in chapter 5.1 of this report and consists of:

- Iberdrola, as a holding company.
- Country subholding companies in the 5 main geographical areas of activity.
- Heads of business companies reporting to the country subholding companies.

## Presence focused on the Atlantic area

Iberdrola carries out its activities mainly in the five countries of the Atlantic area: Spain, the United Kingdom, the United States of America, Mexico, and Brazil.

## Iberdrola Group



## 2014 Data Iberdrola Group

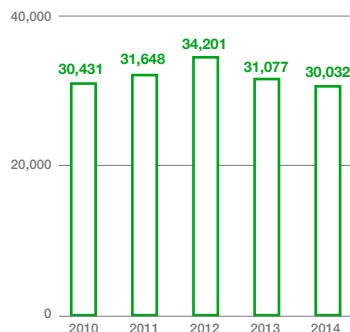
45,089
MW Installed capacity
14,652
MW Renewable installed capacity
138,892
GWh Net output
214,613
GWh Electric power distributed
32.6
Millions of users
29,597
People (1) Direct employment
350,000
People (2) Indirect and induced employment
10,500
€M Tax contribution (€M 5,500 direct + €M 5,000 (2) indirect and induced)
5,408
€M Awarded Procurement
2,848
€M Investments

(1) At 31 December 2014.

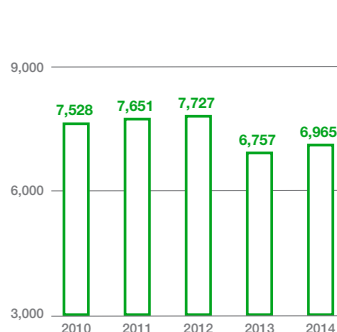
(2) Annual impact estimated by Analistas Financieros Internacionales (AFI), based on Iberdrola's business during the 2009-2013 period.

# 1.2 Company performance

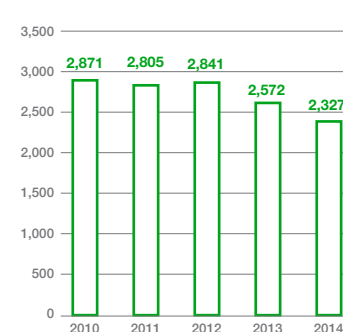
Revenues (€M)



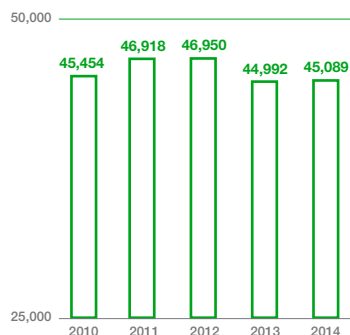
Ebitda (€M)



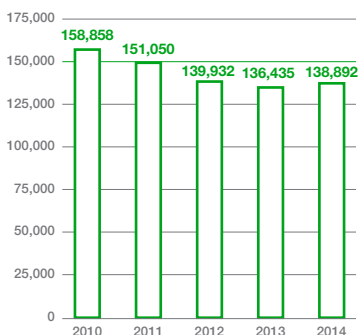
Net profit (€M)



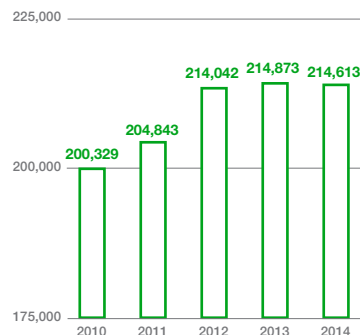
Installed capacity (MW)



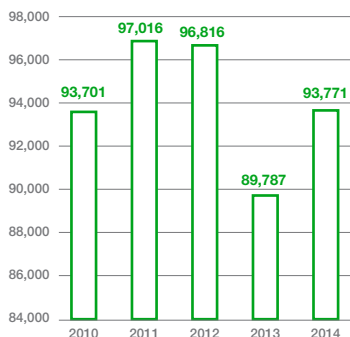
Net output (GWh)



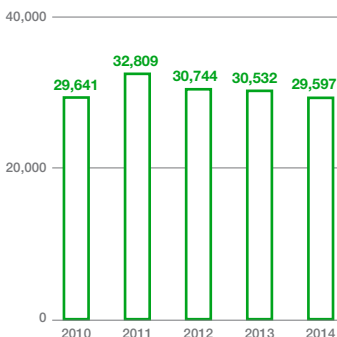
Energy distributed (GWh)



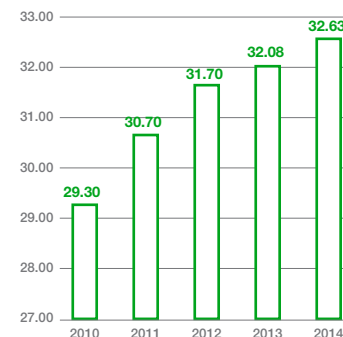
Assets (€M)



Employees



Users (millions)



\* Note: Due to legal requirements, Iberdrola has applied international financial reporting standard IFRS-11 to the financial information for the financial years 2013 and 2014, which aspect should be taken into account in evaluating the historical performance of the Company.



# 1.3 Key figures

Financial performance (€M)	2010	2011	2012	2013	2014	Δ Annual average 2010-14	Δ 2010-14
<b>Revenues</b>	<b>30,431.0</b>	<b>31,648.0</b>	<b>34,201.2</b>	<b>31,077.1</b>	<b>30,032.3</b>	<b>-0.3%</b>	<b>-3.4%</b>
Consolidated gross margin	11,645.2	12,025.8	12,578.1	11,781.9	12,179.5	1.1%	3.4%
<b>Consolidated ebitda</b>	<b>7,528.0</b>	<b>7,650.5</b>	<b>7,726.6</b>	<b>6,756.9</b>	<b>6,964.5</b>	<b>-1.9%</b>	<b>3.1%</b>
<b>Ebitda - Networks (regulated)</b>	<b>3,450.9</b>	<b>3,825.4</b>	<b>3,773.7</b>	<b>3,346.5</b>	<b>3,534.7</b>	<b>0.6%</b>	<b>5.6%</b>
Spain	1,389.7	1,555.2	1,348.3	1,450.3	1,438.5	0.9%	-0.8%
United Kingdom	793.6	832.3	937.3	939.0	1,024.8	7.3%	9.1%
United States	710.8	547.7	660.2	718.2	772.0	2.2%	7.5%
Brazil	556.8	890.2	827.9	239.0	299.4	-11.6%	25.3%
<b>Ebitda - Wholesale and Retail (liberalised)</b>	<b>2,445.3</b>	<b>2,270.7</b>	<b>2,355.2</b>	<b>1,986.6</b>	<b>2,292.2</b>	<b>-1.6%</b>	<b>15.4%</b>
Spain	1,483.1	1,570.7	1,605.4	1,341.2	1,517.6	0.6%	13.2%
United Kingdom	538.6	322.5	360.6	320.4	456.6	-3.8%	42.5%
United States	15.8	15.6	9.1	-22.6	-32.0	-75.6%	41.6%
Mexico	406.8	361.9	380.1	347.6	350.0	-3.5%	0.7%
<b>Ebitda - Renewables</b>	<b>1,455.7</b>	<b>1,423.9</b>	<b>1,620.3</b>	<b>1,501.1</b>	<b>1,326.0</b>	<b>-2.2%</b>	<b>-11.7%</b>
Spain	758.2	668.1	804.3	668.4	420.6	-11.1%	-37.1%
United Kingdom	111.3	173.9	168.1	231.8	265.2	34.6%	14.4%
United States	449.8	417.5	412.2	448.0	495.3	2.5%	10.6%
Mexico	12.0	13.7	37.2	34.1	38.2	54.6%	12.0%
Brazil	7.8	12.9	11.3	9.1	33.0	80.8%	262.6%
Other	116.6	137.8	187.2	109.7	73.7	-9.2%	-32.8%
<b>Ebitda - Other businesses</b>	<b>201.2</b>	<b>168.6</b>	<b>44.3</b>	<b>0.5</b>	<b>-17.0</b>	<b>-27.1%</b>	<b>-3,500%</b>
<b>Ebitda - Corporation and adjustments</b>	<b>-25.1%</b>	<b>-38.1</b>	<b>-66.9</b>	<b>-77.8</b>	<b>-171.4</b>	<b>145.7%</b>	<b>120.3%</b>
<b>Amortisation charge, provisions, and other</b>	<b>-2,698.2</b>	<b>-3,145.4</b>	<b>-3,349.7</b>	<b>-4,537.5</b>	<b>-3,023.6</b>	<b>3.0%</b>	<b>-33.4%</b>
Operating profit (EBIT)	4,829.7	4,505.1	4,376.9	2,219.5	3,940.9	-4.6%	77.6%
<b>Financial result</b>	<b>-1,287.9</b>	<b>-1,061.9</b>	<b>-1,100.3</b>	<b>-1,277.9</b>	<b>-1,122.4</b>	<b>-3.2%</b>	<b>-12.2%</b>
Results from companies accounted for using the equity method	27.4	-34.5	-187.5	205.0	135.4	98.5%	-34.0%
<b>Gains on non-current assets</b>	<b>271.8</b>	<b>45.8</b>	<b>-13.9</b>	<b>-10.4</b>	<b>247.9</b>	<b>-2.2%</b>	<b>-248.3%</b>
Profit before tax (EBT)	3,841.0	3,454.4	3,075.1	1,136.1	3,201.8	-4.2%	181.8%
<b>Corporate tax</b>	<b>-899.3%</b>	<b>-549.2</b>	<b>-206.5</b>	<b>1,466.7</b>	<b>-837.1</b>	<b>-1.7%</b>	<b>-157.1%</b>
Non-controlling interests	-70.8	-100.7	-27.9	-31.0	-38.2	-11.5%	23.2%
<b>Net attributable profit</b>	<b>2,870.9</b>	<b>2,804.5</b>	<b>2,840.7</b>	<b>2,571.8</b>	<b>2,326.5</b>	<b>-4.7%</b>	<b>-9.5%</b>
Total assets	93,701.0	97,016.5	96,816.4	89,786.8	93,771.4	0.0%	4.4%
<b>Equity</b>	<b>31,663.1</b>	<b>33,207.8</b>	<b>34,084.8</b>	<b>35,288.6</b>	<b>35,790.5</b>	<b>3.3%</b>	<b>1.4%</b>
Net investments	5,099.0	4,002.0	3,259.0	3,053.0	2,848.0	-11.0%	-6.8%
<b>Operating cash flow (FFO)</b>	<b>5,468</b>	<b>6,047</b>	<b>6,196</b>	<b>5,619</b>	<b>5,459</b>	<b>0.0%</b>	<b>-2.8%</b>
Net financial debt	30,014.8	31,705.7	30,324.4	26,836.3	25,618.4	-3.7%	-4.5%

Financial ratios	2010	2011	2012	2013	2014	Δ Annual average 2010-14	Δ 2010-14
<b>Ebitda - Outside eurozone (%)</b>	<b>47.1</b>	<b>48.3</b>	<b>51.0</b>	<b>49.5</b>	<b>54.0</b>	<b>3.7%</b>	<b>9.1%</b>
Ebitda margin (Ebitda/sales) (%)	24.7	24.2	22.6	21.7	23.2	-1.5%	6.9%
<b>Net profit margin (Net Profit/Sales) (%)</b>	<b>9.4</b>	<b>8.9</b>	<b>8.3</b>	<b>8.3</b>	<b>7.7</b>	<b>-4.5%</b>	<b>-7.2%</b>
NOE/Gross margin (%)	29.1	29.2	30.1	29.4	29.8	0.6%	1.4%
<b>Net financial debt/ebitda (multiple)</b>	<b>3.99</b>	<b>4.14</b>	<b>3.92</b>	<b>3.97</b>	<b>3.68</b>	<b>-1.9%</b>	<b>-7.3%</b>
Financial leverage (%)	48.7	48.8	47.1	43.2	41.7	-3.6%	-3.7%
<b>Funds from operations (FFO)/Net financial debt (NFD)</b>	<b>18.6</b>	<b>19.1</b>	<b>20.4</b>	<b>20.8</b>	<b>21.3</b>	<b>3.7%</b>	<b>2.4%</b>
Retained cash flow (RCF)/NFD (%)	20.1	17.2	17.2	17.5	17.4	-3.4%	-0.6%
<b>Return on equity (ROE) (%)</b>	<b>9.5</b>	<b>8.6</b>	<b>8.3</b>	<b>7.5</b>	<b>6.6</b>	<b>-7.6%</b>	<b>-12.0%</b>

Stock market performance	2010	2011	2012	2013	2014	Δ Annual average 2010-14	Δ 2010-14
Stock market capitalisation (€M)	31,631	28,465	25,753	28,922	35,756	3.3%	23.8%
Number of shares at year-end (millions)	5,484	5,882	6,139	6,240	6,388	4.1%	2.4%
Share price (€)	5.77	4.84	4.20	4.63	5.60	-0.7%	20.9%
Earnings per share (EPS)	0.52	0.47	0.45	0.41	0.36	-7.7%	-12.2%
Dividend per share (DPS)	0.34	0.34	0.34	0.31	0.27	-4.8%	-11.3%
Dividend yield (%)	5.93	6.96	8.13	6.65	4.91	-4.3%	-26.2%
Total dividend (including payment in kind) (€M)	1,859	1,982	2,093	1,922	1,685	-24.8%	-99.1%
Payout ratio (%)	65.2	71.1	65.4	65.5	75.0	3.8%	14.5%
Price/net earning per share (PER)	11.02	10.10	9.31	11.25	15.37	9.9%	36.6%

- ⊙ Sustainability report
- ⊙ Quarterly results report
- ⊙ Consolidated financial statements

\* Note: Due to legal requirements, Iberdrola has applied international financial reporting standard IFRS-11 to the financial information for the financial years 2013 and 2014, which aspect should be taken into account in evaluating the historical performance of the Company.

Operating performance	2010	2011	2012	2013	2014	Δ Annual average 2010-14	Δ 2013-14
<b>Installed Capacity (MW)</b>	<b>45,454</b>	<b>46,918</b>	<b>46,950</b>	<b>44,992</b>	<b>45,089</b>	<b>-0.2%</b>	<b>0.2%</b>
Net output (GWh)	158,858	151,050	139,932	136,435	138,892	-3.1 %	1.8%
<b>Electrical power distributed (GWh)</b>	<b>200,239</b>	<b>204,843</b>	<b>214,042</b>	<b>214,873</b>	<b>214,613</b>	<b>1.8%</b>	<b>-0.1%</b>
Environmental performance	2010	2011	2012	2013	2014	Δ Annual average 2010-14	Δ 2013-14
<b>Emission-free installed capacity (%)</b>	<b>57.3</b>	<b>58.2</b>	<b>59.4</b>	<b>61.2</b>	<b>61.9</b>	<b>0.4%</b>	<b>1.6%</b>
Renewable energy installed capacity (%)	27.9	29.7%	30.5	31.6	32.5	1.6%	6.5%
<b>Emission-free production (%)</b>	<b>47.8</b>	<b>48.8</b>	<b>51.9</b>	<b>54.6</b>	<b>56.8</b>	<b>0.5%</b>	<b>2.1%</b>
Renewable energy production (%)	16.5	19.8	23.6	24.9	24.4	5.0%	20.0%
<b>Specific CO<sub>2</sub> emissions (t/GWh)</b>	<b>258</b>	<b>248</b>	<b>264</b>	<b>226</b>	<b>212</b>	<b>-1.0%</b>	<b>-3.9%</b>
Fuel consumption (M Tep)	21,994	20,172	19,236	18,968	18,849	-2.1%	-8.3%
<b>Environmental investments (€M)</b>	<b>142.4</b>	<b>1,297.6</b>	<b>1,062.4</b>	<b>1,015.7</b>	<b>1,100.9</b>	<b>202.8%</b>	<b>811.2%</b>
Environmental expenses (€M)	149.7	261.3	723.3	686.4	635.7	18.6 %	74.5 %
<b>Energy produced under certified environmental management systems (%)</b>	<b>88.7</b>	<b>87.6</b>	<b>85.2</b>	<b>84.4</b>	<b>85</b>	<b>-0.3%</b>	<b>-1.2%</b>
Water use/overall production (m <sup>3</sup> /GWh)	645	620	699	976	509	-1.0%	-3.9%
<b>Direct CO<sub>2</sub> emissions. Scope 1 (kt)</b>	<b>39,939</b>	<b>36,193</b>	<b>35,461</b>	<b>31,846</b>	<b>30,217</b>	<b>-2.3%</b>	<b>-9.4%</b>
Indirect CO <sub>2</sub> emissions. Scope 2 (kt)	1,358	1,156	2,122	997	1,544	-3.7%	-14.9%
<b>CO<sub>2</sub> avoided due to efficiency initiatives (kt)</b>	<b>25,188</b>	<b>37,462</b>	<b>24,014</b>	<b>18,480</b>	<b>21,459</b>	<b>12.2%</b>	<b>48.7%</b>
SO <sub>2</sub> emissions (t/GWh)	0.397	0.295	0.366	0.219	0.154	-6.4%	-25.7%
<b>NO<sub>x</sub> emissions (t/GWh)</b>	<b>0.302</b>	<b>0.276</b>	<b>0.334</b>	<b>0.262</b>	<b>0.236</b>	<b>-2.2%</b>	<b>-8.6%</b>

- ⊙ Iberdrola's primary businesses / page 36
- ⊙ Our assets / page 54
- ⊙ About this report / page 82

Social performance	2010	2011	2012	2013	2014	Δ Annual average 2010-14	Δ 2010-14
<b>Users (millions)</b>	<b>29.3</b>	<b>30.7</b>	<b>31.7</b>	<b>32.1</b>	<b>32.6</b>	<b>2.8%</b>	<b>1.7%</b>
Electrical power	25.8	27.5	28.1	28.5	29.0	3.1%	1.8%
Spain	10.6	10.8	10.9	10.9	10.9	0.7%	0.4%
United Kingdom	3.3	3.2	3.5	3.5	3.5	1.5%	0.3%
United States	1.8	1.9	1.8	1.8	1.8	0.0%	0.0%
Latin America	10.1	11.7	11.9	12.4	12.8	6.7%	3.2%
Gas	3.5	3.3	3.6	3.6	3.6	0.9%	1.4%
Spain	0.6	0.8	0.8	0.8	0.8	8.3%	2.4%
United Kingdom	2.0	2.0	2.2	2.2	2.2	2.5%	0.0%
United States	0.9	0.6	0.6	0.6	0.6	-8.3%	0.0%
<b>Number of employees</b>	<b>29,641</b>	<b>32,809</b>	<b>30,744</b>	<b>30,532</b>	<b>29,597</b>	<b>0.0%</b>	<b>-3.1%</b>
Permanent contracts (%)	98.0	98.0	98.0	98.5	98.5	0.1%	0.0%
<b>Employees with collective bargaining agreement (%)</b>	<b>80.0</b>	<b>81.2</b>	<b>79.8</b>	<b>79.4</b>	<b>79.0</b>	<b>-0.3%</b>	<b>1.3%</b>
Employee turnover (%)	12.4	6.2	10.6	6.6	8.6	-7.7%	30.2%
<b>Diversity (men/women)</b>	<b>75/25</b>	<b>77/23</b>	<b>76/24</b>	<b>76/24</b>	<b>77/23</b>	<b>N/A</b>	<b>N/A</b>
Ratio between basic entry level wage and local minimum wage (%)	143	162	151	154	161	3.2%	6.0%
<b>Incident rate (IR)</b>	<b>0.65</b>	<b>0.46</b>	<b>0.34</b>	<b>0.46</b>	<b>0.39</b>	<b>-10.0%</b>	<b>-15.2%</b>
Hours of training (millions of hours)	1.02	1.25	1.12	1.2	1.0	0.2%	-14.2%
<b>Hours of training per employee (h)</b>	<b>35.9</b>	<b>47.1</b>	<b>44.2</b>	<b>44.7</b>	<b>38.7</b>	<b>1.9%</b>	<b>-13.4%</b>
Funds for social development (€M)	88.1	116.2	51.7	91.7	65.0	-6.6%	-29.1%
<b>Contributions to society (€M)</b>	<b>32.6</b>	<b>34.7</b>	<b>37.7</b>	<b>31.6</b>	<b>34.0</b>	<b>1.1%</b>	<b>7.5%</b>
Rural electrification programmes (€M)	55.4	81.5	14	60	31	-11.0%	-48.4%
<b>Investments in R&amp;D+i (€M)</b>	<b>130</b>	<b>136</b>	<b>145</b>	<b>159</b>	<b>170</b>	<b>7.7%</b>	<b>6.8%</b>
General procurement (€M invoiced)	5,893	5,322	4,830	4,359	4,599	-2.1%	24.1%
<b>Procurement from qualified suppliers (%)</b>	<b>98</b>	<b>78</b>	<b>84</b>	<b>87</b>	<b>92</b>	<b>-1.5%</b>	<b>6.3%</b>
Number of suppliers with social responsibility standards	187	1,078	1,233	1,202	1,326	152.3%	10.3%
<b>Procurement in sensitive countries per ILO (%)</b>	<b>N/Av.</b>	<b>9.9</b>	<b>8.9</b>	<b>12.0</b>	<b>10.7</b>	<b>N/A</b>	<b>-10.8%</b>
Procurement from local suppliers (%)	92	91	90	86	87	-1.4%	1.2%





Installation of one of the 108 wind turbines at  
the West of Duddon Sands Offshore Wind Farm /  
United Kingdom



# 1.4 Presence by areas of activity

## Iberdrola in Spain Leading energy company.

2013 / 2014

**GDP 1.4%**

**Electricity demand -1.2%**

2014 Data

**25,283**

MW Installed capacity

**6,109**

MW Renewable installed capacity

**61,052**

GWh Net output

**90,729**

GWh Electric power distributed

**266,024**

Km Power lines

**11.7**

Millions of users

**10,975**

Employees

**520**

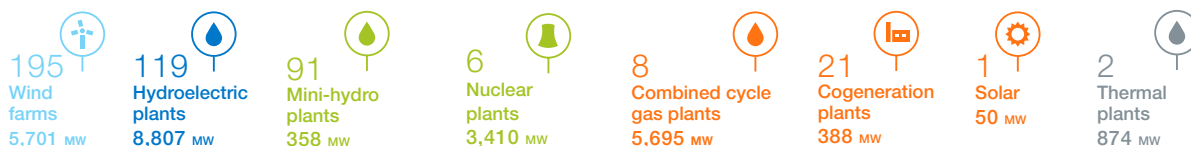
€M Investments

**3,292**

€M Direct tax contribution



## Primary facilities



Wholesale and Retail



Distribution



Engineering and Construction

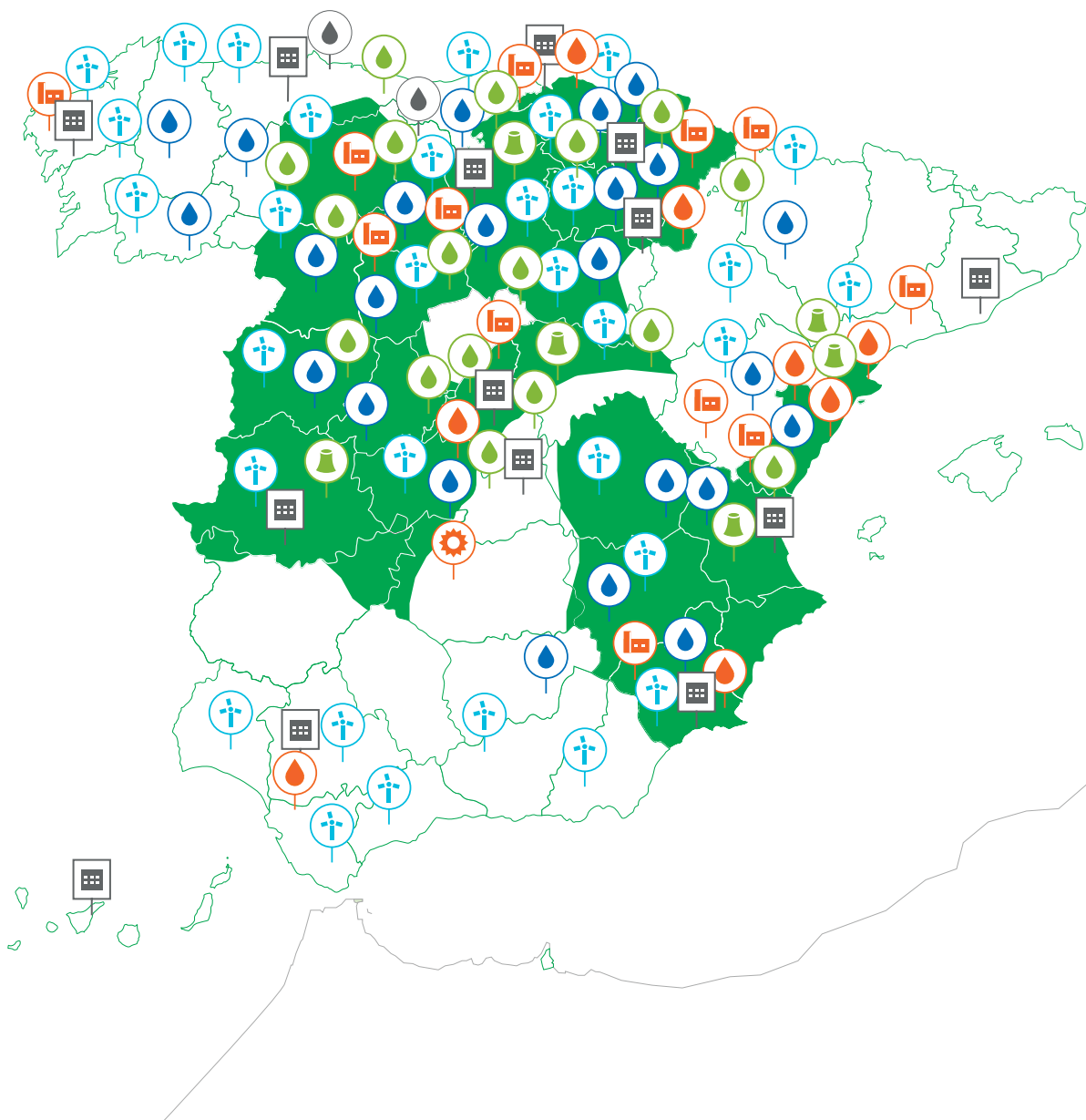


Property Development



Foundation





# Iberdrola in the United Kingdom

## Leading wind producer.

## Third-leading network company.

2013 / 2014

**GDP +2.6%**

**Electricity demand -6.1%**

### 2014 Data

**6,462**

MW Installed capacity

**1,627**

MW Renewable installed capacity

**18,920**

GWh Net output

**36,539**

GWh Electric power distributed

**104,078**

Km Power lines

**5.7**

Millions of users

**6,856**

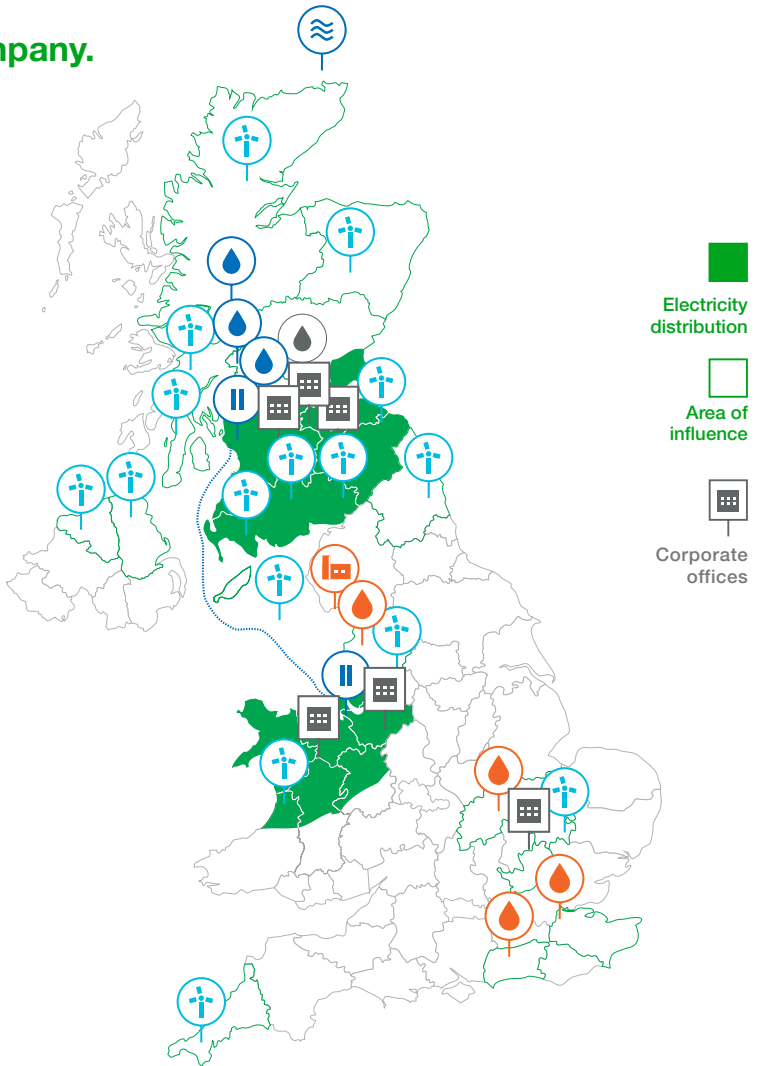
Employees

**1,301**

€M Investments

**454**

€M Direct tax contribution



### Primary facilities

**32**  
Wind  
farms  
1,626 MW

**3**  
Hydroelectric  
plants  
563 MW

**1**  
Underwater power line  
(under construction)  
418 KM

**1**  
Marine energy  
1 MW

**1**  
Cogeneration  
plant  
1 MW

**4**  
Combined cycle  
gas plants  
1,967 MW

**1**  
Thermal  
plant  
2,304 MW

### Corporate



### Distribution



### Renewables



### Engineering and Construction



### Foundation



# Iberdrola in the United States

## Second-leading wind producer.

## Third-leading gas storage company.

## Electricity and gas distributor in New York and Maine.

2013 / 2014

GDP +2.4%

Electricity demand -2.6%

2014 Data

6,479

MW Installed capacity

5,695

MW Renewable installed capacity

17,549

GWh Net output

33,335

GWh Electric power distributed

107,098

Km Power lines

2.4

Millions of users

2.4

BCM Gas storage capacity

5,057

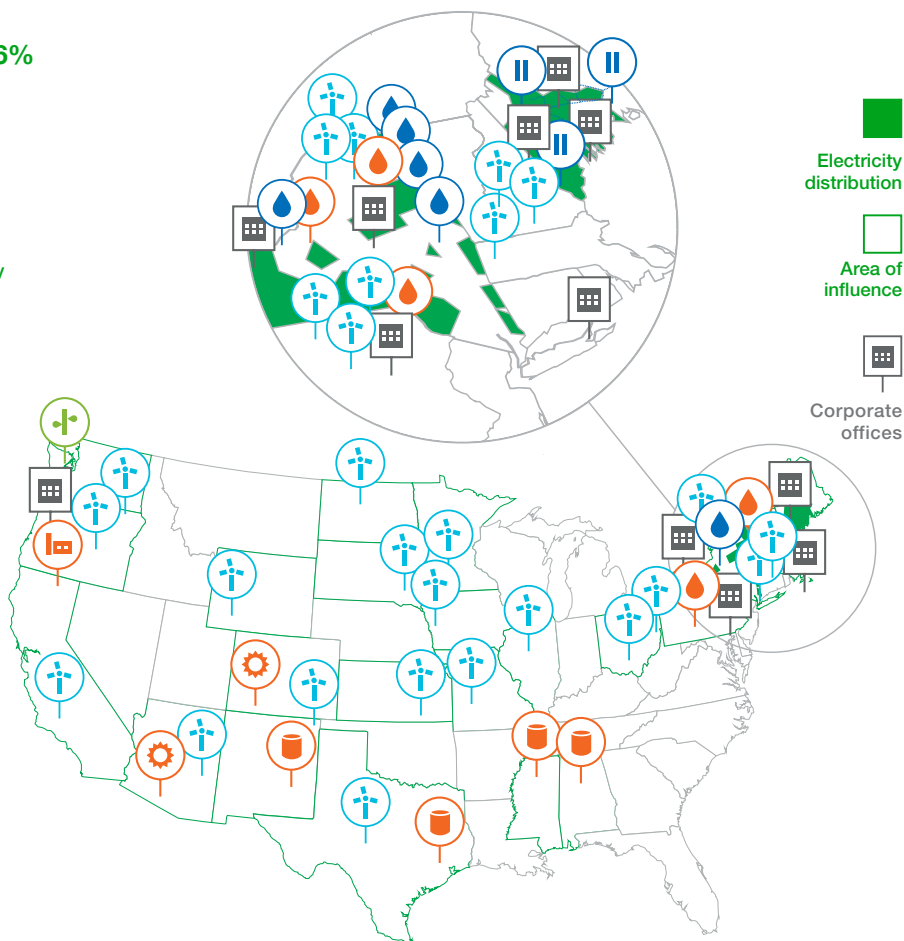
Employees

673

€M Investments

459

€M Direct tax contribution



### Primary facilities

54  
Wind farms  
5,590 MW

9  
Hydroelectric plants  
118 MW

1  
Transmission line (under construction)  
708 KM

1  
Biomass plant  
55 MW

1  
Cogeneration plant  
636 MW

3  
Combined cycle gas plants  
30 MW

2  
Photovoltaic plants  
50 MW

4  
Gas storage

#### Corporate



#### Renewables



#### Distribution and Retail



#### Engineering and construction



#### Gas storage



# Iberdrola in Mexico

## Leading private electricity producer.

2013 / 2014

GDP +2.1%

Electricity demand +1.5%

### 2014 Data

5,259

MW Installed capacity

231

MW Renewable installed capacity

35,928

GWh Net output

736

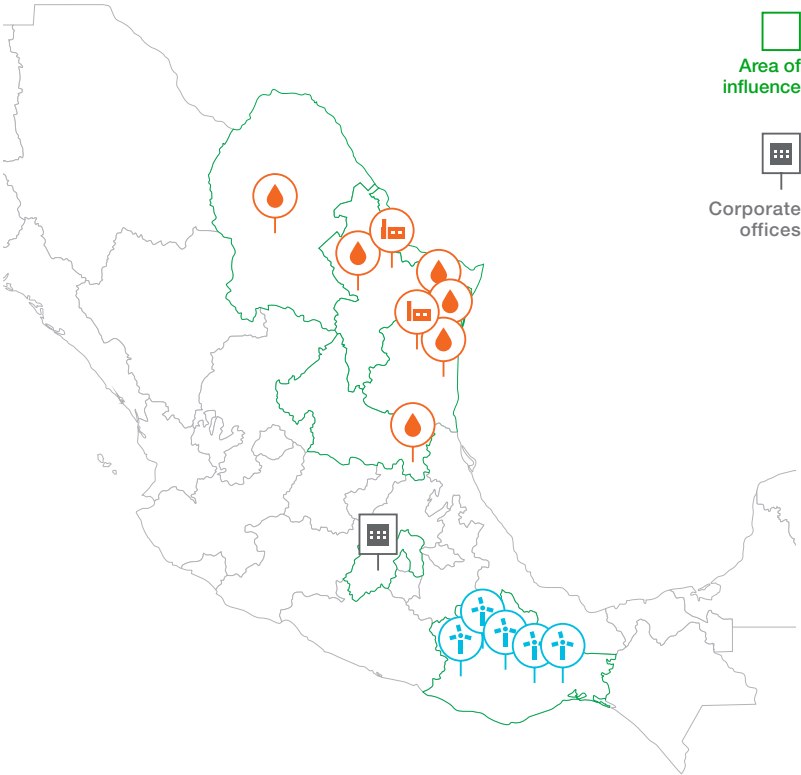
Employees

233

€M Investments

184

€M Direct tax contribution



### Primary facilities

5  
Wind  
farms  
231 MW

2  
Cogeneration  
plants  
201 MW

6  
Combined cycle  
gas plants  
4,827 MW

### Wholesale



### Engineering and Construction



# Iberdrola in Brazil

## Leading distributor in Brazil by number of customers.

2013 / 2014

GDP +0.1%

Electricity demand +2.3%

### 2014 Data

862

MW Installed capacity

245.5

MW Renewable installed capacity

3,987

GWh Net output

54,010

GWh Electric power distributed

556,949

Km Power lines

12.8

Millions of users

5,818

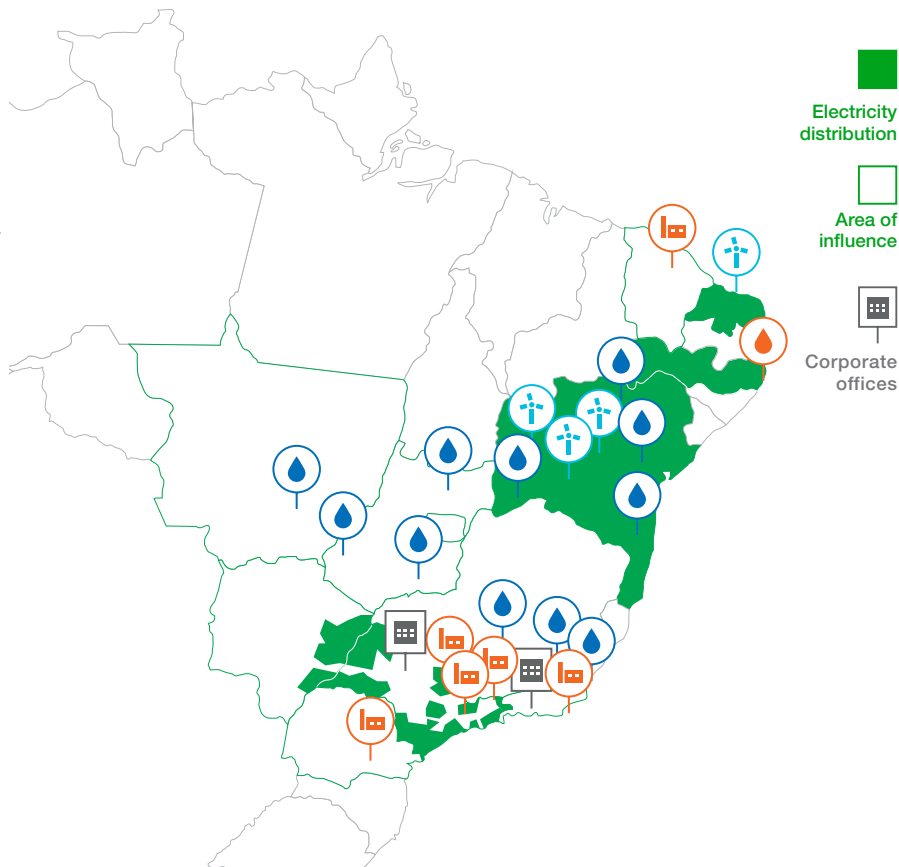
Employees

96

€M Investments

1,009

€M Direct tax contribution



### Primary facilities

11  
Wind farms  
246 MW

11  
Hydroelectric plants  
381 MW

6  
Cogeneration plants  
32 MW

1  
Combined cycle gas plant  
203 MW

#### Distribution



#### Supply



#### Engineering and Construction



#### Renewables



#### Social Causes



# Business model and strategy

Working on the Alzira-Gandia Line / Spain



# 2

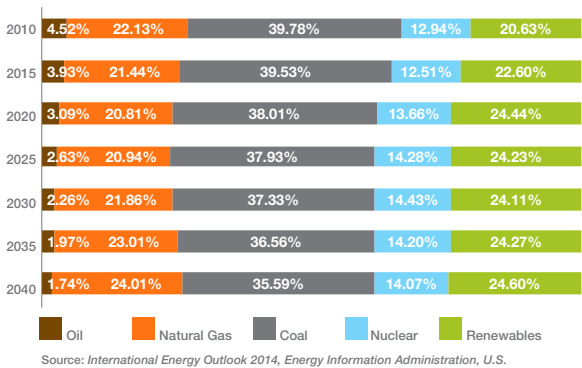


# 2.1 The future of energy

## Opportunities for continued growth

The energy sector will present various opportunities for growth over the long term.

Sources of energy for global electricity generation, 2010-2040 (TWh)



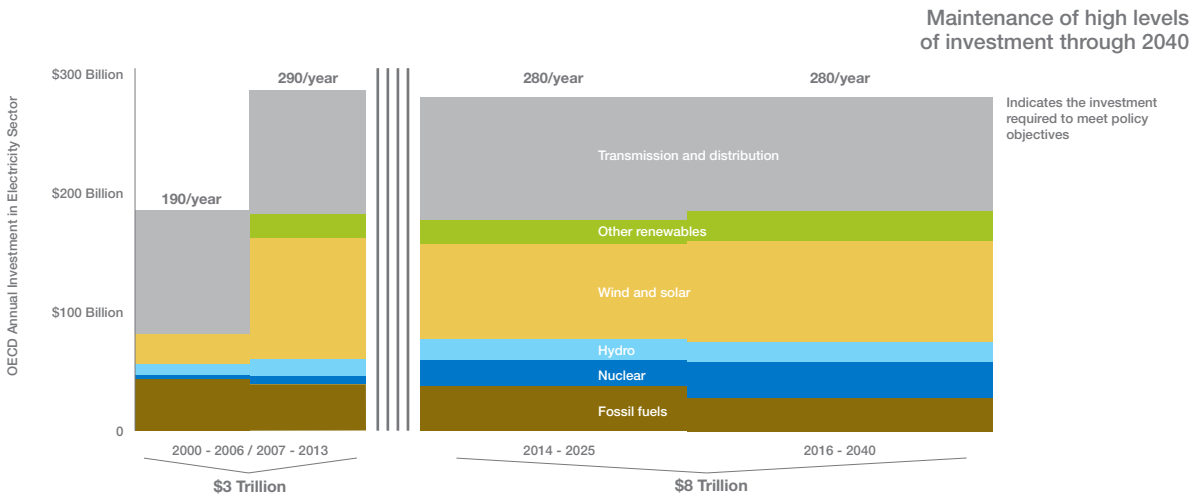
“One of the foremost challenges facing the energy sector in the coming years will be to secure the enormous resources required to finance vital investments”.

Ignacio Galán, at the *World Economic Forum 2015*.

## “The Future of Electricity”, according to the *WORLD ECONOMIC FORUM 2015*

The electricity sector is immersed in a process of transition characterised by:

- A significant reduction in the cost of renewable technologies, combined with new sources of natural gas. This offers the opportunity to “decarbonise” the sector, increase energy security, and reduce dependence on the import of fuel.
- Heavy investment by the OECD countries, reaching 3 trillion dollars since 2000, in new renewable and conventional energy plants, the transmission and distribution of energy, and the development of energy efficiency measures. Another 8 trillion dollars will be necessary during the 2014-2040 period.
- Improvement in the reduction of carbon intensity per unit generated and increase in energy security through the reduction in imports of fossil fuels.

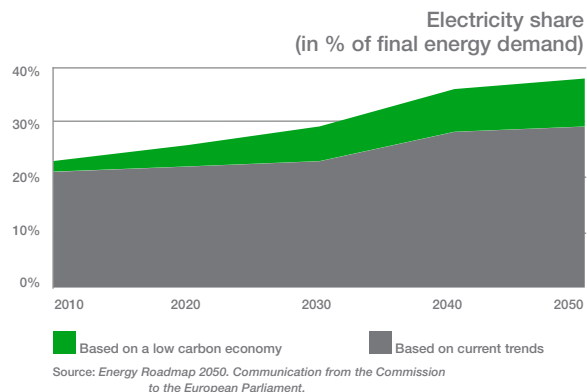


Source: *The Future of Electricity Report*, World Economic Forum 2015.

## Evolution of demand

Within the current context, it is expected that energy consumption will evolve in the coming years following the GDP trend in each region. According to a PwC report, average annual GDP growth in the Atlantic area where Iberdrola operates will be positive through 2050.

The EU Roadmap forecasts that electricity will at least double its share in final energy demand to 36-39 percent in 2050, for which reason it would reduce carbon emissions in heating systems and in the transport sector (electricity could satisfy about 65% of demand from automobiles and light duty vehicles).



**Average annual GDP growth in the Atlantic area where Iberdrola operates will be positive through 2050.**

## Trends in production and use of electricity

### Sectoral<sup>1</sup>

- The electricity sector is leading the transformation of global energy. According to *World Energy Investment Outlook 2014*, the electricity sector contributes more than any other to reducing the proportion of fossil fuels in the energy mix.
- The transition towards a low-emission economy due to the global drive towards a reduction in greenhouse gases (GHG). The OECD forecasts that global GHG emissions will increase by 50% due to a 70% increase in CO<sub>2</sub> emissions relating to power generation.
- Unsustainable pressure on natural resources. A world economy four times larger than today is projected to use 80% more energy in 2050. Without more effective policies to improve the panorama of unsustainable pressure on natural resources, the share of fossil-fuel based energy in the global energy consumption will still remain at about 85%.

### Technological<sup>2,3</sup>

- Technological advances and an improvement in efficiency are grounds for optimism, but constant political efforts are essential to change energy trends for the better.
- Smart grids will introduce home automation to network management and electricity demand management, improving process efficiency.
- Technological developments, such as new renewable energies and advances in distributed generation, can change the current model of the electricity markets.
- Electricity storage, as a still-embryonic technological possibility, can open up new vistas for the operation and management of power systems.
- Technological progress as a path toward reducing emissions, both in obtaining fuels and in producing electricity and managing its use.

### Consumption

- Universal access to energy, as an element to improve well-being. *“World electricity demand will grow by 80% over the next 30 years driven by improved efficiency and the expansion of service to the 1.3 billion people who still do not have access to power”.* Ignacio Galán.
- The development of new uses and applications for electricity may result in new markets and opportunities: electric vehicles, robotics in the use of electricity, etc.

<sup>1</sup> Source: “OECD Environmental Outlook to 2050”;

<sup>2</sup> Source: “Energy Roadmap 2050”;

<sup>3</sup> Source: *World Energy Investment Outlook* (2014).

## 2.2 Business model

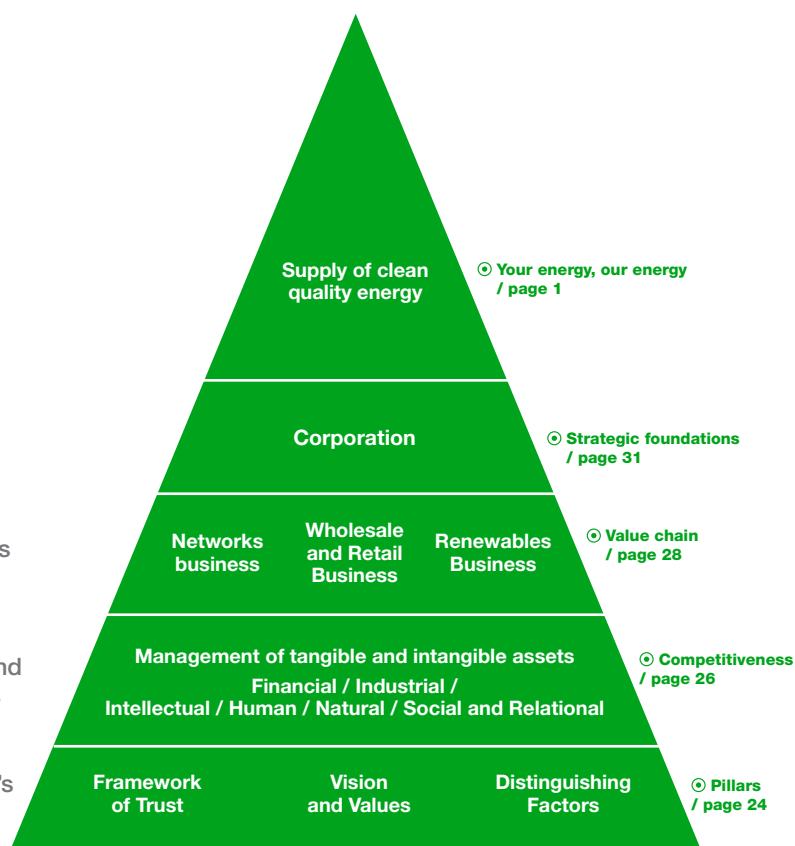
The purpose of the business model defined for the Iberdrola Group is the “supply of reliable, high-quality and environmentally-friendly energy”, through a sustainable, long-term industrial enterprise.

The model is built on three pillars: a **framework of trust** based on an advanced governance model; the Group’s **vision and values**

approved by its management units; and the **distinguishing factors** that make Iberdrola a different company.

The model’s competitiveness is achieved through **responsible management of the tangible and intangible assets** of the Company.

To apply this model, Iberdrola has defined the activities in which it seeks to be an active player, the **value chain**, structuring its management into three global businesses: the Networks Business; the Wholesale and Retail Business; and the Renewables Business, with a Corporation as the Group’s central management unit. The Corporation develops the Group’s strategy and oversees its execution.



### Framework of trust

To ensure the sustainability of its business model, Iberdrola has implemented:

- A Corporate Governance System consistent with best global practices.
- Corporate ethics, internalised by the management units and the organisation as a whole.
- *Social Responsibility Policies, with a view to meeting the expectations of stakeholders.*
- Advanced risk control, to maintain an optimal “risk/opportunity” balance, taking advantage of opportunities and mitigating risks.

### Vision and values

*“We aspire to be the preferred global energy company because of our commitment to the creation of value, quality of life, the safety of people and of supply, the protection of the environment, and customer focus”.*

The Group’s vision is based on six values:

- Corporate ethics and responsibility.
- Financial results.
- Respect for the environment.
- Sense of belonging and trust.
- Safety and reliability.
- Customer focus.

## 2.3 Iberdrola, a different company

◎ Main businesses of Iberdrola  
/ page 36

◎ Presence by areas of activity  
/ page 14

◎ Natural capital  
/ page 64

### Focus on basic and regulated businesses

Approximately 75% of Ebitda comes from regulated businesses.

### International diversification

Approximately 55% of earnings are generated outside of Spain.

### Commitment to clean and competitive energies

- Generation and production of largely emission-free electricity.
- Large portfolio of offshore wind generation projects and wave and tidal power projects.
- Clear goals for reducing emissions.

### Operational efficiency

In a comparative analysis of six European companies in the sector, according to a study by Ernst&Young, Iberdrola leads in three efficiency variables: net operating expenses over gross margin, workforce per unit of installed power, and workforce per number of users.

### Financial strength and solidity of the group

- Strengthening of the balance sheet by reducing debt and improving solvency ratios.
- Liquidity position that covers financial needs for more than 30 months, even under stress scenarios.

### Global, committed and qualified workforce

- Stable and high-quality jobs, with high level of training.
- Health and safety as values: “accident reduction” goal.
- Group companies in Spain and Brazil are considered best places to work in their sector, by Merco and *Guia Você*.

◎ Iberdrola's primary businesses  
/ page 36

◎ Financial capital  
/ page 56

◎ Human capital  
/ page 62

## 2.4 Management of tangible and intangible assets

© Financial capital  
/ page 56

© Manufactured capital  
/ page 58

© Intellectual capital  
/ page 60

### Financial capital

### Manufactured capital

### Intellectual capital

#### What is it?

Economic resources the company holds or obtains through financing.

Tangible assets or goods used by the Company to carry out its activities.

Intangible, knowledge-based assets.

#### Management approach

*To create value for shareholders through sustainable growth.*

*To offer a competitive supply of energy in a safe and reliable environment.*

*To consider innovation as a strategic element of the Company.*

#### Significant assets

- Sound financial structure.
- Operational efficiency.
- Monitoring of investments.
- Sustainable results and dividends.

- Power generation assets.
- Power transmission and distribution assets.
- Other assets.

- Promotion of R&D+i.
- Efficiency and new products and services.
- Disruptive technologies and business models.

The Iberdrola Group holds valuable assets for the development of its business model. The strategy defined by the Company transforms these assets to create value for all its stakeholders.

⦿ Human capital  
/ page 62

⦿ Natural capital  
/ page 64

⦿ Social and relational capital  
/ page 66

## Human capital

Employee knowledge, skills, experience and motivation.

*To guarantee the availability of a committed and qualified workforce.*

- Global human resources management.
- Goal of “accident reduction”.
- Talent management.
- Diversity, equal opportunity, and reconciliation.

## Natural capital

Natural resources affected by the Company’s activities.

*To ensure sustainable use of natural resources and contribute to combating climate change.*

- Environmental management.
- Preservation of biodiversity.
- Prevention of pollution.
- Operating excellence and energy efficiency.
- Waste management.

## Social and relational capital

Ability to share, relate, and collaborate with its stakeholders, promoting community development and well-being.

*To promote relations of trust with stakeholders, improving the quality of life of people in areas where the Group has a presence.*

- Stakeholder relations.
- Community support and electricity access programmes.
- Foundations and non-profit associations linked to the Iberdrola Group.
- Corporate reputation.
- Reputation management.
- Informational transparency.

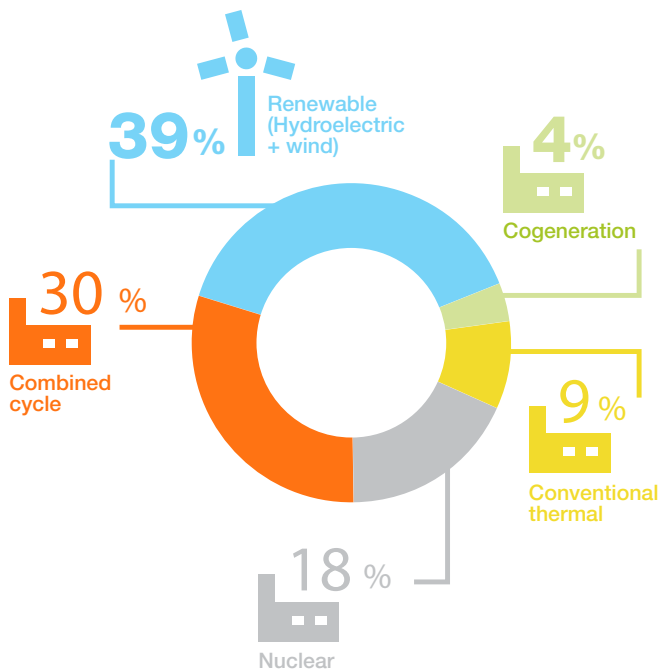
# 2.5 Value chain

## Power generation

Electricity production through the construction, operation, and maintenance of generating plants, and purchase/sale of energy on wholesale markets.

### Generating plants\*

\* % of 2014 net output



## Power transmission and distribution

Construction, operation, and maintenance of electrical lines, substations, transformer centres, and other infrastructure to transmit electric power from production centres to end users.

### Electricity networks\*

\* At 31 December 2014

#### Overhead lines



**4,000**  
High and medium voltage transformer substations

**29,446 Km**

Transmission lines



**846,281 Km**

Distribution lines



## Energy supply

Supply to end users of energy and additional products and services.

## Users\*

\* % by sector at 31 December 2014

### Underground lines



**1.4** million

Medium to low voltage distribution transformers

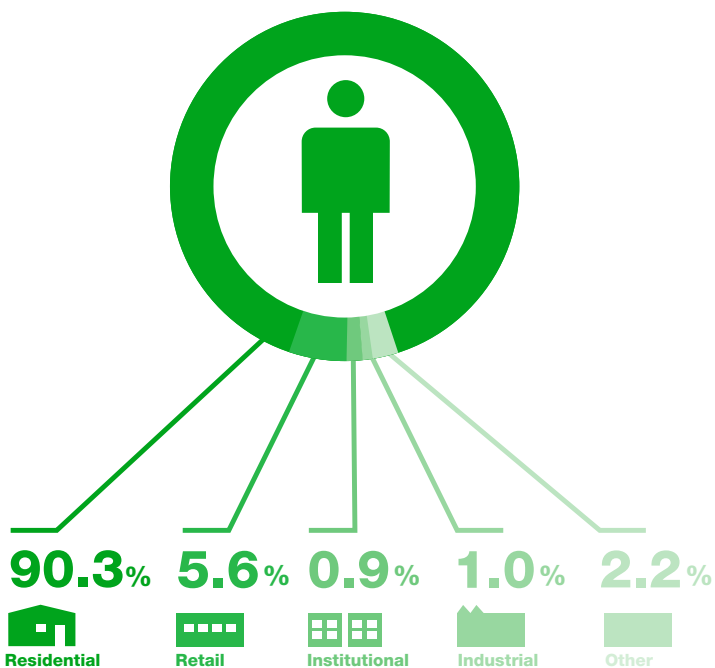
**960 Km**

Transmission lines



**187,868 Km**

Distribution lines



Almendra Dam,  
Salamanca / Spain



# 2.6 Strategic foundations for 2014-2016

## Market conditions

The global energy scenario is trending toward moderate growth in the medium and long terms, driven by the economic recovery. The Company has designed a strategy to address this scenario, with specific measures adapted to the particular needs of its areas of activity.

## Challenges and opportunities

### Challenges

- Management of a scenario involving slow recovery in the demand for electrical power.
- Attainment of higher efficiency levels in all businesses.
- Regulatory management in all businesses, with special emphasis on transmission and distribution businesses.
- Containment of financial expenses in an environment of potential increases in medium-term interest rates.

### Opportunities

- International diversification with a presence in countries with a stable and predictable regulatory framework.
- Balanced business model focused on regulated activities.
- High quality of assets.
- Culture of innovation, efficiency, and results.
- Proven management capacity.

**...maintaining a commitment of sustainable remuneration to shareholders.**

## Growth vectors 2014-2016

### Investments

- United Kingdom: Iberdrola is facing a period of expanding activity in energy transmission and distribution, as well as in onshore and offshore renewable energy projects.
- United States of America: The Company is facing growth in the networks area and in new onshore wind projects.

- Latin America: The Company will consolidate its position as the largest private generator of electricity in Mexico. In Brazil it anticipates a period of growth in hydroelectric capacity.
- Spain: Maintenance and improvement of facilities.

### Operational efficiency

- In all areas of activity.

**...with potential additional growth in EBITDA from improvements in market conditions and energy prices.**

## Beyond 2016 ...

- Projects undertaken in 2014-2016 will provide higher contribution to results.
- Additional investments in stable and attractive businesses and countries.
- Further efficiency measures: structural optimisation and additional headcount reduction.
- Portfolio management to explore new opportunities for growth.

**....to increase shareholder remuneration in line with results.**

## Strategic pillars

Iberdrola's strategy for 2014-2016 will be based on consolidating its financial strength, investing in regulated businesses, and continuing to implement efficiency improvements; thereby maintaining the same strategic pillars that enabled the successful navigation of the global economic and financial crisis.

### 1. Balanced risk profile

- Investments focused on businesses and countries with stable and predictable regulatory frameworks.
- Gross investment of €M 11,200, representing net investment of €M 9,600, with €M 4,400 focused on growth and the rest on maintenance and replacement.
- Electric power transmission and distribution networks will account for 57% of total net investments. Of the overall amount, 22% will be dedicated to renewable energy and 19% to generation.
- The regulated businesses (networks, renewables, and regulated generation) will account for 88% of all planned investments.
- Geographically, Iberdrola will concentrate most of its efforts in the United Kingdom (41%); followed by Latin America (24%) (mainly Mexico), the United States of America (17%), and Spain (15%).

### 2. Operational efficiency

- Continue implementing measures to promote savings and contain operating costs, with a view to improving efficiency and partially absorbing the effects of inflation and activity growth, on both personnel expenses and outside services:

#### Personnel

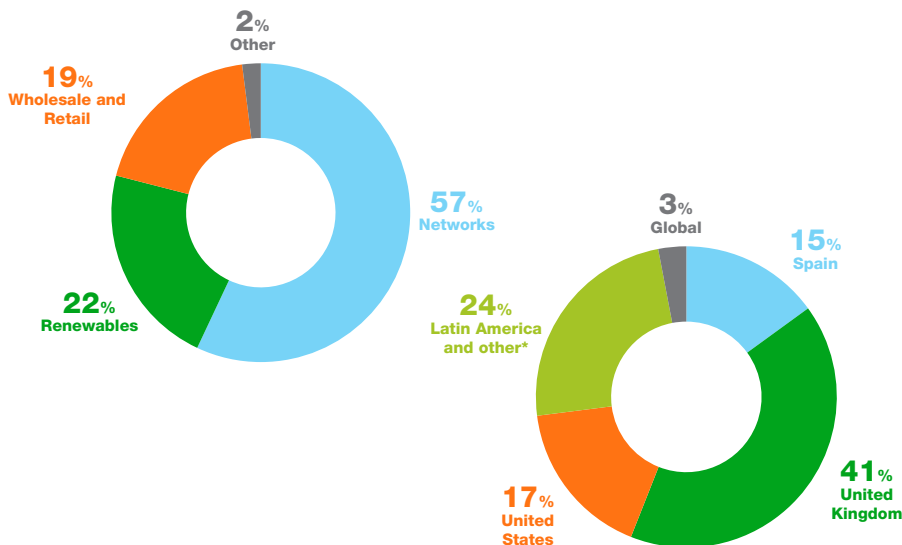
- Organic reduction of 1,000 employees in existing businesses.
- Approximately 27,000 employees by year-end 2016.

#### External services

- Optimisation of corporate structure.
- Procurement management.
- Process management.

**From 2014 to 2016, investments will be focused on companies with stable regulatory environments.**

Investment by businesses and by areas geographical 2014-2016



Financial capital  
/ page 56

\* Includes investments in Neoenergia.



### 3. Financial strength

- Net debt reduction of €M 1,800, down to €M 25,000 by year-end 2016.
  - Operating cash flow (FFO) exceeding investments across all businesses.
- Divestment of €M 500, in addition to the €M 2,000 in the divestment plan announced in 2012.
- Change in the financial model to provide subsidiaries with an optimal capital structure providing appropriate financial signals, in line with current guidelines for structural subordination.
- Optimisation of liquidity position (<€M 9,000) to current market conditions in order to improve financial costs, maintaining 24 months of coverage even during stress scenarios.
- Strengthening of financial ratios, with the following goals through 2016:
  - Leverage  $\approx$  40%.
  - Net debt/EBITDA <3.5.
  - FFO/Net debt >22%.

### Resulting in growth over the period and a sustainable shareholder remuneration policy.

- After the impact of fiscal and regulatory modifications in Spain, the Company estimated Ebitda of €M 6,600 and net profits of €M 2,300 for 2014, with subsequent average growth of 4% annually through 2016.
- Due to the good performance of the businesses, 2014 results were higher than initially forecast. Ebitda reached €M 6,965, with net profit of €M 2,327.
- In this scenario, the Group maintains the goal of providing its shareholders with an annual remuneration of at least €0.27 (gross) per share, which could increase based on profits, with a payout of between 65% and 75%.

€M	2014	Average annual growth* 2014-2016
Ebitda	6,965	4%
Net profit	2,327	4%

\* Average annual growth potential of 4% calculated based on initial results forecasts for 2014: €M 6,600 Ebitda and €M 2,300 net profit.

# 2.7 Comparative results and rewards

## Comparative analysis\*

### Comparative economic/financial variables 2014

#### Growth in EBITDA

CAGR (%)	Average comparables	Iberdrola
31-Dec.-04 / 31-Dec.-14	2.2%**	9.1%

#### Growth in Capitalisation

Total growth (%)	Average comparables	Iberdrola
31-Dec.-04 / 31-Dec.-14	-2.2%	112.1%

Iberdrola held 6th place at the European level in terms of stock market capitalisation for the last 10 years. It is now in third place.

#### Share price

Total growth (%)	Average comparables	Eurostoxx Utilities	Iberdrola
31-Dec.-04 / 31-Dec.-14	-32.0%	-7.1%	19.7%

\*Comparable companies analysed: GDF Suez, EDF, E.On, Enel, RWE. Uses a start date of 7 July 2005 for GDF-Suez (the date on which GDF commenced listing), and 18 November 2005 for EDF (the date of its IPO).

ACGR: Annual Compound Growth Rate, i.e. weighted average annual growth.

\*\*For GDF Suez, the 2004 figure is for Suez S.A. (prior to the merger of GDF and Suez SA).

### Comparative performance of total shareholder return

Profitability (%)	Average comparables	Eurostoxx Utilities	Iberdrola
31-Dec.-04 / 31-Dec.-14	20.9%	55.8%	83.3%

### Iberdrola's performance

Over the last 10 years, Iberdrola has quadrupled its assets, tripled its revenues, doubled its EBITDA and net profit, and increased shareholder remuneration by more than 40%, while maintaining its financial strength.

Iberdrola	31-Dec.-04	31-Dec.-14	Multiple
Assets (€M)	26,189	93,771	3.6x
Revenues (€M)	8,725	30,032	3.5x
EBITDA (€M)	2,913	6,965	2.4x
Net Profit (€M)	1,196	2,327	1.9x
Dividends (€/share)	0.19	0.27	1.4x
Net Debt/Ebitda	3.7	3.7	1.0x

© Other awards  
/ pages 63 and 79



Ignacio Galán  
at 10 Downing Street / London

## External awards

### For the Company:

- Best European Utility (Institutional Investor Research): 2014, 2013, 2011.
- Best Corporate Governance in Spain (World Finance): 2014, 2012.
- Best corporate governance among European utilities (Ethical Boardroom): 2014.
- World's Most Ethical Company Index (Ethispher Institute): 2014.
- Excellence in corporate governance (Institute of Directors, Golden Peacock Award): 2013.
- Leading Ibex 35 company in the tax transparency ranking 2014, from Fundación Compromiso y Transparencia.

### For the Chairman and CEO:

- Best European Utility CEO (Institutional Investor Research): 2014, 2013, 2011.
- Responsible Capitalism Award (First): 2014.
- Commander of the Most Excellent Order of the British Empire: 2014.
- Honorary Doctorate from the Universities of Salamanca (2011), Strathclyde (2013), and Edinburgh (2011).

### For other members of the Company:

- Best European Utility CFO (Institutional Investor Research): 2014, 2012.
- Best European Utility Investor Relations (Institutional Investor Research): 2014, 2013, 2012, 2011, and 2010.

# Iberdrola's primary businesses

**Regulation is a key factor in the sustainability of Iberdrola's activities.**

**Energy policies must set clear and predictable goals in order to attract the investment needed to guarantee a safe, competitive, and sustainable supply, developing its potential as a source of growth and employment.**

View of the West of Duddon Sands  
offshore complex with the substation in the  
foreground / United Kingdom



3



# 3.1 Regulatory environment

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## European Union

- Work continues on completing the internal market. Guidelines have been published to authorise state aid for renewables and back-up generation, preserving the internal market and price competitiveness to the extent possible.
  - There are various ongoing initiatives to drive the development of energy infrastructure, including a strengthening of interconnections in Spain and the United Kingdom.
  - A new energy and climate framework for 2030 has been approved that includes a goal to reduce CO<sub>2</sub> emissions by 40%, and others targeting a 27% increase in renewables and decrease in consumption. This new framework will give investors long-term signals for building infrastructure.
  - Initiatives are being promoted to strengthen and stabilise the signal on emissions trading, in order to promote the change towards low-emission technologies.
- 

## Spain

- Most of the regulatory steps on electricity and gas reform were already taken during 2013 and 2014, for which reason a tariff deficit is not expected for 2014.
  - An energy efficiency fund has been created by means of which all energies (electricity, gas, and gasolines) contribute in proportion to their demand to the costs of implementing the European goal of energy efficiency for 2020.
  - A regulated tariff applying to approximately 90% of consumers is maintained.
- 

## United Kingdom

- In April 2014 the Competition and Markets Authority (CMA) opened an investigation into the entire gas and electricity supply sector. Its conclusions and proposed remedies will be published at the end of 2015.
  - The Government's Energy Market Reform package, which mainly deals with the capacity market and the implementation of contracts for difference for low carbon energy, was mostly completed in 2014.
  - There will be work on reforming the wholesale market, for integration into the single European market.
-

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## Brazil

The unfavourable water situation is driving the use of more expensive thermal generation and an increase in energy prices on the spot market. A number of measures have been implemented to try to mitigate the effects of this situation:

- Provision of funds to mitigate the impact on distributors of involuntary exposure to the spot market.
  - Reduction in the maximum price of energy on the spot market, from R\$822/MWh to R\$388/MWh.
  - Use of tariff bands since the beginning of 2015, which are intended to signal the cost of generation to consumers. The tariff rises when more expensive sources of generation are used.
  - Approval at year-end 2014 of a modification in the concession agreements for distributors, allowing them to recognise regulatory assets and liabilities.
- 

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## United States and Canada

- The State of New York, along with other states, will continue to consider changes in the regulatory model for utilities, taking into account technological advances both in generation and distribution of electricity.
  - There is expected to be continuing debate on the establishment of an efficient and stable foundation for investment in renewable energy, influenced by the latest controversies over climate change and fracking.
  - The Environmental Protection Agency (EPA) expects to publish two independent regulations in 2015 proposing a reduction in CO<sub>2</sub> for the electricity generation sector that could have a considerable impact on decision-making for electric companies.
- 

## Mexico

- The new energy reform, the legislative development of which will continue during 2015, ends the state monopoly in the hydrocarbon and electricity sectors. In the electric sector, it will encourage investment in new generation projects that will operate in a competitive environment after the creation of various markets. The share of clean energy is forecast to increase to 35% by 2024 with the creation of a Clean Energy Certification system, based on which certain supply obligations will be determined. Furthermore, contracts with private parties will begin in the area of networks, which are still under state ownership and considered to be a public service.
-



Line inspections,  
Burgos / Spain

## 3.2 Networks

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### Regulatory environment of the business

#### Spain

- The transitional remuneration methodology approved in 2013 is being applied in 2014 and 2015.
  - Awaiting a complete definition of the new regulatory scheme, which is pending publication of the base unit costs.
- 

#### United Kingdom

- Transmission activity managed under the RIIO-T1 scheme in effect for the 2013-2021 period.
  - The current DPCR5 regulatory period ends in April 2015. In November 2014 Ofgem published a final determination for the new RIIO-ED1 2015-2023 period.
- 

**New tariff periods entered into force for ScottishPower in the United Kingdom and for Elektro in Brazil during 2015.**

#### United States

- In 2014 current tariff conditions were extended for distributors in New York.
  - A new rate agreement entered into force on July 2014 for CMP (Maine), which will be in effect for one year.
- 

#### Brazil

- The indicators to be used in the 4th cycle of the tariff revision for distributors will be determined in 2015.
  - Elektro's tariff agreement ends in August 2015, when the 4th tariff cycle will begin. In 2014, the annual tariff adjustment was 37.78%.
  - The tariff agreements for the distributors of Neoenergia are in force through April 2017 for Celpe and April 2018 for Coelba and Cosern. The annual tariff update for 2014 was 17.79% for Coelba, 15.35% for Cosern, and 12.75% for Celpe.
  - The Brazilian government has eliminated the impact on results and limited the impact of involuntary exposure to the spot market on the cash flow of the distributors.
-

## Objectives, risks and principal activities

### Objectives

- Satisfy supply under strict safety conditions, in compliance with environmental requirements.
- Increase quality in energy supply by investing in the expansion and renewal of networks, improvement of our processes, and use of the latest advances in technology.
- Maximise efficiency in system operations.
- Zero accidents.

### Significant risks

- Regulatory uncertainty.
- Safety of individuals from risk of accidents.
- Incidents with environmental impact.
- Major network incidents.
- Increased fraud.

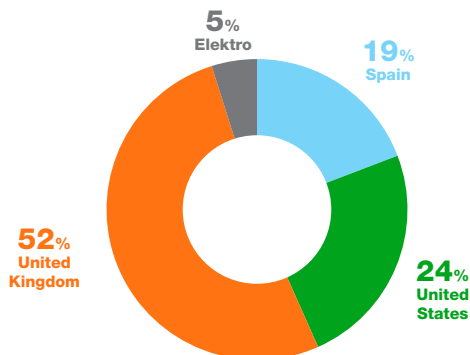
### Principal activities 2014

- **Spain:** continuation of the STAR project for the roll-out of smart grids, after already installing over 4 million meters. 12 new electric substations were also placed into service.
- **United Kingdom:** the DPCR5 period ended in March 2015. At 31 December 2014, there was more than 90% compliance with the commitments made.
- **United States:** progress in accordance with forecast for the MPRP transmission project in Maine (700 km of network, 5 new substations, and 6 expanded substations). The level of project achievement exceeded 90%. The NY Transco initiative was launched in 2014 to develop \$M 1,700 in transmission infrastructure in NY through 2018. Iberdrola contributes 20% to the programme (the other contributions will be made by transmission companies in the State of New York).
- **Brazil:** development of facilities to cover increases in demand, and connection of new customers.

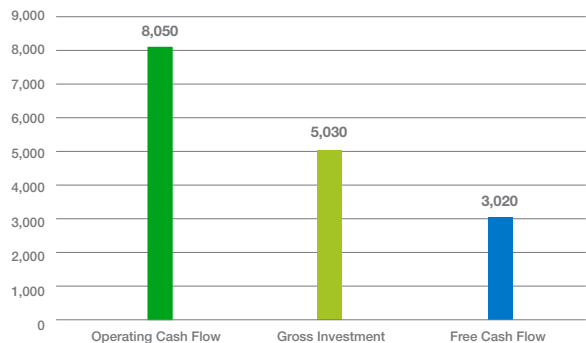
### Outlook

- 57% of the Iberdrola Group's investments will be allocated to the Networks business.
- Work is being carried out to identify new development opportunities in transmission and the application of new technologies for the development of smart grids.

Net investment of €M 5,030 between 2014 and 2016, 56% for growth activities



Generation of cash flow 2014-2016 to finance investments (€M)



## Key figures of the Networks Business

		Spain		United Kingdom		United States		Brazil				Total	
								Elektro		Neoenergia <sup>1</sup>			
Item	Unit	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014
Gross margin	€M	1,905	1,952	1,193	1,331	1,469	1,498	396	459	-	-	4,962	5,241
Ebitda	€M	1,450	1,439	939	1,025	718	772	239	299	-	-	3,346	3,535
Electric power distributed	GWh	91,656	90,729	37,750	36,539	33,187	33,335	16,663	16,933	35,552	37,077	214,809	214,613
Users (Electricity)	Millions	10.8	10.8	3.5	3.5	1.8	1.8	2.4	2.4	10.0	10.3	28.6	28.8
Gas supply	GWh	-	-	-	-	37,069	40,870	-	-	-	-	37,069	40,870
Users (Gas)	Millions	-	-	-	-	0.6	0.6	-	-	-	-	0.6	0.6
Investments	€M	283	304	587	729	543	432	80	75	-	-	1,494	1,541
Workforce	No.	4,055	3,906	2,910	2,894	4,131	4,133	3,778	3,801	2,182	2,091	17,056	16,825

International financial reporting standard (IFRS) 11 has been applied to the financial information for both 2013 and 2014.

(1) Operational information is deemed to be 100% from Neoenergia.

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## Safety, quality of supply, and operational efficiency are the three strategic pillars of the Networks Business upon which the entire business rests.

### Safety

- Ongoing efforts to improve safety in networks activities, which is reflected in the decrease in the Incident Rate.
- Implementation of best practices at all networks companies to reduce the risks associated with operation.
- Development of safety improvement initiatives for all Networks personnel and subcontractors.
- There has been a 23% reduction in network anomalies in Spain.

### Quality of supply

- Ongoing effort to improve supply quality indicators.
- Between January and December 2014 the quality of service indicators generally improved over the prior period in all of the Company's areas of operation, exceeding the best historical records in Spain, and at Elektro in Brazil.
- Development of transmission and distribution projects in the United Kingdom and United States to ensure the reliability of supply and optimise the cost of energy.
- Network automation project in Spain to improve its operation.

### Efficiency

- Increase in operating expenses contained despite strong increase in activity.
- Implementation of best practices throughout the networks companies, mainly in the areas of asset management, processes and technology, control and automation systems, and customer service.





## 3.3 Wholesale and retail

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### Regulatory environment of the business

#### Spain

- The new billing method of the *Voluntary Price for the Small Consumer* based on daily prices, implemented since April 2014, and the new regulated billing form since October.
  - The current capacity availability service has been extended in 2015 while the Royal Decree modifying capacity payments is developed during the course of the year.
  - Applicable remuneration for cogeneration and waste facilities specified due to approval of RDL 9/2013.
- 

#### United Kingdom

- The *Secure & Promote* obligations to facilitate access by small suppliers and to create a market for wholesale electricity products entered into force on 31 March 2014.
  - The first auction in the 2018/2019 capacity market took place in December 2014, with the participation of both existing plants and new projects. The clearing price was 19.40 £/kW.
  - The *Carbon Tax*, which applies to carbon emissions, will increase from 9.55 £/t to 18.08 £/t in April 2015, changing the equilibrium of the market. After that, it will remain constant until 2020.
  - The changes in transmission network tolls for generators will become effective in April 2016.
  - The ECO programme, which requires suppliers to comply with certain targets to reduce emissions and home energy costs, has been extended through 2017.
- 

#### Europe

- The REMIT<sup>1</sup> registration and information obligations, to ensure the integrity and transparency of the wholesale energy market, will enter into effect in 2015.
- 

#### Mexico

- The Electricity Industry Act (*Ley de la Industria Eléctrica*) (LIE) establishing a timetable for liberalisation was approved in August 2014. Load centres included in self-supply contracts or that have a capacity above 3 MW, which limit will be progressively reduced to 1 MW over the next three years, may thus be qualified users.
  - During the first half of 2015, it is expected that there will be approval of the general terms for the electricity market, which must implement a capacity market and a power market, with the ability to enter into hedge agreements. The electricity market will allow the development of new generation by private investors.
- 

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<sup>1</sup> REMIT: Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency.

## Objectives, risks and principal activities

### Objectives

- Operating excellence, safety, and respect for the environment.
- Risk identification and minimisation.
- Continuous improvement in operating efficiency.
- Competitive supply and excellence in service to customers.
- Analysis of growth opportunities.

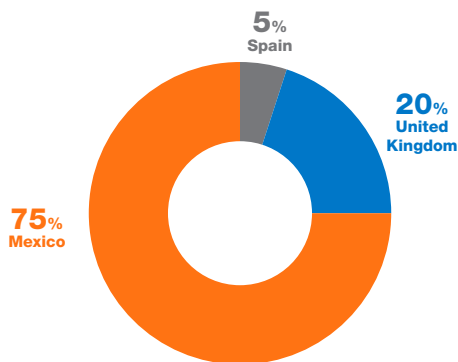
### Significant risks

- Regulatory uncertainty in the countries in which it operates.
- Changes in production of and demand for electricity and gas.
- Fluctuations in hydroelectric, wind, and solar production.
- Environmental costs and costs of fossil fuels.
- Changes in the market prices for electricity and gas.
- Credit, exchange-rate, and interest-rate risks.
- Risk of accidents with an environmental impact.
- Operating risks due to downtime of facilities.

### Outlook

- Focus stays on efficiency of operations, resources, and operation of generating plants in Spain and the United Kingdom.
- New flexible hydroelectric capacity in Spain: San Pedro II (25 MW) HP and final start-up of La Muela (852 MW).
- Mexico is focus for growth in generation and search for new generating opportunities.
- Supply, customer loyalty-building in mature markets (Spain and United Kingdom), and development in Mexico.

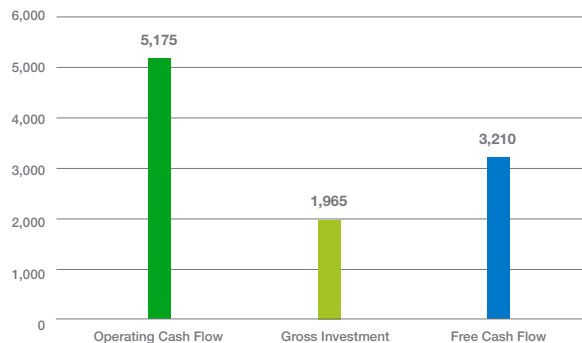
Net investment of €M 1,200 between 2014 and 2016 in growth activities and app. €M 250/year in maintenance



### Principal activities 2014

- **Spain:** request authorisation for the closing of the Castellón 3 (800 MW) CCGT plant to optimise the generating facilities of the Group. Continue developing customer loyalty-building initiatives (*Fixed payment* campaign, *Customers* app, etc).
- **United Kingdom:** agreement with National Grid to provide the Supplemental Balancing Reserve (SBR) service for the 2014-2015 period, guaranteeing 675 MW of capacity to the system. Decrease in residential electricity and gas rates due to changes in the ECO programme.
- **Mexico:** Placement into service of the expansion of the Enertek (37 MW) cogeneration plant and commencement of construction on the Kimberly Clark (50 MW) cogeneration plant, the Baja California III (300 MW) CCGT plant, and the 5th unit of the Monterrey (300 MW) CCGT plant.

2014-2016 Cash flow generation to finance investments (€M)



## Key figures of the Generation and Retail Business

		Spain		United Kingdom		United States and Canada		Mexico		Total	
Item	Unit	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014
Gross margin	€M	2,926	3,068	1,045	1,205	14	3	453	457	4,439	4,734
Ebitda	€M	1,343	1,517	320	457	-23	-32	348	350	1,989	2,292
Installed capacity	MW	19,379	19,174	4,865	4,835	N/A	N/A	4,987	5,028	29,231	29,037
Net output (excluding renewables)	GWh	44,219	47,844	17,142	15,810	N/A	N/A	34,212	35,175	95,573	98,829
Electricity contracts	Millions	10.6	10.4	3.4	3.3	N/A	N/A	N/A	N/A	14.0	13.7
Gas contracts	Millions	0.8	0.8	2.2	2.2	N/A	N/A	N/A	N/A	3.0	3.0
Products and services contracts	Millions	3.7	4.4	0.1	0.1	N/A	N/A	N/A	N/A	3.8	4.5
Total retail contracts	Millions	15.1	15.7	5.8	5.5	N/A	N/A	N/A	N/A	20.9	21.2
Investments	€M	145	146	123	98	4	4	54	175	325	423
Workforce	No. people	3,552	3,478	2,981	2,505	122	117	433	442	7,088	6,542

International financial reporting standard (IFRS) 11 has been applied to the financial information for both 2013 and 2014.

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**The Wholesale and Retail Business is focused on operating efficiency, the loyalty of customers, and growth in Mexico, which will allow for the stability of results and ensure the generation of funds for the Group.**

### Efficiency

- Optimisation of coal production, with investments in low-cost NO<sub>x</sub> in Spain and the United Kingdom.
- Facilitating operations in complementary markets in Spain and the United Kingdom.
- Operating improvements to increase the availability and energetic yield of the Mexico facilities.

### Growth in generation

- Mexico: Placement of 650 MW into service in 2016:
  - Baja California III CCGT (300 MW).
  - 5th Unit of Monterrey CCGT (300 MW).
  - Kimberly Clark Ramos Cogeneration (50 MW).
- United Kingdom: Participation in 2019-2020 capacity auction with the Damhead Creek II CCGT (800 MW).

### Supply

- Building loyalty of customers in Spain and launching new energy efficiency products and services (home electricity protection scheme, etc).
- Recover quality of service in Supply in United Kingdom after the stabilisation of the new systems.
- Retail development in Mexico pursuant to changes in legal provisions on energy reform.

Maintenance work on a wind turbine at  
Maranchón Wind Farm / Spain



## 3.4 Renewables

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### Regulatory environment of the business

#### Spain

- Stability in current regulation of renewable energy is expected after the regulatory adjustments made in 2014.
- 

#### United Kingdom

- During 2014 facilities were pre-qualified in order to access the contracts for differences auctions process. The first auction will take place in February 2015.
  - The *Renewable Obligation*, which continues to be interesting for our onshore facilities, can still be chosen through 2017.
- 

**The business will develop sustainable growth, based on onshore and offshore wind investments in the countries most important to the Group.**

#### United States

- There is an extension of the incentives for wind energy plants that began construction before year-end 2014. No changes for solar energy that enters into service before 1 January 2017.
  - It is expected that government schemes to encourage renewables will retain a relatively stable framework.
  - The adoption of measures to improve the integration of renewables into electricity systems will continue to progress.
- 

#### Mexico

- The new energy reform, although still in development, is expected to be an active means of developing renewable energy.
  - The general foundations of the system are already in place based on tradable clean energy certificates, and in which it appears that auctions will play an important role.
- 

#### Brazil

- The auction model for the development of wind and solar energy is expected to be stable. 2.2 GW of wind and 0.9 GW of photovoltaic were awarded under this mechanism during 2014.
  - The local content requirements for material investment in facilities may be increased.
-

## Objectives, risks and principal activities

### Objectives

- Efficiency in operations to maximise the profitability of the assets.
- Profitable growth in onshore and offshore wind investments in the countries that are strategic for the Group.

### Significant risks

- Regulatory uncertainty in the countries in which it operates.
- Prices of energy and green certifications.
- Operational and technological risk.
- Risk of access to evacuation networks and limits on production due to technical restrictions on networks.

### Principal activities 2014

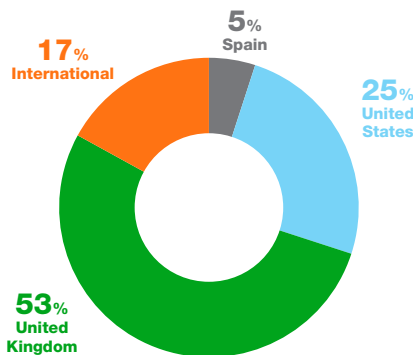
- 215 MW of onshore wind capacity were installed during the year: 202 MW in the United States and 13 MW in the United Kingdom.
- Two installations with a total of 136 MW in Mexico and a third with 38 MW in the United Kingdom are also under construction.
- In Brazil, 174 MW was awarded in two auction awards in June and November of this year.
- In the offshore wind area in the United Kingdom, there has been the startup of the West of Duddon Sands wind farm (388 MW\*) and final approval has been received for the construction of the East Anglia One wind farm.
- The main contracts have been awarded for the 350 MW Wikinger project, located in Germany in the waters of the Baltic Sea.

\* Iberdrola has 50% share (194 MW).

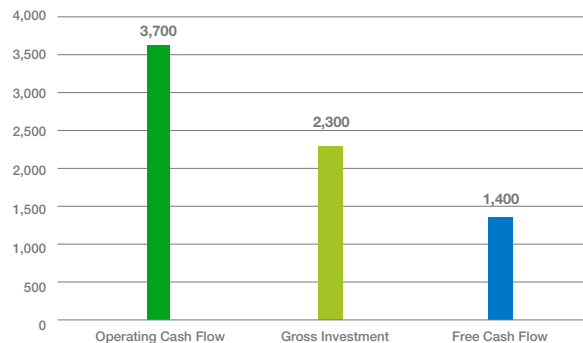
### Outlook

- Deceleration of investments, with moderate current growth, and potential to make additional investments.
- New facilities are focused on the United States, the United Kingdom, Mexico, and Brazil.
- Promotion of offshore wind projects, through a strategy based on technological efficiency and investment profitability.

Investment plan of €M 2,300 between 2014 and 2016, 90% for growth activities



2014-2016 Cash flow generation to finance investments (€M)





## Key figures of the Renewables Business

Item	Unit	Spain		United Kingdom		United States		Mexico		Brazil		Rest of World		Total	
		2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014
Gross margin	€M	978	728	303	368	704	736	41	51	17	42	159	108	2,201	2,033
Ebitda	€M	668	421	232	265	448	495	34	38	9	33	110	74	1,501	1,326
Installed capacity	MW	5,865	5,865	1,462	1,612	5,332	5,534	231	231	49	187	621	621	13,560	14,051
Output	GWh	13,275	12,685	2,767	3,083	14,336	14,462	560	671	143	344	1,573	1,247	32,653	32,492
Load factor	%	25.80%	24.7%	25.5%	23.4%	30.7%	31.0%	29.9%	33.2%	33.0%	37.2%	24.6%	22.9%	27.8%	27.2%
Investments	€M	-28.7	-13.5	526.9	475.1	40.5	236.5	65.7	62.7	0.0	20.8	3.6	-23.4	608.0	758.2

— The new consolidation standard deriving from international financial reporting standard IFRS-11 has been applied to the financial information for both 2013 and 2014. In the application thereof to operating information, 244.32 MW in Spain, 161 MW in the United States, 122 MW in Italy, 75 MW in Brazil, and 15 MW in the United Kingdom is no longer consolidated.

— The 2014 investment figures for Spain include a reversion of old provisions as well as the removal of the turbine warehouse used for projects in another country.

— The investment figures for the United States are net of ITC tax incentives.

— The figures for the United Kingdom include those of the offshore division.

— The investment figure for Rest of World include the removal of the turbine warehouse used for other countries.

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**The business will have sustainable growth, based on onshore and offshore wind investments in the countries most important to the Group. Efficiency is a key factor for business sustainability in the medium and long terms. Iberdrola will take technological advances into account and will act on the supply chain to allow for improvement in the coming years.**

### Load factor

Maximising the load factor of facilities, while minimising down time through operating and maintenance measures, as well as other external factors.

### Prices

Minimisation of risks through appropriate hedging.

### Operation and maintenance costs

Continuous improvement in efficiency through global standardisation and systematisation processes.

### Project portfolio

Development of the portfolio of onshore wind projects in the United Kingdom, the United States, Mexico, and Brazil, and the Wikinger (Germany) and East Anglia 1 (United Kingdom) offshore wind projects.

## 3.5 Supply costs, the main factor in the political and social agenda

The cost of electricity supply is taking on a greater role in the political and social agenda. The principal challenge is to reconcile secure and environmentally friendly supply with the use of renewable energy at prices that are competitive and can be afforded by society as a whole.

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### In the European Union

- The impact of high energy costs on the competitiveness of European industry and the well-being of citizens is one of the issues of greatest concern in the EU. The accords on the 2030 framework for climate and energy propose measures for meeting environmental targets whilst allowing energy prices to remain competitive.
  - Various initiatives are being adopted to improve this situation. In January 2014 the European Commission released an analysis of the components of final energy prices, making it possible to identify the measures required to reduce them.
  - There are measures to support industrial sectors at risk of being pushed off-shore due to carbon emission costs, and to protect vulnerable customers.
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### In Spain

- Rates paid by electricity consumers incorporate costs derived from the pursuit of strategic energy goals: environmental (aid for renewable energy and the costs of reducing CO<sub>2</sub> emissions), industrial (interruptibility of large consumers and aid for co-generation), social (subsidies for domestic coal mining and for electricity in non-mainland territories), economic (recovery of tariff deficits from previous years), and public finance.
  - Less than half the costs of electricity supply are directly related to providing the service; the rest are subsidies and taxes. With some supply costs below the European average, the end prices of electrical energy for Spanish consumers are higher than the Community average.
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## In the United Kingdom

- There is intense public debate on electricity and gas prices, with the involvement of political leaders and wide media coverage. This will be on the agenda in the run-up to the general elections in May 2015, with the government championing more competition and the opposition championing more regulation.
- The recent decline in international gas prices partly offset the rising costs of the energy policy, mainly the Energy Companies Obligation (ECO). In January, all of the companies announced reductions in their gas rates.
- The required future investment in networks and cleaner generation will also entail greater price pressure.

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## In the United States

- Tariff revisions currently under discussion or preparation reflect pressure by regulators to limit returns on capital, while at the same time maintaining the investments required to improve the network infrastructure.
- The closure of coal plants, following the appearance of unconventional gas and new regulations being drawn up by the Environmental Protection Agency (EPA), may increase pressure on gas and electricity prices.
- Restrictions on transporting natural gas by pipeline in the Northeast may lead to volatility in electricity market prices during periods of extreme weather.
- The development of smart grids, the rapid replenishment of supplies in the face of extreme weather conditions, and the integration of new energy sources into the system require major investment, which sometimes conflicts with the goal of limiting compensation to the companies.

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## In Brazil

- Involuntary exposure of distributors to the short-term market, together with the increase in the price of energy in this market, due mainly to the unfavourable water scenario the country is experiencing, has generated a cash flow imbalance for distributors during all of 2014. This was recognised and alleviated by the government, earmarking specific funds that will have to be covered by upcoming tariff adjustments.

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## In Mexico

- Energy reforms were launched last year, with one of the key goals being to reduce system costs in order to lower electricity prices for end users. The reform is ongoing at the corresponding regulatory bodies.

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**Iberdrola will support frameworks that expand market deregulation and transparency and that provide incentives for required investments and efficient operations, through tariff structures that give efficient signals to consumers and do not penalise them with costs unrelated to the supply of electricity.**

# Our assets

**Iberdrola's assets are the basis for the creation of value by the Company, which carries out its activities through the sound management of these assets.**

In this report, Iberdrola's assets are identified in accordance with the IIRC classification system:

- Financial capital
- Manufactured capital
- Intellectual capital
- Human capital
- Natural capital
- Social and relationship capital

4



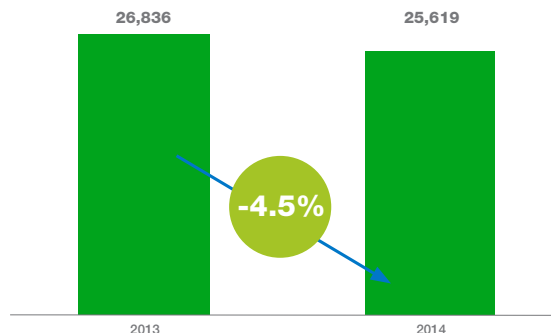


# 4.1 Financial capital

	Management approach	2014 Results	Outlook
<b>Solid financial structure</b>	<ul style="list-style-type: none"> <li>Iberdrola is committed to bolstering its financial strength in order to successfully contend with market turbulence and be well placed to capitalise on the expected medium-term upturn in the economic cycle. Its strategy is geared towards further reducing debt, attaining positive cash flow in all of the businesses, and improving its solvency ratios.</li> </ul>	<ul style="list-style-type: none"> <li>Gross margin of €M 12,179, growing by 3.4%.</li> <li>Net profit of €M 2,327, a year-on-year drop of 9.5% due to the impact of regulatory and tax measures in Spain. Recurring net profit was €M 2,113 (-2.8%).</li> <li>Cash flow of €M 5,459.</li> <li>Reduction of net debt by €M 1,217, to €M 25,619.</li> <li>Liquidity of more than €M 9,000, which covers more than 30 months of financing needs.</li> </ul>	<ul style="list-style-type: none"> <li>Average annual EBITDA and net profit growth of 4% over the 2014-2016 period.</li> <li>Maintenance of net debt at approximately €M 25,000 in 2015 and 2016.</li> <li>Improvement of the net debt/EBITDA and operating cash flow/net debt financial ratios.</li> <li>Optimisation of the liquidity position to cover financing needs for 24 months.</li> </ul>
<b>Operational efficiency</b>	<ul style="list-style-type: none"> <li>The current macroeconomic and regulatory environment requires an additional effort to keep operating costs under control.</li> </ul>	<ul style="list-style-type: none"> <li>Net operating expense increased 4.8% due to the drop in activations and other non-recurring effects, such as efficiency measures affecting future periods.</li> <li>Recurring operating expenses grew 1.1%, less than the gross margin. Therefore, the net operating expenses / gross margin ratio improved to 28.8%, compared to 29.4% in 2013.</li> </ul>	<ul style="list-style-type: none"> <li>Containment of increase in operating expenses, keeping them below gross margin growth and thereby helping to boost efficiency.</li> </ul>
<b>Monitoring of investments</b>	<p>Targeted control of investments will enable:</p> <ul style="list-style-type: none"> <li>Assurance of return on equity through projects geared towards rapid recovery or increased stability of results, focusing on regulated businesses.</li> <li>Generation of positive free cash flow in all businesses and reduction of financial debt.</li> <li>Tailoring of investment levels to the actual needs of each market.</li> </ul>	<ul style="list-style-type: none"> <li>Total investment of €M 2,848, with almost 81% channelled into regulated businesses.</li> <li>Divestment plan of €M 2,500 almost completely implemented.</li> </ul>	<ul style="list-style-type: none"> <li>Strict investment criteria based on earnings security, project profitability, and short implementation periods.</li> <li>Strategies of investment in businesses and countries with predictable and stable regulation, and divestiture of non-strategic assets and in non-strategic countries.</li> <li>Net investment of €M 9,600 over the 2014-2016 period, concentrating on regulated businesses.</li> </ul>
<b>Sustainable results and dividends</b>	<ul style="list-style-type: none"> <li>Iberdrola offers its shareholders an industrial enterprise for the long-term creation of value. The confidence of its shareholders enables Iberdrola to secure the resources needed to move its enterprise forward.</li> </ul>	<ul style="list-style-type: none"> <li>Shareholder remuneration of 0.275 euro per share, equal to a dividend yield of 4.91%</li> <li>Flexible dividend offering tax benefits.</li> </ul>	<ul style="list-style-type: none"> <li>Continuation of the flexible dividend programme, with a target annual payout of 0.27 euro per share over the 2014-2016 period.</li> <li>Target of maintaining the number of shares at 6,240 million, neutralising the capital increases associated with implementation of the flexible dividend programme.</li> <li>Potential increase in the dividend per share, based on net profit.</li> </ul>

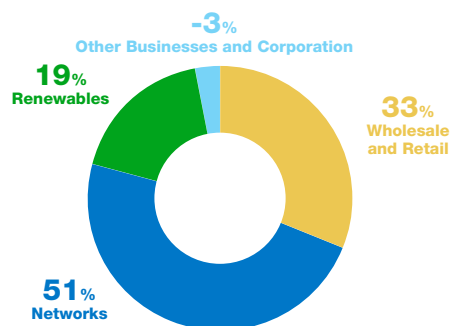
## Create value for the shareholder with sustainable growth

### Debt (€M)

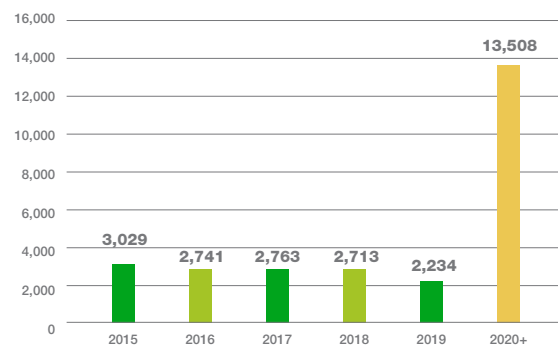


Strengthening of the balance sheet, as planned.

### Ebitda by business 2014



### Maturity of financial debt\* (€M)

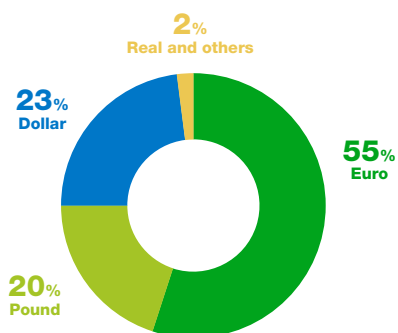


\* Does not include drawn credit facilities.

\*\* Assumes renewal of outstanding balance of notes in the amount of 829 thousand euros.

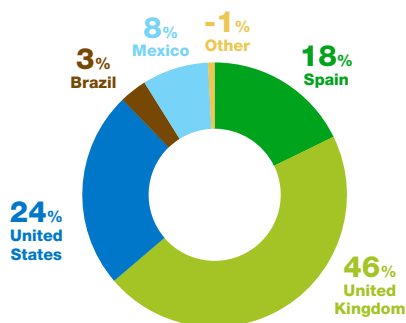
Comfortable maturity profile.

### Debt structure by currency in 2014



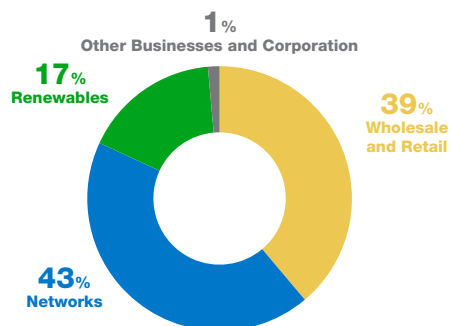
Debt structured by origin of cash flow earned in each currency

### Investment by geographic areas 2014



Diversification of investments, with a heavy concentration outside of the euro zone.

### Gross margin by business 2014



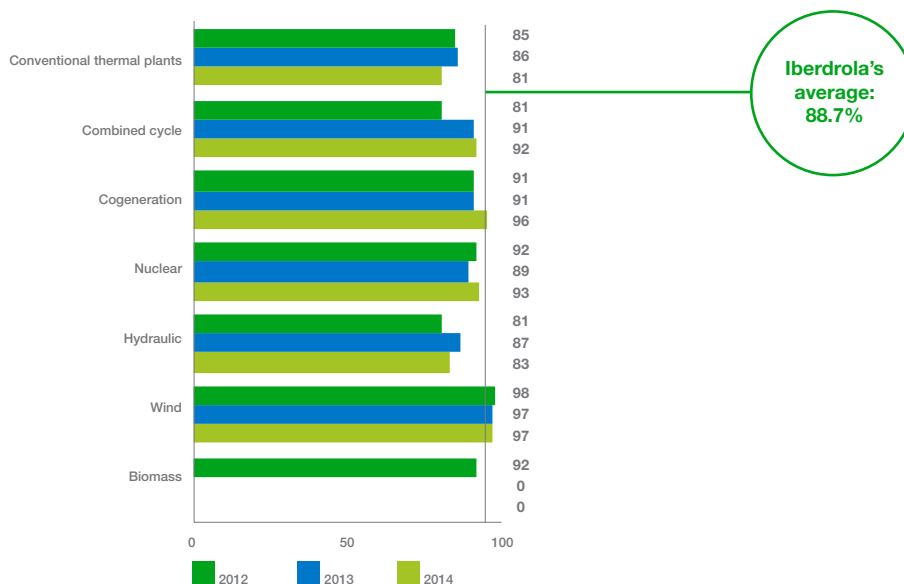


## 4.2 Manufactured capital

	Scope	Principal activities 2014	Outlook
<b>Electrical power generation assets</b>	<ul style="list-style-type: none"> <li>Iberdrola's generation assets comprise nearly 300 wind farms, almost 90 hydroelectric power plants (in addition to the mini-hydro plants), 34 thermal power stations using various technologies, 5 of which are nuclear, and other facilities built and operated according to the best available practices.</li> </ul>	<ul style="list-style-type: none"> <li>ISO 9001 and ISO 14001 quality and environmental certification has been attained for the Company's generation operations in Spain, the United Kingdom, and Mexico.</li> <li>ISO 9000 certification has also been attained for the operation of wind farms in Spain and the United Kingdom.</li> </ul>	<ul style="list-style-type: none"> <li>Commencement in England of the largest renewables project in the Company's history, East Anglia, an offshore wind farm with a capacity of 7,200 MW in one of the most important enclaves in the world.</li> <li>In Mexico, together with an analysis of coming developments, construction will continue on the combined cycle plants of Baja California III (300 MW) and Unit 5 of Monterrey (300 MW), as well as the new Kimberly Clark cogeneration station (50 MW). They are expected to enter into operation in 2016.</li> </ul>
<b>Power transmission and distribution assets</b>	<ul style="list-style-type: none"> <li>Iberdrola's electricity transmission and distribution networks comprise over 30,000 km of transmission lines, over 1 million km of distribution lines, roughly 4,000 substations and over 1.4 million transformers, built and operated to supply a high-quality, reliable service.</li> </ul>	<ul style="list-style-type: none"> <li>Iberdrola USA obtained ISO 9001:2008 certification in 2014 for the quality management system covering the design, construction and startup of large electricity and natural gas investment projects.</li> <li>The quality of service indicators improved over the prior period in all of the Company's areas of operation, exceeding the best historical records in Spain, the United Kingdom, and Brazil.</li> </ul>	<ul style="list-style-type: none"> <li>Construction of a new electricity transmission line corridor between the electricity systems in Canada and the United States, aimed at improving reliability in the New England area.</li> <li>Investments in the United Kingdom transmission network, to improve the reliability and quality of supply. Especially noteworthy is the "Western Link", a subsea cable linking the networks of Scotland and England.</li> <li>Development of the P2020 strategic project in Spain, aimed at achieving increased efficiency, operational safety, and quality of supply.</li> </ul>
<b>Other assets</b>	<ul style="list-style-type: none"> <li>Iberdrola has corporate offices in all of the geographic regions in which it distributes electricity, as well as other buildings and ancillary infrastructure associated with its operations.</li> </ul>	<ul style="list-style-type: none"> <li>Certifications have been obtained for the energy management system in accordance with the UNE-EN ISO 50001:2011 standard for the Torre Iberdrola (Bilbao) and Tomás Redondo (Madrid) properties in Spain.</li> <li>All of the real property in Spain is covered by a certified environmental management system, with the scope being expanded to the sales offices in 2014.</li> </ul>	<ul style="list-style-type: none"> <li>Expansion of the environmental management system at the ScottishPower properties.</li> <li>Construction of the new corporate headquarters of ScottishPower in Glasgow, Scotland. This 14-storey building, which is currently under construction, is located in the centre of Glasgow and will have a maximum capacity of more than 1,700 workers.</li> <li>Construction of the Iberdrola Campus in the Community of Madrid (Spain), which is expected to open in 2016.</li> </ul>

## Offer a secure supply of energy that is competitive in price and quality

### Average availability factor of Iberdrola's generation facilities

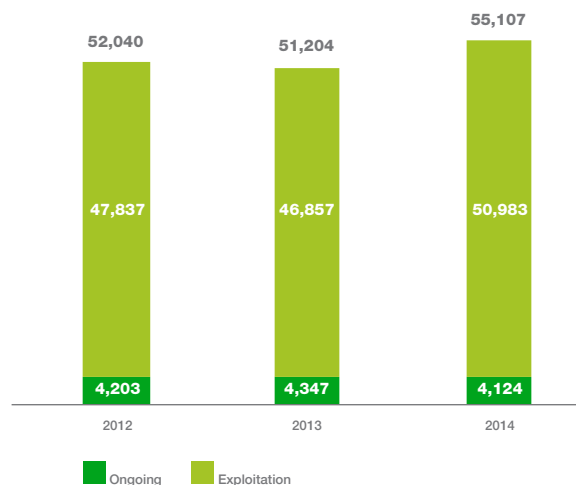


### Quality of electricity supply

Average power outage duration		2013	2014
Spain	TIEPI (m)	62.4	55.7
United Kingdom	CML (m)	44.0	44
United States	CAIDI (h)	2.47	1.89
Brazil	DEC (h)	18.61	19.93
Power outage frequency		2013	2014
Spain	NIEPI (no.)	1.20	1.07
United Kingdom	CI (ratio)	44.0	48.00
United States	SAIFI (index)	1.24	1.23
Brazil	FEC (frequency)	7.64	7.62

TIEPI: Installed Capacity Equivalent Interrupt Time.  
 CML: Customer Minutes Lost Per Connected Customer.  
 CAIDI: Customer Average Interruption Duration Index.  
 DEC: Equivalent Duration of Interruption by Consumer Unit.  
 NIEPI: Installed Capacity Equivalent Interrupt Number.  
 CI: Customer Interruptions Per 100 Connected Customers.  
 SAIFI: System Average Interruptions Frequency Index.  
 FEC: Equivalent Frequency of Interruption by Consumer Unit.

### Property, plant, and equipment (€M)



## 4.3 Intellectual capital

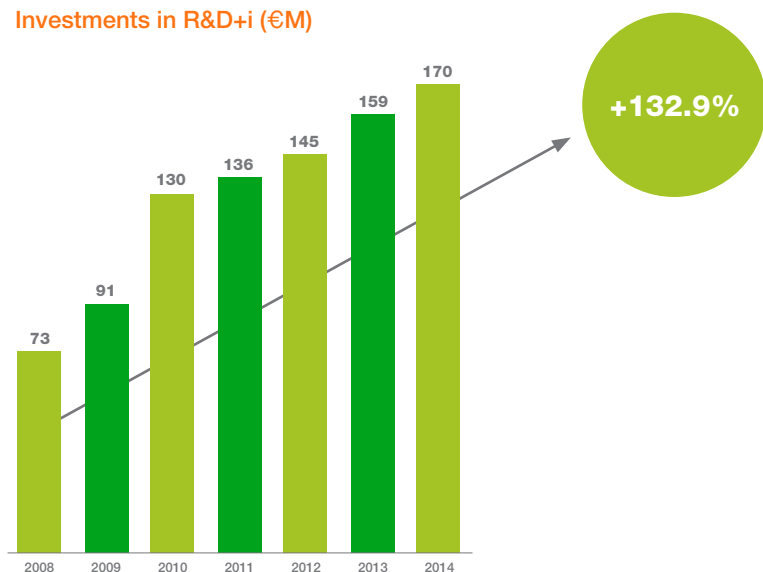
	Management approach	Principal activities 2014	Outlook
<b>Promotion of R&amp;D+i</b>	<ul style="list-style-type: none"> <li>Promotion of research, development and innovation (R&amp;D+i) activities, enabling Iberdrola to guarantee the sustainability and reliability of supply.</li> </ul> <p>© <b>Innovation report</b></p>	<ul style="list-style-type: none"> <li>Significant increase in R&amp;D+i investment: €M 170 in 2014, a 7% increase over 2013.</li> <li>Open, decentralised international R&amp;D+i management model that prioritises collaboration with technology providers and the promotion of employee innovation.</li> <li>Implementation of over 200 R&amp;D+i projects within the various Businesses of the Group.</li> </ul>	<ul style="list-style-type: none"> <li>Development of the R&amp;D+i Plan 2014-2016.</li> <li>Consolidation of an open, decentralised international management model.</li> <li>Continue to promote R&amp;D+i projects.</li> </ul>
<b>Efficiency and new products and services</b>	<ul style="list-style-type: none"> <li>Continuous optimisation of our operations in the management of the lifecycle of facilities and equipment, reducing operating and maintenance costs, and decreasing environmental impact.</li> <li>New products and services that meet customer needs in an increasingly global and competitive market.</li> </ul>	<ul style="list-style-type: none"> <li>New products and services in the areas of energy efficiency, electric vehicles, smart grids, and distributed generation.</li> <li>Creation of an R&amp;D+i technology centre in Qatar relating to the development of smart grids.</li> </ul>	<ul style="list-style-type: none"> <li>Positioning as innovation leaders on prestigious external indices and ratings.</li> <li>Foster the creation of new business opportunities for Iberdrola.</li> </ul>
<b>Disruptive technology and business models</b>	<p>Through <i>Iberdrola Ventures-Perseo</i>, the Company's corporate venture capital programme, investments are made in disruptive technologies and new businesses to ensure the sustainability of the energy model. Lines of activity:</p> <ul style="list-style-type: none"> <li>Distributed energy resources (DER): customer-side technologies including energy efficiency and active demand response, distributed generation and storage, green mobility, etc.</li> <li>Renewable energy: solar (PV and thermal), wind (offshore), marine (wave and tidal), etc.</li> <li>New technologies for the operation and maintenance of energy infrastructures.</li> <li>Other technologies aimed at improving the sustainability of the energy sector.</li> </ul>	<p>With an investment of more than €M 48 since 2008. The main activities in 2014 included:</p> <ul style="list-style-type: none"> <li>An investment in the Californian company <i>QBotix</i>, which develops tracking systems using robotics, designed to significantly reduce the cost of developing and operating photovoltaic solar plants.</li> <li>The launch of the <i>Open Innovation Ventures programme</i>, to boost cooperation with key technology partners in order to accelerate the development of new products of interest to Iberdrola. The first activity under this programme was the creation of the <i>GDES Tech4Services venture</i>, owned by Iberdrola and Grupo Domínguez, to develop and market technologies and new products for use in the operation and maintenance of assets in the electric sector.</li> </ul>	<ul style="list-style-type: none"> <li>Ensure Iberdrola's access to the energy technologies of the future.</li> <li>Foster entrepreneurship and the development of an innovative entrepreneurial fabric within the energy sector: investment in initiatives with a high social and job creation component.</li> <li><i>Open Innovation Ventures</i>: establishment of alliances with key technology providers for Iberdrola.</li> <li>Within the framework of the Spanish government's <i>Invierte</i> programme, more than €M 25 will be invested in the coming years in new technology projects for the energy sector.</li> </ul>

## Emphasise the value of the Company's intangible assets

### Main R&D+i research projects

Renewable energy	<ul style="list-style-type: none"> <li>• OCOA Project for the development of new gravity foundations for installation at intermediate depths (30-50 metres).</li> <li>• Continuation of OWA activities in the United Kingdom to reduce costs and the implementation risk of offshore wind technology.</li> <li>• Completion of the INNFACTO OPENFOAM project to develop computational analysis models and their application to energy resource estimates.</li> <li>• Various projects to improve operation and maintenance in order to reduce operating costs.</li> </ul>
Smart grids	<ul style="list-style-type: none"> <li>• Deployment of smart grids and PRICE projects in Spain and ARC and <i>Flexible Net</i> in Scotland. European UPGRID project for the advanced operation and the exploitation of low- and medium-voltage networks in the area of smart grids, strengthening the ability for them to be integrated into the active demand and distributed generation network.</li> <li>• Other European projects like <i>Grid4EU</i> and <i>iGreenGrid</i> projects for the integration of renewable energy into electricity networks.</li> </ul>
Clean generation	<ul style="list-style-type: none"> <li>• The <i>Coeben II</i> and <i>DESOX</i> projects for the reduction of NO<sub>x</sub> and SO<sub>2</sub> emissions, respectively.</li> <li>• <i>INSROCA</i>, <i>SIRO</i> and <i>ECRIGEN</i> projects to ensure the structural integrity of files and maximise the life cycle.</li> <li>• <i>CO2FORMARE</i> project to reduce environmental impact.</li> </ul>

### Investments in R&D+i (€M)



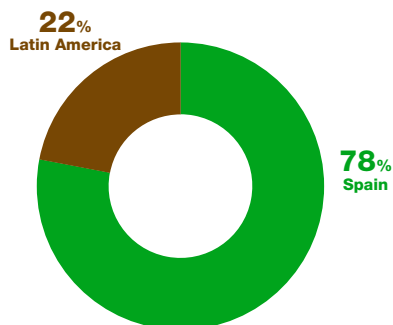
# 4.4 Human capital

	Management approach	Principal activities 2014	Outlook
<b>Global human resources management</b>	<ul style="list-style-type: none"> <li>• Achieve the goals of competitiveness and business efficiency in a climate of social peace, fostering stable, high-quality employment.</li> <li>• Harmonise human resources processes and make inroads with implementing the Iberdrola culture in all countries, respecting specific local conditions.</li> </ul>	<ul style="list-style-type: none"> <li>• Implementation of the project for global consolidation of the Human Resources Model (OneHR project) in the United Kingdom, Mexico, Brazil, and ROW.</li> <li>• Management of an appropriate labour relations framework that can be adapted to suit business and social requirements.</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen the commitment to social responsibility, fostering ethical and responsible behaviour.</li> <li>• Consolidate the Human Resources function at Elektro, extending and unifying best practices.</li> </ul>
<b>Goal of “accident reduction”</b>	<ul style="list-style-type: none"> <li>• Prioritise the safety of individuals at the Group's facilities and within its sphere of influence, fostering a progressive reduction in incident rates and improving health and safety conditions.</li> <li>• Replicate the best practices identified with respect to occupational health and safety, fostering a culture of excellence in management and coordinating global preventive activities.</li> </ul>	<ul style="list-style-type: none"> <li>• Attainment and/or maintenance of the OHSAS 18001 certification, and development of a system of global prevention standards.</li> <li>• Establishment of proactive and reactive indicators among the Group's companies for the global scorecard.</li> <li>• Continue harmonising and monitoring of goals.</li> <li>• Identification and application of best safety practices/Exchange of lessons learned/Creation of groups to promote safe behaviour.</li> </ul>	<ul style="list-style-type: none"> <li>• Assessment of level of conformance to global standards.</li> <li>• Analysis of incident rate and establishment of a global model for the management of occupational health and safety at subcontractors.</li> <li>• Systems to identify and recognise the best ideas in order to optimise health and safety.</li> <li>• Global campaigns to raise awareness on certain types of common accidents.</li> </ul>
<b>Talent management</b>	<ul style="list-style-type: none"> <li>• Drive staff qualifications, preparing employees to work in a multicultural environment and making continual efforts to improve their employability.</li> <li>• Develop alternatives to compensate for factors stemming from the ageing of the workforce.</li> <li>• Define a framework to develop a global quality management system.</li> </ul>	<ul style="list-style-type: none"> <li>• Promotion of job and international mobility within multicultural teams.</li> <li>• New programmes and initiatives at the Management School to strengthen collaborative learning (e-leaders).</li> <li>• International non-management professional development process (Spain, United States, and United Kingdom).</li> <li>• Campaign to encourage Gender Equality in hiring processes.</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen the talent and leadership development management model at the international level.</li> <li>• International certification of training quality.</li> <li>• Define and implement the Global Development Roadmap for the Iberdrola Group.</li> <li>• Global executive talent management.</li> </ul>
<b>Diversity, equal opportunity, and reconciliation</b>	<ul style="list-style-type: none"> <li>• Tackle diversity in all Human Resources activities of the Group, ensuring equal opportunity and the labour integration of disadvantaged groups.</li> <li>• Develop these principles, providing measures to help reconcile personal, family, and working life.</li> <li>• In the countries in which Iberdrola operates, foster a position of leadership in these areas similar to that enjoyed in Spain.</li> </ul>	<ul style="list-style-type: none"> <li>• International cultural exchange programmes.</li> <li>• International Volunteering Day. “Sao Paulo 2.0” multicultural volunteer programme in Brazil and professional volunteering programme in Ethiopia.</li> <li>• Continue with “Family-Responsible Company” certifications.</li> <li>• Join with “Women in Renewable Energy Scotland” in the United Kingdom, “Troops to Energy” in the United States, and “Energy for the future” in Brazil.</li> </ul>	<ul style="list-style-type: none"> <li>• Foster improvements in the quality of people's lives through social-welfare activities in all of the countries in which the Iberdrola Group has a presence, creating a global volunteer community.</li> <li>• Strengthen team pride and job commitment.</li> <li>• Promote the internationalisation of social programmes and bring together employees from various countries.</li> </ul>

## Ensure the availability of a committed, qualified workforce in a safe and stable environment

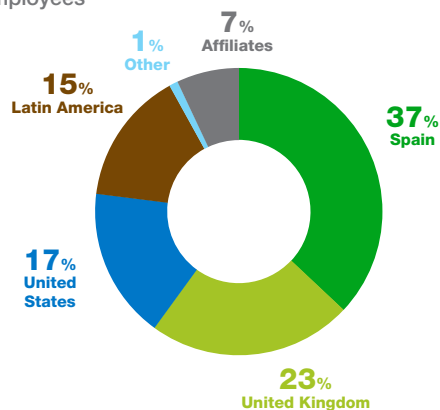
### Growth and geographic diversification of the workforce

2006: 16,155 employees



2014: 29,597 employees

© Key figures / page 10



### Incident rate (2011-2014): progressive reduction



### Commitment to people

Iberdrola Sao Paulo Volunteering 2.0-2014



"My guest" cultural exchange programme 2014



### Social recognition

Iberdrola: among the best 3 companies to work for in Spain.



Elektro: again chosen as best company to work for in Brazil.



### Iberdrola university restoration report



# 4.5 Natural capital

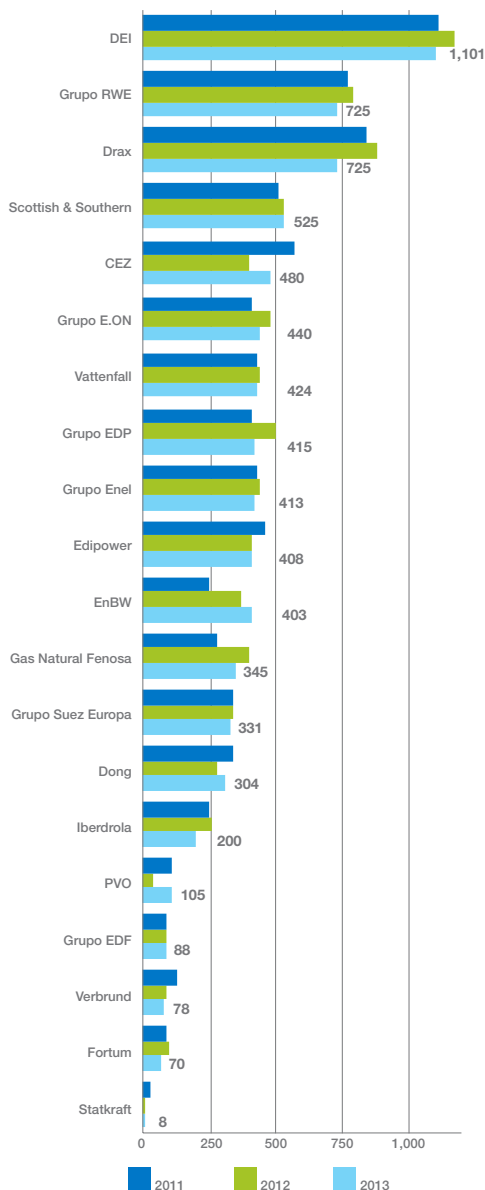
	Management approach	Principal activities 2014	Outlook
<b>Environmental management and biodiversity</b>	<ul style="list-style-type: none"> <li>• Actively promote environmental and biodiversity management due to the repercussions thereof on the availability of natural resources and its ties to social development.</li> <li>• Inform and raise awareness, both internally and externally, of the compatibility of the Company's activities with the protection, conservation, and sustainable use of the natural environment.</li> </ul>	<ul style="list-style-type: none"> <li>• Implementation of corporate model for environmental risk management.</li> <li>• Development of a methodology for economic evaluation of ecosystem services and the impact on biodiversity.</li> <li>• Fostering and promotion of social values relating to the environment and natural resources.</li> <li>• Approval of EU LIFE2+ CO2FORMARE Project at the Castellón plant.</li> </ul>	<ul style="list-style-type: none"> <li>• Restoration, recovery, improvement, and maintenance of surroundings and habitats.</li> <li>• Identification and classification of the biodiversity in the vicinity of Iberdrola's facilities and dissemination of the knowledge acquired.</li> <li>• Broader implementation of the ISO 14001 standard.</li> </ul>
<b>Prevention of pollution</b>	<ul style="list-style-type: none"> <li>• Prevent pollution and the emission of greenhouse gases through practices that reduce or eliminate the production of pollutants at source.</li> <li>• Reduce emissions per GWh produced via the installation of desulphurisation units, the introduction of improvements to the combustion process, and the decommissioning of less environmentally efficient units.</li> </ul>	<ul style="list-style-type: none"> <li>• 6% reduction in intensity of CO<sub>2</sub> emissions per kWh produced.</li> <li>• Thermal emission factor has decreased from 483 gr/thermal kWh generated in 2013 to 476 gr/kWh generated in 2014.</li> <li>• Increase in emission-free installed capacity.</li> <li>• Development of methodology to calculate the environmental footprint of the Group's activities (<i>EPI Environmental Performance Index Project</i>).</li> <li>• Signing of the CDP <i>Roadmap to Paris</i>, with a commitment to reduce emissions and participation in the Climate Change Week in New York.</li> </ul>	<ul style="list-style-type: none"> <li>• Achieve a 30% reduction in emissions intensity by the year 2020 in comparison to 2007, a figure 20% better than the scenario suggested by the IEA.</li> <li>• Increase the scope of independent verification of emissions.</li> <li>• Develop innovation projects geared towards reducing pollution.</li> <li>• Active participation in preparations for the upcoming Climate Change Conference to be held in Paris (December 2015).</li> </ul>
<b>Operating excellence and energy efficiency</b>	<ul style="list-style-type: none"> <li>• Performing activities that foster environmental conservation will enable Iberdrola to improve its competitiveness, with greater efficiency in the production and use of energy.</li> <li>• Efficient management of scarce resources such as water is a priority for the Company.</li> </ul>	<ul style="list-style-type: none"> <li>• Activities aimed at continual improvement to increase energy efficiency and promote the use of environmentally friendly resources.</li> <li>• Public water management strategy via the CEO Water Mandate and CDP Water.</li> </ul>	<ul style="list-style-type: none"> <li>• Development and promotion of eco-design initiatives.</li> <li>• Life-cycle and green purchasing analysis.</li> </ul>
<b>Waste management</b>	<ul style="list-style-type: none"> <li>• Non-hazardous waste is managed via environmental management systems, which set targets for waste reduction and the use of recycled material.</li> <li>• The production and disposal of hazardous waste is carried out in accordance with the strict laws applicable in each country.</li> </ul>	<ul style="list-style-type: none"> <li>• Reuse of waste from thermal coal plants.</li> <li>• Carry out waste minimisation plans, recycling plans, and awareness campaigns aimed at employees.</li> <li>• Iberdrola and GE Hitachi join in a project to reuse nuclear fuel in the United Kingdom.</li> </ul>	<ul style="list-style-type: none"> <li>• Make progress in the optimisation of waste management.</li> <li>• Draw up economic and financial analyses of the best waste management strategies.</li> </ul>



## The environmental dimension is a key factor in the concept of sustainability

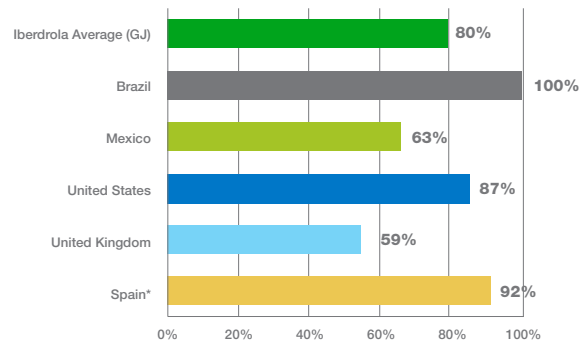
### CO<sub>2</sub> emissions at companies in the industry

(Carbon factor in kg CO<sub>2</sub>/MWh)



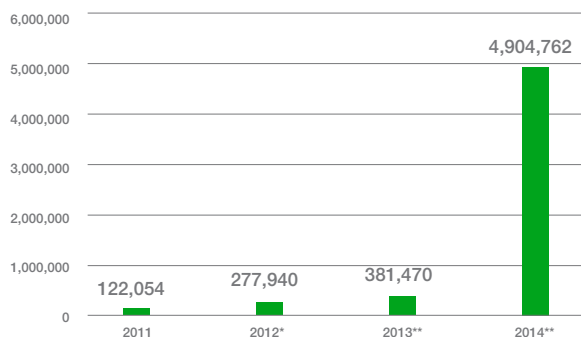
European carbon factor 2013: 328 kg CO<sub>2</sub>/MWh  
Source: "Changement climatique et Électricité, facteur carbone européen Comparaison des émissions de CO<sub>2</sub> des principaux électriciens européens" PwC France.

### Production of Iberdrola plants using local energy sources in the countries in which it operates



\* Nuclear fuel acquired from the Spanish company ENUSA is considered a local source.

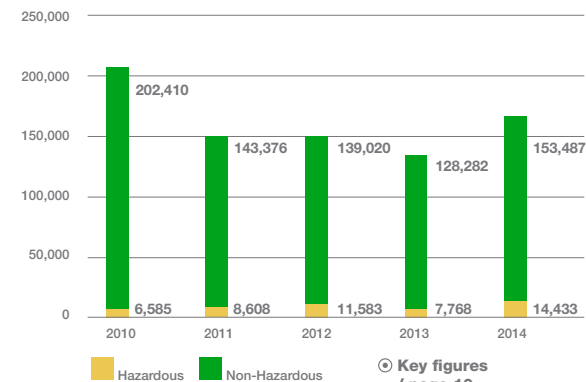
### Energy savings of green products and services (GJ)



\* Includes data from Spain and Brazil.

\*\* Includes data from Spain, the United States of America, and Brazil.

### Volume of recovered, reused, or recycled waste



Legend: Hazardous (Yellow), Non-Hazardous (Green)

© Key figures / page 10

# 4.6 Social and relationship capital

## Stakeholder relations

Iberdrola wants to strengthen trust and the connection to institutions and companies in its environment, maintaining responsible relations with groups that affect or are affected by the activities carried out by the Company (stakeholders).

	Management approach	Principal activities 2014 and outlook
Stakeholder relations	<p>Iberdrola's strategic approach sets great store by its relations with stakeholders, giving importance to the dual facets of this relationship:</p> <ul style="list-style-type: none"> <li>• In terms of social responsibility, meeting stakeholder expectations and needs.</li> <li>• In terms of reputation, managing stakeholders' perception of the Company.</li> </ul>	<ul style="list-style-type: none"> <li>• Consolidation of channels of communication with stakeholders to identify the most important issues and provide a well balanced, reasonable response thereto.</li> <li>• Completion of implementation of the AA1000 Assurance Standard, in accordance with the principles of inclusiveness, materiality, and responsiveness established in such standard, through a multi-annual programme deployed in the businesses as well as in the corporate areas of the Group. The AA1000 standard will continue to be applied and refined through the Company in the coming years.</li> <li>• The Board of Directors approved a <i>Stakeholder Relations Policy</i> in February 2015.</li> </ul>

A materiality analysis allows for prioritisation of the issues most important to the Company's stakeholders.

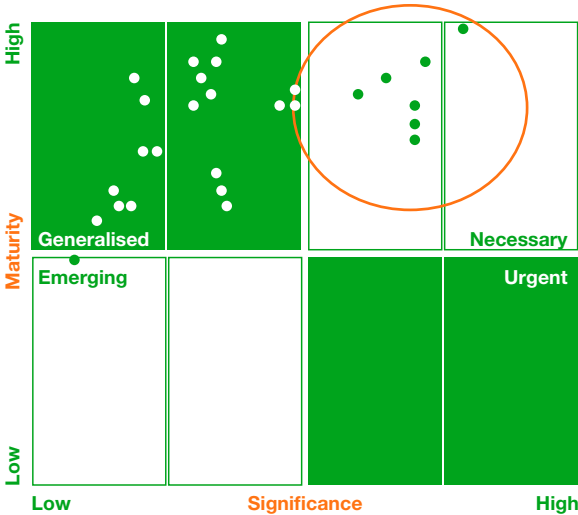
## Materiality

### Materiality analysis

Evaluation of materiality enables the issues that are most important to stakeholders to be prioritised according to their degree of significance and maturity. These issues are represented in the upper right quadrant of the chart, and comprise the following:

- Electricity generation.
- Renewable energy development.
- Price risk management.
- Climate change strategy.
- Business opportunities.
- Government relations/public policy/lobbying.
- Customer relations management.
- Impacts on and benefits for local communities.
- Transmission and distribution.

In the *Sustainability Report 2014* Iberdrola explains the management approaches taken by the Company in regard to these significant issues and any results achieved during the financial year.



## Community support and electricity access programmes

### Primary programmes

#### Activities 2014

- Contribution of €M 34 to the community, measured according to the London Benchmarking Group (LBG) international standard, in the countries in which Iberdrola operates.
- International corporate volunteering programme, offering more than 6,000 volunteering opportunities to employees in Spain, the United Kingdom, the United States, Mexico, and Brazil.
- Entrepreneurial support: over €M 41 of procurement from companies in operation for less than 4 years, and €M 70 in venture capital for new initiatives with high technological value.
- Programmes and pricing to aid vulnerable groups in Spain, the United Kingdom, the United States, and Brazil.
- Rural electrification programmes in Brazil, to which over €M 31 has been allocated on a consolidated basis.
- Programmes implemented by the Foundations created by Iberdrola in the principal countries in which it operates.
- Development of the Electricity for Everyone programme.

### Electricity for everyone

In order to promote universal access to electricity, Iberdrola implements a programme with the following lines of action:

- a) financing of projects through equity investment,
- b) activities conducted by the Businesses in the countries in which the Company has a presence, and
- c) development of projects with a high social component, with support for NGOs and through corporate volunteering.

As a major support tool, a Chair for the Universalisation of Basic Energy Services was created within the Centre for Innovation in Technologies for Human Development (*Centro de Innovación en Tecnologías para el Desarrollo Humano*) of Universidad Politécnica de Madrid (ITD-UPM).

### Economic value distributed (€M)

Item	2013	2014
Procurement from suppliers	4,359	4,599
Payments to providers of capital	2,554	2,753
Payments to government	2,591	2,391
Employee remuneration	1,998	2,320

© Sustainability report

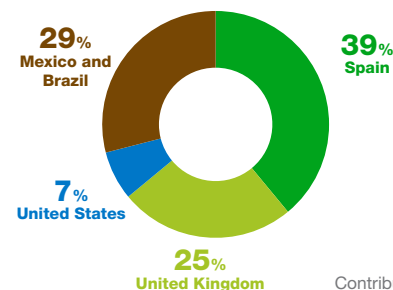
### Foundations linked to the Iberdrola group: Fundación Iberdrola

#### Activities 2014

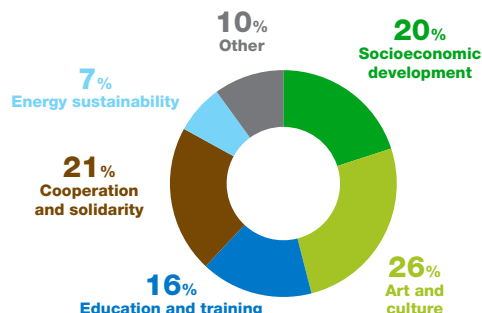
- Fundación Iberdrola, which is linked to Iberdrola España, S.A.U., the subholding company grouping together the energy businesses in Spain, has completed its Master Plan 2010-2014 in its four areas of activity:
    - Training and research
    - Art and culture
    - Sustainability and biodiversity
    - Cooperation and community service
  - The *Scholarship and Research Aid Programme in Energy and Environmental Research* granted 80 Master's scholarships at prestigious universities in Spain, the United Kingdom, and the United States in 2014. In addition, 4 scholarships were granted for training and research at the Restoration Workshop of the Prado Museum and the Fine Arts Museum in Bilbao.
- The Prince of Asturias Chair in Information Science and Related Technologies at the University of New Mexico, focusing primarily on research in the area of smart grids, has become firmly established.
- In 2014, 45 social organisations benefited from the *Social Assistance* programme.
  - Significant examples in other areas are the restoration of Romanesque churches in Spain and Portugal within the Atlantic Romanesque Programme, and the Bird Migration project in collaboration with *SEO-BirdLife*.

### Programme results 2014

Contribution by region (%)



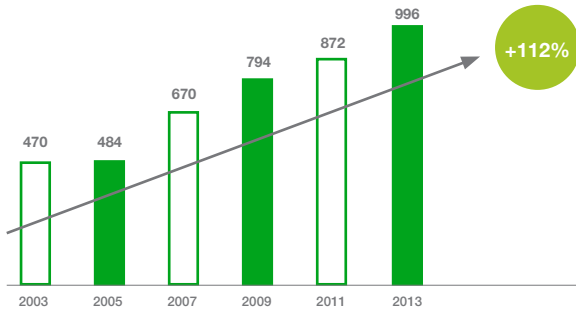
Contribution by programme (%)



## Soundness and strength of the brand

- Manage the brand in such a way that it transmits the corporate Vision and Values and reflects the environmental commitment of the Company's strategy.
- Consolidation of an international brand, strengthening communication and alignment under a single brand positioning strategy in the countries in which the Company operates.

Brand value\* (€M)



\* Source: Ranking of Best Spanish Brands by Interbrand.

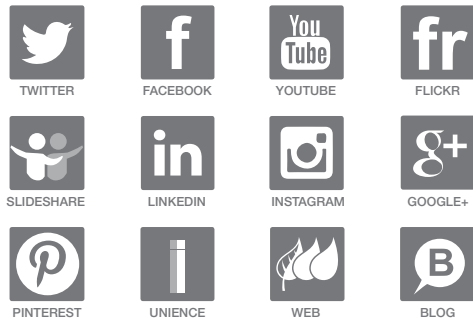
## Corporate reputation

- Stakeholders are a significant element in the management of Iberdrola's reputation.
- The Group's reputational management model assesses the degree of alignment between the company's actions and the perceptions of its stakeholders.
- Management of the reputational strengths of Iberdrola compared to its competitors.
- Periodic evaluation of the Group's reputation, a process initiated in 2005, using the *RepTrak* international standard.
- Completion of the Reputation Programme 2013-2014, incorporating reputation as a cultural factor of Iberdrola.
- Identification of priority stakeholders, society, customers, and regulatory bodies for the new Reputation Plan 2015-2017.
- Specific actions to improve stakeholder confidence in the 7 dimensions of Iberdrola's reputation model, which is aligned with the Reptrak international standard.
- Progress made in reputational risk management, stemming from implementation of the Company's *Reputational Risk Framework Policy*. Coordination and integration of the Triple Line of Defence function.
- Updating and monitoring of the reputational impact activities map.
- Reputational analysis of perception in social media and detection of reputational opportunities to differentiate Iberdrola from the industry.
- Monitoring and management of external indices.

## Evolution of the digital ecosystem

- Offer useful and dynamic information, with messages adapted to each stakeholder.
- Facilitate direct interaction with our stakeholders, overcoming barriers and making use of existing synergies.

Iberdrola on social media and the internet





# A framework of trust

Iberdrola Tower,  
Bilbao / España

5





# 5.1 Corporate governance model

## Foundations of Iberdrola's corporate governance model

### A. Corporate governance system

Iberdrola has adopted a Corporate Governance System made up of the *By-Laws*, *Corporate Policies*, internal corporate governance rules, and other internal codes and procedures, all available at [www.iberdrola.com](http://www.iberdrola.com).

The content thereof is inspired by and based on a commitment to the values assumed by the Company and to best corporate governance practices, business ethics, and social responsibility in all of its areas of activity.

The Company pursues the fulfilment of the corporate interest, which is understood as the common interest of all shareholders of an independent company oriented towards the sustainable exploitation of its corporate object and the creation of long-term value for the shareholders' benefit, taking into account other stakeholders related to its business activity and to its institutional reality. Furthermore, the Company aspires for its conduct and that of the persons connected therewith to adhere to ethical and social responsibility principles.

Position	Director	Status	Date of last appointment	Date term ends
Chairman & Chief Executive Officer	Mr José Ignacio Sánchez Galán (Salamanca, Spain, 1950)	Executive	26-03-2010	26-03-2015
Director	Mr Xabier de Irala Estévez (New York, United States, 1946)	Proprietary	22-06-2012	22-06-2016
Director	Mr Íñigo Víctor de Oriol Ibarra (Madrid, Spain, 1962)	Independent	22-06-2012	22-06-2016
Director	Ms Inés Macho Stadler (Bilbao, Spain, 1959)	Independent	22-06-2012	22-06-2016
Director	Mr Braulio Medel Cámara (Marchena, Seville, Spain, 1947)	Independent	22-06-2012	22-06-2016
Director	Ms Samantha Barber (Dunfermline, Fife, Scotland, United Kingdom, 1969)	Independent	22-06-2012	22-06-2016
Director	Ms María Helena Antolín Raybaud (Toulon, France, 1966)	Independent	26-03-2010	26-03-2015
Director	Mr Santiago Martínez Lage (Betanzos, A Coruña, Spain, 1946)	Independent	26-03-2010	26-03-2015
Director	Mr José Luis San Pedro Guerenabarrena (Bilbao, Spain, 1946)	Other external	22-06-2012	26-03-2015
Director	Mr Ángel Jesús Acebes Paniagua (Ávila, Spain, 1958)	Independent	22-06-2012	26-03-2015
Director	Ms Georgina Kessel Martínez (Mexico City, Mexico, 1950)	Independent	28-03-2014	28-03-2018
Director	Ms Denise Mary Holt (Vienna, Austria, 1949)	Independent	24-06-2014	27-03-2015
Director	Mr José W. Fernández (Cienfuegos, Cuba, 1955)	Independent	17-02-2015	27-03-2015
Director	Mr Manuel Moreu Munaiz (Pontevedra, Spain, 1953)	Other external	17-02-2015	27-03-2015

B. Governance model

Appropriate differentiation between the duties of supervision and management:

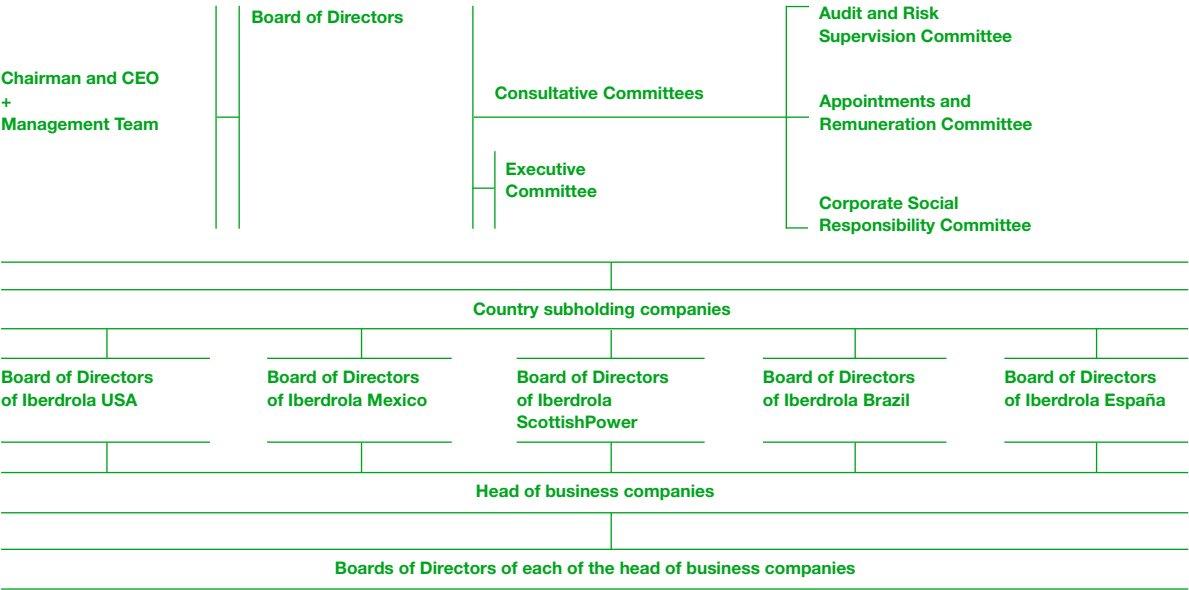
- The Board of Directors of Iberdrola, S.A., made up of a large majority of independent directors, focuses its activity on the determination, supervision, and monitoring of the strategies and general guidelines that must be followed by the Group.
- The chairman of the Board of Directors & chief executive officer and the rest of the management team are responsible for the organisation and strategic coordination of the Group, through the dissemination, implementation, and monitoring of the overall strategy and basic guidelines.
- In all of the countries in which the Company operates, organisation and strategic coordination is implemented through country subholding companies, which group together equity stakes in the head of business companies carrying out their

activities in the respective country and centralise the provision of services common to such companies. The country subholding companies have boards of directors that include independent directors and their own audit and compliance committees, internal audit areas, and compliance units or divisions.

- The head of business companies are in charge of the day-to-day administration and effective management of each business. They also have boards of directors, which include independent directors and specific management teams.

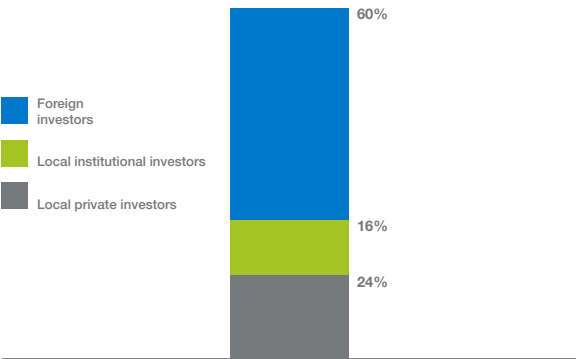
This structure, which operates together with the Group’s Business Model, allows for an overall integration of the businesses (Networks, Liberalised, and Renewables) and focuses on maximising the operational efficiency thereof through the exchange of best practices among the companies involved.

Iberdrola’s corporate and governance structure.



C. Equity structure

Iberdrola has more than 600,000 shareholders throughout the world, and none of them has the power of control.



Foreign institutional shareholders account for 60% of the capital.

External corporate governance awards / page 34

Iberdrola’s response to the corporate governance challenge

A. Continuous improvement of its corporate governance rules and practices

The Company refers to generally accepted recommendations in the international markets on corporate governance matters.

77% of the non-executive directors are independent.

Remuneration policy	Executive directors’ variable remuneration tied to objectives.
	Transparency.
	Provision for revising deferred variable remuneration.
Operation of the Board	77% of non-executive directors are independent, all having less than 12 years in office.
	System of checks and balances, including a lead independent director ( <i>consejera coordinadora</i> ).
	All members of the consultative committees are independent.
	Gender diversity: 5 women on the Board. All consultative committees are chaired by women.
	Cultural diversity: directors from 7 countries of origin.
	Rationale for proposed appointments.
Social responsibility and corporate reputation	External evaluation of governance bodies.
	Specific Corporate Social Responsibility Committee
	<i>Social Responsibility Policies.</i>
	Company social responsibility strategy through connected foundations in Spain, United Kingdom, Brazil, United States, and Mexico.

Ethics and social responsibility / page 78

## B. Commitment to shareholders and investors

- The strength of the Group's industrial and financial model has made it possible to consolidate profits and maintain shareholder remuneration despite the decline in the economic environment and the impact of regulatory measures in various countries.
- Engagement: Shareholders are the key players within the Corporate Governance System, which include good governance practices beyond those required by applicable law. The *Shareholder Engagement Policy* is implemented through various channels of participation intended to build a continuous dialogue beyond the General Shareholders' Meeting.
- Participation encouraged: Iberdrola has encouraged shareholders' participation at the General Shareholders' Meeting through the payment of an attendance bonus. Since its implementation in 2007, attendance at the General Shareholders' Meeting has exceeded 75%, and has exceeded 81% during the last two years.

**The quorum at the 2014 General Shareholders' Meeting was 82.24%.**



## C. Alignment between corporate governance and strategy

- Director remuneration aligned with strategic objectives. The remuneration model for directors is based on three primary components:

### Remuneration model for the Board

Type of remuneration	External (non-executive)	Executive directors
Fixed	According to their duties.	On market terms.
Short-term variable	Not applicable	Tied to annual targets.
Long-term variable	Not applicable	Tied to multi-annual targets and paid in shares (3-year accrual period and payment deferred over 3 years following accrual).

Variable remuneration is tied to pre-established financial, industrial, and social responsibility parameters, including shareholder return. The Annual Director Remuneration Report 2013 only received 1.37% votes against.

### Parameters to which the annual variable remuneration of executive directors is tied in 2015

Financial	Results. Shareholder return.
Industrial	Quality and service level. Labour climate.
Social responsibility	Presence on international indices. Publication of an integrated report. Level of consensus received for the proposals of the Board at the General Shareholders' Meeting.

© Annual director remuneration report 2014

# 5.2 Risks

## Main risks facing the Iberdrola Group

The Iberdrola Group is exposed to various risks inherent in the different countries, industries, and markets in which it operates and in the activities it carries out, which may prevent it from achieving its objectives and from successfully implementing its strategies. The following significant risks can be pointed out:

- Regulatory uncertainty in the countries in which it operates.
- Volatility in the prices of electricity and fuel, including the potential effects of the collapse in oil prices.
- Volatility in exchange rates and interest rates.
- Changes in the production of and demand for electricity and gas due to the effect of climatological variables (temperature, hydraulic activity, wind activity), and growth in internal consumption over the long term.
- Operational risks due to downtime of facilities and significant incidents affecting the grids, including those arising from improper access to information or to the information technology and communications systems of the Group (cyberattacks).

## Commitment of the Board and of Senior Management

Iberdrola's Board of Directors and Senior Management is strongly committed to and engaged in the management of the Group's risks:

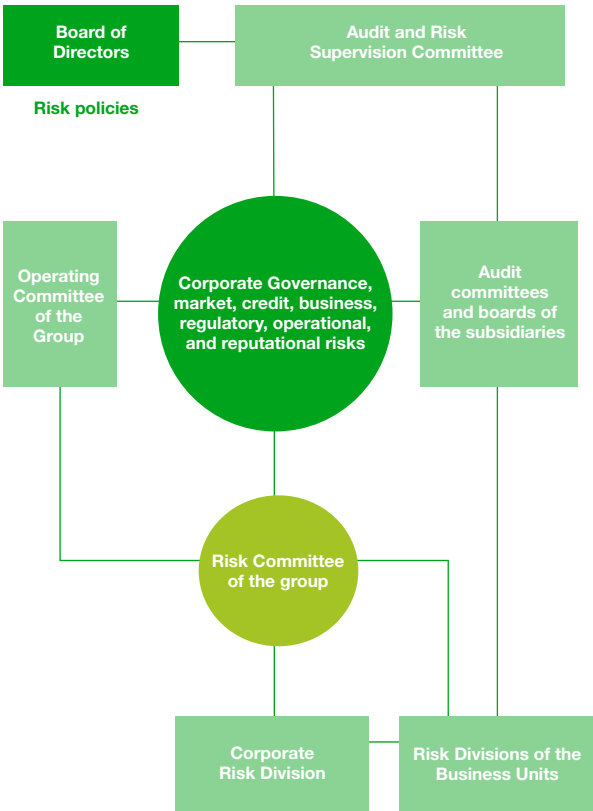
- Acceptable levels of risk tolerance are reviewed and approved *ex ante* on an annual basis through risk policies and limits that establish the qualitative and quantitative risk appetite at the Group level and at each of the main businesses.
- There is then a periodic monitoring *ex post* of significant risks and threats and of compliance with the approved risk policies and limits.

Ⓢ Consolidated financial statements

The essential elements of proper risk management are foresight and control, acting with independence and commitment to the business objectives

Comprehensive risk control and management system

At the operational level, the commitment of the Board of Directors is implemented by means of a comprehensive risk control and management system, supported by a Risk Committee and an independent specialised risk organisation deployed within the main businesses of the Group.



⦿ Risks facing Iberdrola's primary businesses / page 42

Duties of the Risk Division

ERM Approach – Integrated Vision

Ensure that the Group's significant risks are adequately identified, measured, managed, and controlled and that they are periodically reported.

Basic instruments:

- Risk policies and limits.
- Reports on key risks

Centralised approach – Active management

Credit risk

- Approval of counterparties and limits and/or establishment of admission criteria in order to minimise credit losses within the Group.

Market risk

- Approval of detailed limits in order to delimit the effects of volatility in the markets in which the Group operates.

Operational risk management through insurance.

# 5.3 Ethics and social responsibility

## Compliance Unit

Iberdrola has a Compliance Unit, as a collective, internal, and permanent body linked to the Corporate Social Responsibility Committee of the Board of Directors.

There are also compliance divisions at the level of the country subholding companies and/or the head of business companies.

Their goals include promoting a culture of ethical behaviour and zero tolerance for the commission of unlawful acts or fraud.

There is a compliance system intended to encourage action by the organisation in accordance with ethics and applicable legal provisions by means of a set of procedures and actions designed to prevent, detect, and react to irregular activities, fraud, or acts contrary to the *Code of Ethics* of the Iberdrola Group or applicable regulations.

### Main activities in the area of ethics and compliance

As part of the Compliance System, various programmes, control systems, and activity frameworks are implemented within the Group to encourage the organisation to act in accordance with the most stringent ethical standards and in accordance with applicable laws and regulations.

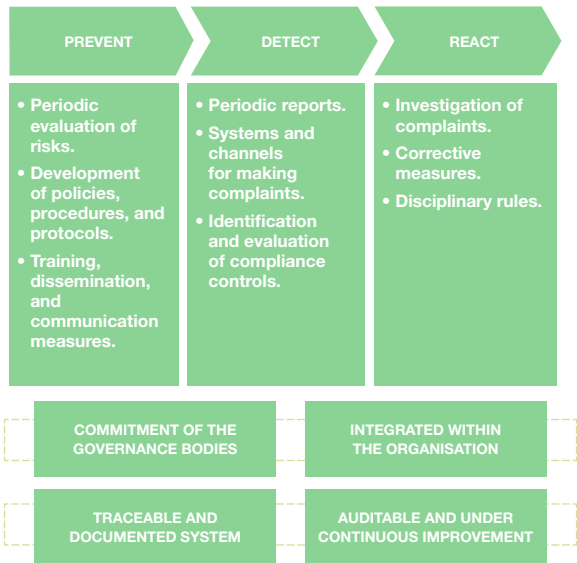
These include the *Crime Prevention Programme*, which is implemented within the framework of the process of reviewing and adapting the duties imposed by the Spanish Criminal Code, without prejudice to the legal provisions applicable in any other jurisdiction in which the Company does business.

In addition to the foregoing, the Compliance Unit has defined an action framework for compliance with the Code of Ethics, the fundamental goal of which is to foster a culture of corporate ethics and transparency, disseminating the principle of “zero tolerance” with respect to fraud and promoting mechanisms and actions to prevent corruption and fraud.

## Powers of the Unit

The Compliance Unit has powers related to the *Code of Ethics*, the *Crime Prevention and Anti-Fraud Policy*, the *Internal Regulations for Conduct in the Securities Markets*, legal provisions regarding the separation of activities, and all other powers that may be entrusted thereto by the Corporate Social Responsibility Committee or the Board of Directors of the Company or that are established in Iberdrola’s Corporate Governance System.

## The Iberdrola Group’s ethics and compliance system



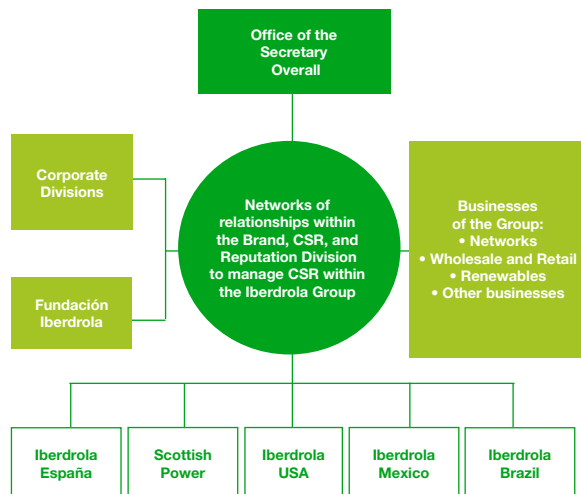
### Action framework for compliance with the Code of Ethics

- The *Code of Ethics* is the “cornerstone” upon which this framework and its actions and procedures are implemented, including plans for training and dissemination in this area.
- It is projected towards third parties with which the Group works.

## Iberdrola regards the commitment to good corporate governance, business ethics, and transparency as “business values”

### Organisation of social responsibility within the Group

The Iberdrola Group has an organisational structure designed to promote and manage responsible actions with its stakeholders.



The Corporate CSR and Reputation Committee and the CSR and Reputation Committees of the country subholding companies coordinate the balanced development of these matters within the Iberdrola Group. The CSR Committee of the Board of Directors performs the duties of supervision within its purview.

#### CSR plans of the group

In 2014, Iberdrola completed the *Social Responsibility Plan* for the 2013-2014 period, which is articulated around the goals of contributing to the generation of a culture of global responsibility within the Group, strengthening trust through the continuous promotion of responsible behaviour, and contributing to the creation of value shared with its stakeholders.

This plan is analysed by the Corporate CSR and Reputation Committee and the CSR Committee of the Board of Directors every six months, and upon the completion thereof, it reached a 96% level of compliance with the established goals.

The CSR Plan for the 2015-2017 period is currently being prepared.

#### External awards



86 points.



First utility with nuclear assets to be selected on the index.



Carbon Disclosure Leadership Index (CDLI), 99 points.



Carbon Performance Leadership Index A.



Iberdrola one of the developers.



First Spanish utility.



Iberdrola selected.



Sustainability Yearbook 2014 “Silver Class” in the electricity sector.



Honourable Mention in Environment and Sustainability.



Iberdrola is leading most sustainable Spanish utility and third worldwide.



Leader among Spanish utilities: electricity, gas, and water.



Classified as “Prime”.



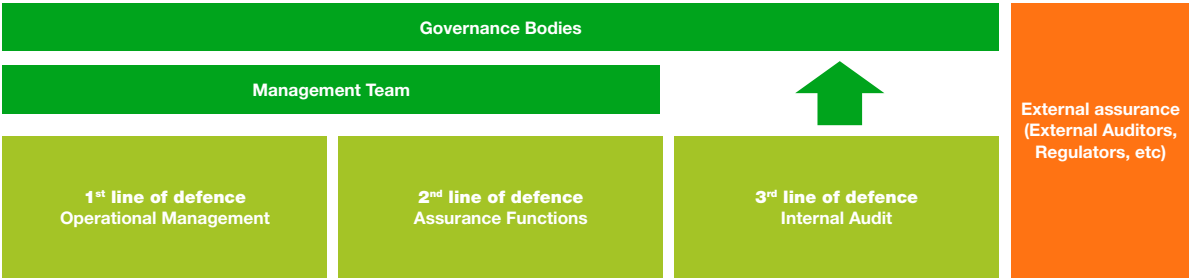
Leading company on the Ibex 35 in the Tax Transparency ranking 2014.



# 5.4 Triple line of defence

## Model of Triple Line of Defence

The *Internal Control System* of Iberdrola and the companies of its Group is configured by reference to international best practices. It is based on a guarantee combined around three lines of defence, providing a comprehensive view of how the different parts of the organisation interact in an effective and coordinated manner, making more efficient the processes for management and internal control of the entity's significant risks.



Based on the document "Guidance on the 8th EU Company Law Directive, article 41" ECIIA/FERMA, September 2010

## Operational management

As the first line of defence, the Management Team and the professionals of Iberdrola and its Group are the direct managers of the risks of the entity. Thus, the Management of the Company is responsible for maintaining effective control and implementing procedures to control risks on a continuous basis.

⦿ **Risks facing Iberdrola's primary businesses**  
/ page 42

Internal Control Objectives (COSO. May 2013)

- **Operations objectives** - Pertain to the effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss.
- **Reporting objectives** - Pertain to internal and external financial and non-financial reporting and may encompass reliability, timeliness, transparency, or other terms as set forth by regulators, recognised standard setters, or the entity's policies.
- **Compliance objectives** - Pertain to adherence to laws and regulations to which the entity is subject.

## Assurance functions

As the second line of defence, certain duties provide the foundation for the entity's internal control system, proposing guidelines to the Board and monitoring how the first line of defence implements them.

The primary assurance functions within Iberdrola, within their respective areas of responsibility, are (i) the Risk Committee of the Group, within the framework of its duties within the Comprehensive Risk Control and Management System; (ii) the Compliance Unit, which is responsible for the Compliance System; and (iii) the Internal Control Division, which is part of the Administration and Control Division, within its duties relating to the internal control and risk management systems in relation to the issuance of financial information (ICFRS).

- ⦿ **Comprehensive risk control and management system**  
/ page 77
- ⦿ **Compliance unit**  
/ page 78

# Iberdrola adopts the triple line of defence model to guarantee effective and integrated management of its Internal Control System

## Internal Audit

The internal audit function, in its capacity as the third line of defence, supervises the internal control and risk management systems, auditing how the first and second lines carry out their respective duties of management and control.

To ensure its independence, the director of the Internal Audit Area reports hierarchically to the Chairman of the Board of Directors and functionally to the Audit and Risk Supervision Committee.

The internal audit divisions of the various country subholding companies have this same positioning, and are coordinated under the framework of the *Basic Internal Audit Regulations* of Iberdrola and the Companies of its Group.

The 2014 annual activities plans of the Internal Audit Area Division of Iberdrola, S.A. and of the internal audit divisions of the Group responded to the requirements established by the Audit and Risk Supervision Committee of Iberdrola, S.A. and the respective audit and compliance committees of the country subholding companies in their respective regulations, and included work for the Senior Management and the rest of the organisation, including:

- Annual audits of compliance with the *Code of Ethics* at Iberdrola, S.A. and at each of the country subholding companies.
- Audit of the Corporate Risk Policy regarding Treasury Shares.
- Six-month reviews of the operation of the most critical controls of the Internal Control Over Financial Reporting (ICFR) Model, as well as reviews of the various cycles of preparation of the financial information of Iberdrola, S.A. and the various companies of the Group, within the framework of the general goal of reviewing the entire ICFR over a period of 3 years.

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Basic Internal Audit Regulations of Iberdrola and the Companies of its Group

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- Approved by the Board of Directors of Iberdrola, S.A. upon a proposal of its Audit and Risk Supervision Committee.
- Defines the nature, activities, organisation, operation, basic powers, and duties of Internal Audit.
- Establishes the framework of relations with: i) the Board of Directors, its chairman, and Committees; ii) the internal audit divisions of the other companies of the Group; and iii) the rest of the organisation.
- Disseminates the knowledge of the Internal Audit function among the professionals of the Group.
- Serves as a reference for the management model and the quality system of the Internal Audit Area of the Company and the Internal Audit divisions of the other companies of the Group.

## External assurance

The auditors, regulatory bodies, and other entities external to the organisation play a significant role in the general structure of governance, internal control, and risks of Iberdrola, especially in the regulated businesses.

The regulators establish requirements with the intention to strengthen the controls of an organisation and perform a function of independent and separate monitoring.

On the other hand, the auditors provide assurance regarding the true and fair view of the entity's financial information.

© Regulatory environment  
/ page 38

© Report of the auditor of the consolidated financial statements

# About this report

This report, which Iberdrola directs to both its shareholders and investors and all of its stakeholders, has been prepared under the emerging “integrated report” concept, and constitutes one more example of the Group’s intention to be innovative in the area of transparency.

Whitelee Wind Farm,  
Scotland / United Kingdom

6



# 6.1 About this report

## Integrated report

- This report has been prepared in accordance with the reporting framework published by the International Integrated Reporting Council (IIRC) and in accordance with the recommendations thereof, taking into consideration the individual and consolidated financial statements of the Company formulated by the Board of Directors, audited and pending approval by the shareholders at the General Shareholders' Meeting of Iberdrola, S.A.
- A multi-disciplinary team made up of corporate businesses and areas of the Group was created in order to provide a complete view of the Company, its business model, the challenges and risks it faces, and its social, environmental, financial, and governance performance. The participating organisations guarantee the completeness of the information included.
- This report has been analysed by the Operating Committee of the company and approved by the Board of Directors of Iberdrola at its meeting of 17 February 2015.
- As regards the key issues identified by the IIRC, it is expected that future reports will delve into the establishment of increased interrelation between the Company's objectives and their effects on capital.

## Information boundaries

- The information submitted covers Iberdrola, S.A. and its subsidiaries and affiliates. The information boundaries are defined in the Group's *Annual Financial Statements* and *Sustainability Report*.
- The Group's performance over the last years is connected to external corporate transactions and internal management decisions, which the reader should take into account in order to properly interpret this report. These transactions and activities are described in the Group's public information, the following being particularly noteworthy:
  - The acquisition and merger of companies in Brazil (2011) and the nationalisation in Bolivia (2011).
  - Beginning on 1 January 2011, the focus on a Group management model based on global businesses.
  - The application of IFRS 11 to the 2013 and 2014 figures, which mainly affect Brazil.

## Material aspects

- Iberdrola has channels of communication and dialogue with its stakeholders, developed in accordance with the principles of the AA1000 Assurance Standard, as described in detail in the *Sustainability Report*.
- In addition, it performs materiality analyses that help identify matters of significance to the Company's stakeholders, bringing to light particularly sensitive financial, environmental, or social issues related to the business in the various communities and geographic areas in which the Group operates.
- The contents of this report have been selected by taking into account the existing channels for dialogue as well as the materiality analyses and the framework defined by the IIRC for this kind of information.

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**This report has been prepared in accordance with the reporting framework published by the International Integrated Reporting Council (IIRC).**

## Internal and external verification

- This report has been subject to a process of internal verification, by means of a limited review performed by the Management of the Internal Audit Area of Iberdrola, S.A.
- Although it has not been subject to a process of independent external verification, a significant portion of the information contained herein relating to financial year 2014 and to previous years comes from annual financial reports and sustainability reports, all of which have been the subject of an external audit or verification for which the respective certificates are available. The remaining information comes mainly from other reports or public presentations made by the Company.

## Legal disclaimer with respect to forward-looking statements, errors, and omissions

- This document contains forward-looking information and statements about Iberdrola, S.A. Such statements include projections and estimates and their underlying assumptions, statements regarding plans, objectives, and expectations with respect to future transactions, investments, synergies, products, and services, and statements regarding future performance. Forward-looking statements are not historical facts and are generally identified by the words “expects”, “anticipates”, “believes”, “intends”, “estimates”, and similar expressions.
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- Forward-looking statements are not guarantees of future performance and have not been reviewed by the auditors of Iberdrola, S.A. You are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date they were made. All forward-looking statements included in this report are expressly qualified by the cautionary statement above. All forward-looking statements included in this document are based on information available as of the date of publication hereof. Except as required by applicable law, Iberdrola, S.A. does not undertake any obligation to publicly update its forward-looking statements or to revise any forward-looking information, even if new data are published or new events occur.







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