



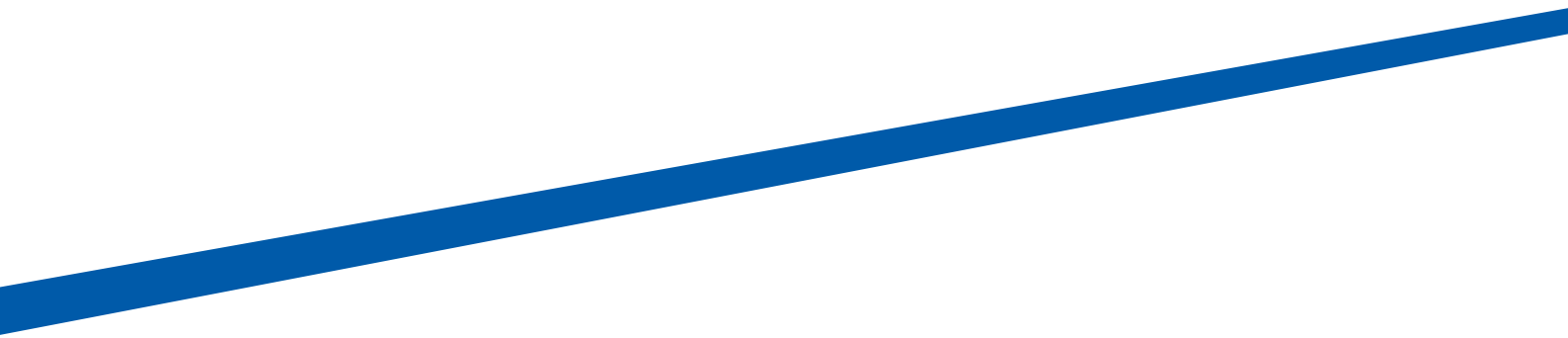
2017

Annual Report 2017
Integrated Report

Terna S.p.A. and Terna Group

A photograph of a modern, multi-story office building at night. The building's facade is illuminated with blue and white lights. The Terna logo is prominently displayed on one of the lower floors. In the foreground, a highway with multiple lanes shows light trails from cars, indicating traffic flow. A blue diagonal line runs across the lower portion of the image, serving as a background for the slogan.

Energy is our responsibility



Annual Report 2017

and

Integrated Report

TERNA S.P.A. AND TERNA GROUP





Our mission

*Energy is our responsibility.
Responsibility is our energy.*

“To play a leading role in the coming sustainable energy transition, by leveraging our distinctive innovation capabilities, competencies and technologies for the benefit of all stakeholders.”

We are a major operator of grids used to transport energy.

We manage the High-Voltage transmission of electricity in Italy, ensuring **security, quality and cost-effectiveness over time**.

We are working hard on **development of the electricity grid**, the achievement of ongoing improvements in operational efficiency and integration with the European grid.

We guarantee **equal access** to all grid users.

We are developing **Non-Regulated Activities** and new business opportunities, building on the experience and technical expertise gained in managing complex systems and on our technological excellence.



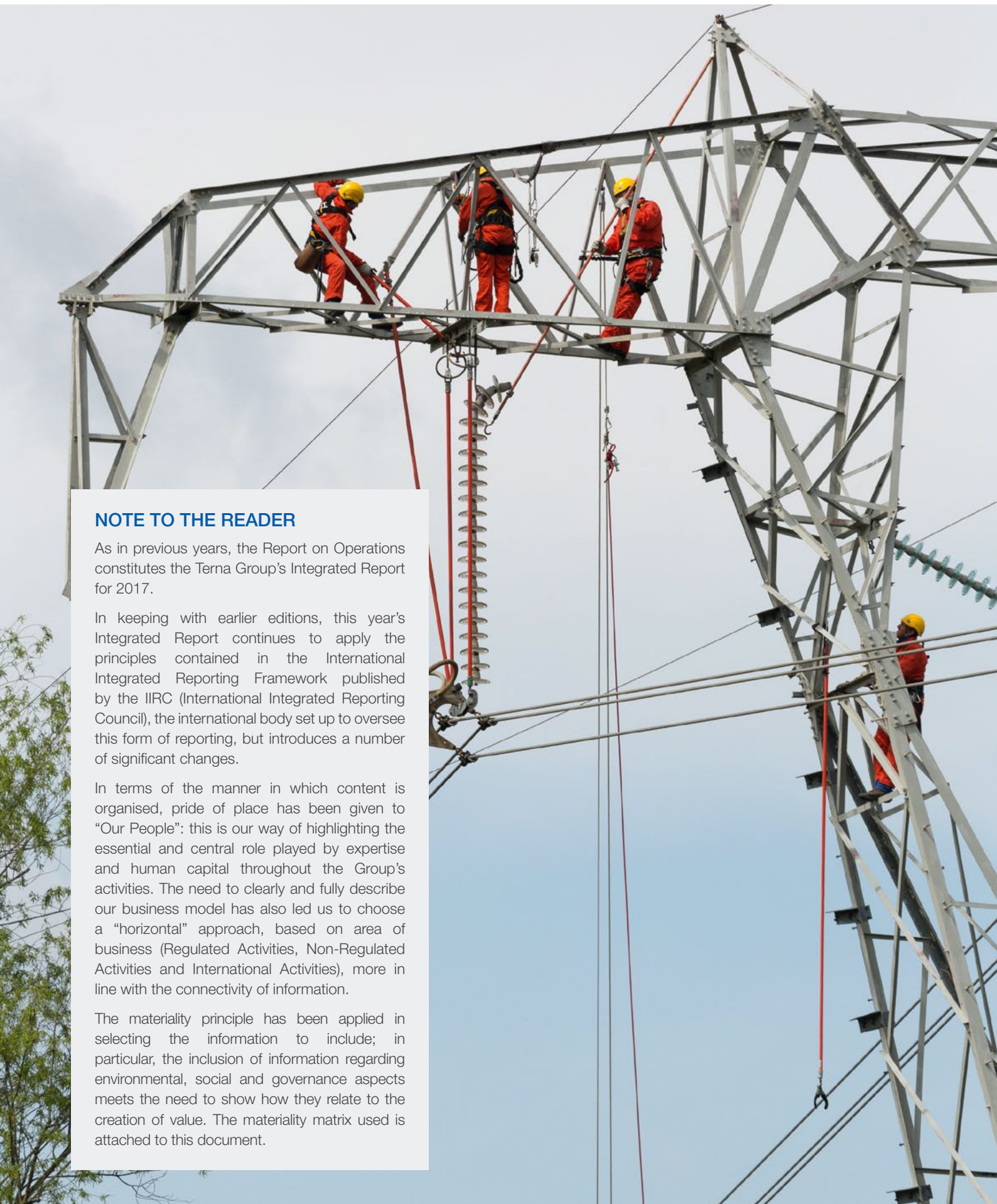


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A low-angle, upward-looking photograph of electrical equipment. On the left, a large white cylindrical structure, possibly a transformer or cooling tower, is partially visible. In the center and right, there are dark, vertically oriented insulators with multiple disc-like segments. White cables are draped across the scene. The background is a clear, bright blue sky. The text "Integrated Report" is written in white, slanted font across the middle of the image.

Integrated Report



NOTE TO THE READER

As in previous years, the Report on Operations constitutes the Terna Group's Integrated Report for 2017.

In keeping with earlier editions, this year's Integrated Report continues to apply the principles contained in the International Integrated Reporting Framework published by the IIRC (International Integrated Reporting Council), the international body set up to oversee this form of reporting, but introduces a number of significant changes.

In terms of the manner in which content is organised, pride of place has been given to "Our People": this is our way of highlighting the essential and central role played by expertise and human capital throughout the Group's activities. The need to clearly and fully describe our business model has also led us to choose a "horizontal" approach, based on area of business (Regulated Activities, Non-Regulated Activities and International Activities), more in line with the connectivity of information.

The materiality principle has been applied in selecting the information to include; in particular, the inclusion of information regarding environmental, social and governance aspects meets the need to show how they relate to the creation of value. The materiality matrix used is attached to this document.

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Statement to Stakeholders from the Chairwoman and the Chief Executive Officer

The world of energy is changing extremely rapidly and against this backdrop, our goal is to enable the transition to a **more efficient, secure and sustainable energy system**. Recent developments have brought a series of new challenges, such as how to manage the decarbonisation process and the need to guarantee security of supply and the cost-effectiveness of the service for businesses and households.

Terna is playing a strategic role in this scenario. We are developing a more resilient and sustainable grid, increasing cross-border interconnections and resolving localised congestion. We are also improving our grid, reducing the risk of interruptions to supply and implementing **innovative, digital solutions**.

Against this backdrop, in accordance with our new Strategic Plan for the period 2018-2022, presented to the financial community on 22 March 2018, we intend to give priority to investment in our domestic market. Our aim is to focus on the needs of the system, with a view to strengthening the electricity grid and enabling the integration of renewable sources. In terms of our International Activities, the new Plan concentrates on the completion of projects already in progress, preserving the Company's low risk profile. Our continued commitment, in relation to our Non-Regulated Activities, is to develop value added services based on our distinctive competencies.

Sustainability is a part of our business model, with our environmental and social indicators included in the cost-benefit analysis (CBA) applied to our projects. The green economy and innovation go hand in hand: the introduction of green transformers (insulated with vegetable oil rather than mineral oil) and the dispatching of renewable energy are good examples of this.

Energy for change depends on our **people**, in whom we are continuing to invest in the knowledge that they are the key to Terna's future success. We are investing in development and training, reducing the age of our workforce through voluntary retirement schemes and by creating the conditions for new initiatives designed to attract talented young people. The aim is to create an environment in which employees can develop both personally and professionally.

At Terna, **dialogue** with our stakeholders forms the basis for everything we do. We take a proactive approach to engagement with interest parties, such as national and local authorities, municipalities, the general public, trade unions and environmental organisations, and we believe that the involvement of stakeholders is key to delivering our business objectives.

This year, we are once again proud to present you with an improved set of results, further proof of the ongoing progress achieved by the Group in terms of operational and financial efficiency. This financial strength and earnings performance are the foundations on which **we can together build** the Terna of the future.

Backed by a solid financial structure, Terna is capable of creating further lasting and sustainable value for its shareholders and stakeholders. **This is why we like to say that energy is Terna's responsibility and that responsibility is our energy.**

Catia Bastioli
Chairwoman

Luigi Ferraris
CEO





01

The Terna
Group



Highlights

Revenue

2,248 €m

+6.9%

EBITDA

1,604 €m

+3.8%

Profit attributable to owners of the Parent

688 €m

+8.7%

Capital expenditure

1,034 €m

+21%

Net debt

7,796 €m

-2.3%

Total Shareholder Return

514%

since the IPO at the end of 2017

Dividends:

Interim for 2017

7.43 euro cents per share

Final for 2017

proposed to AGM

14.57 euro cents per share

PERFORMANCE

FINANCIAL
HIGHLIGHTS

SHARE PERFORMANCE
AND SHAREHOLDER RETURN

ASA

(Average Service Availability)

99.99%

This figure, close to 100% as in previous years, is a mere tenth of a percentage point below the maximum possible, confirming the high quality of Terna's services.

32%

of Italy's demand covered by renewable electric sources

Interconnection capacity*

8.9%

With the entry into service of the International interconnections envisaged in the Strategic Plan 2018-2022, Terna expects to reach the target of 10% set by the European Community for 2020.

Principal new lines entering service

- Udine West-Redipuglia
- Capri-Mainland

Lines demolished

98.3 km

Over 1,000 kilometres of lines have been removed since 2010

CO₂ emissions

0.47%

SF₆ leakage rate

Leakages of the greenhouse gas, SF₆, as a percentage of total installed gas capacity. This gas represents the principal source of Terna's direct CO₂ emissions.

Carbon intensity

66.0 tonnes of CO₂ per €m

In line with the last three years.

Waste reused or recycled

87%

Recovery of machinery and packaging exceeds 95%.

Training

50 hours per capita

The number of per capita hours of training provided is well above the average for FTSE MIB companies (25.8 in 2016, based on the latest available data).

Injury rate

0.81

The injury rate is down 19% on 2016.

Turnover among the under 30s

1.0%

Turnover among the under 30s is down 49% on 2016.

OPERATIONAL HIGHLIGHTS

ENVIRONMENTAL PERFORMANCES

SOCIAL PERFORMANCES

(*) Ratio of interconnection capacity to net installed capacity.



Milestones

ORIGINS

1962-1999

From a Monopoly to an Independent System Operator

Terna's principal activities date back to the former electricity monopoly: in 1962, Law 1943 paves the way for nationalisation of the electricity industry, handing ENEL responsibility for all the stages of the electricity supply chain (production-transmission-distribution-sale), previously in private hands.

The monopoly operator is able to complete electrification of the entire country, but the driving force behind the changes that have led to the current operating environment is, without doubt, the process of deregulation of the Italian electricity market. This is promoted by the European Union through the issue of a number of specific directives which, as regards transmission, establish that it is necessary to create a grid management company that is independent of individual operators within the industry, and above all free of the influence of the dominant operator.

Decree 79 of 16 March 1999 (the so-called "Bersani Decree") thus establishes that ENEL is to incorporate a national grid operator (Gestore della Rete di Trasmissione Nazionale or GRTN), a joint-stock company owned by the Ministry of the Economy. The government then grants GRTN a concession covering transmission, dispatching and planning for the development of the electricity grid. The key provision in the Bersani Decree is the separation of ownership of the various elements making up the National Transmission Grid from management of the grid itself (involving transmission and dispatching) along the lines of the so-called "Independent System Operator" model. Two new companies are therefore established: Terna, owner of the Italian transmission grid, and GRTN (the National Transmission Grid Operator).

THE NEW TERNA

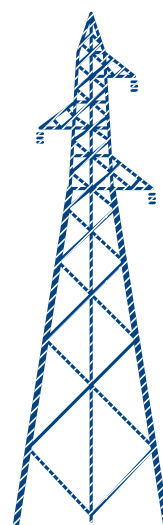
2004

Terna's Initial Public Offering

A Cabinet Office Decree gives the Group a new corporate governance system, designed to guarantee the neutrality and impartiality of Terna's management.

50% of the Company's share capital is floated on the Italian Stock Exchange (in the Blue Chip segment). The remaining shares are retained by ENEL.

The shares, having been bought primarily by US, UK and Italian investment funds, close their first day of trading up 3.60%.



2005-2008

Unification of the roles of Transmission Operator and System Operator: Terna's new mission to serve the country

Ownership and management of the grid are combined. This marks the culmination of a process that began in 1999 and the start of a new stage in Terna's mission to serve the country.

To safeguard Terna's independence as the National Transmission Grid Operator, the Ministry of the Economy and Finance acquires a 29.99% in Terna from ENEL through CDP (Cassa Depositi e Prestiti), thereby becoming the largest shareholder.

In this period, the Company records continuous growth, acquiring many portions of the grid, including control of the sections of the national transmission grid (NTG) owned by ACEA, Edison, AEM and AEM TE. The subsidiary, Terna Participações, is listed on the Sao Paulo Stock Exchange (BOVESPA).



BRASILE

2009

Terna becomes the largest TSO in Europe. Shareholders see the value of the investments grow

The Business Plan for the 2009-2013 period. This envisages capital expenditure of approximately €3.4 billion, including €2.6 billion in development of the grid. Terna acquires 18,600 km of High-Voltage lines from Enel, thereby becoming the leading independent grid operator in Europe and the seventh largest in the world. Terna now owns 98.6% of Italy's national grid.

In 2009, Terna sells 66% of Terna Participações to Cemig for a total of €797 million, recording a gain of over €400 million, some of which is invested in development of the Italian electricity network and some is returned cash to shareholders.



THE PRESENT DAY

2014-2017

The new Strategic Plan for the 2014-2018 period envisages investment of €5 billion over 5 years (€3.6 billion to be invested in development of the grid and €1.3 billion in Non-Regulated Activities).

In 2015, Terna acquires the Ferrovie dello Stato group's high-voltage grid for €757 million, consolidating its leadership in Europe with approximately 72,600 km of grid managed. Terna's value has more than doubled since its IPO.

In 2016, Terna focuses on strategic power lines. The Villanova-Gissi and Sorgente-Rizziconi lines enter service. The latter is a record-breaking power line, connecting Sicily and Calabria and the Italian Peninsula with the rest of Europe via the country's High-Voltage electricity system.

2010-2013

In 2011, Terna develops infrastructure of international excellence. The SA.PE.I. line (connecting Sardinia with the mainland) starts operating, as does the Chignolo Po-Maleo line in Lombardy. Work begins on the Sorgente-Rizziconi line (linking Sicily and Calabria).

Two new operating companies are established **in 2012**: Terna Rete Italia SpA, responsible for Regulated Activities, and Terna Plus Srl, with responsibility for expanding the non-regulated services offered by Terna.



2018

The Terna Group's new Strategic Plan, "Grid and Values"



In line with the guidance provided by the United Nations (COP21), EU guidelines and the objectives set out in the National Energy Strategy (NES), Terna has a key role to play in enabling the integration of all the new resources and for planning and managing the system in order to ensure its security and efficiency.

Against this backdrop, Terna has stepped up the pace of investment, focusing on development of the national transmission grid in order to facilitate the integration of renewable sources and improve the system's security. At the same time, it intends to renew the Group's asset base in order to mitigate the risk of interruptions to supply, boost environmental sustainability and make it easier to carry out maintenance activities through the use of digital grid technologies.



Key events

during the year and after the end of the reporting period

Corporate events

- On **15 March 2017**, Terna's Board of Directors approved the results for the year ended 31 December 2016.
- On **31 March 2017**, the merger of Terna Rete Italia Srl and Terna Storage Srl with and into Terna SpA became effective.
- On **27 April 2017**, the Annual General Meeting of Terna's shareholders approved the financial statements for 2016 and elected the new Board of Directors. At the first meeting of the new Board, Luigi Ferraris was appointed as the new Chief Executive Officer and Catia Bastioli was re-appointed Chairwoman.
- Agostino Scornajenchi was appointed Terna SpA's Chief Financial Officer and the Manager Responsible for Financial Reporting with effect from **1 September**.

Operations

- **Between 16 and 19 January**, a number of areas in the Abruzzo and Marche regions were hit by an extreme weather event that was unprecedented in terms of the size of the area affected, its intensity and duration. Terna worked closely with the authorities, Civil Protection units and distribution companies in order to minimise the impact on the electricity service.
- On **31 March 2017**, as part of the upgrade taking place in the Benevento area and of the connection with renewable energy plants, the Benevento III (BN) substation, equipped with 5 bays (3 of 380 kV and 2 of 150 kV), entered service.
- On **1 June 2017**, Terna presented its plan for the "Rationalisation of the high-voltage grid in the areas of Venice and Padua" to the Technical Committee for Environmental Impact Assessment at the Ministry of the Environment and of the Protection of Land and Sea, as part of the process of obtaining authorisation for the project.
- On **27 June 2017**, the connection between the island of Capri and the Italian mainland became operational.
- On **1 October 2017**, the 380 kV "Udine West-Redipuglia" power line entered service, following on from the MED's issue, on 14 February 2017, of a new authorisation decree (EL-146 bis) giving the go-ahead for construction of this important infrastructure. This project was included in the 2003 Development Plan and was critical to ensuring the electricity security provided by the Friuli grid, previously consisting of two 380-kV lines dating back to the 1970s and 80s, as well as to meeting energy demand in the area, which has more than doubled. The line - which has entered service after thirteen years of talks with municipal, provincial and regional authorities and ministries - not only guarantees the supply of electricity to households, but also to businesses. Indeed, thanks to the improved security of supply provided by the new power line, the latter can now proceed with investment in the areas concerned, bringing major benefits for a community of 230,000 people, including the creation of jobs. The 40 km of new line, built at a cost of approximately €110 million, also means that Terna can begin the demolition of 110 km of old lines and around 400 pylons across 30 municipalities in southern Friuli. 680 buildings currently located no more than 100 metres from the lines to be demolished will benefit from this process, whilst 367 hectares of land will no longer be subject to the related easements. These figures are proof of Terna's commitment to combining development with sustainability, bringing significant benefits for local communities.



- In **September**, the process of re-routing the 132-kV “Ca’ Poia-Redipuglia” power line began. This will allow for 4 km of old line to be decommissioned and the demolition of 15 pylons near houses. Furthermore, a new line is to be constructed away from residential areas, making use of existing road access: 1.25 km will be overhead lines and 3.0 km will be underground cable.
- On **11 October 2017**, a Memorandum of Understanding was signed with Électricité de France (EDF) for the construction of the Sa.Co.I 3 link. The goal is to create a new DC tri-terminal connection providing up to 400 MW of capacity (100 MW of which to provide power for the island of Corsica), by 2023. The new Sa.Co.I 3 link will replace the current Sa.Co.I 2. link and will be constructed largely by making use of existing assets, involving the upgrade and modernisation of the two-way exchange conversion substations and the laying of new terrestrial and submarine cables close to existing routes.
- On **8 March 2018**, ARERA published Resolution 129/2018, “Urgent measures relating to output-based incentives for the transmission service. Amendments to the provisions governing the recognition of high-risk projects”, which has introduced a series of measures applicable to Terna, including: incentives for the resolution of congestion between internal zones and on interconnections, by investing up to €150 million in new transmission capacity in the period 2019-2023; incentives for development of the grid with the aim of resolving congestion within zones, constraints on the grid affecting voltage regulation and the provision of essential services (the general criteria for quantifying the incentives are based on the expected benefits in terms of potential savings on the DSM as a result of the above projects, whilst definition of the detailed criteria will be dealt with in a later resolution); the reinstatement of the return on work in progress (calculated by assuming a WACC with a debt-to-equity ratio of four) for highly complex and risky projects with a duration of over 3 years (between obtaining the necessary consents and entry into service) and when expenditure has not already exceeded 50%. The resolution puts off measures regarding other incentives relating to the following issues until later resolutions: grants from grid operators and overseas entities; additional measures designed to improve efficiency, promote market integration and security of supply and support the related research activities; the implementation of initiatives aimed at fostering stakeholder capabilities and building awareness among local authorities of the benefits of infrastructure.

International interconnections

Private Italy-France Interconnector

On **4 July 2017**, the sale of Piemonte Savoia Srl to the Interconnector Italia Scpa consortium was completed. At the same time, the Terna Group and the “Interconnector Italia Scpa” consortium, set up by a number of “energy-intensive” private companies (the selected undertakings), signed the related EPC and operation and maintenance (O&M) contracts for the private part of the project. On this occasion, the entire capital of Piemonte Savoia Srl was transferred to the Interconnector Italia consortium.

As regards the progress of work on the project, in August 2017, work began at sites in the municipalities of Bussoleno, Susa and Exilles.

On 25 October 2017, the Ministry of Infrastructure and Transport approved the agreement granting PI.SA. the right to carry out the private part of the project and to cross the relevant section of the A32 motorway operated by Società Italiana per il traforo autostradale del Frejus (SITAF). Following approval of the agreement, in November 2017, work began on the motorway.



Italy-Montenegro Interconnector

Work continued on the submarine cable to connect the Abruzzo coast with Montenegro on other side of the Adriatic. Installation of the first pole has been completed, whilst installation of the terrestrial section is in progress. Work is progressing on the substations in Cepagatti (on the Italian side, involving the assembly of equipment, transformers and converters), and Kotor (on the Montenegrin side, involving completion of the foundations for equipment and the main buildings).

International business

Russia

On **2 June 2017**, as part of the St. Petersburg International Economic Forum, SPIEF '17, Terna and Rosseti signed a non-binding MoU for a 36-month period. The memorandum regards the exchange of know-how, best practices and cooperation in certain key technological areas in the electricity transmission sector, including storage and the identification of advanced solutions for the planning and construction of high-voltage networks, aimed at boosting resilience to weather-related events, such as snow and ice.

Brazil

On **26 June 2017**, an agreement with the Planova Group, a Brazilian company whose business involves the construction of civil works and infrastructure, was finalised in Brazil. The agreement regards the acquisition of two 30-year concessions for the construction and operation of approximately 500 km of electricity infrastructure. Following signature of the agreement on 2 February 2017, the transaction was completed through the subsidiary, Terna Plus, and conducted via the acquisition of two Brazilian vehicle companies, "SPE - Santa Maria Transmissora de Energia SA" and "SPE - Santa Lucia Transmissora de Energia SA". Under the agreement, the Terna Group will hold the concession and operate the line, while all engineering, procurement and construction (EPC) activities will be entrusted to Planova. The total expected capital expenditure amounts to €180 million.



Peru

On **8 September 2017**, Terna Plus - via its subsidiary, Terna Peru SAC - formalised the contract for the construction of 132 km of 138-kV power line in central Peru, connecting the electricity substations of Aguaytia and Pucallpa. The concession, which Terna was awarded at the end of May following the call for tenders issued by Proinversion (the state agency for infrastructure investment controlled by the Peruvian Ministry of Energy and Mines) has a duration of thirty years and is worth approximately US\$9 million.

Business Development

- On **10 October 2017**, Terna - via its subsidiary, Terna Plus - signed an agreement to acquire 70% of a New. Co. to which Avenia's principal assets are to be transferred. Avenia is a leader in the energy efficiency sector and certified as an Energy Service Company (ESCO). This transaction is part of the process of identifying and acting on new commercial opportunities for the provision of energy efficiency services and projects, in order to further strengthen Terna Plus's role as a supplier of comprehensive integrated energy services and expand its range of innovative solutions as an Energy Solutions Provider. This is in line with the strategy set out in the Strategic Plan for the Group's non-regulated business. Transaction closing took place on **15 February 2018**.

Finance

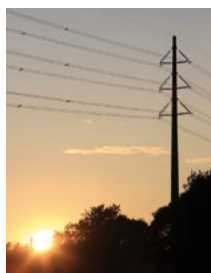
- On **6 March 2017**, Fitch affirmed Terna's "BBB+" rating, with a Stable Outlook. The agency deemed that the regulator's independence, the mature risk-free scenario in terms of volume and ready access to financial markets are such as to enable the agency to maintain the current rating. Moreover, such rating was not affected by the downgrade of the Italian Republic to "BBB/Stable", occurred on 21 April 2017.
- The **final dividend for 2016**, amounting to €269,137,928.80 (€0.1339 per each of the 2,009,992,000 shares outstanding) was paid on **21 June 2017**.
- On **27 June 2017**, Terna SpA signed an agreement with the European Investment Bank (EIB) for a 22-year loan of €85 million. The loan will fund investment in development of the Capri-mainland connection and in the restructuring of the network serving the Sorrento Peninsula, involving replacement of the current 60 kV network with a new 150 kV network. The agreement includes a fixed-rate tranche of €73.55 million at 1.386%, and a variable-rate tranche of €11.45 million, subject to certain conditions, with interest equal to 6-month EURIBOR + 0.343%.
- On **14 July 2017**, Terna signed a Project Finance agreement worth US\$81 million to fund construction of a 500-kV transmission line to connect the cities of Melo and Tacuarembó in Uruguay. The funding consists of a 17-year loan of approximately US\$56 million from the Inter-American Development Bank (IDB) and a 15-year loan of approximately US\$25 million from Banco Bilbao Vizcaya Argentaria (BBVA). The facility has been qualified as a "green loan" by Vigeo Eiris, an agency specialising in the assessment of aspects relating to the sustainability of business strategies and management, due to the positive impact the new transmission line will have on electricity generation from renewables in Uruguay. On 15 March 2018, the financing was awarded the prize for "Latin America Transmission/Distribution deal of the year", organised by IJ Global's Project Finance and Infrastructure Journal (one of the leading infrastructure publications in the world, focusing on the energy market), whose website receives an average of 175,000 visitors a month. The journal is owned by Euromoney, recognised as one of the world's most authoritative sources of financial market information.
- On **19 July 2017**, Terna SpA successfully launched a fixed-rate bond issue amounting to €1 billion under its €8,000 million Euro Medium Term Notes (EMTN) Programme, which has been rated "BBB" by Standard and Poor's, "(P)Baa1" by Moody's and "BBB+" by Fitch. The bonds, with a term to maturity of 10 years and a maturity date of 26 July 2027, will pay a coupon of 1.375%. Application has been made for the instruments to be listed on the Luxembourg Stock Exchange. The transaction is part of the financial optimisation strategy designed to support investment in a more sustainable, secure and efficient electricity network.
- On **21 July 2017**, Terna and the European Investment Bank (EIB) signed an agreement for a €130 million loan to fund investment in the public portion of the "Piedmont-Savoia" project. The loan, with a term to maturity of 22 years, includes a single tranche at a fixed rate of 1.64%. In addition, the Italy-France Interconnector Project was voted European Power Deal of the Year at the **Project Finance International Awards for 2017**, an event organised by the magazine Project Finance International, a leading source of global project finance intelligence. The magazine, which is part of the Thomson Reuters group, is one of the most important providers of information on project financing and infrastructure financing. One of the reasons for Terna winning the award was the fact that the magazine has classified the project as "first-of-a-kind", in recognition of the innovative nature of the transaction. The project's financial structure, involving a pool of four banks, stands out due to the fact that, according to the magazine, it is the first ever merchant interconnector debt facility to be put together within the EU. The facility consists of a non-amortizing portion (something highly unusual in the project financing market) of over €440 million and an innovative junior facility provided by the EIB, thereby permitting the entire debt package to benefit from credit enhancement.
- On **13 October 2017**, Terna SpA renewed its €8,000,000,000 EMTN Programme. Deutsche Bank and Citigroup acted as joint arrangers for the Programme, which was assigned a BBB rating by S&P, (P)Baa1 by Moody's and BBB+ by Fitch.

€ **85** m

for a 22-year EIB loan to fund development of the Capri-Mainland connection and restructuring of the network for the Sorrento Peninsula.



Uruguay



- On **30 October 2017**, S&P Global Ratings upgraded Terna SpA's long-term rating from 'BBB' to 'BBB+', confirming its short-term rating at 'A-2' (with a stable outlook). Terna's upgrade follows that of the Italian Republic from 'BBB-' to 'BBB' and reflects the Company's stand-alone credit profile (SACP), which S&P judges to be level 'a-'.

Innovation

- On **8 September 2017**, Terna, Cariplo Factory and the Cariplo Foundation renewed the partnership set up to accelerate youth employment and entrepreneurship in the electricity sector, after the highly successful first edition of the Next Energy project.
- On **27 September 2017**, a workshop entitled "The role of storage in grid management. Terna's experience: innovation for the electricity system" was held at the Polytechnic University of Milan. The main aim of the event, organised by Terna, was to report on the initial results of Terna's pilot storage projects on Italy's two largest islands and in the south of the country. The event, which included presentations made by representatives from the Ministry for Economic Development, ARERA (Italy's Regulatory Authority for Energy, Networks and the Environment) and CA-ISO (California's independent system operator) and was attended by firms operating in the sector, market participants and university professors and students, was also an opportunity to take a closer look at the wider issue of the current process of energy transition and the role that storage can play in this process.
- On **9 October 2017**, Terna signed up to the Bits & Watts research programme led by Stanford University's Precourt Institute of Energy, which aims to develop solutions capable of enabling decarbonisation of the electricity system.
- On **17 November 2017**, Terna and Legambiente signed a Memorandum of Understanding with a view to developing innovative smart solutions for the environmentally and socially sustainable production of electricity on Italy's smaller islands. The initiative aims to redevelop rundown areas in order to produce electricity from renewable sources in keeping with the characteristics of the local area.
- On **12 December 2017**, the Consortium Agreement for the "OSMOSE - Optimal System-Mix of Flexibility Solutions for European Electricity" project was signed. The project, which is being funded by the European Commission out of financing provided by call LCE-04-2017 under the European Horizon 2020 programme, involves 33 partners from 8 different EU countries with RTE - Réseau de transport d'électricité (the French TSO) as the lead partner. Terna's role is to lead Working Package 5 (WP5, one of the 4 demonstrators of actual grid situations) called "Multiple services provided by grid devices, large demand-response and RES generation coordinated in a smart management system". The objective of the project is to develop a new Energy Management System capable of providing more flexibility in management of the electricity system. The project's Italian partners, coordinated by Terna, are RSE, Ensiel, IBM, ABB, Enel Green Power, Edison Engineering (as well as Dolomiti Energia and the Bruno Kessler Foundation, who are engaged in another Working Package within the same project).
- On **16 January 2018**, Terna and Luiss signed a partnership agreement that aims to exploit high-potential talents through the recruitment and development of human capital. This marks the launch of Terna's training programme, which is intended to bring the business and academic worlds together in order to promote development of the expertise and skills needed in today's labour market and contribute to the country's growth.

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January 2018

Terna and Luiss signed a partnership agreement that aims to exploit high-potential talents through the recruitment and development of human capital.



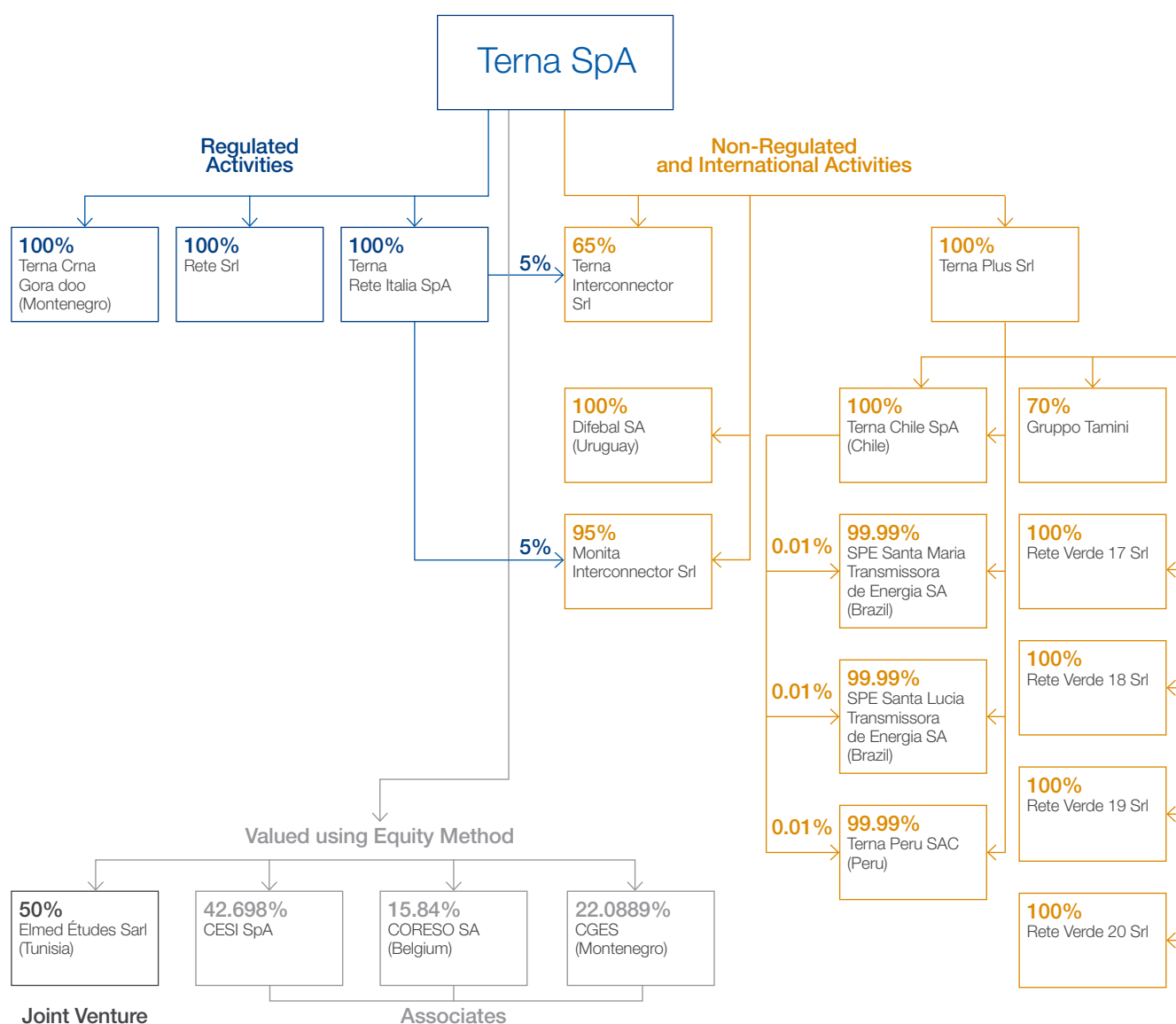
Business sustainability and integrity

- On **31 January 2017**, Terna became the first Italian company to obtain anti-corruption certification according to the new international regulation ISO 37001:2016 - Anti-bribery Management Systems. The certification also covers Terna Rete Italia and Terna Plus.
- In **April 2017**, Terna adopted guidelines entitled "Respect for human rights within the Terna Group" in order to implement the recommendations of the guidelines on business and human rights set out in the Ruggie Report published by the United Nations. The first due diligence assessment conducted in accordance with the guidelines revealed that approximately 60% of the Group's processes are not exposed to the risk of human rights violations; for the remaining 40%, the existing mitigation measures were found to be adequate.
- On **26 May 2017**, Terna's inclusion in the Euronext index published by the ratings agency, Vigeo Eiris, was confirmed for a sixth consecutive year thanks to its Environmental, Social and Governance performances.
- On **7 September 2017**, Terna's inclusion in the Dow Jones Sustainability Index was confirmed for the ninth year running. Compared to last year, Terna has further improved its ranking in the Index, with 89 points rising from fifth to fourth position (among the 64 companies evaluated), thanks to progress achieved in various key measures of sustainability. This confirms its position as the number one Italian company in the Electric Utilities sector, according to the assessment carried out by RobecoSAM, which selects the world's leading companies in terms of sustainability.
- On **20 September 2017**, Terna's inclusion in the Stoxx Global Leaders Index was confirmed for the seventh year running. This attests to the central role that sustainability plays in Terna's strategy, combining investment with the country's growth, through the development and modernisation of an increasingly secure electricity grid, with a low environmental impact and at a reduced cost to the public. Thanks to its outstanding performance in all areas analysed - environmental, social and governance - Terna was confirmed in all three indexes that make up the ESG Leaders index.
- In **October 2017**, the second edition of Next Energy was launched. This programme aims to aims to develop the potential of young new graduates and support innovative projects with a roadshow visiting universities and accelerators. The selection process came to an end in December, following the receipt of applications from over 100 engineering graduates and a similar number of teams of innovators and start-ups. The programme got underway in January 2018.
- In **November 2017**, the Board of Directors approved the Global Compliance Programme (GCP), which aims to monitor the performance of the Group's overseas companies in order to prevent the commission of offences of a criminal nature under foreign law.
- On **20 December 2017**, Terna, Coldiretti and ANBI (the National Association of Consortia engaged in the Protection of Italy's Landscape and Irrigation Water) signed an agreement setting out a joint action plan that aims to ensure the optimal management of irrigation resources, energy efficiency and nature conservancy.

89 points
in the Dow Jones
Sustainability Index,
rising from fifth
to fourth position.



Structure of the Group





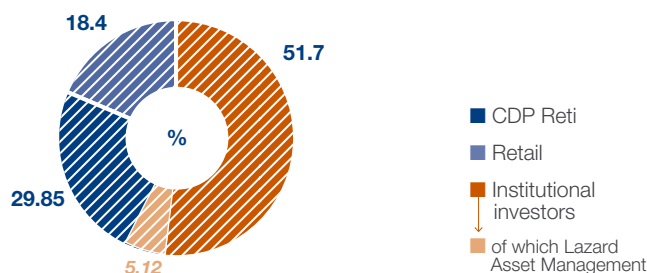
Shareholder structure

At the date of preparation of this report, Terna's share capital amounts to €442,198,240, comprising 2,009,992,000 fully paid-up ordinary shares with a par value of €0.22 each.

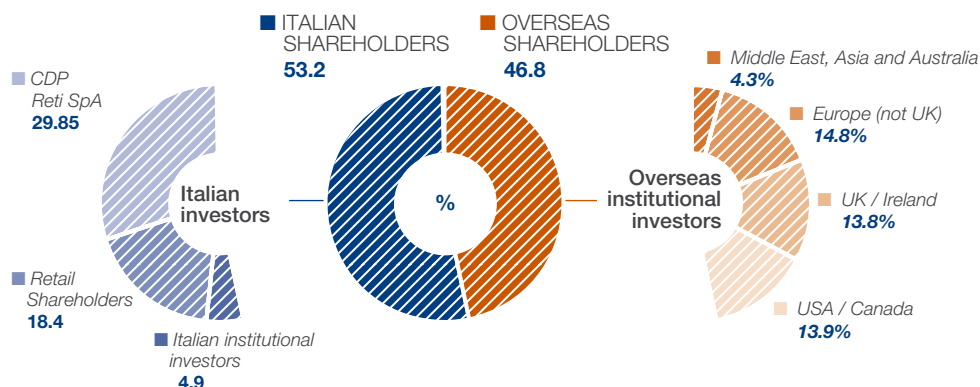
Based on periodic surveys carried out by the Company, it is estimated that 53.2% of Terna's shares are held by Italian shareholders, with the remaining 46.8% held by overseas institutional investors, primarily from the USA and Europe.

Based on information from the shareholders' register and other data collected as at February 2018, Terna's shareholder structure breaks down as follows.

SHAREHOLDERS BY CATEGORY



SHAREHOLDERS BY GEOGRAPHICAL AREA AND CATEGORY



Major shareholders¹

CDP RETI S.p.A.²

(a company controlled by Cassa Depositi e Prestiti SpA): _____ 29,851%

LAZARD ASSET MANAGEMENT LLC

(as a discretionary asset manager): _____ 5,122%

Socially Responsible Investors

At the end of 2017, 103 socially responsible investors (SRIs) had invested in Terna's shares in application of an approach that takes into account ESG (Environmental, Social, Governance) aspects. Overall, at the end of 2017, SRIs represented 8.32% of Terna's free float (6.35% at the end of 2016) and 10% of the capital held by identifiable institutional investors (approximately 10% at the end of 2016).

Information on the ownership structure, restrictions on the transfer of shares, securities that grant special rights, and restrictions on voting rights, as well as on shareholder agreements, is provided in the "Report on Corporate Governance and Ownership Structures" for 2017. This is available in the Investor Relations section of Terna's website (www.terna.it).

¹ Shareholders who, based on the available information and notifications received from the CONSOB, own interests in Terna SpA that are above the notifiable threshold established by CONSOB Resolution 11971/99.

² On 27 November 2014, a shareholder agreement was entered into by Cassa Depositi e Prestiti SpA (CDP), on the one hand, and State Grid Europe Limited (SGEL) and State Grid International Development Limited (SGID), on the other, in relation to CDP RETI SpA, SNAM SpA and TERNAL SpA. This was later amended and supplemented to extend the scope of the agreement to include Italgas SpA.



Governance

Terna's corporate governance system has been designed with the aim of guaranteeing the security of the electricity system whilst, at the same time, creating value for shareholders. This objective is pursued taking into account the social and environmental importance of the Group's operations and the resulting need to adequately consider all stakeholders in conducting our business.

In this regard, the ultimate guide relating to matters of sustainability is the **Code of Ethics**³, which references the ten principles regarding human rights, labour, the environment and corruption covered by the Global Compact, the multi-stakeholder network set up by the United Nations and which Terna has been a member of since 2009. The Code of Ethics also requires the Group to publish an annual Sustainability Report, which in the Group's case also includes the non-financial statement required by art. 4 of Legislative Decree 254/2016. The Sustainability Report contains disclosures on fulfilment of our environmental and social commitments and on the consistency of the results achieved with the targets set.

Board of Directors

Chairwoman

Catia Bastioli

Chief Executive Officer

Luigi Ferraris

Directors

Fabio Corsico
Luca Dal Fabbro
Paola Giannotti
Yungpeng He
Gabriella Porcelli
Stefano Saglia
Elena Vasco

Board Committees

Audit, Risk, Corporate Governance and Sustainability Committee

Stefano Saglia (Chairman, independent)
Elena Vasco (independent)
Paola Giannotti (independent)

Remuneration Committee

Fabio Corsico (Chairman, independent)
Gabriella Porcelli (independent)
Stefano Saglia (independent)

Board of Statutory Auditors

Chairman

Riccardo Enrico Maria Schioppo

Standing Auditors

Vincenzo Simone
Maria Alessandra Zunino de Pignier

Alternates

Davide Attilio Rossetti
Cesare Felice Mantegazza
Renata Maria Ricotti

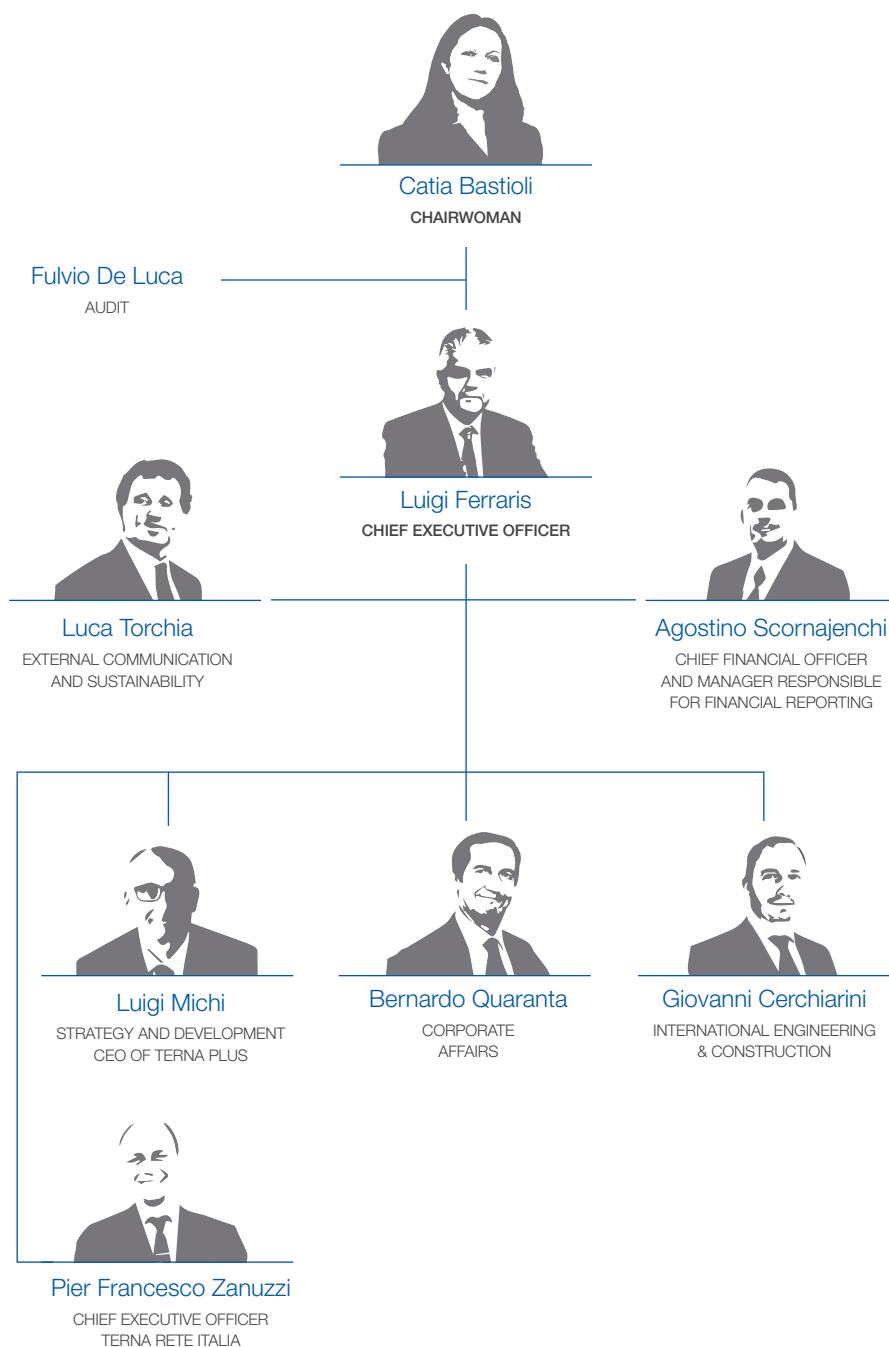
Independent Auditors

PricewaterhouseCoopers S.p.A.



³ Available on Terna's website at <http://www.terna.it/it-it/investorrelations/corporategovernance/eticadimpresa/codiceetico.aspx>, via the link <http://download.terna.it/terna/0000/0063/62.pdf> and the link <http://download.terna.it/terna/0000/0054/05.pdf>

Our Management Team





Business integrity and values

The Terna Group's sustainability policies provide clear guidance designed to ensure fairness and transparency in the conduct of business.

As noted above, the Code of Ethics plays a key role in setting out the Group's values. The Code contains a series of rules of conduct designed to ensure that the governance system is capable of creating shared value and establishing reciprocal trust with all stakeholders. Aware of the strategic importance of these relations, the Group has adopted a "Stakeholder management model", based around a map of stakeholders, the most appropriate methods of engagement and a system for monitoring opinions and expectations and the degree of satisfaction with relations with Terna.

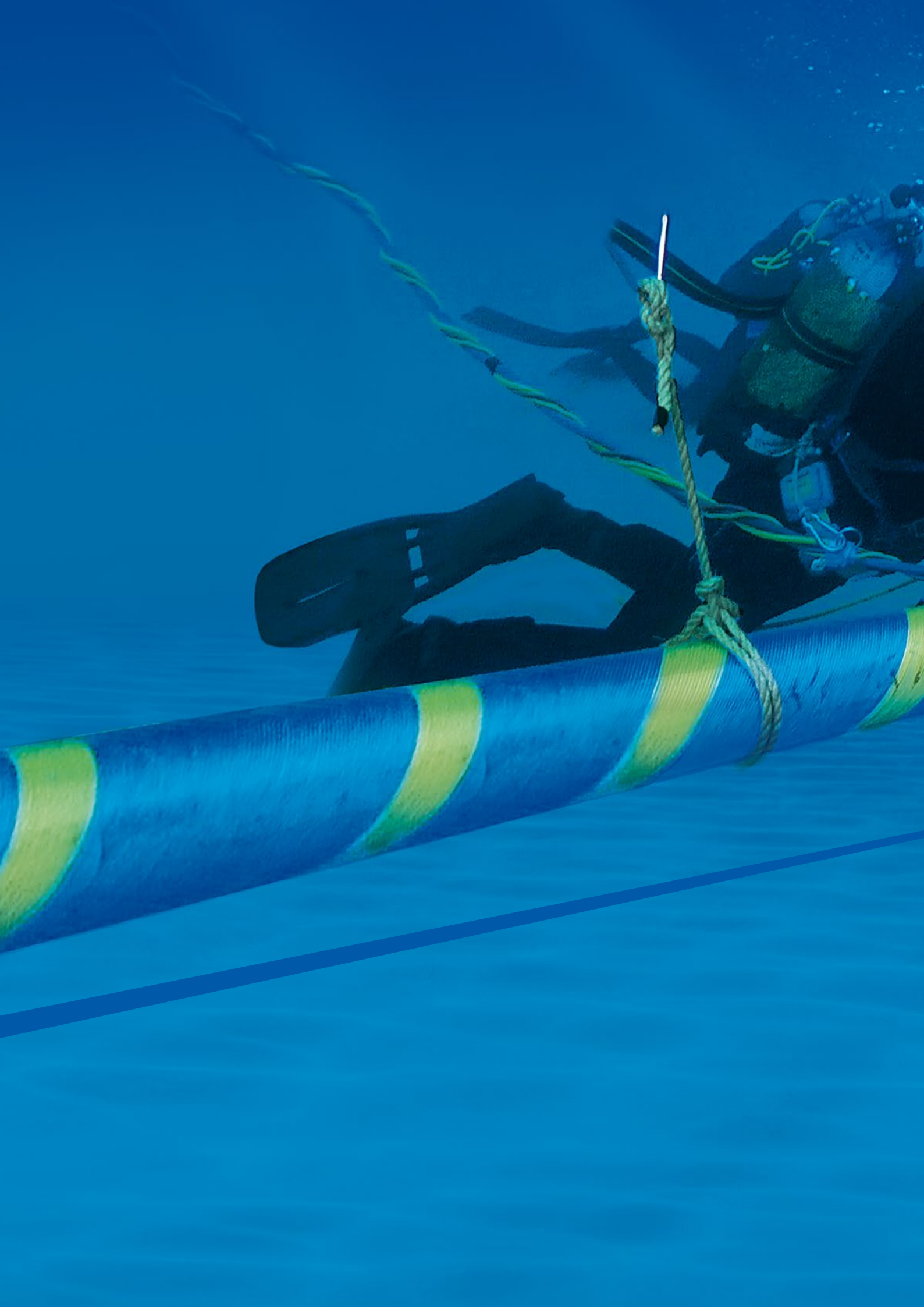
The importance given to integrity and sustainability as key elements of responsible management has also resulted in Terna's formal adherence to the **United Nations Global Compact**, approved by the Board of Directors in 2009, and its participation in national and international initiatives.

Respect for human rights and for the environment and efforts to combat corruption are management principles that Terna has extended to its supply chain, with suppliers required to provide suitable documentation regarding their compliance in this regard at the time of qualification.

In January 2017, Terna obtained certification of its **anti-corruption management system** in accordance with the new international ISO 37001 standard ("Anti-bribery management systems"). In line with the expected growth of the Group's overseas operations, in April 2017, it adopted guidelines regarding "**Respect for human rights**". These apply the guiding principles ("Protect, Respect, Remedy") for businesses and human rights contained in the United Nations Ruggie Report ("The guiding principles on business and human rights").

Further information on these matters is provided in the section, "Responsible management of the business" in the Sustainability Report for 2017.







02 Operating environment



Macroeconomic environment

In 2017, the Italian economy benefitted from an upturn in the international economic cycle.



+3.7%

GROWTH
ECONOMIC
WORLD
2017

The **global economy recorded solid growth** of 3.7% in real terms, according to International Monetary Fund (IMF) estimates, with both advanced and emerging economies improvements. The growth was reflected in increased trade, resulting in a 4.7% increase in world trade (IMF estimate), double the rate of growth seen in 2016.

Growth strengthened in the euro area in 2017 (2.5% according to preliminary estimates from EUROSTAT) compared with the previous year (1.8%), driven by exports and, to a lesser extent, consumption, aided by a favourable monetary policy. In the meantime, inflation remained low at 1.5%, held in check by the performance of its core components, and by the controls put in place by the European Central Bank.

The Italian economy continued to grow in 2017, with the pace of improvement accelerating with respect to the previous year. This is expected to have resulted in annual average GDP growth of 1.5% (based on a preliminary estimate from ISTAT, Italy's Office of National Statistics), compared with 0.9% recorded in 2016.

This performance benefitted from both exports, driven by the increase in world trade, and internal demand. Capital investment was among the fastest growing components, helped by tax relief, whilst consumer spending was driven by the increase in disposable income resulting from an increase in employment.

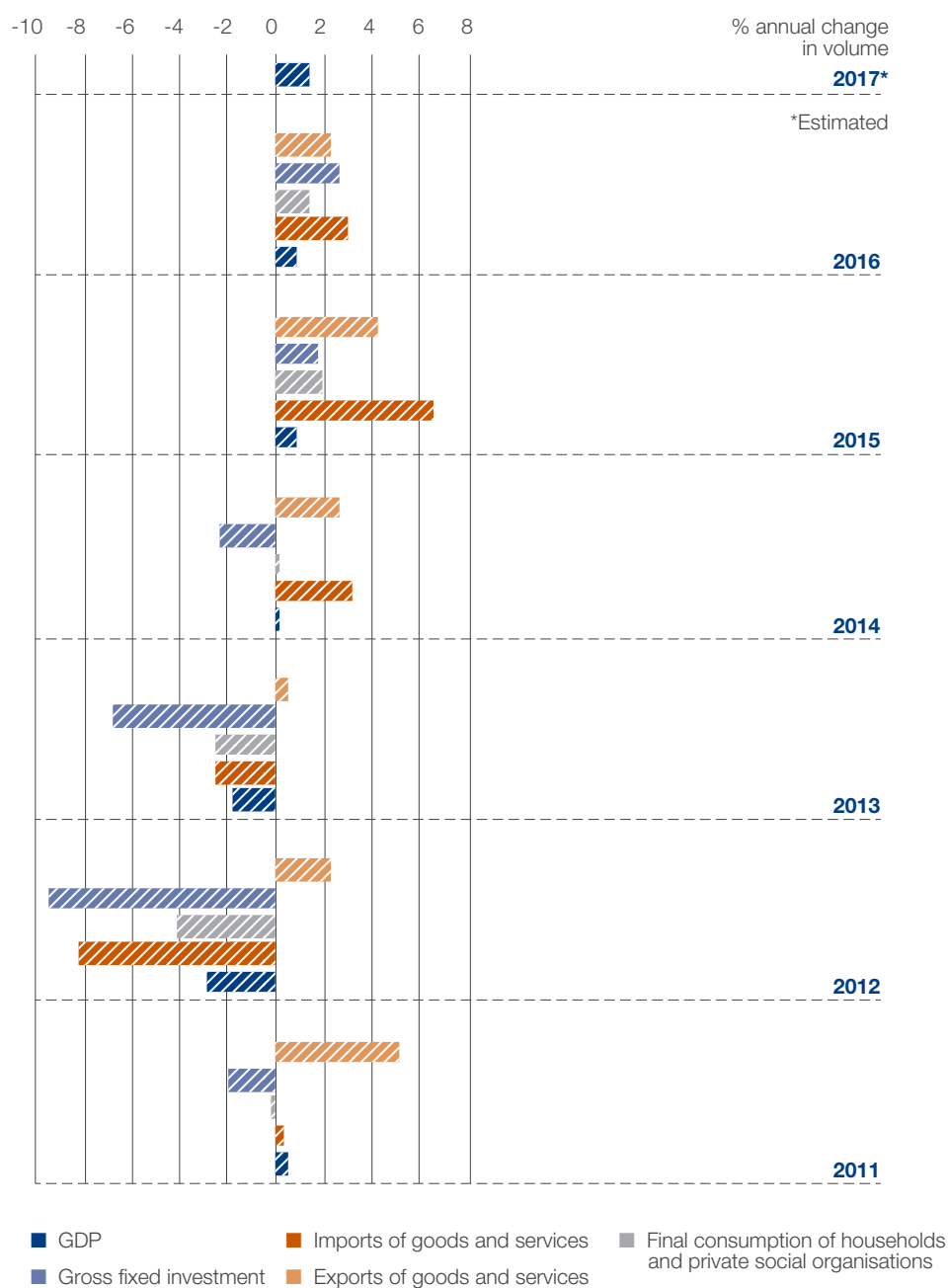


+3.0%

INDUSTRIAL
OUTPUT
REGISTERED
AVERAGE
GROWTH 2017

In terms of sector, industrial companies saw an increase in value added, following growth in manufacturing and a recovery in construction, whilst the value added generated by services remained more or less stable. **Industrial output** registered average growth of 3.0% in 2017 compared with the previous year (2.5% based on raw data, after calendar-related adjustments). The biggest increases were registered by the pharmaceutical sector (up 7.4%), vehicles (up 5.6%) and steel products (up 3.7%), whilst reductions were only registered for the production of computers, electronic and optoelectronic equipment, electromedical equipment, measuring devices (down 3.1%) and for the production of electrical devices and non-electric household appliances (down 0.7%).

ITALIAN GDP AND KEY ECONOMIC INDICATORS IN VOLUME TERMS





Market environment

At international level, guidelines for development of the energy sector are provided in the United Nations **Sustainable Development Goals (SDGs)**, which - in keeping with the decisions set out in the COP 21 - set out a path for creating an energy system based around renewable sources by 2030. In the meantime, the European Union's **Clean Energy Package**, which is in the process of being approved, will lead to major changes in the rules and policies applied to the sector, ranging from the electricity markets to the energy efficiency of buildings. In line with these guidelines, the Italian government approved the country's **National Energy Strategy (NES)** at the end of 2017.

THE UNITED NATIONS SDGs

Approved by 193 member states of the United Nations in September 2015, the 17 Sustainable Development Goals (SDGs) form the heart of the 2030 Agenda, the global plan that aims to eradicate poverty and promote economic prosperity, social development and protection of the environment.

The 2030 Agenda sums up humanity's major priorities in the "five Ps" - People, Planet, Prosperity, Peace and Partnership: to tackle the root causes of poverty and inequality and to aim for sustained, sustainable growth for all, bringing together economic, social and environmental aspects and, at the same time, identifying new opportunities for growth.

To meet the challenges posed by the SDGs, participating countries are committed to devising national strategies and targets designed to encourage companies to adopt operational procedures and business strategies in keeping with the sustainable development goals.

In October 2017, the Italian government approved the country's "National Sustainable Development Strategy", implementing the SDGs in Italy and, in keeping with the commitments made in Paris (COP21) and the Circular Economy package approved by the European Parliament, setting the foundations for all Italy's sustainable development policies.

Terna is playing a central role in enabling the energy system's transition to one in which production is based on renewable sources.

Terna's activities and its mission coincide almost entirely with a number of the SDGs and the related targets. These are SDG 7 ("Affordable and Clean Energy - Ensure access to affordable, reliable, sustainable and modern energy for all"), SDG 9 ("Industry, Innovation and Infrastructure - Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation") and SDG 13 ("Climate Action - Take urgent action to combat climate change and its impacts"), which intersect with each other and whose achievement depends primarily on implementation of the National Transmission Grid Development Plan.

Key SDGs for Terna

			
Target	Ensure access to affordable, reliable, sustainable and modern energy for all.	Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation.	Take urgent action to combat climate change and its impacts.

Italy's **National Energy Strategy (NES)** is a key policy document, forming the basis for plans to develop the Italian Energy System of the future and setting a number of objectives, including to improve market competitiveness and to achieve sustainable growth, whilst pursuing security of supply.

These objectives, starting from the immediate full deregulation of the retail market, will facilitate the alignment of Italian and European energy prices. From now until 2020, this will be achieved through competitive auctions and long-term contracts for large-scale power generation and by promoting self-consumption for smaller power plants. After 2020, the focus will switch to support for renewables based on the concept of market parity.

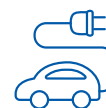
The *sustainable growth* targets are backed up by a range of measures. One of the aims is to cut final energy consumption by 1.5% a year through to 2030, compared with average annual consumption in the three-year period 2016-2018. This will translate into a saving of 10 Mtep by the end of the period. A further goal is to develop renewables, thereby boosting the share of total consumption generated by renewable energy sources from 17.5% to 28% by 2030. The electricity sector has been set even more challenging goals, with the aim of increasing the share of total electricity consumption represented by renewables from 33.5% in 2015 to 55% in 2030. This will increase the quantity of electricity generated from renewables to 184 TWh by 2030, compared with 109 TWh in 2015. Sustainable growth will also be enabled through the development of new technologies - such as electric vehicles, with up to 5 million vehicles expected to be in circulation by 2030 - and technologies that ought to be used more widely, in view of the efficiency improvements they offer, such as heat pumps. The key element underpinning these measures for the electricity sector is the announced phase-out of coal for power generation by 2025.

The measures designed to promote *security of supply* for energy, above all electricity, are dependent on the introduction of the Capacity Market, which is due to be launched in 2018, and on a further upgrade, development and modernisation of Italy's grids in order to facilitate integration with renewable production plants and improve congestion. There are also plans to increase the capacity of storage systems, above all through the use of pumps and a further expansion of interconnections with neighbouring countries. Investment in *resilience* will also play a major role, by helping to increase the network's ability to cope with extreme weather events and emergencies, boosting coordination at European level. This has taken on added importance given the structural changes currently taking place in the electricity systems of many European countries, primarily linked to progressive decarbonisation and the reduction in nuclear generation capacity.



-1.5 %

REDUCTION
PER YEAR IN FINAL
CONSUMPTION
UP TO 2030



5 million

ELECTRIC
VEHICLES BY
2030

2025

PHASE-OUT OF
COAL PRODUCTION

Focus

NATIONAL ENERGY STRATEGY - STRATEGIA ENERGETICA NAZIONALE - "SEN"

Cuts in final energy consumption

Cuts of 1.5% per year compared with average annual consumption in the period 2016-2018 (excluding transmission). A total reduction of 10 Mtep by 2030 compared with the status quo; the expected contributions to this saving of 10 Mtep are 36% from households, 25% from transport, 23% from services + agriculture, and 16% from industry.

Development of renewables

RES are to increase from 17.5% in 2015 to 28% in 2030 as a share of total energy consumption. In the electricity sector, the increase will be from 33.5% in 2015 to 55% in 2030. Increased use of heat pumps and electric vehicles, which have been included in the renewable targets, with up to 5 million vehicles expected to be in circulation by 2030.

Competitiveness of the energy sector

Competitive auctions; long-term contracts for large-scale power generation; promotion of self-consumption for smaller power plants; support for renewables based on the concept of market parity; full deregulation of the retail market.

Security of energy supply and diversification

Introduction of the Capacity Market, due to be launched in 2018. Development of the grid to facilitate integration with renewable production plants and improve congestion. Increased storage systems capacity, above all through the use of pumps and further expansion of interconnections with neighbouring countries. Investment in resilience to increase the network's ability to cope with extreme events.

Sustainability: decarbonisation of power generation

Phase-out of coal with aim to cut capacity by 2025: partial (down 2 GW) or total (down 8 GW).

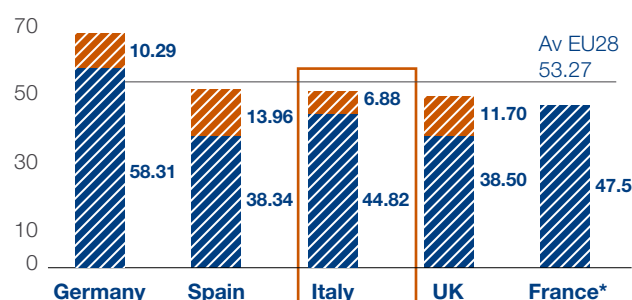
Protections

In the industrial sector, the reconversion of infrastructure to improve sustainability. Additional measures to combat energy poverty; reform of the current so-called "social bonus".

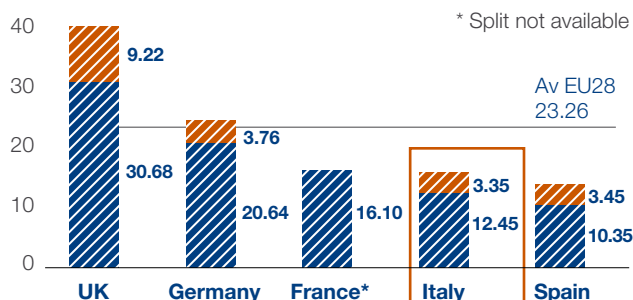
Continual changes in the electricity supply chain make it necessary to take a new systemic and organic approach to innovation, as discussed in detail in the section, "Terna and innovation".

Terna was quick to take steps to implement European energy policy and the NES guidelines, recently adopting new long-term demand scenarios in line with the above guidelines. These are described in the document, "Description of Terna's Scenarios for 2018".

NETWORK COST (€Mwh) HOUSEHOLDS



NETWORK COST (€Mwh) BUSINESSES



■ Transmission
■ Distribution
* Split not available

Network cost

Based on data published by the regulator, ARERA, it is possible to estimate that the cost of the transmission service accounts for approximately 3.5% of the amount billed to a typical domestic user.

According to European Commission data for 2015, in both the household and industrial segments, the so-called “network costs”⁴ incurred by Italian consumers are below the European average (see chart above).

European and international relations

In this regard, opportunities for engagement and dialogue are provided by Terna's membership of the principal national and international trade associations, as well as of the leading associations connected with sustainability issues.

EUROPEAN RELATIONS

This is the European Network of Transmission System Operators for Electricity involved in the process of integration and coordination of the continent's electricity networks in implementation of the EU's Third Energy Package. ENTSO-E's aims are: to draw up European network codes, to ensure development of the European transmission network through preparation of the Ten-Year Network Development Plan (TYNDP) and of the related scenarios. The TYNDP forms the basis for the European Commission's decisions regarding projects of common interest (PCIs) in implementation of Regulation (EU) 347/2013.

Terna works with EASE to encourage industrial research and development in the field of storage systems applications and to promote the use of this technology in the transition to a stable, flexible, environmentally sustainable and low-cost energy system.

The Association, whose members are TSOs and NGOs, aims to promote, via the development of electricity grids, the integration of renewable energy sources.

INTERNATIONAL RELATIONS

An international non-profit association that conducts research regarding high-voltage grids. The organisation has 58 member countries and Terna has been appointed as Chair and Vice Chair of the Italian Committee.

This international association brings together the 19 leading transmission system operators worldwide, with the aim of sharing best network management practices. Terna chairs the “Reliability and security” group that deals with the resilience of the electricity system.

Stakeholder

ENTSO-E

EASE
(European Association
for Storage of Energy)

RGI
(Renewables Grid Initiative)

Stakeholder

CIGRE
(Conseil International des
Grands Réseaux Électriques-
International Council on
Large Electric Systems)

GO15
(Reliable and Sustainable
Power Grids)

⁴ “Network costs” include transmission and distribution costs, losses, metering and system costs.

Stakeholder

INTERNATIONAL RELATIONS - *continued*

Med-TSO
(Mediterranean
Transmission System
Operators)

This association brings together the TSOs from 18 Mediterranean countries, with the aim of promoting the standardisation of development plans and the coordinated management of grids. Terna hosts the association's registered office and operational headquarters in Rome and appoints its Secretary General, as well as chairing Technical Committee 1, which is responsible for planning the Mediterranean electricity grid.

RES4MED / RES4AFRICA
(Renewable Energy
Solutions for the
Mediterranean)

These associations aim to share existing know-how in order to develop renewable sources and implement projects in the northern and sub-Saharan Africa.

WEC Italy
(World Energy
Council/Italian National
Committee)

The national committee is a member of the WEC, an international organisation bringing together operators from over 90 countries, with the aim of promoting efforts to build sustainable energy system at global level.

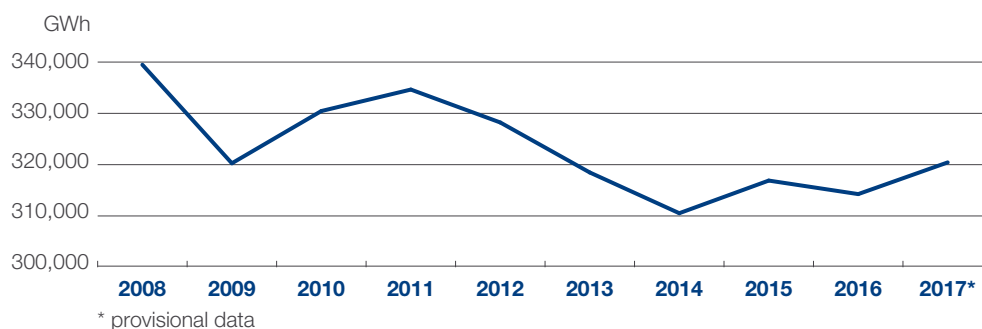
During 2017, Terna strengthened its presence in industrial associations dedicated, in particular, to the Mediterranean basin, namely Res4Med and Med-TSO, as well as, at global level, in GO15 and in the Italian National Committee of the World Energy Council. The Company also consolidated its presence in organisations with a broader scope (such as Diplomatia, the Council on Foreign Relations, etc.), so as to monitor the socio-political and economic environments in which to develop and consolidate its business.

At bilateral level, Terna and RTE, France's TSO, implemented the provisions of the Memorandum of Understanding signed in 2015 and in the process of being extended, with the aim of strengthening collaboration in certain areas of interest (grid development, Non-Regulated Activities, research and technological innovation). In addition, on 2 June 2017, Terna and Rosseti, a power grid operator in Russia, signed a non-binding MoU regarding the sharing of expertise, best practices and cooperation in certain key technological areas relating to electricity transmission.

Electricity demand and production in Italy

Demand for electricity in Italy amounted to 320,438 GWh in 2017, an increase of 2% compared with 2016, which in contrast registered a fall of 0.8% compared with the previous year.

DEMAND FOR ELECTRICITY IN ITALY FROM 2008



ELECTRICITY BALANCE IN ITALY (GWH)	2017*	2016	CHANGE	% CHANGE
Net production	285,118	279,702	5,416	1.9
From overseas suppliers (imports)	42,895	43,181	(286)	(0.7)
Sold to overseas customers (exports)	(5,134)	(6,154)	1,020	(16.6)
For use in pumping**	(2,441)	(2,468)	27	(1.1)
Total demand in Italy	320,438	314,261	6,177	2.0

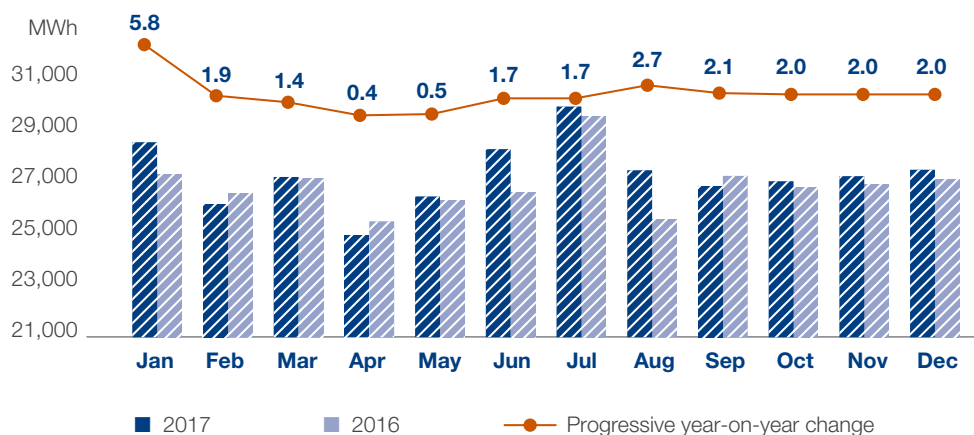
* Provisional data

** Electricity used for pumping water, for sole subsequent use in electricity production.

Note: does not include demand for energy for ancillary services related to electricity production.

Monthly demand for electricity in Italy in 2017 was higher in every month of the year compared with the previous year, except for February and April. This was solely due to calendar-related events (February 2016 was one day longer, whilst Easter fell in April 2017), providing further evidence of the current economic recovery.

MONTHLY DEMAND FOR ELECTRICITY IN ITALY (2017 VS. 2016)



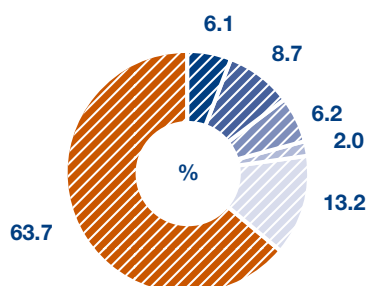
In terms of electricity production by type of source, 2017 recorded a sharp fall in hydroelectric

NET ELECTRICITY PRODUCTION BY SOURCE

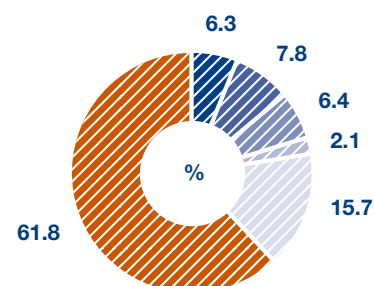
- Net wind production
- Net photovoltaic production
- Net biomass production
- Net geothermal production
- Net hydroelectric production
- Net thermoelectric production

* provisional data

2017*
285.1 GWh



2016
279.7 GWh

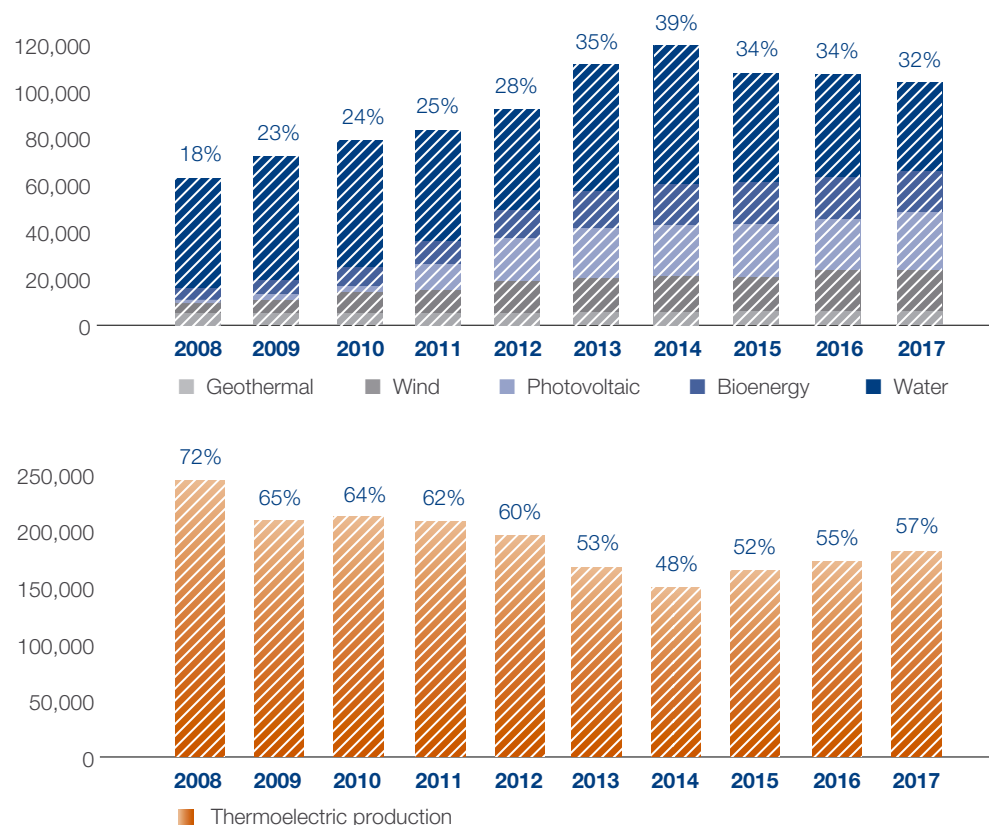


production (down 14%), partly owing to the weather conditions during the year. This was partially offset by an increase in solar production (up 14%). Other sources (wind, biomass and geothermal) were broadly stable, if slightly down. This resulted in an increase in thermoelectric production in proportion to the total.

During 2017, **renewable sources** accounted for approximately 32% of total energy demand. The performance of renewable production in Italy in the last 10 years is shown below with, as a comparison over the same time period, the performance of thermoelectric production.

As can be seen from the charts the progressive increase in production from renewable sources has been matched by a similar reduction in thermoelectric production. This demonstrates Italy's commitment to observing European Community directives requiring that renewable sources account for over 27% of demand by 2020. From as early as 2012, Italy has achieved, maintained and then improved on this target.

SOURCES OF PRODUCTION AS A PROPORTION OF DEMAND ⁵



⁵ The percentages shown in the two charts compared refer to the share of demand met by renewable sources (the chart above) and thermoelectric sources (the chart above).

Italy's demand

32%

covered by renewable
electric sources



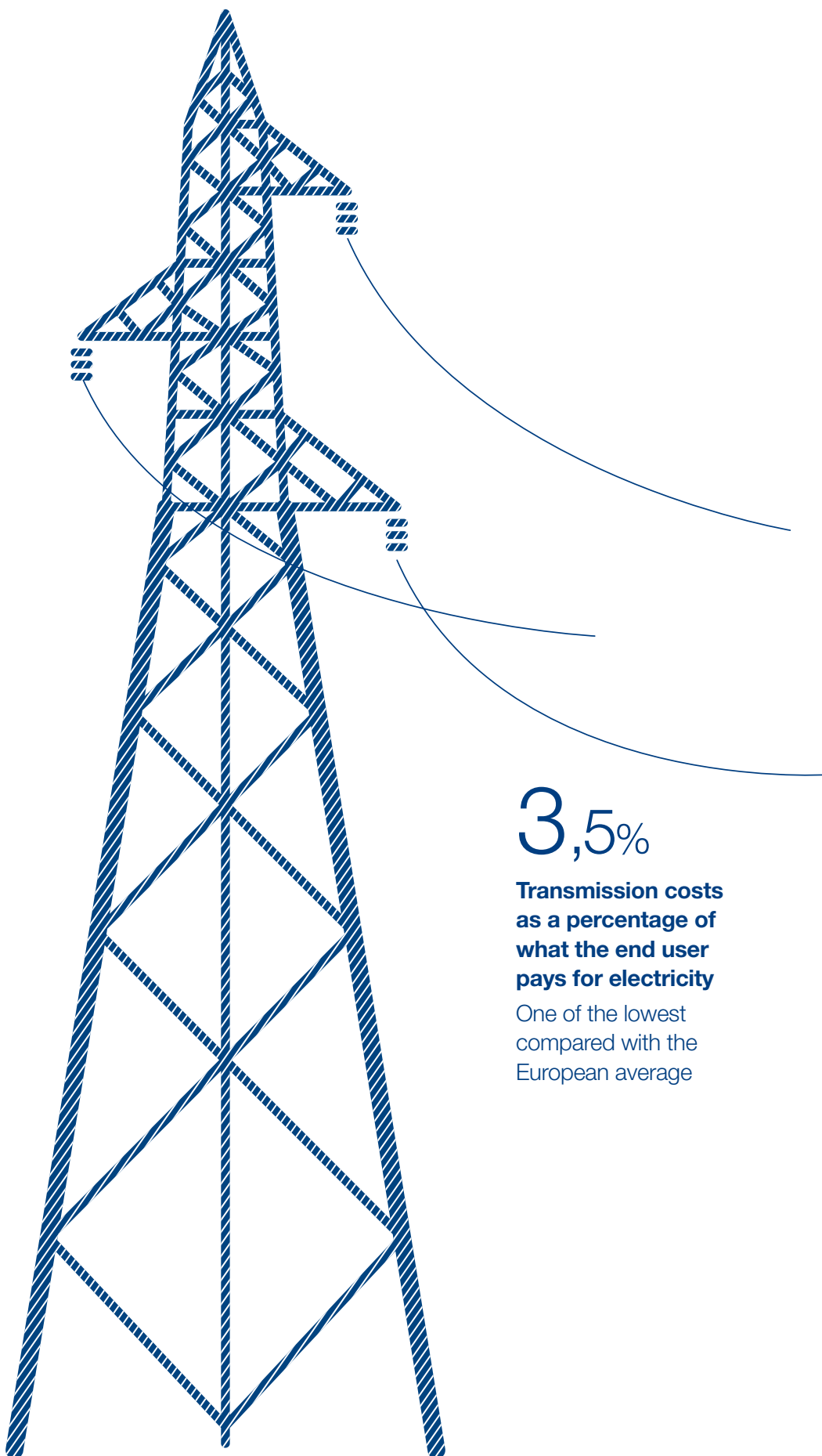
+2%

Electricity demand

3,5%

**Transmission costs
as a percentage of
what the end user
pays for electricity**

One of the lowest
compared with the
European average





Regulatory environment

Regulated revenue, which represents approximately 87% of the Group's total revenue, mostly derives from transmission and dispatching

Regulated revenue, which represents approximately 87% of the Group's total revenue, mostly derives from transmission and dispatching, subject to regulation by the Regulatory Authority for Energy, Networks and the Environment (ARERA).

In Resolutions 653/2015/R/eel, 654/2015/R/eel and 658/2015/R/eel, ARERA set the tariff regime for electricity transmission, distribution, metering and dispatching services and regulations regarding the quality of the transmission service for the 2016-2023 regulatory period (the fifth regulatory period). This period has been divided into two sub-periods: NPR1 (2016-2019) and NPR2 (2020-2023).

In the first four years, the situation is essentially in line with the past, despite a number of changes and, more generally, a greater emphasis on output-based regulation. Instead, for the second four-year period, ARERA envisages a new method of regulation for the transmission service, involving the recognition of costs based on the total expenditure incurred (operating expenses and capital expenditure), also known as the "TOTEX" approach.

At the same time, in Resolution 583/2015/R/com, ARERA announced the procedure for determining and revising the Weighted Average Cost of Capital (WACC) for a period of six years (2016-2021). This applies to infrastructure services in the electricity and gas sectors and is subject to revision, mid-way through the period, in order to adjust the WACC in a predictable and transparent manner in line with economic trends.

A number of key aspects of regulation in the period NPR1 are described below, with regard to allowed revenue for transmission and dispatching services.

Transmission revenue makes up the most significant portion of regulated revenue and is generated from application of the related transmission charge (**TC**), billed by Terna to distributors connected to the National Transmission Grid. This charge pays for the transmission services provided by all transmission service operators, including the owners of residual portions of the grid (external to the Terna Group), and is divided into two components: a power component (equal to 90% of revenue, expressed in euro cents/kW/year) and an energy component (10% of revenue, expressed in euro cents/kWh).

The **dispatching service charge (DSC)** aims to recompense Terna for carrying out the activities relating to the dispatching service and is billed by Terna to users of the dispatching service in proportion to the quantity of energy dispatched.

Allowed costs that combine to determine the TC and DSC components are attributable to three main categories, as summarised below:

THE THREE MAIN TYPES OF ALLOWED COST

Determined on the basis of the Regulated Asset Base (RAB) and the Weighted Average Cost of Capital (WACC). The RAB represents net invested capital for regulatory purposes. It is revalued annually on the basis of data from ISTAT (Italy's Office of National Statistics) on the change in the deflator of gross fixed investment and updated on the basis of the trends for investments and disposals. The WACC⁶ represents the weighted average cost of equity and debt. The methods of determining and revising the WACC are established by the regulator.

To cover
the return
on capital (RAB)

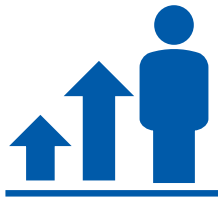
Allowed depreciation (calculated on the basis of an asset's useful life for regulatory purposes) is revalued annually based on the change in the deflator applied to gross fixed investment.

To cover
depreciation

Allowed costs are determined by the regulator at the beginning of the regulatory period, based on the actual operating costs in the relevant year (which, in the case of NPR1, was 2014) and increased by any remaining portions of additional efficiencies achieved in the previous two regulatory periods. The resulting amount is revalued annually to take account of inflation and reduced by an efficiency factor designed to ensure that additional efficiencies are, over time, passed back to end users in full.

To cover
operating costs

⁶ For the period 2016-2018, the real pre-tax WACC for the transmission service is set at **5.3%**.



Social environment

A favourable social environment is essential to Terna's ability to carry out the investments envisaged within the established time-scale, and to exploit available opportunities in its non-regulated business, whether in Italy or overseas. It translates into the Company's possession of adequate social capital.

Good stakeholder relations, based on reciprocal trust, are essential, as they are directly linked to a firm's ability to be successful and to generate a profit. Good relations with employees, suppliers, customers and local communities have a positive impact on the business via talent attraction, motivation, productivity, the quality of its products/services, long-term partnerships, brand loyalty, goodwill and a social licence to operate. To best manage its stakeholder relations, Terna has put in place a series of organic operating processes and procedures designed to engage with stakeholders in order to periodically monitor relations.

The following page includes a description of the key aspects of Terna's social environment. The Company has adopted an approach to stakeholder engagement that is based on a model⁷ consisting, among other things, of a monitoring system that, in 2017, began conducting specific surveys among its stakeholders.

The "Stakeholder Management Model" plays a key role in effectively managing relations with the Group's various stakeholders, avoiding the risk of delays in becoming aware of potential problems. A specific engagement programme is conducted each year to identify the actions to be taken in order to bring the Group's relations into line with best practices and to ensure that the most influential stakeholders are listened to on a regular basis.

A number of stakeholder engagement initiatives were carried out in 2017 as part of the second annual survey, focusing, among other things, on the views of customers of the Group's non-regulated business, employees and a number of local communities.



⁷ The "Stakeholder Engagement Model" was drawn up in 2015 in accordance with the AA1000 Stakeholder Engagement Standard (SES) developed by AccountAbility in the 2011 version, as the latest update of the standard was published in November 2015, when the model had already been adopted.

KEY ASPECTS OF THE SOCIAL ENVIRONMENT

Stakeholder

The most significant aspect of Terna's social environment regards generalised opposition, from residents in the affected location, to the introduction of new infrastructure into a local area. It is often referred to with the expression "NIMBY (Not In My Backyard) syndrome".

This opposition stems from people's strong desire to defend their neighbourhood or nearby countryside from initiatives that do not immediately benefit the local community.

The need to ensure the security and efficiency of the electricity service provided by Terna in the general interest - even when widely acknowledged and accepted - is not considered important compared with the aim of protecting a local area.

To reduce the potential for social conflict, Terna has, since 2002, adopted a voluntary approach designed to foster the prior involvement of local government (regional and local authorities, park authorities, etc.). Since 2015, this has been extended to include people from the communities directly affected by Terna's plans through public meetings called "Terna incontra". Thirteen meetings were held in 2017 (in Auronzo, Cortina d'Ampezzo, Vaiano, Formazza, Domodossola, Comignago, Avigliana, Val di Susa, Chiomonte, Volpago and Scorzé) and this figure is due to increase in 2018.

Local communities:
opposition to the
construction of new
electricity infrastructure

Terna's commitment to the environment and biodiversity led, in 2009, to the conclusion of partnership agreements with critical stakeholders, such as leading environmental organisations, with the aim of arriving at shared solutions designed to boost the environmental sustainability of the National Transmission Grid (NTG). Growing concerns over the impact of climate change, and the accompanying focus on energy transition initiatives, has led to further cooperation between Terna and these organisations. In particular, in 2016, Terna renewed and expanded its partnerships with Legambiente, the WWF and Greenpeace.

Environmental
organisations: protection
of the environment and
nature conservation

Following COP 21 in Paris on climate change and approval of the United Nations Sustainable Development Goals, many stakeholders have begun focusing much more on issues relating to sustainability. One of the effects of this heightened attention has been the creation of national sustainable development strategies, including the one drawn up by the Italian government. It has also led to calls from numerous institutional investors - one being Blackrock - for major companies to conduct an informed and full assessment of the business risks linked to ESG issues and to manage those risks, and to the adoption, by European countries, of Directive 2014/95/EU on non-financial disclosures, requiring large Italian companies to annually publish a non-financial statement. Of particular importance, in terms of transparency and reporting, are the recommendations from the Task Force on Climate-related Financial Disclosures (the so-called Bloomberg Task Force) regarding the publication of information on the implications of climate change for business strategies, in terms of risks and opportunities. This is considered of central importance, with regard to both the best possible allocation of investment and efforts to combat climate change.

Investors: a growing request
for transparency regarding
environmental, social and
governance aspects





03 The Group's strategy and businesses



Our people

Terna's personnel, whose expertise is often of a rare or unique nature in the electricity industry, play a vital role in all areas of the Company's business.

Terna's relations with its personnel are characterised by:

- **attention to safety and accident prevention;**
- **investment in training** to ensure the development of the Company and its employees;
- the creation of management and development systems designed to **improve performance and develop individual skills;**
- **remuneration and welfare policies** that aim to align individual performance with business objectives and provide employees with financial security;
- **listening to employees** by using ways to gauge their opinions;
- a complex system of **industrial relations based on engagement with the trade unions.**

THE WORKFORCE	AT 31 DECEMBER 2017	AT 31 DECEMBER 2016	CHANGE
Senior managers	71	76	(5)
Middle managers	569	567	2
Office staff	2,021	1,978	43
Blue-collar workers	1,236	1,248	(12)
TOTAL	3,897	3,869	28

Changes in the workforce⁸ are primarily linked to generational turnover, the Group's continued recruitment of personnel following the acquisition of Rete Srl and the related electricity assets from FSI SpA, efforts to strengthen core competencies and the growth of Non-Regulated Activities.

At 31 December 2017, the number of agency workers employed by the Terna Group totalled 53 (61 in 2016).

The total turnover rate (5.85%), which is up compared with 2016, includes the effect of early retirement schemes, with 85% of the total due to retirements.

The incidence of summary dismissals is very low (0.49%), in line with previous years (0.60% in 2016 and 0.35% in 2015).

⁸ The following commentary refers to Terna Group employees, with the exclusion of employees of the Tamini Group (368 in number), of Terna Crna Gora d.o.o. (9) and of the other overseas companies (the local workforces in Brazil and Peru, totalling 9 and 3, respectively).



COMPOSITION OF THE WORKFORCE	2017	2016	CHANGE
Permanent employees	100%	99.9%	+0.1%
Average age (in years)	42	43	-2.3%
University and high-school graduates	93.5%	91.8%	+1.7%
Women as a % of the total	12.3%	11.7%	+0.7%
Women in senior and middle management roles out of total senior and middle managers	17.5%	17.3%	+0.2%

In terms of type of contract, all employees are on permanent contracts.

The average age of the workforce is 42 with respect to the previous year at 43.

University and high-school graduates make up 93.5% of the total workforce (92% in 2016, an increase of 1.7%).

In terms of gender, there has been a significant increase in women employed (up 0.7%), although the majority of the Group's workforce consists of men (accounting for 87.7% in 2017).

The presence of women in the workforce (12.3% of all employees) is growing, partly reflecting general labour market trends, which show that female participation is on the rise (the percentage of women in the total workforce in Italy was 9.0% at the end of 2005). In addition, 27.1% of new recruits, excluding operating personnel, were women in 2017 (20.2% in 2016).

In 2017, as in previous years, no fatal workplace accidents were registered among Group employees, while only one serious injury was reported. The total number of injuries amounts to 24. Both the injury rate and the lost day rate registered reductions.

OCCUPATION INJURIES SUFFERED BY TERNA EMPLOYEES - GRI-ILO DEFINITIONS	2017	2016
Injury rate	0.81	1.00
Lost day rate	27.62	31.28
Absentee rate	6,239.9	6,831.4
Number of injuries	24	28
- of which serious	1	-
- of which fatal	-	-



Focus

New organisation

The Group's organisational structure witnessed the creation, in 2017, of the External Relations and Sustainability department, reporting directly to the Chief Executive Officer. This department has taken on the roles previously carried out by External Relations, CSR and Investor Relations. The International Engineering & Construction unit was also created with, among other things, responsibility for the overseas operations previously managed by Terna Plus.

In addition, a new Mergers and Acquisitions unit has been set up and reports to Agostino Scornajenchi, the new Chief Financial Officer, appointed from 1 September 2017 and also Terna SpA's Manager Responsible for Financial Reporting.

A General Affairs unit has also been set up within the Corporate Affairs department and to which responsibility for Health & Safety, Services and Insurance was transferred from 1 January 2018.

Finally, the process of integrating network controls and remote operation of the infrastructure operated by Terna Rete Italia SpA was completed, combining the activities of the three remote operations centres at Dolo, Rondissone and Bari with the primary control and remote operations centres (Scorzè-VE, Turin and Naples).

Focus

Engagement Survey 2017

During the year, the 2017 Engagement Survey, an internal climate survey involving the entire workforce, was conducted. The response rate was 80%. The survey measured the level of engagement among Terna's workforce, based on three components: rational (an understanding of the Company's objectives and strategies), emotional (a sense of belonging and of pride) and motivational (a willingness and desire to contribute). The emotional component scored highly, with a positive perception of the Group's social and environmental responsibility and its respect for ethical principles, its commitment to occupational health and safety, the quality and adequacy of its training programmes, above all for new recruits, and the fairness and competitiveness of pay with respect to other companies. The results for the rational and motivational components revealed that there is room for improvement regarding communication of the Company's objectives and strategies, the spirit of cooperation and the management of resources.

Overall, Terna's engagement score (81%) is broadly in line with the average across other companies in Italy who use this form of survey.

The results were presented in 2018 during a series of specific meetings at all the Company's offices. Definition of the related priorities and a targeted action plan is in progress, with the involvement of 60 representatives from all areas of the Company.

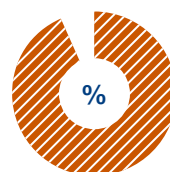


3,897

Group resources

42
years

is the average age



93.5

University and
high-school graduates

Potential
assessment: **330** resources
involved

178,856 thousand
training hours provided

50 hours of training
per capita provided

TERNA'S APPROACH

Occupational safety

Safety and injury prevention to guarantee the physical integrity of employees are among the Company's main priorities. In 2017, no fatal or serious workplace accidents were registered, whilst the overall injury rate remained at a low level (1%). Further details are provided in the "Sustainability Report".

Training

Training is continuously provided at Terna throughout employees' working lives. The aim is to create value for people by increasing and diversifying their skills (employability), and to create value for the Company by developing human capital in line with its mission and business strategy. The Grid Experience Campus is the name that brings together all the different kinds of training, which is provided in accordance with a training model based on the transfer of specialist know-how by the most experienced staff (faculty) and on external contributions (universities and business schools), in order to guarantee a variety of incentives.

Employees received 50 hours of training per capita. This is down on the figure for the period 2015-16 (an average of 53.5 over the two years) when training activities were particularly intensive as a result of early retirement schemes and the resulting recruitment of large numbers of technical personnel.

The figure is extremely positive when set against the average for the 40 companies listed in the FTSE-MIB, which in 2016 (the latest figure available) was 25.8 hours per capita.

Development of human capital

In support of human resources development policies, Terna uses the Professional System as a basic architecture to manage roles, skills and development paths within the organisation, enhancing competencies and crafts ("professional families") identified on the basis of core business and corporate processes. In 2017, human capital development initiatives included implementation of a potential assessment process involving approximately 330 staff. Work also began on the design of a new Performance Management System, with the aim, among other things, of defining and communicating objectives, outcomes and expected organisational behaviours, as well as promoting a culture of appraisal and feedback as a way for managers to develop and coach members of their teams.

43 apprentices, interns
and people engaged
in project work

5 career days

School
and Work: 12 vocational training institutes
around the country

360 high-school
students involved

Staff recruited on the external labour market are university graduates - especially engineers - and graduates from technical colleges, most of whom have specialised in electrical engineering. Once hired, new recruits acquire the specific knowledge and skills they need via dedicated training courses. The preferred channel for collecting candidates' applications is the "Work with us" section of the Company's website.

Recruitment
and selection

The Human Resources and Organisation department also manages relations with schools, universities and job centres in order to support the process of recruiting new staff and to sustain a virtuous circle of sharing between the Company and the outside world. In this connection, during 2017, a work experience scheme dubbed "*Trasmettere il Sapere*" ("Transmitting Knowledge") was set up. The scheme involved around 360 fourth-year students from 12 vocational training institutes around Italy. The Company also entered into partnerships with major Italian universities and business schools, funding 5 specialist master's courses and 2 research doctorates, taking on 43 apprentices, interns and people engaged in project work, and took part in 5 career days. A new work experience scheme was launched in early 2018, involving 13 vocational training institutes around the country and approximately 600 fourth- and fifth-year students.

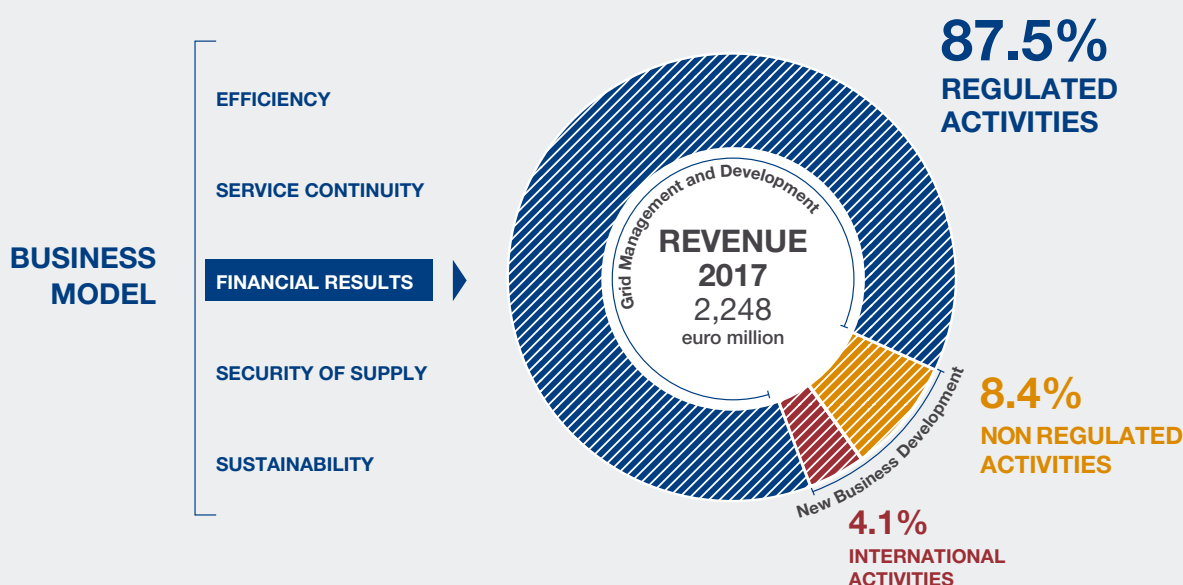
In October 2017, Terna signed an agreement with the trade unions that introduces a new welfare package. Specifically, an employee may choose to benefit from a performance-linked cash bonus, or use the bonus to benefit from one or more of the goods and services provided free of charge by the Company. For 2017, the agreement provides for an extra 12% on top of the bonus should an employee voluntarily decide to convert the cash into goods or services. Further steps have also been taken to improve the work-life balance and to support parenthood: an initial trial of smart working is expected to begin by July 2018; employees who have recently become fathers will be granted five days' leave, in addition to the number of days provided for by law; parents will be granted half a day's leave to accompany their children on their first day of school (first year).

Company
welfare

BUSINESS MODEL

Terna's business model focuses primarily on its **Regulated Activities**, consisting of the transmission and dispatching of electricity. By leveraging the expertise developed in managing its core business, the Company's **Non-Regulated** and **International Activities** help to boost growth, taking advantage of the opportunities resulting from technological discontinuities and from energy sector trends in Italy and abroad.

Terna's Strategic Plan, which focuses on the long term, sets out targets, priorities and investments, based on an analysis of medium- and long-term trends that could present challenges, and on the consequent identification of the related solutions. As discussed in depth in the section on the operating environment, good examples are the changing energy scenarios and the resulting need to upgrade the electricity transmission grid, or the increasing integration of grids at European level.



The **Regulated, Non-Regulated and International Activities** benefit from Terna's financial resources and the technical expertise of its personnel, which is often unique in the electricity sector and represents an example of distinctive human capital. Against a rapidly changing external environment (e.g. economic conditions, the evolution of the electricity system, technological upgrades, social issues and environmental challenges), **innovation, quality of service** and the **minimisation of environmental impacts** play a key role in driving the Group's performance.

As well as avoiding the risk of failing to become aware of potential problems in a timely manner, stakeholder engagement, based on reciprocal trust and transparency, strengthens the Group's social capital and enhances the sustainability of the business model, including over the medium to long term.

Strategic Plan 2018-2022



On 21 March 2018, Terna approved the Strategic Plan for the period 2018-2022, setting out the following goals: play a leading role in the coming sustainable energy transition, by leveraging our distinctive innovation capabilities, competencies and technologies for the benefit of all stakeholders.

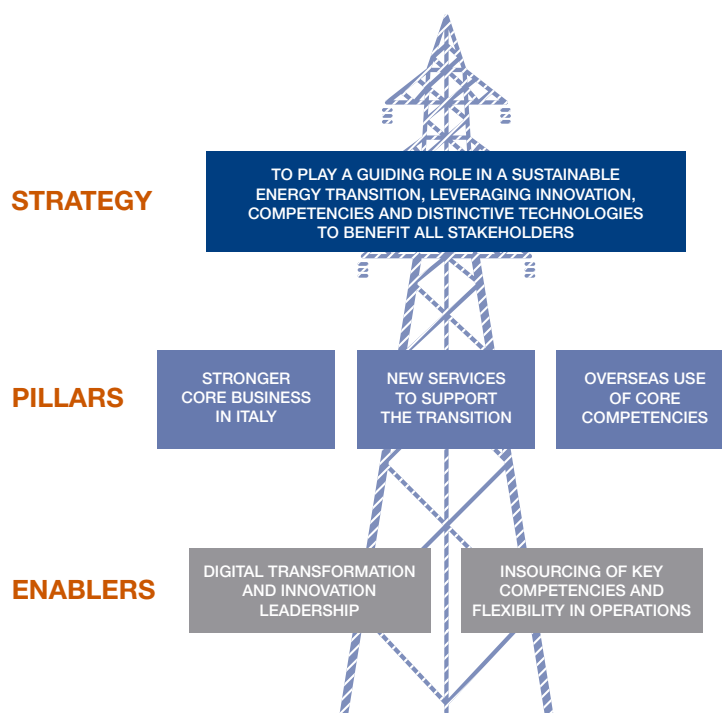
The electricity sector is rapidly evolving as a result of the radical transition underway, which aims to achieve challenging objectives linked to sustainability, decarbonisation, competitiveness and security. In particular, the sector is witnessing the strong development of renewables, resulting in measures designed to integrate them within the electricity system. We will achieve the security of supply by strengthening interconnections, developing grid storage and power grid resilience and, finally, increasing competitiveness in the market, by the relations between TSOs and other parties operating within the system.

In this context, the leading European TSOs are redesigning their strategies and increasing investments to meet the requirements of the new system. Their investment plans take into account the varying stages of energy transition in different countries and are strongly impacted by the development of renewables.

Consequently, the following Group's strategic guidelines have been identified:

- **Regulated Activities in Italy:** strengthening the core business by giving top priority to all activities that enable Italy to face its energy challenges in a safe, efficient and sustainable way;
- **Non-Regulated Activities:** launching new high value-added services to support the energy transition, taking advantage of opportunities beyond our core activities, to be pursued in line with Terna's mission;
- **International Activities:** leveraging the core capabilities as a TSO in order to develop international operations.

In order to provide operational support for these initiatives, the Company plans to increase investment in innovation and digital solutions to manage the growing complexity of the system. Attention will also be paid to the development and insourcing of strategic skills to cope with projects of growing size and complexity.



The guidelines identified for the Group's various strategic areas have been divided into appropriate priority actions to be carried out over the life of the Plan.

With reference to **Regulated Activities in Italy**, the system needs a new investment drive to respond to the developing needs of the system, with a focus on maximising long-term use and sustainability. The role of proactive system operator in defining the grid's structure should also be strengthened by combining Terna's specialist expertise with the experience gained in the most advanced markets.

Non-Regulated Activities should be geared towards supporting the energy transition, especially as an **energy solutions provider**, involving the development of services for companies and taking advantage of value added market opportunities for traditional and renewable energy customers. On the other hand, the telecommunications business will aim to pursue opportunities based around boosting the Group's infrastructure capabilities.

International operations will focus on the execution of projects in progress, taking advantage of the Group's specialist expertise. Among the priority actions, the main focus will be on selecting international growth opportunities with a high technological content (a key aspect for Terna) and involving potential agreements/partnerships, including the management of assets without the need to tie up large amounts of capital.

Maintenance of a strong capital structure through robust cash generation will also help to support an attractive dividend policy.



MAIN TARGETS

REGULATED ITALY	Net Regulated Capex ₁₈₋₂₂	~ €5.3bn	vs ~ €4.0bn ₁₇₋₂₁
	CAGR RAB* ₁₈₋₂₂	> 3%	up to ~ €17.5bn
NON REGULATED	EBITDA ₁₈₋₂₂	~ €350m	vs ~ €300m ₁₇₋₂₁
	Capex ₁₈₋₂₂	~ €300m	
INTERNATIONAL	EBITDA**	~ €150m	
	Capex*** ₁₈₋₂₂	~ €600m	
EFFICIENCY AND CREATION OF VALUE FOR THE GROUP	Efficiency: CAGR ₁₈₋₂₂ of EBITDA	> 3%	
	Value creation: CAGR ₁₈₋₂₂ of EPS	~ 3%	

* Calendar RAB, including work in progress.

** Includes financial income on Uruguay project.

*** Investment already included in Development, Security and Renewal plans.



Regulated Activities

Operating results of Regulated Activities

A review of the key results from our Regulated Activities is provided below⁹. Further details are provided in the Terna Group's financial review.

(€m)

OPERATING RESULTS OF REGULATED ACTIVITIES	2017	2016	CHANGE
Total regulated revenue	1,967.2	1,916.6	50.6
Tariff revenue	1,915.5	1,846.3	69.2
- Transmission revenue	1,803.6	1,735.0	68.6
- Dispatching and metering revenue	111.9	111.3	0.6
Other Regulated revenue	30.6	49.1	(18.5)
Revenue from construction services performed under concession in Italy	21.1	21.2	(0.1)
Total cost of Regulated Activities	425.5	421.1	4.4
Personnel expenses	217.8	226.5	(8.7)
External resources	154.7	153.7	1.0
Other	31.9	19.7	12.2
Cost of construction services performed under concession in Italy	21.1	21.2	(0.1)
EBITDA from Regulated Activities	1,541.7	1,495.5	46.2

EBITDA from Regulated Activities amounts to €1,541.7 million, an increase of €46.2 million compared with the figure for the previous year. This primarily reflects revenue growth resulting from the full recognition of revenue generated by transmission charges for the NTG acquired from the FSI group.

50.6 €m

the increase
in revenues from
Regulated Activities

Regulated revenue is up €50.6 million, reflecting the following:

- an increase in **transmission revenue** (up €68.6 million): this includes the charge relating to the NTG acquired from the FSI group at the end of 2015 (up €65.9 million), which in the comparative period only covered operating costs and the increased charge due to the Parent Company (up €2.7 million, primarily due to revision of the related tariff after the one-off effects recognised in 2016);
- an increase in **dispatching and metering revenue** (up €0.6 million), reflecting revision of the tariff applicable during the year;
- the negative impact of the **quality of service** (down €8 million), due essentially to the impact, in both 2017 and 2016, of regulatory decisions regarding a number of "major events" occurring in recent years in central and northern Italy;
- a reduction in **other core revenue** (down €10.5 million): above all this reflects the increased revenue generated in 2016 by the so-called "Copper Plan" (down €11.6 million), consisting of the progressive replacement, and sale to third parties, of a number of copper conductors present on power lines with new aluminium conductors.

⁹ The Terna Group's operating segments are in line with the internal audit system adopted by the Parent Company, in keeping with the Strategic Plan for the period 2018-2022.

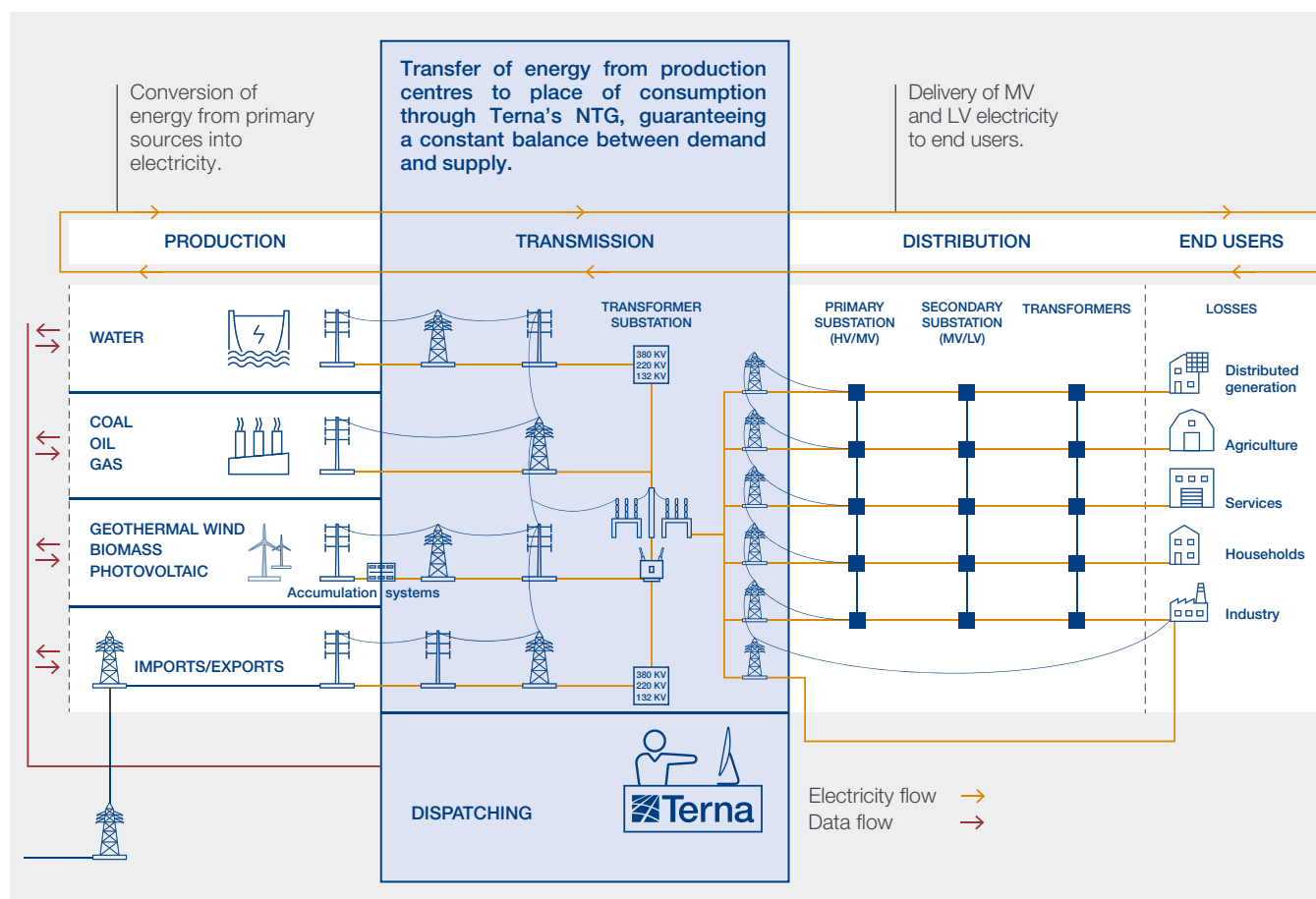
The **cost of Regulated Activities** is up €4.4 million, primarily due to the increased cost of the **quality of service** (€18.3 million), partially offset by a reduction in **personnel expenses** (down €8.7 million, reflecting the higher amount of provisions made in 2016 for early retirement schemes, after taking into account the greater cost of recruitment linked to the increase in Rete's assets).

Our regulated business

Terna's role in the Italian electricity supply chain

The Italian electricity supply chain consists of four segments: production, transmission, distribution and the sale of electricity.

The Terna Group's main Regulated Activities are the transmission and dispatching of electricity in Italy. Terna performs these activities in its role as the Italian TSO (Transmission System Operator) and ISO (Independent System Operator), under a monopoly arrangement and a government concession. Regulated revenue, which represents approximately 87% of the Group's total revenue (in 2017) is measured on the basis of the rules set by the Regulatory Authority for Energy, Networks and the Environment (ARERA).



72,900 km

Terna is the largest grid operator in Europe by kilometres of power line

DIMENSIONS OF THE NATIONAL TRANSMISSION GRID		UNIT OF MEASUREMENT	2017	2016
	Electricity substations	no.	871	855
	Transformers	no.	781	708
		MVA	149,215	145,456
	Connection bays	no.	6,253	6,162
	Power lines	Km	66,362	66,366
	Circuits	Km	72,881	72,844

Electricity transmission

Planning for development of the National Transmission Grid, the performance of construction services and the maintenance of electricity infrastructure are the three areas of responsibility included in the regulated electricity transmission business. The Group adopts a sustainable approach throughout every stage of the process. This takes the form of transparency in managing the Group's social capital through engagement with the stakeholders directly affected by the Group's development initiatives, with a view to building awareness of the importance of delivering the planned new electricity infrastructure.



Planning the national transmission grid

By analysing electricity flows through the grid and developing supply and demand projections, Terna is able to identify any critical areas. As a result, it is able to schedule new projects needed to ensure that the system is adequate over the short, medium and long term, in relation to balancing, the security of operations, reducing congestion and improving quality and continuity of service.

The new works to be carried out are included in the **NTG Development Plan**, presented annually to the Ministry for Economic Development for approval. Terna follows the complex authorisation process.

The NTG Development Plan sets out the grid development initiatives envisaged over the next ten years, as well as the state of progress of the development works planned in previous years.

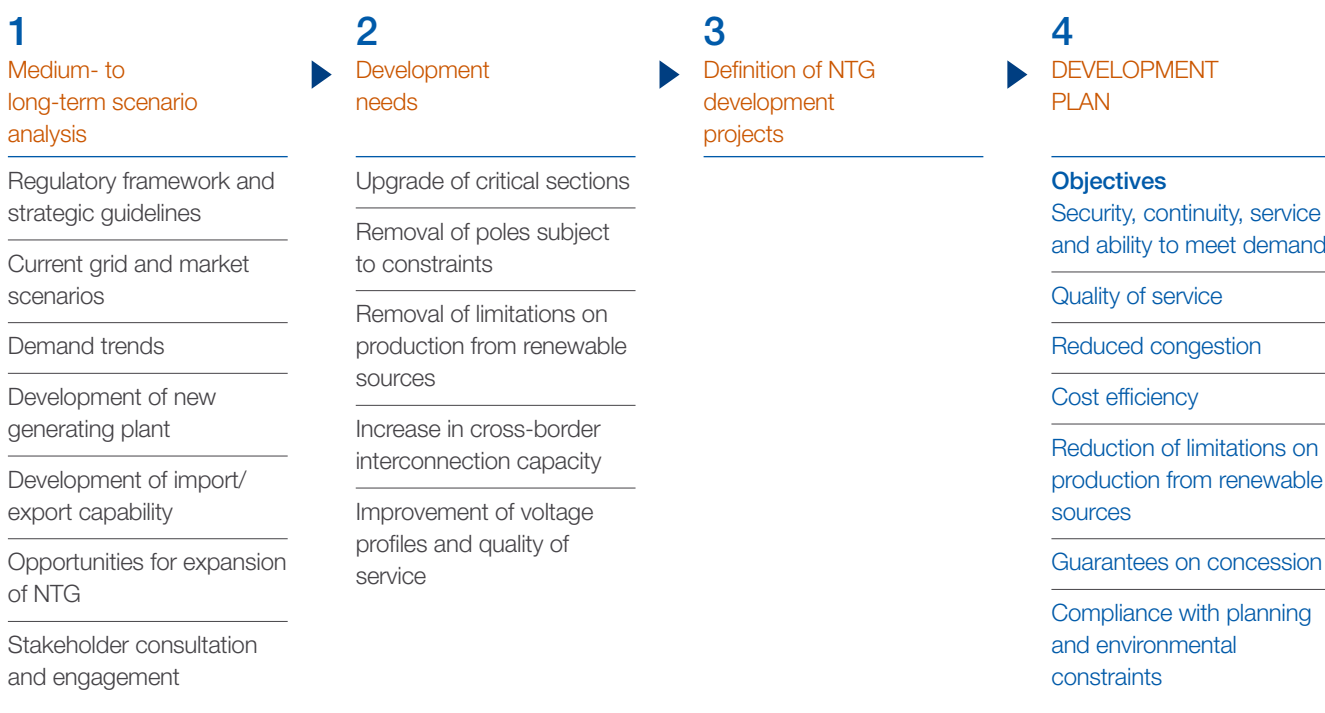
The Plan contains all the investments that Terna is committed to carrying out in order to guarantee the efficiency of the grid, the security of supply and of the service and the integration of production from renewable sources, in keeping with the growth targets set out in the National Energy Strategy for 2017. All investment in development of the grid is subject to a prior cost-benefit analysis, comparing the related expenditure with the resulting benefits, expressed in monetary terms.

A positive cost-benefit ratio is a necessary condition for the investment's inclusion in the Development Plan.

The Development Plan is fully in keeping with changes in the electricity sector at Italian and European level, reflecting the impact of the drive for decarbonisation. As detailed in the section, "Energy market", this is reflected in the National Energy Strategy for 2017 (NES 2017), adopted on 10 November 2017 by ministerial decree issued by the Ministry for Economic Development and

the Ministry of the Environment and of the Protection of Land and Sea. This contains the Italian government's ten-year plan designed to manage and support change in the energy system.

Grid Development planning has to be in line with the growth targets for renewable energy production set out in the Italian National Energy Strategy, by necessity taking advantage of all the available flexibility resources (including exports and imports and storage systems) and the methods for controlling power generation.



The **2018 Development Plan** entails capital expenditure of approximately €12 billion, which will enable the Company to achieve the following electricity system efficiencies and benefits:

- increased interconnection capacity, estimated at up to approximately 6,000 MW;
- a reduction in congestion of approximately 5,000 MW;
- a reduction in energy losses of approximately 1,600 million kWh per year;
- cuts in CO₂ emissions of approximately 9.4 million tonnes a year, due to the production mix and reduced network losses, corresponding to equivalent emissions of approximately 11 million cars¹⁰.

-9.4 million tonnes
a year in CO₂ emissions

¹⁰ Average emissions from a car equal to 120 grams of CO₂ per km, based on average mileage of 10,000 km a year.



The Development Plan is based on the following drivers:

- **decarbonisation**: the electricity system's transition to complete decarbonisation requires use of all the tools necessary in order to fully integrate renewable production plants in order to reduce emissions over the long term, guaranteeing the system's security;
- **market efficiency**: the structure and mix of Europe's generation mix in general and of Italian generation in particular are undergoing a radical transformation, just as transmission lines are being developed in keeping with new European directives regarding Market Design. The adoption of new mechanisms at national level (in particular, the Capacity Market and the reform of the dispatching services market) will have a major impact on development of the electricity system;
- **security of supply**: the third driver for the Plan aims to ensure the security of the national electricity system and, at the same time, create an increasingly resilient system, capable of handling critical events external to the system itself.

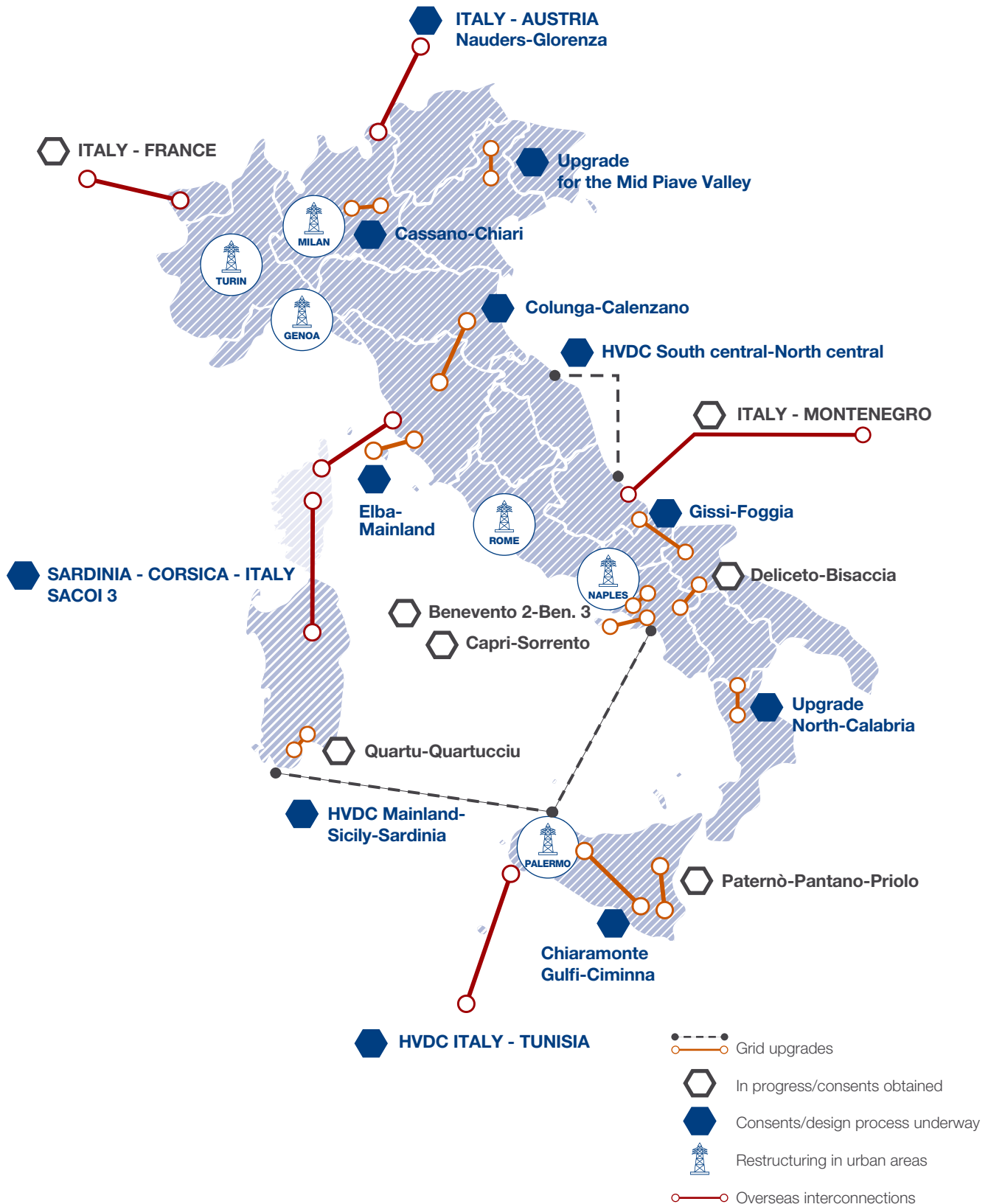
At the same time, the need for a **systemic approach to sustainability** cannot be ignored. This consists of the ability to conceive, design and implement following rigorous analysis capable of maximising the environmental and economic benefits. In this sense, for the first time and with the aim of ensuring transparency, the Development Plan has set measurable sustainability goals, designed to be both comparable and challenging.

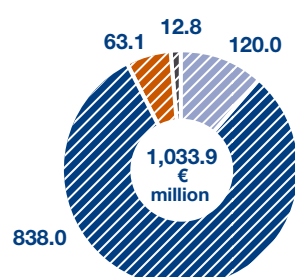
With regard to decarbonisation, in line with Legislative Decree 93/11 and Resolution 627/16, as amended¹¹, Terna has included a specific section in the National Development Plan setting out the actions needed in order to make full use of the power produced by renewable plants. The network assessments conducted with a view to facilitating the use and development of renewable production have led to the identification of the work to be carried out on both the primary 380-220 kV transmission grid and on the 150-132 kV high-voltage grid.

For the above purpose, the following figure shows an overview of the main development projects on the 380 kV Very High-Voltage grid.

¹¹ Resolution 627/2016/R/eel, as amended - Provisions for consultation on the ten-year National Transmission Grid Development Plan and approval of the minimum requirements for the Plan, in relation to the assessments for which the regulator is competent.

PRINCIPAL PROJECTS INCLUDED IN THE 2018 DEVELOPMENT PLAN





THE GROUP'S CAPITAL INVESTMENT

- Investment incentives
- Other regulated assets
- Non-regulated assets
- Capitalised financial expenses

Implementation of development initiatives¹²

Within the Group, responsibility for the design and construction of the works included in the Development Plan has been assigned to Terna Rete Italia SpA¹³, which provides support to the Parent Company during the authorisation process, decides on the need for external resources and the budget, establishes the related solutions and the technical specifications for the components and materials to be used, if necessary adopting innovative technological solutions, and in compliance with the technical regulations in force. It also defines the engineering standards for plants connected to the grid, above all standards of construction and the performances required of equipment, machinery and substation and power line components. Following an assessment, Terna SpA identifies the best ways of connecting operators who have submitted an application to the transmission grid.

The Terna Group's **total capital expenditure in 2017** (as shown in the above chart) amounts to **€1,033.9 million**, compared with €854.3 million in the previous year (up 21%). This was higher than expected. **Investment incentives** amounted to **€120.0 million**, up from the €72.7 million of the previous year.

Investment in non-regulated assets, amounting to €63.1 million, primarily regards the private part of the Italy-France interconnector.

+21%
total capital
expenditure vs 2016

THE GROUP'S CAPITAL EXPENDITURE (€M)	2017	2016	CHANGE	% CHANGE
Incentives for regulated assets*	120.0	72.7	47.3	65.1
Other regulated assets	838.0	715.4	122.6	17.1
Investment in regulated assets	958.0	788.1	169.9	21.6
Investment in non-regulated assets	63.1	50.2	12.9	25.7
Capitalised financial expenses	12.8	16.0	(3.2)	(20.0)
TOTAL CAPITAL EXPENDITURE	1,033.9	854.3	179.6	21.0

* Classification of investments in accordance with ARERA Resolution 579/2017/R/EEL.

The following pages provide a summary of the principal construction work carried out during the year¹⁴, highlighting the related benefits for the system¹⁵:

¹² Details are provided in the document, "progress of work on previous Development Plans - updated to 31 December 2016", available at www.terna.it, in the form provided for in Resolution 627/2016/R/EEL, Annex A, art. 7 of 4 November 2016.

¹³ Under an agreement covering the lease of certain operations, concluded in 2012, Terna Rete Italia SpA is responsible, within the Terna Group, for operation and routine and extraordinary maintenance of the owned portion of the NTG, and for management and implementation of the grid development initiatives included in the related concession arrangement for transmission and dispatching operations, as set out in Terna SpA's Development Plan. The above lease agreement also grants the subsidiary exclusive access to the resources, assets and know-how necessary in order to carry out the above activities.

¹⁴ The following amounts include capitalised financial expenses.

¹⁵ Calculated on the basis of a Cost Benefit Analysis (CBA 2.0), as provided for in ARERA Resolution 627/2016/R/EEL of 4 November 2016.



CONSTRUCTION WORK CARRIED OUT AND EXPECTED BENEFITS

Principal construction work carried out (capital expenditure in 2017)

The 380 kV Udine West-RediPuglia power line, included in the Grid Development Plan and authorised by the MED on 14 February 2017 with Decree EL-146 bis, became operational on 1 October 2017.

380 kV Udine West-Redipuglia power line (€25.1 million)

For the electricity system

This infrastructure represents a strategic project for northern and eastern Italy, upgrading the Friuli electricity system, which is currently not well meshed. It also offers benefits in terms of reducing the risk of Energy Not Supplied, has improved the quality of the electricity service offered to local businesses and households, and improved the security of cross-border interconnections with eastern Europe.

For the country as a whole

The new infrastructure is expected to result in savings of between €110 and €150 million a year for the Italian electricity system.

For local communities

In terms of the environment, the infrastructure will make it possible to retire around 100 km of lines, thanks to a rationalisation plan involving 220 kV and 132 kV lines. It will also result in a reduction in CO₂ emissions of between 750 and 890 thousand tonnes per year.

The submarine cable linking the island of Capri with the Italian mainland became operational on 27 June 2017. This project is included in the Grid Development Plan and was authorised by the MED on 26 May 2010 with Decree EL-210.

Capri-Mainland interconnector (€14.4 million)

For the electricity system

This infrastructure represents a strategic project for power supplies to the island of Capri, with electricity currently supplied by aged oil-fired thermoelectric plants that are not always able to meet peak demand on the island.

For the country as a whole

The new infrastructure is expected to result in savings of €17 million a year for the Italian electricity system.

For local communities

In terms of the environment, the connection consists entirely of invisible submarine or underground cable and a compact substation, thus reducing the footprint. The new connection has reduced the risk of outages, above all at times of peak demand (during the summer season).

Further projects were completed in 2017 and are briefly described in the section, "Development of the NTG", in the annexes.

Main progress made in 2017

WORKS IN PROGRESS

380/150 kV substations and the related connections to the high-voltage network to collect renewable energy: reinforcement of the very high-voltage and high-voltage network in the area between Foggia and Benevento

On 10 April 2017, Terna received the necessary consents to build the new 380 kV Deliceto-Bisaccia power line.

For the electricity system

The 380 kV “Deliceto-Bisaccia” line will increase interconnection capacity between the Southern and South central section, facilitating integration with renewable production plants and security of the service.

For the country as a whole

This will result in significant benefits in terms of an increase in Social Economic Welfare, and the full use of wind resources, as well as improving security of supply.

For local communities

As regards the environment, the infrastructure has been designed pursuing the aim of maximising its integration into the surrounding area.

Venice lagoon cables - Power lines linking the “Sacca Serenella Primary Substation - Cavallino Primary Substation” and “Fusina 2 - Sacca Fisola Primary Substation” (€23.3 million).

Work on construction of the 132 kV power lines between the “Sacca Serenella Primary Substation - Cavallino Primary Substation” and the “Fusina 2 - Sacca Fisola Primary Substation” in cable continued in 2017. The project is included in the Grid Development Plan approved by the MED.

75% of the Sacca Serenella-Cavallino terrestrial section has been installed (out of 4 km), whilst 94% of the submarine cable has been laid (out of approximately 10 km). Drilling to create the Cavallino landing point was also completed.

The infrastructure is needed to provide greater margins of security and ensure reliable power supplies for the Venetian lagoon.

For the electricity system

This infrastructure will improve operational security and increase the reliability of the grid that serves the city of Venice, removing the current antenna structure that powers the Cavallino primary substation and simultaneously increasing connections with the portion of the grid associated with the 380/132 kV Salgareda substation.

For the country as a whole

The new infrastructure is expected to result in savings of between €9 and €18 million a year for the Italian electricity system.

For local communities

In terms of the environment, the infrastructure will make it possible to retire around 7 km of 132 kV lines.



In addition, other main projects in progress include the following:

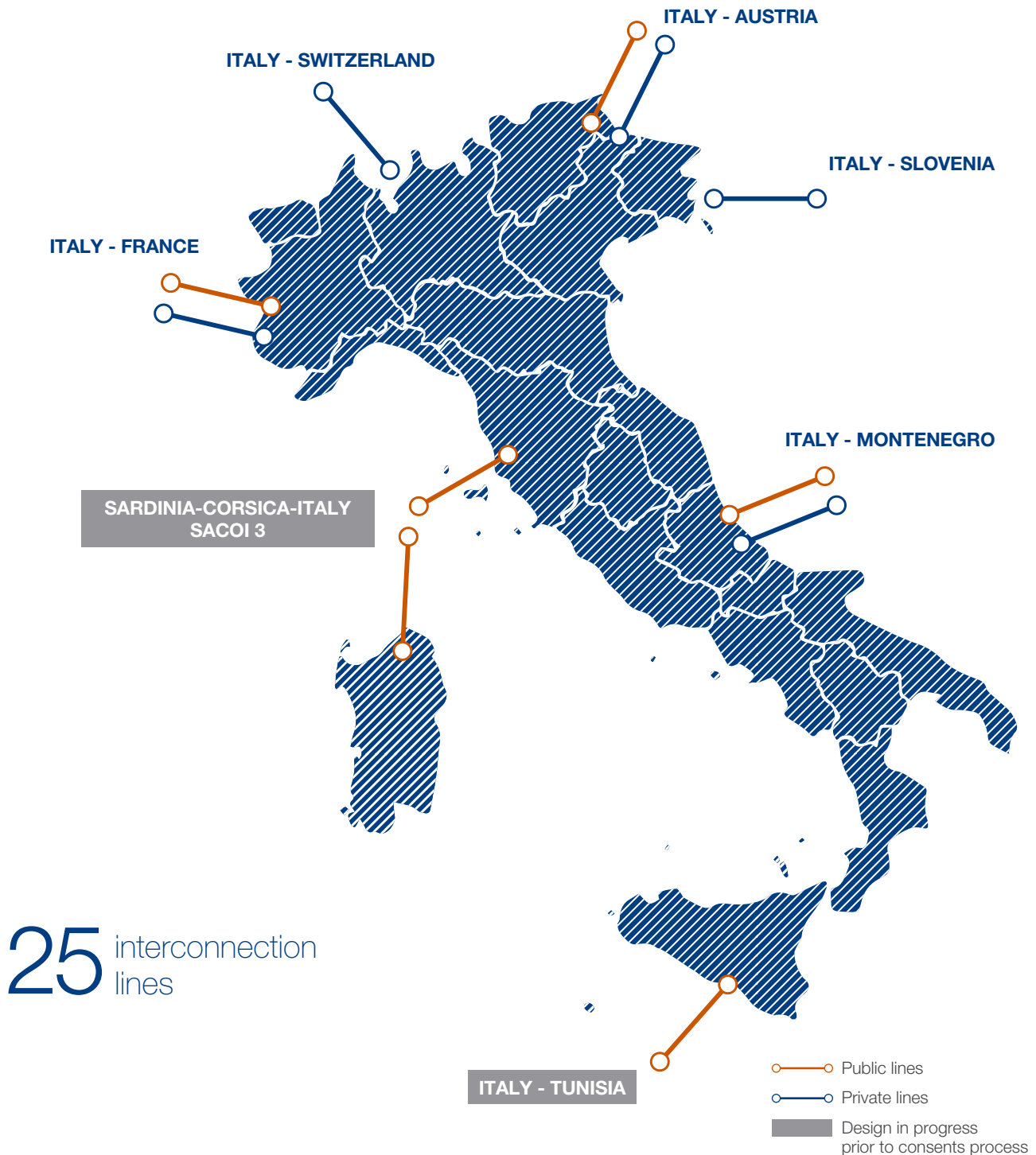
- **investment in the grid acquired from the FSI group (€75.9 million)**: relating to regulated investment without incentives, primarily in the functional separation of substations, totalling €47.4 million (111 substations, to add to the 61 separated in 2016), purchase of the three electricity substations needed to supply the Treviglio-Brescia railway line at a cost of €10.7 million and the renewal of lines, above all the Cesena-Riccione line, at a cost of €1.3 million;
- the **“Fibre Network Development” project (€28.2 million¹⁶)**: the fibre network has been extended by a total of 4,050 km, by laying 1,850 km of new fibre and purchasing approximately 2,200 km from third parties. At 31 December 2017, 351 electricity substations in the NTG have been connected and lit and the process of connecting primary substations and renewing the fibre network has begun;
- the **purchase of the 150 kV “Stornarella” cable (€17.4 million)**: the cable was purchased from third parties on 29 December 2017, following the transfer of title and inclusion in NTG assets as a result of Ministerial Decree 30164 of 28 December 2017;
- the **purchase of the 150 kV Macchialupo substation (€14.5 million)**: the substation and two 150 kV double three-phase power lines between Bisaccia and Macchialupo 1 and 2 (20.4 km);
- increase of the capacity of the **North-West power lines (€13.8 million)**, above all the 380 kV Lacchiarella-Chignolo Po and Vado Ligure-Vignole Bordera lines, and the Rondissone and Trino II electricity substations;
- **restructuring of Palermo metropolitan area (€11.3 million)**: work is nearing completion at the Casuzze substation in relation to the replacement of the 150 kV lines in the old overhead section with a new compact 150 kV section. Cable for the 150 kV “Ciminna-Casuzze” connection has been laid, with the exception of the last 3 sections, which are to be completed in 2018.

¹⁶ This amount includes investment of €1.2 million in fibre by the subsidiary, Rete Srl.

OVERSEAS
INTERCONNECTOR
PROJECTS AND STAGE
OF COMPLETION

Its geographical position makes Italy a natural hub in the Mediterranean area and it can count on an electricity border made up of 25 interconnectors¹⁷, in addition to new power lines under construction.

This development work aims to increase interconnection capacity (Net Transfer Capacity - NTC) on the electricity borders with foreign countries, enabling a reduction in energy procurement costs and the integration of markets, with the possibility of having more resources for use in managing the Italian and European electricity system.



¹⁷ These include 3 merchant lines, or lines not owned by Terna, and the Italy-Malta connection owned by Enemalta.

PRINCIPAL INTERCONNECTORS IN PROGRESS 2017

(Capital expenditure 2017)

The new Italy-France interconnector is a project unique in the world in terms of the engineering, technological and environmental solutions used: 190 km of line connecting the substations of Piossasco (Italy) and Grand'Ile (France) through 25 municipalities in the province of Turin, consisting entirely of direct current underground cable.

The power line will be the longest underground line in the world and will have a very low impact on the environment and the local area, thanks to its ground-breaking design.

The 320kV power line will have capacity of 1,200 MW, using two independent two-way modules each of 600 MW).

On 25 October 2017, the Ministry of Infrastructure and Transport approved the agreement granting Terna the right to carry out the project and to cross the relevant section of the A32 motorway operated by Società Italiana per il traforo autostradale del Frejus (SITAF). In August 2017, work began in the municipalities of Bussoleno, Susa and Exilles and, in November 2017, work began on the A32 operated by SITAF

"Italy-France"
interconnector
(€62.5 million)

For the electricity system

Completion of the new interconnector will bring benefits for the electricity markets of Italy and France. The increase in energy exchanges will result in a reduction in congestion between the two countries and the potential for more efficient use of renewable sources. This therefore also makes the interconnector a Project of Community Interest (PCI). In November 2017, it was included in the third PCI list, published by the European Commission in accordance with EU Regulation 347/2013.

For the country as a whole

The infrastructure will increase social and economic welfare at European level, reducing the price differential between Italy and France. Additionally, based on the content of the 2016 TYNDP, the interconnector will increase production from renewable sources in Italy and improve energy efficiency at European level.

For local communities

The use of underground cable technology guarantees lower environmental and visual impacts, thereby preserving the Alpine landscape in both France and Italy. The creation of the new infrastructure in the same location as road infrastructure, such as the Fréjus safety tunnel, offers another strategic advantage in terms of social/environmental issues.

(Capital expenditure 2017)

PRINCIPAL INTERCONNECTORS IN PROGRESS 2017 - continued

"Italy-Montenegro"
interconnector
(€212.8 million)

The interconnector between Italy and Montenegro is a strategic project at European level, marking a major opportunity for the Italian electricity system as part of efforts to develop the interconnection between Italy and the Balkans. The project involves construction of a direct current connection, part in submarine cable and part in terrestrial cable, between the substations of Villanova (IT) and Lastva (ME) and covering a distance of approximately 445 km.

Construction, which is currently in progress, will involve the use of engineering and technical solutions capable of significantly minimising the environmental impact. The project involves construction of a direct current interconnector with a capacity of approximately 1,200 MW. In this regard, in April 2017, laying and protection of the first pole of the submarine cable between Italy (Pescara) and Montenegro (Kotor), which began in October 2016, was completed. Installation of the second pole has been postponed and is subject to a financial feasibility assessment. Laying of the terrestrial section and construction of the converters in both Italy and Montenegro is in progress.

For the electricity system

The work, which when completed at the end of 2019 will increase interconnection capacity, has been included among the Projects of Common Interest (PCI) by the European Commission, which co-financed the feasibility studies in connection with the programme to support the Trans-European Network (TEN) priority electrical infrastructure. In November 2017, it was included in the third PCI list, published by the European Commission in accordance with EU Regulation 347/2013.

For the country as a whole

The infrastructure is a key step for the European Energy Union and crucial for integrating the entire Balkan area into Europe, via Italy.

For local communities

The project will have minimal environmental impact, as the cables will be placed 1200 metres beneath the Adriatic sea and buried for the remaining terrestrial section.

"Italy-Austria"
interconnector

The high-voltage interconnector between Prati di Vizze (IT) and Steinach (AT), planned to be operational in 2019, will take advantage of the existing Prati di Vizze - Brennero power line. Preparations to create the new 132/110 kV electricity substation in Brennero and the related lines are currently in progress.

For the electricity system

The line will significantly increase electricity interconnection capacity between Italy and Austria, supporting market integration, the use of renewable sources and security of supply.

For the country as a whole

It will provide significant benefits in terms of increased social economic welfare, helping to reduce price differentials between Italy and Austria, and ensuring full use of hydroelectric resources, whilst also improving the security of electricity supply. The use of existing infrastructure will minimise the environmental impact of the works.

For local communities

To allow imported power transported along the future Prati di Vizze - Steinach interconnector to be securely added to the grid, the mesh of the local 132 kV grid will be strengthened and transport limitations will be removed as appropriate. These actions will enable optimal use and further development of production capacity from renewable sources, which will serve the relevant portion of the local grid.





MAINTENANCE
PREDICTIVE OF
THE ELECTRIC
NETWORK

Infrastructure maintenance

Maintenance of electricity grid infrastructure is essential in order to guarantee quality and continuity of service. These operations are carried out on the basis of a predictive approach, with the aim of ensuring that grid reliability meets the very highest standards. The tools used to support maintenance activities are subject to continuous innovation, as regards the scheduling and execution of operations (Workforce Management) and the adoption of modern aerial inspection techniques for the electricity grid. Terna has, for many years, participated in international benchmarking for the sector, with the aim of sharing best maintenance practices. It has consistently ranked as one of the best TSOs in terms of fault rates and the efficiency of its maintenance process.

Implementation of the plan to progressively assume responsibility for operation and maintenance (O&M) of the electricity substations owned by Rete Srl (following acquisition of RFI's assets) proceeded in 2017. By the end of the year, responsibility for 172 of the 350 substations acquired had been transferred.

Maintenance of the electricity grid is the responsibility of Terna Rete Italia SpA through three Area Offices, which are responsible for eight Operational Transmission Areas. The Area Offices are also tasked with extraordinary maintenance activities and the renewal of existing assets, in order to improve the reliability and prolong the useful lives of the assets. The related criteria are defined by the Engineering and Asset Management department, which is also responsible for establishing the methods and tools to be used in carrying out operations.

INFRASTRUCTURE MAINTENANCE IN 2017

Monitoring and control

26,000 checks on substations of various voltage levels; visual inspections of 85,500 km of three-phase power line, of which around 40,500 km using helicopters (visual + infra-red) with an average total frequency of around 1.2 inspections a year for each transmission line; in addition, a further 41,800 km of power line underwent instrumental controls, both from the ground (including with the use of the LLW or live-line working technique), and from the air using helicopters to operate flights that use laser scanning surveys to identify any obstructions, particularly trees.

Routine maintenance

Repairs are carried out when signs of deterioration are identified as a result of the monitoring process or by on-line sensors. These indications and any problems identified are processed by the expert system used to support MBI (Monitoring and Business Intelligence) decisions. This system, which has been in use since 2005, draws up the maintenance plan on the basis of engineering models developed by the Asset Management department.

Vegetation management

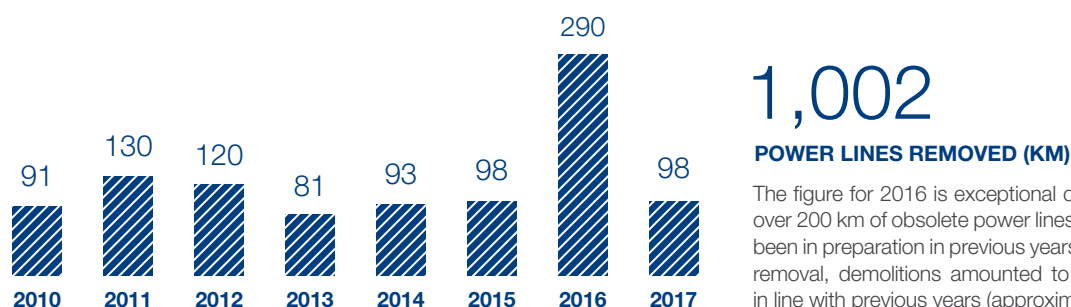
During 2017, vegetation was cut back on around 21,300 km of power line; vegetation has to be cut back to ensure the correct and safe operation of the lines.

Live-line working (LLW)

Approximately 1,600 checks and 600 line maintenance interventions using live-line working were carried out. These activities, performed with the line in operation, increase the availability of the infrastructure and help to improve the quality and continuity of service.

Extraordinary maintenance

Renewal work (the replacement of components and entire systems) was carried out in 2017 in order to prolong the useful lives of power lines and substations. In terms of power line alone, work was carried out on over 1,000 km of line.



Environmental impact of Terna's Regulated Activities

The commonest and most significant environmental aspect of Terna's core business is the physical presence of power lines and power stations and the related impact in terms of the landscape and land use.

The main initiatives designed to mitigate the impact of power lines are included among the investments in the Development Plan. These regard:

- **Rationalisation:** complex initiatives involving several components of the grid, replacing certain components with others of a superior type, thereby eliminating parts of the grid that are of little use following the installation of new infrastructure or adding new elements of the grid to avoid the upgrade of power lines that have reached saturation point. The demolition of obsolete lines represents one of the most important positive contributions that Terna makes to improving the environment: 98 km of lines were demolished in 2017, bringing the total number of kilometres of line demolished since 2010 to 1,022. Demolition is defined as the physical removal of overhead lines (or their replacement with underground cable) and does not include declassified or upgraded lines.
- **Use of pylons with a reduced visual impact:** Terna increasingly uses new single-pole pylons with a low environmental impact (occupying only 10 m² of ground, rather than the 150 m² occupied by the traditional pad/pyramid type pylons).

Electricity substations are significant from an environmental viewpoint partly as they are the principal source of the Group's direct greenhouse gas emissions. These consist of leakages of SF₆ (sulphur hexafluoride), a gas used as insulation in certain electrical equipment (circuit breakers, current transformers and armoured equipment). Leakages, which had fallen to their lowest ever level as a percentage of installed gas capacity in 2016 (0.39%), have risen over the last year (in 2017, the rate was 0.47%). This was due to certain equipment, which in many cases has already undergone routine and extraordinary maintenance.

The Group's direct CO₂ equivalent emissions have thus risen, resulting also in greater carbon intensity, which is, however, not significantly different from recent years.

TOTAL DIRECT AND INDIRECT GREENHOUSE GAS EMISSIONS - TONNES OF CO ₂ EQUIVALENT ¹⁸	2017	2016	2015
<i>Direct emissions</i>			
Total direct emissions	75,792.9	61,991.7	66,799.4
of which: Leakages of SF ₆	67,371.4	54,101.9	58,478.3
<i>Indirect emissions</i>			
Electricity¹⁹	72,489.3	74,715.5	70,325.6

¹⁸ The conversion of direct energy consumption and leakages of SF₆ (sulphur hexafluoride) and refrigerant gases into CO₂ equivalent emissions has been carried out using the parameters indicated in the IPCC Fifth Assessment Report (AR5) and the Greenhouse Gas Protocol (GHG) Initiative.

¹⁹ The conversion of indirect electricity consumption is carried out taking into account the share of total Italian electricity production represented by thermoelectric production in 2017. Allocation for the purposes of the production mix was based on the December 2017 issue of the "Monthly Report on the Electricity System", available on the website at www.terna.it.

CARBON INTENSITY - TONNES OF CO ₂ EQUIVALENT / REVENUE (€M)	2017	2016	2015
Total emissions (direct and indirect)	148,282.2	136,707.2	137,125.1
Ratio of total emissions to revenue	66.0	65.0	65.9

At the end of their normal lifecycle, the materials used in electricity infrastructure are recovered for reuse in operations. Only a residual portion is sent to landfill and has an impact on the environment. The percentage of waste recovered amounted to 87% in 2017 (93% in 2016 and 92% in 2015). The effective amount recovered depends on the materials contained in the waste: some of them are easy to separate out and thus reuse (for example, the iron parts of pylons); in other cases, instead, it is not possible or it is too costly to separate the various parts, above all when dealing with the most obsolete equipment. For this reason, annual changes in the percentage of waste recycled should not be interpreted as indicating a trend.

Quality of service

Each segment of the electricity system - generation, transmission and distribution - plays a role in ensuring the availability of electricity in Italy, guaranteeing adequate quality standards and keeping the number of outages below pre-set thresholds.

Terna monitors service continuity through various indicators defined by ARERA (Resolution 250/04) and in Terna's Grid Code.

CONTINUITY INDICATORS USED

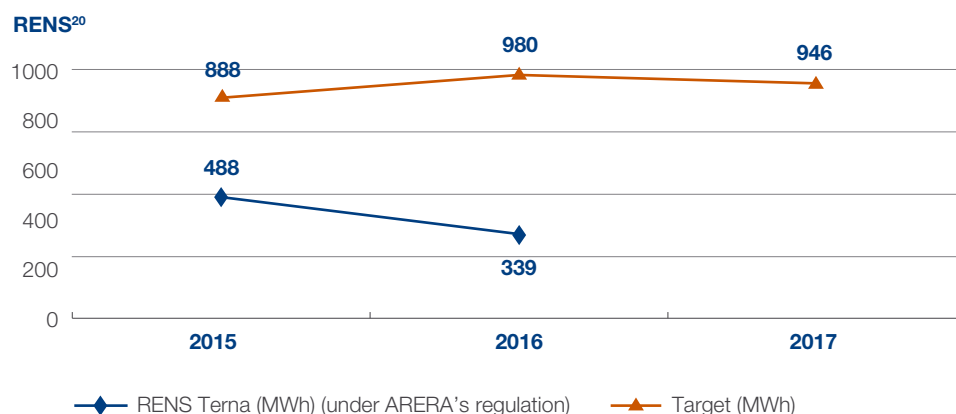
Indicator	What it measures	How it is calculated
RENS*	Energy not supplied following events affecting the relevant grid**	The sum of the energy not supplied to users connected to the NTG (following events affecting the relevant grid, as defined in the ARERA regulations governing quality of service).
ASA***	Availability of the service provided by the NTG	Based on the ratio of the sum of energy not supplied to users connected to the NTG (ENS) and energy fed into the grid.

* Regulated Energy Not Supplied

** The "relevant grid" refers to all of the high-voltage and very high-voltage network.

*** Average Service Availability

These continuity indicators are significant for the system, as they monitor the frequency and impact of events that have occurred on the electricity grid as a result of faults or due to external factors, such as weather events. In all cases, the period of observation is four years, a period in which there have been no significant changes, testifying to the high quality of service achieved.



As regards the ASA indicator, the operating performance shows that ASA has remained stable at a high level over the years (the higher the indicator, the better the performance). This indicator shows that the energy not supplied following a fault on the owned grid represents a minimal part of the total quantity of energy supplied to users of the grid. In particular, availability was 99.99974% in 2016, compared with 99.99986% in the previous year.

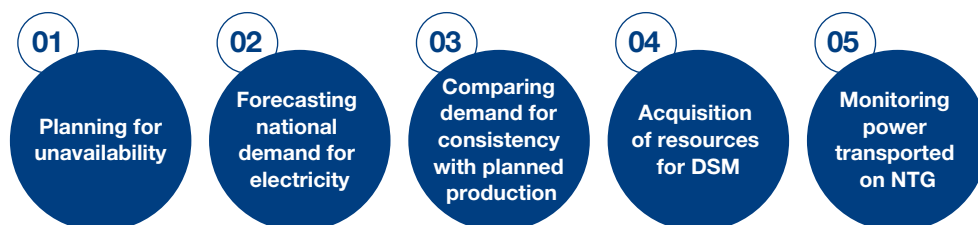
Existing regulations (set out in Resolution 653/2015/R/eel) envisage a series of mechanisms designed to regulate and encourage improvements in the quality of service provided by Terna. The overall economic effects of the bonus/penalty mechanisms related to quality of service for 2017, compared with 2016, are shown below.

QUALITY OF SERVICE (€M)	2017	2016	CHANGE
RENS bonuses/(penalties)	7.4	15.4	(8.0)
Revenue	7.4	15.4	(8.0)
Mitigation and sharing mechanisms	10.6	3.2	7.4
Contributions to the Fund for Exceptional Events	2.4	3.0	(0.6)
Compensation mechanisms for HV users	0.6	0.5	0.1
Contingent assets	(3.1)	(14.5)	11.4
Costs	10.5	7.8	18.3
TOTAL	(3.1)	23.2	(26.3)

²⁰ For the RENS indicator, the targets for 2012-2015 have been set as an average of the RENS 2008-2011 indicator, referred to in ARERA Resolution ARG/elt 197/11, with a 2% improvement in performance required for each year compared with the previous one. The target for 2016-2023 has been set as an average of the 2012-2015 RENS indicator, referred to in ARERA Resolution 653/15/R/eel, with a 3.5% improvement in performance required for each year compared with the previous one. Since 2016, Terna's bonus/penalty mechanism also includes the performance of the grid operated by Terna Rete Italia Srl, established in 2017. The 2017 figure is provisional.

Dispatching of electricity

“Dispatching” is the set of activities necessary to ensure that there is a balance between supply and demand in the country’s electricity system. The high degree of complexity and coordination necessary to guarantee the correct operation of the system require the presence of a central coordinator, the provider of the dispatching service. This coordinator has control over a high number of both supply-side and demand-side players, and in the last few years also over production from non-programmable renewable sources.



Dispatching includes planning for the unavailability of the grid and of production plants over different time-scales, forecasting national demand for electricity, comparing demand for consistency with planned production in the free energy market (the Power Exchange and over-the-counter contracts), the acquisition of resources for dispatching and monitoring power transfers for all the power lines that make up the grid.

This area of operation also includes management of the Dispatching Services Market (DSM), through which the resources for dispatching services are procured.

In particular, “real-time” control of the National Electricity System is ensured by the National Control Centre, the nerve centre for Italy’s National Electricity System, which coordinates the other centres around the country, monitors the system and dispatches electricity. The Centre intervenes, by issuing instructions to producers and Remote Centres, in order to modify supply and capacity on the grid. To avoid the risk of prolonged power outages, it may also intervene in an emergency to reduce demand.

The Group’s dispatching activities are managed by the subsidiary, Terna Rete Italia SpA, operating through the “National Dispatching” department and the Dispatching units at Area Offices.

The following key events in relation to efficient management of the grid took place in 2017.



KEY EVENTS IN 2017

The Italian Power Exchange, set up in 2004, is the place where supply (the electricity generated by producers) meets demand, under an energy market-based supply regime, broken down into: the Day Ahead Market, the Intraday Market and the Dispatching Services Market (DSM).

Terna is responsible for the dispatching of electricity in Italy, overseeing the security of the electricity system at the lowest possible cost through procurement on the Dispatching Services Market.

The Energy Markets Operator (GME) organises and manages the Day Ahead Auction Market and the Intraday Market, in which producers and purchasers “adjust” Day Ahead Market programmes. GME and Terna have assessed the potential for introducing new intraday market sessions.

From **1 February**: two new intraday market sessions were introduced under the responsibility of GME, alongside two new dispatching market sessions, for which Terna is responsible, with a market session every 4 hours, providing operators with the greatest possible flexibility, in line with the target European model and the aim of integrating renewable sources.

The first of the two new DSM sessions takes place in the middle of the night (with the results announced just after 2.00am in the morning) and regards planned production between 4.00am and midnight on the same day. The second takes place in the late afternoon (with the results announced just after 6.00pm) and regards the last 4 hours of the day.

These changes have made Terna's procurement more flexible and, at the same time, enabled electricity producers who participate in the electricity market to optimise the resources supplied, with benefits for both producers and the system.

The new Electricity Market

On 29 November, the “Crisis Communication Tool” (CCT) was successfully launched. This is a tool for communication between ENTSO-E and TSOs with the aim of supporting the latter in the external communication of major critical events with an impact on the European interconnector network.

Crisis Communication Tool

Black start simulations are needed to check that the electricity system is working properly and to improve its efficiency by ensuring a rapid reboot of the system in the event of a blackout. In 2017, a number of blackouts were simulated, followed by the related black starts. In particular, an innovative anti-blackout simulation was successfully conducted in partnership with France, involving over 1,400 km of power lines from France to Puglia, passing through 6 Italian regions (Piedmont, Liguria, Tuscany, Lazio, Campania and Puglia).

Black start simulations

KEY EVENTS IN 2017 - *continued*Dynamic Thermal Rating
at altitude

With a view to ensuring ever greater flexibility in the management of our assets, a new Dynamic Thermal Rating (DTR) application has been developed by the National Dispatching department and the North-eastern Office.

By exploiting the cooler climate in the north east of Italy, above all during the winter, when loads are highest, the DTR is able to increase load capacity so as to meet demand in the short term.

As is the case with other DTR applications already in use, a system for monitoring environmental conditions and temperatures has been installed.

Electricity cost trends

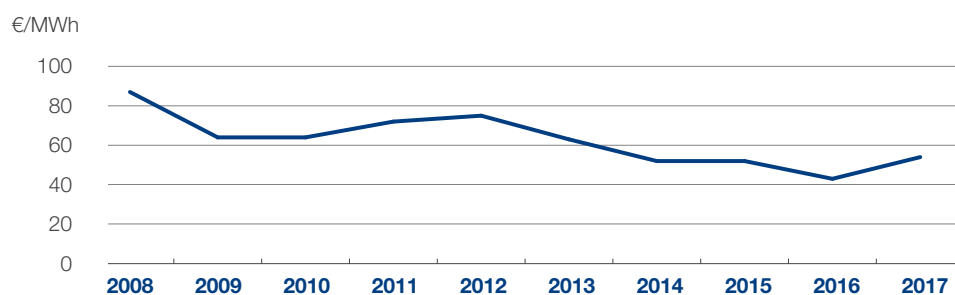
Electricity prices

The average hourly price on the Italian Power Exchange (IPEX²¹/SNP-Single National Price) for 2017 is €54 per MWh, up 26% compared with 2016. The increase reflects rises in commodities and in demand for electricity in Italy, whilst there was an increase in thermoelectric production, accompanied by a decline in hydroelectric production.

The Day Ahead Market, which sets the SNP, is based on supply and demand, although Italy must, by necessity, also take account of its particular geography, with the physical nature of the electricity grid, the widespread nature of its infrastructure and the location of consumption, and the resulting grid congestion. This means that there are a number of “bottlenecks” on the transmission grid, which have made it necessary to identify “market zones” and set transmission limits. Eliminating these bottlenecks is one of Terna’s tasks, above all through development of the grid.

The following chart shows the performance of the SNP from 2008 to 2017, revealing a decline over the period (-38%).

PERFORMANCE OF THE SINGLE NATIONAL PRICE (SNP) FROM 2008

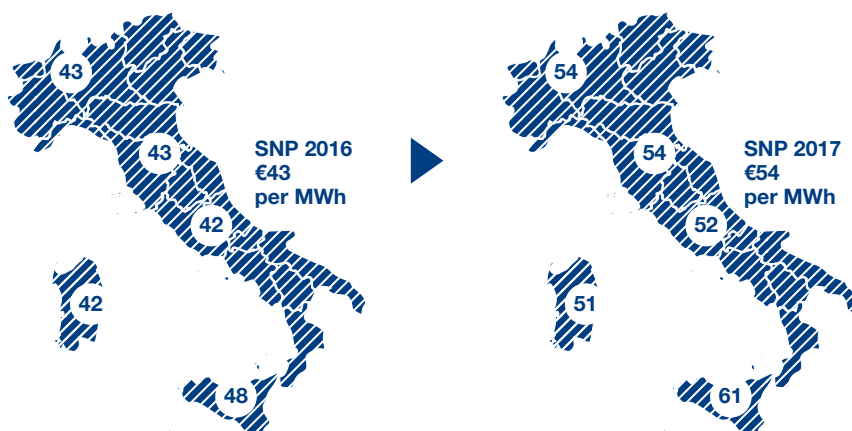


Over the years, prices in the principal zones that make up the Italian electricity market have fallen into line and the Single National Price (SNP) has decreased significantly.

In 2017, all the zonal prices, and as a result the SNP, rose for the reasons explained.

²¹ IPEX: the Italian Power Exchange.

PERFORMANCE OF ITALY'S SNP



Trade with other countries

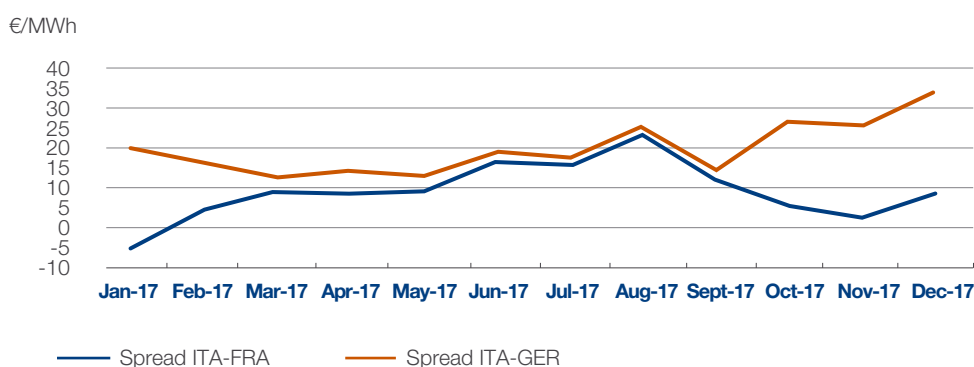
Trade with other countries in 2017 resulted in a slight increase in net imports, which are up 1.1 TWh on the previous year (up 3% on the previous year).

Between October 2016 and February 2017, there was a sharp reduction in the quantity of electricity imported, compared with the available transmission capacity in the Northern interconnection. This was due primarily to **the unavailability of French nuclear plants**, and difficulties in Europe during the winter of 2016-17.

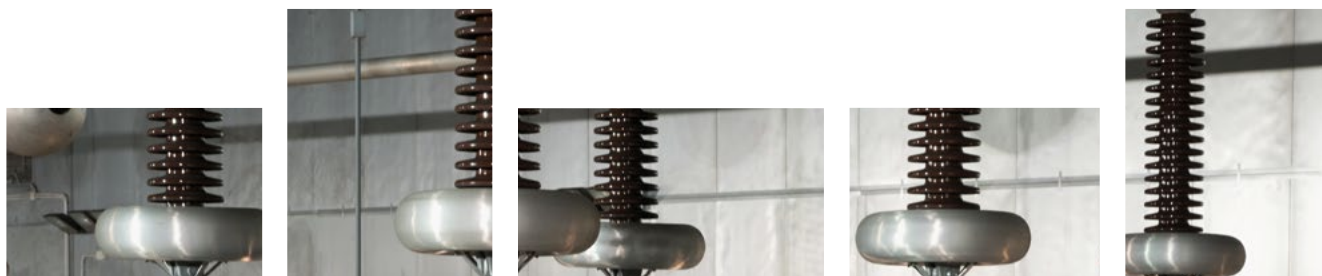
The same situation was repeated in the October-December 2017 period, but with a lesser impact.

Prices on the French (PNX) and German (EEX/PHELIIX) exchanges, which had risen year on year in line with the increase in commodity prices, registered differing trends during the colder months when, traditionally, French demand for electricity rises sharply. This increase has been even more critical, from 2016, due to maintenance work on the country's nuclear plants.

MONTHLY SPREAD FOR ENERGY PRICES COMPARED WITH FRANCE (PNX) AND GERMANY (EEX/PHELIIX)



- The price on the French exchange (PNX) was €45 per MWh (sharply up on the previous year, as the critical situation described only occurred during the closing months of the year in 2016).
- The price on the German exchange (EEX/PHELIIX) was €34 per MWh (up 18% on the previous year).



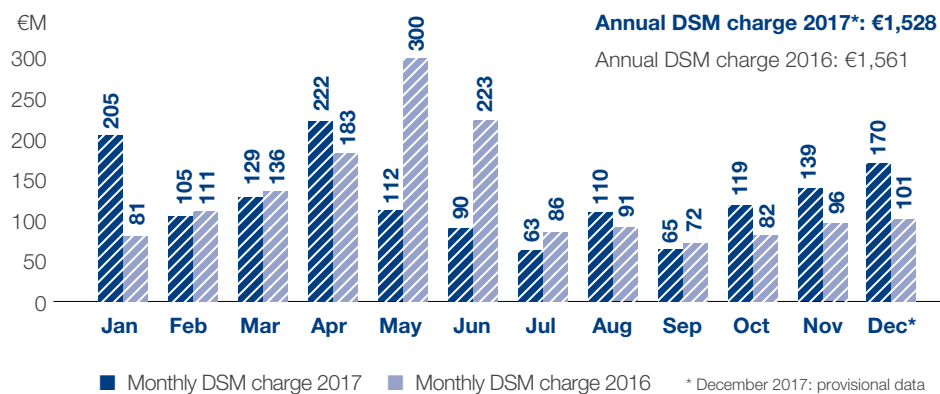
Dispatching Services Market

Terna uses the Dispatching Services Market (DSM) to procure dispatching resources to guarantee the security and adequacy of the electricity system.

In 2017, the net charge for using the DSM was €1,528 million (provisional data), slightly down on the same period of the previous year (€1,561 million). The reduction is due above all to:

- a reduction in the cost of selection, resulting from the need to meet technical constraints due to an increase in the number of plants in service as a result of Electricity Market trends and the application of ARERA's new regulations governing the provision of essential services;
- in part offset by an increase in the cost of selecting providers of reserve capacity due to the cold snap in Europe and Italy, the reduced contribution from imports from France and Switzerland due to the shutdown of a number of nuclear plants, and works (in particular, on lines and connections to the islands in October), with resulting constraints on sections of the market.

ANNUAL AND MONTHLY DSM COSTS (€M)

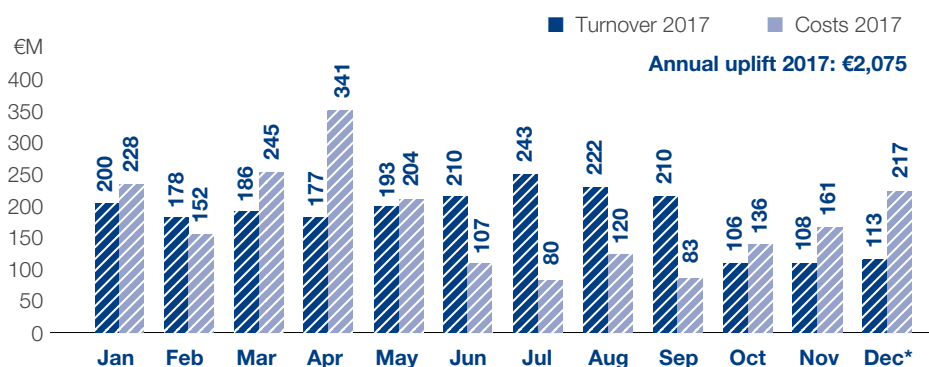




Cost of procuring resources on the Dispatching Services Market (uplift)

ARERA Resolution 111/06 (TITLE 4) regulates charges for dispatching services and the connected guarantees. Dispatching charges include the cost of procuring resources on the Dispatching Services Market (known as the uplift), pursuant to article 44, as amended.

Uplift payments are the tool used by the system to recover the net costs deriving from energy-related items from the end user, including the supply of services and energy to cover system imbalances in the DSM, imbalance costs, congestion revenue and the related coverage (CCT, CCC, CCP and DCT²²) and the cost of the virtual interconnection (the Interconnector).



* December 2017: provisional data

The charge is invoiced pro-rata to dispatching users based on energy withdrawn, to cover the expected accrued monthly cost and any prior differences.

In 2017, the total uplift was €2,075²³ million (provisional data), down on the same period of the previous year. This was primarily due to reductions in the cost of using the DSM and in imbalance costs (particularly on the consumption side), linked to the impact of new regulations that came into force in August 2016 and September 2017.

²² These abbreviations, which refer to the Italian terms, have the following meanings:

CCT: Fees for Assignment of Rights of Use of Transmission Capacity

CCC: Contract Covering the Risk of Volatility of the Fee for Assignment of Rights of Use of Transmission Capacity

CCP: Contract Covering the Risk of Volatility of the Fee for Assignment of Rights of Use of Transmission Capacity

DCT: Contract Covering the Fee for Assignment of Rights of Use of Transmission Capacity on Foreign Interconnections

²³ The uplift includes the virtual interconnection, amounting to approximately €256 million in 2017 (compared with approximately €288 million in 2016).



Non-Regulated Activities

Operating results of Non-Regulated Activities

A breakdown of the Terna Group's results from its Non-Regulated Activities for 2017 and 2016 is shown below²⁴. Further details are provided in the Terna Group's financial review.

(€m)

REVENUE FROM NON-REGULATED ACTIVITIES	2017	2016	CHANGE
Revenue from Non-Regulated Activities	189.1	182.4	6.7
Services for external customers	80.5	80.0	0.5
- Telecommunications	43.0	31.0	12.0
- O&M	17.1	16.5	0.6
- EPC	11.0	16.0	(5.0)
- Other	9.4	16.5	(7.1)
Italy-France interconnector	16.0	-	16.0
Tamini	92.6	102.4	(9.8)
Cost of Non-Regulated Activities	126.7	131.3	(4.6)
Tamini	99.0	109.2	(10.2)
Other	27.7	22.1	5.6
EBITDA from Non-Regulated Activities	62.4	51.1	11.3

EBITDA from Non-Regulated Activities amounts to €62.4 million in 2017, an increase of €11.3 million due to higher revenue from the private Italy-France interconnector, following the sale of Piemonte Savoia Srl.

6.7 €m

increase from
Non-Regulated
Activities

Revenue from Non-Regulated Activities is up €6.7 million, primarily due to the following factors:

- a reduction in revenue at the **Tamini Group** (down €9.8 million), primarily due to a decline in sales of transformers during the year;
- an increase in revenue from telecommunications, above all due to new contracts granting **usage rights on certain fibre assets** (up €11 million);
- the recognition of revenue relating to the **private Italy-France interconnector** (up €16 million), representing the accrued portion of the revenue attributable to the Group for services provided during construction;
- a reduction in contract revenue (down €5 million), essentially due to the greater volume of connections and substation upgrades carried out for external customers in 2016;
- adjustment of the exposure to contractual obligations following the sale of a **photovoltaic project** (down €2.5 million);
- the recognition, in 2016, of the impact of renewal of the **vehicle fleet** (down €4.2 million);

²⁴ The Terna Group's operating segments are consistent with the internal control system adopted by the Parent Company, in line with the Strategic Plan for the period 2018-2022.

The **cost of Non-Regulated Activities** is down €4.6 million, reflecting the above reduction in contract work at the Tamini Group (down €10.2 million) and the increased cost of fulfilling contracts to provide telecommunications services.

Our non-regulated business

In line with the guidelines in its Strategic Plan, the Group pursues opportunities beyond its core operations, whilst remaining true to its mission (e.g., energy solutions) and if distinctive and capable of adding significant value, as a platform for innovation and sustainability within the process of the TSO's development. Exploitation of these opportunities depends on establishing relations with a new type of stakeholder: the customers of our non-regulated business whose potential, in financial terms, is destined to grow as a driver of the Group's revenue diversification.

As in the previous year, stakeholder's satisfaction with relations with Terna was the subject of a specific survey in 2017.

Descriptions of the various areas of business are provided below:

- **SERVICES FOR THIRD PARTIES** (Energy Solutions, Telecommunications, O&M)
- **PRIVATE INTERCONNECTORS PURSUANT TO LAW 99/2009**
- **TRANSFORMERS - TAMINI GROUP**

SERVICES FOR THIRD PARTIES

In Italy, during 2017, Terna continued to provide its services to external customers in the areas of **ENERGY SOLUTIONS** (the development of technical solutions and the supply of innovative services), **TELECOMMUNICATIONS** (the housing of telecommunications equipment and maintenance services for fibre networks) and **O&M** (operation and maintenance of high-voltage and very high-voltage infrastructure).

As regards Engineering services, Terna obtained several EPC (Engineering, Procurement and Construction) contracts: this model involves the design, development and implementation of solutions to meet the growing demand for infrastructure and grid connections.

As regards Telecommunications services, Terna has expanded its proprietary fibre network through the targeted laying of new cable. The new network has been exploited via long-term IRU (Indefeasible Right of Use) contracts with major Italian telecommunications operators, including provision of the related maintenance and housing. In addition, Terna has pre-qualified for participation in a number tenders for contracts to build fibre networks and has begun the experimental development of projects aimed at exploiting the pylons in its high-voltage network.



NEW TYPE OF
STAKEHOLDER:
THE CUSTOMERS
OF NON-REGULATED
ACTIVITIES

SERVICES FOR THIRD PARTIES - *continued*

Telecommunications

The acquisition of contracts to supply long-distance fibre infrastructure with Open Fiber, Tim Sparkle, Wind, Retelit and others led to the delivery, in 2017, of over 10,000 km of fibre network and the start-up of work on a further 15,000 km to delivered in the next three years. These contracts generated new revenue of approximately €13.5 million in 2017 and will result in new revenue of approximately €22 million in the next three years. The related housing and maintenance contracts will also generate recurring revenue of around €1 million a year for the next 15 years. Having qualified in 2016, at the end of 2017, a three-year framework agreement was entered into with Infratel for the supply of backhaul networks as part of the National Ultra-Broadband Plan. This will enable Terna to take part in the related tenders, amounting to a total of €150 million, which will be broken down into lots from January 2018.

Finally, Terna has begun experimental development of projects aimed at exploiting the pylons in its high-voltage network as smart towers or for wireless transmission in remote area (Fixed Wireless Access).

Energy Solutions

The main contracts obtained include:

- i) a contract for the construction of a high-performance, gas-fuelled cogeneration plant with an installed capacity of approximately 380 kWe, with financing subject to performance guarantees (currently awaiting the necessary consents);
- ii) start-up of the process of obtaining consents for a photovoltaic generator with the related storage system and advance control system, which will make the island of Giannutri the first Smart Island to be created by Terna;
- iii) participation, with Avenia, in the tender called by a leading Italian steelworks, with the contract to be awarded by the end of 2018, for the supply and installation, under an EPC (Energy Performance Contract), of a heat recovery generator using steam from walking beam ovens.

Operation of third-party infrastructure

Contracts to operate third-party infrastructure include the long-term contract to maintain a submarine cable connecting Sardinia, Corsica and Italy (SACOI) and contracts to maintain third-party users' substations, power lines and substations used in renewable energy production.

**Agreement with Rete Ferroviaria Italiana**

Last year, Terna SpA and Rete Ferroviaria Italiana SpA signed a Letter of Intent with the aim of working together in order to identify and deliver renewable energy initiatives of shared interest in Italy.

The agreement envisages that the two companies will develop a project for the construction of photovoltaic plants to supply clean energy for use in RFI's rail network.

The agreement will lead to the identification of locations to host photovoltaic plants with capacity of up to 200 MW, providing Rete Ferroviaria Italiana with up to approximately 300 GWh of clean energy a year.

Locations for plants to provide the first 70 MW of capacity have so far been selected and the process of obtaining the necessary consents for the initial 52 MW has begun.

PRIVATE INTERCONNECTORS PURSUANT TO LAW 99/2009

In order to support the development of a single electricity market by expanding the infrastructure needed for interconnections with other countries, EU legislation was introduced, setting out guidelines for the creation of interconnections with other countries by entities other than grid operators.

The European guidelines have been introduced into Italian legislation by **Law 99/2009**, which assigned Terna responsibility for selecting undertakings (the "selected undertakings"), on the basis of public tenders, willing to finance specific interconnectors in exchange for the benefits resulting from a decree granting a third-party access exemption with regard to the transmission capacity provided by the new infrastructure. In particular, the law states that these entities, in exchange for a commitment to finance such projects, are required to commission Terna to build and operate the interconnectors.

A total of 5 interconnectors are planned for the borders with France, Montenegro (both at an advanced stage of completion), Austria, Switzerland and Slovenia (currently awaiting the necessary consents).

The new "Italy-France" direct current interconnector, between the substations of Piossasco and Grande Ile, will make the cross-border interconnection with France the most important for Italy, increasing cross-border interconnection capacity by 1200 MW (of which 350 MW available in third-party access exemption to the selected undertakings), which will rise from the current level of approximately 3 GW to more than 4 GW.

[Italy-France
Interconnector Project](#)

The project aims to create a total of approximately 1200 MW of new cross-border interconnection capacity between Italy and Montenegro split into two modules of 600 MW each. A portion of the 600 MW provided by the first module will be available in third-party access exemption to the selected undertakings (private investors).

[Italy-Montenegro
Interconnector Project](#)

The Italy-Austria Interconnector (Reschenpass project), currently awaiting the necessary consents, involves the creation of a new 220 kV alternating current interconnector between the substations of Nauders (AT) and Glorenza (IT). The connection will consist of approximately 26 km of underground cable and will require the related adjustments on the domestic grid. The project will enable an increase in cross-border interconnection capacity between Italy and Austria of approximately 300 MW, which will practically double the capacity currently available.

[Italy-Austria
Interconnector Project](#)

The project involves the development of new transmission lines between Italy and Switzerland, partly in alternating current and partly in direct current. As far as the first type is concerned, a 380 kV connection will be built between Airolo All'Acqua (CH) and the new substation of Pallanzeno (IT). This will be connected to a system in direct current up to the 380 kV Baggio substation, making a total distance of more than 160 km.

The project, which is currently awaiting the necessary consents on the Italian side, will significantly increase interconnection capacity between Italy and Switzerland, raising it from the existing 4 GW to approximately 5 GW.

[Italy-Switzerland
Interconnector Project](#)

The creation of a direct current line is planned, partly in undersea cable, between the substations of Salgareda (IT) and Divaca/Bericevo (SL), together with work on upgrading the domestic grids in Italy and in Slovenia. The project is currently awaiting the necessary consents on the Italian side. The expected increase in cross-border capacity by approximately 1 GW will raise the interconnection capacity to more than double the existing level.

[Italy-Slovenia
Interconnector Project](#)



INTERCONNECTORS IN PROGRESS - ACTIVITIES CARRIED OUT IN 2017

Italy-France Interconnector Project

On 6 April 2017, the vehicle company, Piemonte Savoia (PI.SA.), received notification of exemption from the MED, taking into account the MED's Decree of 20 July 2016 and the positive opinion issued on 9 December 2016 by the European Commission under the terms of Regulation (EC) no. 714/2009. In addition, on 22 June 2017, ARERA approved the draft contract between Terna and PI.SA. for commercial operation of the private interconnector in accordance with the exemption. In implementation of Law 99/09, on 4 July 2017, the Terna Group and the "Interconnector Italia Scpa" consortium, set up by a number of "energy-intensive" private companies (the selected undertakings), signed the related EPC and operation and maintenance (O&M) contracts for the private part of the project. On this occasion, the entire capital of Piemonte Savoia Srl was transferred to the Interconnector Italia consortium.

As regards the progress of work on the project, in August 2017, work began at sites in the municipalities of Bussoleno, Susa and Exilles.

On 25 October 2017, the Ministry of Infrastructure and Transport approved the agreement granting PI.SA. the right to carry out the private part of the project and to cross the relevant section of the A32 motorway operated by Società Italiana per il traforo autostradale del Frejus (SITAF). Following approval of the agreement, in November 2017, work began on the upper and lower sections of the A32.

Italy-Montenegro Interconnector Project

In April 2017, laying and protection of the submarine cable, which began in October 2016, was completed. Installation of the terrestrial section and construction of the converter substations is currently underway.

Italy-Austria Interconnector Project

In December 2017, Terna and the Austrian TSO, APG, signed a Cooperation Agreement. This agreement envisages that the two TSOs will coordinate work on construction of the infrastructure.

TRANSFORMERS - THE TAMINI GROUP

Tamini Trasformatori Srl operates in the electromechanical sector and is a leader in the design, production, commercialisation and repair of power transformers for electricity transmission and distribution grids, of industrial transformers for the steel and metals industry and of special transformers for convertors used in electrochemical and electrolytic production.

With a hundred years of experience, Tamini has a well-established name in Italy and overseas, thanks to its technological and engineering capabilities, combined with the degree of customisation and production flexibility it can offer.

Through Tamini, the Terna Group has 5 production plants located in Italy at Legnano (MI), Ospitaletto (BS), Valdagno (VI), Novara and Rodengo (BS) and two trading companies in the United States and India.

The Rodengo plant specialises in services, whilst the Novara production plant continues to manufacture coils, operating as a service centre for all the production sites that manufacture for both the Power and Industrial sectors.

Having manufactured more than 9,000 transformers, Tamini has installed more machinery worldwide than any other operator in the sector of specialist transformers for steelworks. In addition, Tamini also holds the record for the most powerful transformer for steelworks in the world, located in Turkey.



THE TAMINI GROUP IN 2017

Orders for transformers rose 35% in 2017 compared with the previous year (in line with expectations).

Service orders also rose (39%) with respect to the previous year in 2017. Factory order books are up compared with the end of 2016.

Orders

During 2017, the supply of Phase Shifting Transformers was completed. This is a complex project, of strategic importance for Tamini, which has managed to break in to this important sector at European level.

Phase Shifting
Transformer

Testing of the first transformer using vegetable oil to be manufactured in Italy was successfully carried out at the Legnano plant.

Vegetable
oil transformer



International Activities

Operating results of International Activities

A breakdown of the Terna Group's results from overseas activities for 2017 and 2016 is shown below²⁵.

(€m)

BREAKDOWN OF REVENUE FROM INTERNATIONAL ACTIVITIES	2017	2016	CHANGE
Revenue from International Activities	91.7	4.2	87.5
Cost of International Activities	91.9	6.1	85.8
EBITDA from International Activities	(0.2)	(1.9)	1.7

Negative EBITDA from International Activities amounts to €0.2 million for 2017, which is of marginal significance in absolute terms given that construction work has only just begun in South America.

This marks an improvement of €1.7 million compared with the previous year, primarily reflecting the contribution from construction services provided in Brazil (€3.1 million) and construction of the power line in Uruguay (€0.9 million). This was offset by the impact of substantial completion of the Chilean contract in 2016 and other costs incurred in providing support for overseas initiatives.

Revenue and costs in **Brazil** and **Peru** refer to concessions in the two countries and, in accordance with IFRIC 12, EBITDA is recognised as the effective profit on construction services.

Our International business

The Group aims to take advantage of opportunities for international expansion by leveraging its core competencies developed in Italy as a TSO, where such competencies are of significant importance in its home country.

Overseas investment focuses on countries with stable political and regulatory regimes and a need to develop their electricity infrastructure.

²⁵ The Terna Group's operating segments are consistent with the internal control system adopted by the Parent Company, in line with the Business Plan for the period 2018-2022.

INTERNATIONAL INITIATIVES

Terna seeks to develop its offering in other countries, with a view to diversification with respect to its Italian businesses. This is done partly in collaboration with other energy companies with a consolidated presence in foreign markets.

International markets offer opportunities in terms of the development of transmission plant, driven by growing demand for electricity (e.g., growth of 2.4% per year through to 2025 in Latin America) and the opening up of markets to foreign operators (e.g., BOOT/BOT in Latin America, merchant in the US). Terna has set itself three strategic priorities with regard to its overseas operations:

- to strengthen its EU presence (assessing and monitoring M&A opportunities and merchant interconnector projects);
- to grow its core TSO operations where Terna can play a leading role or with a high technological content;
- to deprioritise low added-value activities (e.g., traditional EPC) in favour of advanced, capital light services.

In this context, in September 2016, Terna won a contract in Uruguay to carry out three electricity infrastructure projects: in particular, Terna is to build a 213-km long, 500 kV power line from Melo to Tacuarembó.

Overseas initiatives of interest to the Terna Group are:

- **Concessions**: this model envisages the acquisition and operation of transmission systems abroad by taking part in international concession awards;
- **EPC**: this involves the performance of Engineering, Procurement & Construction projects for Energy Solutions that the Terna Group will develop on behalf of third-parties;
- **Technical assistance**: this envisages the supply of engineering and regulatory consulting services for third-parties operating in the electricity sector, including through participation in public tenders;
- **BOOT** (Build, Own, Operate, Transfer) and **BOT** (Build, Own, Transfer): the BOOT model involves the design, construction and operation of transmission plant and its ownership for a defined period of time; at the end of this period, ownership of the asset is transferred to the other party under the terms of the contract; the BOT model only involves design and construction and normally the transfer of ownership of the infrastructure.



BRAZIL
CHILE
PERU
URUGUAY

In 2017, overseas operations progressed in line with the Group's strategy.

INITIATIVES

Chile

Work in Chile progressed further with the construction of a Control Room and a warehouse unit. Work is currently in progress and is expected to be fully completed in 2018.

Uruguay



In July 2017, Terna signed a Project Finance agreement worth US\$81 million to fund construction of a 500-kV transmission line to connect the cities of Melo and Tacuarembó in Uruguay. The facility has been qualified as a "green loan" by Vigeo Eiris, an agency specialising in the assessment of aspects relating to the sustainability of business strategies and management, as the new power line will enable the country to increase its generation and consumption of energy from renewable sources, boosting its contribution to the country's overall production. In August 2017, UTE - the state-controlled, vertically integrated company responsible for the generation, transmission, distribution and sale of electricity - obtained environmental clearance for construction of the "Melo - Tacuarembó" line, which is expected to be completed by the end of 2019.

Civil engineering work began in September 2017. The procurement of material for the infrastructure and construction engineering activities are in progress.

The total value of the investment is approximately €70 million.

Brazil

In February 2017, the Terna Group, through its subsidiary, Terna Plus, entered into an agreement with Planova, a Brazilian company whose business involves the construction of civil works and infrastructure, regarding the acquisition of two concessions for the construction and operation of a total of approximately 513 km of electricity infrastructure in the South American country. On 26 June 2017, the transaction closed with the release of the related construction permits and, from this date, the organisational structure set up to manage the two concessions in situ was implemented.

The two concessions, each lasting thirty years, will lead to the construction of 158 km of new lines in the State of Rio Grande do Sul and 350 km of lines in the State of Mato Grosso.

Under the agreement, the Terna Group will hold the concession and operate the line, while all engineering, procurement and construction (EPC) activities will be entrusted to Planova, as the "contractor" operating on Terna's behalf.

Work began in July 2017.

The procurement of the relevant materials is in progress, as well as their shipment to the related site, whilst engineering work is 72% completed. Construction, which primarily regards civil works, is 23% completed.

The total expected investment amounts to approximately €180 million.

Peru

In May 2017, the Terna Group, through its subsidiary, Terna Plus, was awarded a contract in Peru following the call for tenders by Proinversion - an agency, controlled by MIEM (the country's Ministry of Energy and Mines), that promotes private investment in Peru. The contract regards the construction, operation and maintenance of new electricity infrastructure for the country.

Via the subsidiary, Terna Peru SAC, the Group will engineer and build 132km of new 138kV lines between Aguaytia and Pucallpa and expand two electricity substations, which will host the new bays.

The Group, via its subsidiary, Terna Peru SAC, will enter into a contract with MIEM, giving it 36 months from conclusion of the contract to build and prepare the line for operation. It will then operate and maintain the line for a period of 30 years.

Engineering work for the infrastructure and the process of obtaining environmental clearance began in October 2017.





Terna and Innovation

At a time of transformation, **innovation** and **value added activities** are central to the creation of long-term value, not only for Terna, but for the country's entire electricity system.

The current energy transition process requires a new systemic and organic approach to innovation, based around a strategic acceleration of a portfolio of effective Research, Development and Innovation initiatives in keeping with the Group's strategies.

Terna decided to further speed up innovation in 2017, adopting a centralised, coordinated vision in order to encourage an ongoing exchange of ideas and needs. The aim is thus to create an effective innovation ecosystem within the Company, capable of enabling the transition to a new TSO 2.0 model. This requires a new approach to managing the electricity system, which is increasingly intelligent and flexible both at the level of the grid, thanks to the use of efficient and innovative technologies (smart grids, storage, distributed generation, intelligent demand management, etc.), and in terms of the market. This will entail an unprecedented revolution that will rapidly result in the integration of distributed generation resources, storage and market demand for services, and the Europe-wide integration of national markets. Moreover, in the medium term, it will be necessary to ensure the progressive integrability and interoperability of electricity grids and other networks (transport, gas, water, etc.), in order to make the Italian and European economies stronger and more eco-sustainable.

The steps taken in this regard include implementation of an Open Innovation process within the Company and the creation of a structured **Innovation Plan**. Today's form of innovation calls for an approach capable of opening up new possibilities for development and cooperation with the outside world and the creation of dynamic interactions, including close attention to start-ups, which offer Terna the chance to invest in technological initiatives capable of creating more value for the Company and for Italy's electricity and energy system.

The Innovation Plan organises the new initiatives in a coherent manner, whether they are generated internally or as a result of the Open Innovation process. Initiatives are classified within a framework consisting of 6 key clusters (Transmission Technologies, Management of the Electricity System, Network, Market and Regulatory Development, Smart Grids and Storage, Business Improvement & Security, Sustainability), accompanied by the categorisation of projects depending on whether their focus is on core activities, now looked at with new expectations and approaches, or on highly innovative sectors.

Focus

Terna's innovation framework

SCOPE OF CLUSTERS

Transmission Technologies



Management of the Electricity System



Grid, Market and Regulatory Development



Smart Grid & Storage



Business Improvement



SUSTAINABILITY

GUIDELINES

DECARBONIZATION

MARKET EFFICIENCY

SECURITY OF SUPPLY

CONTINUOUS IMPROVEMENT

OPEN INNOVATION

INDUSTRIAL PARTNERSHIPS

ACADEMY

START-UPS & SMALL BUSINESSES

TOOLS

Leveraging competencies and assets

SCOPE OF THE CLUSTERS IN THE INNOVATION PLAN

Cluster	Description
Transmission Technologies	This brings together cutting-edge initiatives and solutions for the operation and construction of transmission plant.
Management of the Electricity System	This covers technologies capable of improving control and management of the National Transmission Grid, providing high standards of security and reliability.
Network, Market and Regulatory Development	This includes grid development initiatives, the definition of new market models, the analysis of regulatory and geoclimatic trends at national and international level.
Smart Grids & Storage	This includes the development of new business models for large-scale storage, innovative projects based on smart grids and new research into innovative network services.
Business Improvement	This includes all the initiatives aimed at improving management of the Company's internal business and operational processes.
Sustainability	This includes all the projects aimed at promoting a more sensitive approach to environmental issues. It is an integral part of the corporate mission and is relevant to all the other clusters.

The main strategic project streams relating to **Transmission Operator (TO)** and **System Operator (SO)** activities were also identified, as well as the enabling factors and functional tools needed to guarantee the innovation necessary to achieve the Group's medium- and long-term objectives. Specifically, R&D and Innovation activities regarding TO activities are guided by the Development Plan. In this regard, priorities are focused on HVDC issues, cable laying technologies, the optimisation of overhead lines and asset management technologies.

The focus in relation to SO activities is on enabling the market participation of distributed generation resources and demand for electric power and storage, with the aim of encouraging the penetration and integration of non-programmable renewable sources within the National Electricity and Energy System. The priority innovation project streams in this sector, therefore, relate to the flexibility of the Electricity System (e.g. vehicle-to-grid projects, demand-side response, etc.) and the secure management of the Electricity System (e.g. R&D activities regarding the resilience of the Electricity System, pilot projects on improved observability of distributed resources, etc.).

Digital transformation is the main enabling tool for innovation and, in general, the current energy transition, to be implemented via projects in the following areas: connectivity (e.g. IoT technologies for asset management and dynamic network management), synchronous data management (e.g. advanced forecasting technologies for data management and electricity market processes), asynchronous data management (e.g. big data technologies and machine learning for use in data analytics and the exploitation of historical data).

Innovation in the Company is supported and promoted via multiple tools and resources, which are for the most part centrally managed, including:

- **Systems and processes to support the enhancement of assets and internal expertise:** this includes tools for enhancing intellectual capital and sharing corporate know-how, as well as portfolio management tools.
- **Open innovation:** this encourages openness towards new areas for development within and beyond the Company, through dynamic interactions with universities and research centres, partnerships with peers and large industrial players, as well as access to start-ups and small and medium enterprises.
- **Access to incentive and soft financing mechanisms:** this promotes access to incentives (e.g. tax relief for companies investing in research and development activities, and patent box provisions) and specific funding programmes for both international and national R&D projects.

OPEN INNOVATION IN THE DEVELOPMENT PLAN

Description	Sector
The signature of agreements and partnerships with energy businesses who are not competitors (TSOs, DSOs, utilities, etc.). Membership of and active participation in leading associations and international bodies involved in the electricity sector and innovation. <i>Examples: RTE, ENI, RFI, ENTSO-E, EASE</i>	Peers, energy sector and infrastructure
Collaborations to promote and coordinate studies and research with national universities and research centres of excellence in areas of strategic interest, in order to contribute to the preparation of expert researchers in this field and to promote and encourage initiatives aimed at teaching and training in the energy sector. <i>Examples: RSE, Ensiel</i>	Universities and research centres
The signature of agreements and partnerships with suppliers or companies who may be competitors, regarding areas of common interest in the electricity sector or applications aimed at ensuring greater sustainability, cost-effectiveness and security in the management of grids. <i>Examples: Tesla Motors</i>	Large companies and industries
The scouting of start-ups and mature enterprises in order to grasp opportunities for the development of specific initiatives of interest to Terna and/or business partnerships. <i>Examples: the Next Energy programme</i>	Start-ups, SMEs and venture capital

The main innovation, research and development initiatives undertaken in 2017 are summarised below:

MAIN INITIATIVES

Projects and programmes

Description

NEXT ENERGY programme and the start-up ecosystem

In September, a call for tenders was launched for the second edition of **NEXT ENERGY**, which envisages the introduction of another call (**Call for Growth**), in addition to the already well established **Call for Talents** and **Call for Ideas**. This additional call, held in synergy with Cariplo Factory's growlTup platform, is aimed at start-ups able to offer services and products that are more technologically mature than those in the Call for Ideas offering. These start-ups will gain access to a process concerning the definition of a pilot and testing project designed to respond to specific issues and requirements for Terna's business.

Terna also took part in the **Open Italy** programme promoted by the Elis consortium during the six-month term of ANAS's presidency, in order to identify start-ups in Italy with whom to develop businesses of potential interest. After the selection process, from January 2018, Terna will collaborate with a start-up from the cyber security sector that creates innovative security systems for the protection of highly critical sites using big data management technologies.

Academy

In 2017, Terna joined the research programme launched in October 2016 by the Precourt Institute of Energy at Stanford University (one of the 30 research centres at this Californian university, which is a point of reference for engineering). The programme, called Bits & Watts as a reminder of the strong correlation between electricity grids and digital transformation, aims to identify solutions to facilitate and accelerate the current transition in the electricity sector, by combining university and industry expertise to develop innovative projects and solutions.

The advantages of the project include targeted high level education and training programmes that provide for participation in multidisciplinary team activities, and the opportunity for some Terna personnel to be visiting scholars at Stanford University and participate in the conduct of specific research programmes.

In 2017, following the memorandum of understanding signed with **Ensiel** (a consortium set up by the main Italian universities operating in the power systems sector) and the adoption of the innovative contractual format with the direct award of contracts for research and development services, Terna launched 11 projects in 2017, involving 14 Italian universities from among those most active in the electricity and energy systems sector.

As part of the partnership agreement signed with the **Polytechnic University of Turin** on 21 February 2017, Terna promoted the launch of two scholarships aimed at supporting two three-year electrical engineering PhDs on the following subjects: *vehicle-to-grid as a resource for grid services*, and *innovative analysis tools and methods for electricity transmission systems*.

Description

With a view to accelerating the strategic initiatives linked to Terna's new Innovation Plan, steps have been taken to monitor internal needs and to scout for external opportunities, regarding both partnership networks and financing instruments. This has led to two important results: the first is the approval, notified by the European Commission in August, of the **OSMOSE** Horizon 2020 project and the second is approval of the **National Energy Technological Cluster** proposal and the two associated initial projects.

Overall, the OSMOSE - Optimal System-Mix of Flexibility Solutions for European Electricity project aims to identify and demonstrate the technical feasibility of an "optimal" mix of flexibility solutions to maximise the technical and financial efficiency of the European electricity system, thus guaranteeing its security and reliability. The project involves a broad consortium of 33 partners from 8 different EU countries with the company, RTE, as the lead partner.

Terna's role is to lead Working Package 5 (WP5, one of the 4 demonstrators of actual grid situations) called "Multiple services provided by grid devices, large demand-response and RES generation coordinated in a smart management system".

The energy cluster, with Enea as lead partner and Terna as leader of one of the two projects, is part of the network of 12 national technological clusters, which act as resource catalysts to meet local and market needs, thus coordinating and strengthening the link between the research and business worlds.

The objective of the project led by Terna, called Living Grid, is to analyse a local grid to test the flexibility services offering for TSOs and DSOs, in order to study and validate new solutions aimed at improving integration between TSOs and DSOs.

Projects and programmes

Origination and R&D projects

Alongside these initiatives, efforts to boost the value of the Company's human capital are supported by increasingly active participation in major international associations and committees in the electricity and innovation sectors. By way of example, Terna is taking part in the Mission Innovation project, a global initiative promoted by 23 countries with the aim of doubling investment in the clean energy sector over the next 5 years. The most important events in which Terna took part in 2017 include the Energy Storage World Forum, European Sustainable Week, European Utility Week, the Grid Edge World Forum in California, the Monitoring Centre for Energy Innovation (Innov-E) and the international IEEE ISGT (Innovative Smart Grid Technologies) conference. This event was also actively supported by Terna as a Silver Supporter.

As part of efforts to publicise Terna's commitment to innovation and excellence, a workshop was organised and held at the Polytechnic University of Milan in September. The event, entitled "*The role of storage in grid management. Terna's experience: innovation for the electricity system*", was held to report on the initial results of Terna's pilot storage projects.



WORKSHOPS
ON THE ENERGETIC
TRANSACTION
WITH THE POLYTECHNIC
UNIVERSITY OF MILAN





04 Financial review for 2017

Introduction

The Annual Report for 2017 has been prepared in accordance with the requirements of art. 154-ter of Legislative Decree 58/98 introduced by Legislative Decree 195 of 6 November 2007 (the "Transparency Decree"), as amended by Legislative Decree 27 of 27 January 2010.

As required by Legislative Decree 38 of 28 February 2005 and EEC Regulation 1606/2002, the financial statements of the parent company Terna SpA and the consolidated financial statements of the Terna Group for the year ended 31 December 2017 were prepared in compliance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board and endorsed by the European Commission (hereinafter "EU-IFRS").

In compliance with the provisions of art. 2364 of the Italian Civil Code and art. 9.2 of the Company's Articles of Association, the Board of Directors, has decided to call an Annual General Meeting of shareholders within 180 days of the end of the annual reporting period, given that Terna SpA is a company required to prepare consolidated financial statements.

Basis of presentation

The measurement and recognition criteria applied in this Annual Report are consistent with those adopted in the consolidated financial statements for the year ended 31 December 2016.

In order to present the performance of the Terna Group and Terna SpA and to analyse the financial positions, separate reclassified statements have been prepared. These differ from the statements required by the EU-IFRS adopted and described in the consolidated and separate financial statements for the year ended 31 December 2017.

These reclassified statements contain alternative performance indicators, which differ from those resulting directly from the separate and consolidated financial statements. Management considers these indicators to be useful in assessing the performances of the Group and of Terna SpA and representative of the business's operating results and financial position.

In line with the guidance provided by ESMA/2015/1415, the criteria used in constructing these indicators are described in specific notes, reconciling them with the amounts presented in the consolidated and separate financial statements. The notes are contained in an annex to this Integrated Report.

For the purposes of presentation, a number of comparative amounts in the income statement and statement of financial position have been reclassified, without, however, affecting the result for 2016 or equity at 31 December 2016.

The Terna Group



Scope of consolidation

The following changes in the structure of the Group have taken place with respect to 31 December 2016.

Acquisitions and the establishment of new companies:

- In relation to development of the renewable energy initiatives provided for in the partnership agreement between Terna and RFI signed in November 2016, the subsidiary, Terna Plus Srl, has established four limited liability companies: Rete Verde 17 Srl and Rete Verde 18 Srl (on 10 May 2017); Rete Verde 19 Srl and Rete Verde 20 Srl (on 14 July 2017).
- On 13 June 2017, the subsidiaries, Terna Plus Srl and Terna Chile SpA, established the Peruvian-registered company, Terna Peru SAC, with 99.99% and 0.01% interests respectively, in order to build a 138 kV power line (132 km).
- On 26 June 2017, the subsidiary, Terna Plus Srl, acquired two Brazilian-registered joint-stock companies called SPE Santa Maria Trasmittora de Energia SA and SPE Santa Lucia Trasmittora de Energia SA. Terna Plus Srl holds interests of 99.999998% and 99.999999% in the companies, whilst the remaining 0.000002% and 0.000001% are held by Terna Chile SpA.
- On 4 July 2017, Terna Interconnector Srl sold the Group's entire interest in Piemonte Savoia Srl to the Interconnector Italia Scpa consortium.

Mergers:

- On 31 March 2017, the merger of the wholly owned subsidiaries, Terna Storage Srl and Terna Rete Italia Srl, with and into Terna SpA became effective
- Within the Tamini Group, on 8 June 2017, the merger of the wholly owned subsidiaries, T.E.S. Transformer Electro Service Srl and V.T.D. Trasformatori Srl, with and into Trasformatori Tamini Trasformatori Srl became effective.

Finally, on 15 December 2017, following the entry of two new shareholders (the Irish companies, SONI Ltd. and EirGrid PLC) in CORESO SA, Terna SpA's investment was reduced to 15.84% in the same proportion as the other shareholders, via the sale for consideration of a portion of its shareholding, without affecting its classification as an associate.

The Group's reclassified income statement

The Terna Group's operating results for the year 2017, compared with those for the previous year, are summarised in the following reclassified income statement, obtained by reclassifying amounts in the consolidated income statement.

	(€m)			
	2017	2016	CHANGE	% CHANGE
TOTAL REVENUE	2,248.0	2,103.2	144.8	6.9
- Regulated revenue	1,946.1	1,895.4	50.7	2.7
- Non-regulated revenue	189.1	182.4	6.7	3.7
- Revenue from overseas activities	10.3	4.2	6.1	145.2
- Revenue from construction services performed under concession *	102.5	21.2	81.3	-
TOTAL OPERATING COSTS	644.1	558.5	85.6	15.3
- Personnel expenses	252.8	263.6	(10.8)	(4.1)
- Cost of services, leases and rentals	170.5	179.1	(8.6)	(4.8)
- Materials	75.4	66.5	8.9	13.4
- Other costs	35.9	35.9	-	-
- Quality of service	10.5	(7.8)	18.3	-
- Cost of construction services performed under concession*	99.0	21.2	77.8	-
GROSS OPERATING PROFIT (EBITDA)	1,603.9	1,544.7	59.2	3.8
- Amortisation, depreciation and impairment losses	526.5	508.7	17.8	3.5
OPERATING PROFIT (EBIT)	1,077.4	1,036.0	41.4	4.0
- Net financial income/(expenses)	(88.8)	(102.8)	14.0	(13.6)
PROFIT/(LOSS) BEFORE TAX	988.6	933.2	55.4	5.9
- Income tax expense	294.4	305.3	(10.9)	(3.6)
PROFIT FOR THE YEAR	694.2	627.9	66.3	10.6
- Profit/(Loss) attributable to non-controlling interests	5.9	(5.2)	11.1	-
PROFIT FOR THE YEAR ATTRIBUTABLE TO OWNERS OF THE PARENT	688.3	633.1	55.2	8.7

* Includes revenue and costs generated by concession arrangements in Italy and overseas, recognised in application of IFRIC 12.

Gross operating profit (EBITDA) for the year amounts to **1.603,9 million**, up €59.2 million compared with the €1,544.7 million of 2016. This primarily reflects the improved result from Regulated Activities.

	(€m)		
REGULATED ACTIVITIES	2017	2016	CHANGE
Regulated revenue	1,946.1	1,895.4	50.7
- Tariff revenue	1,915.5	1,846.3	69.2
- Other regulated revenue	30.6	49.1	(18.5)
Revenue from construction services performed under concession in Italy	21.1	21.2	(0.1)
Total	1,967.2	1,916.6	50.6

Regulated revenue is up €50.6 million, reflecting recognition in full of the **Transmission Charge** relating to the NTG acquired from the FSI group at the end of 2015 (up €65.9 million), partially offset by the negative impact of the **quality of service** (down €8 million) and increased revenue generated in 2016 by the so-called "Copper Plan" (down €11.6 million).

(€m)

NON-REGULATED BUSINESS	2017	2016	CHANGE
Services for third parties	80.5	80.0	0.5
Private Italy-France interconnector	16.0	-	16.0
Tamini	92.6	102.4	(9.8)
Total non-regulated revenue	189.1	182.4	6.7

Non-regulated revenue is up €6.7 million, primarily due to an increase in revenue relating to the **private Italy-France interconnector** (following the sale of Piemonte Savoia Srl), after the impact of a reduction in sales at the **Tamini Group**.

(€m)

INTERNATIONAL ACTIVITIES	2017	2016	CHANGE
Revenue from construction services performed under International concessions	81.4	-	81.4
Other revenue from International Activities	10.3	4.2	6.1
Total revenue from International Activities	91.7	4.2	87.5

Revenue from International Activities is up €87.5 million, reflecting investment in assets held under concession in Brazil (up €80.2 million) and construction of the power line in **Uruguay** (up €7.2 million).

Operating costs have increased €85.6 million compared with the previous year. This reflects the following:

- **Personnel expenses:** down €10.8 million, primarily reflecting the higher amount of provisions made in 2016 for early retirement schemes (down €12.5 million), the release of provisions for the energy discounts granted to pensioners (down €12.2 million, as a result of the agreement reached during the year), reduced costs at the Tamini Group (down €4.4 million), after increased provisions for management incentive schemes (up €8.4 million) and recruitment to meet the needs arising from expansion of the Rete's infrastructure operated;
- **Services, leases and rentals:** down €8.6 million, largely due to savings resulting from the insourcing of maintenance work, primarily relating to management of Rete Srl's power lines, and reduced costs at the Tamini Group (down €3.3 million, primarily due to a decline in contract work);
- **Materials:** up €8.9 million, primarily due to increased costs relating to performance of contracts for telecommunications services (up €3.4 million) and in South America (up €4.2 million, reflecting increased activity in Uruguay, offset by the impact of completion of the contract in Chile);
- **Quality of service:** up €18.3 million, mainly due to increased costs incurred during the year (up €6.9 million, relating to events in Abruzzo and Marche at the beginning of the year) and the greater amount of contingent assets recognised in the previous year (up €11.4 million) in relation to provisions for exceptional events and the method of allocating the cost of certain major events that occurred in central and northern Italy in 2015;
- **Cost of construction services performed under concession:** up €77.8 million, essentially reflecting the development of operations in South America, above all in Brazil (recognised in application of IFRIC 12).



Amortisation, depreciation and impairment losses for the year amount to €526.5 million, up €17.8 million on 2016, primarily following the entry into service of new plant.

Operating profit (**EBIT**), after amortisation, depreciation and impairment losses, amounts to **€1,077.4 million**, compared with the €1,036.0 million of 2016 (an increase of 4%).

Net financial expenses for the year total €88.8 million and are primarily attributable to the Parent Company (€87.4 million). This figure is down €14 million compared with the €102.8 million of 2016, primarily due to the refinancing of debt on more competitive terms.

After net financial expenses, the **profit before tax** amounts to **€988.6 million**, up €55.4 million (5.9%) on the previous year.

Income tax expense for the year totals €294.4 million, marking a reduction of €10.9 million (3.6%) compared with the previous year. This essentially reflects the impact of the reduction in the rate of corporation tax (IRES) from 27.5% to 24% (in accordance with Law 208/2015, the 2016 Stability Law), partially offset by the changes made to the tax relief designed to stimulate economic growth (ACE - Aiuto alla Crescita Economica) introduced by Law Decree 50/2017. The tax rate for the year is 29.8%, down from the 32.7% of 2016.

Profit for the year amounts to **€694.2 million**, up €66.3 million (10.6%) compared with the €627.9 million of 2016.

Profit for the year attributable to owners of the Parent (after excluding the share attributable to non-controlling interests) amounts to **€688.3 million**, up €55.2 million (8.7%) on the €633.1 million of 2016.

Cash flow

The above performance, combined with non-cash items, has resulted in cash flow from operating activities of €1,634.2 million, enabling the Group to finance its investing activities, totalling €1,033.9 million, and to pay dividends of €418.4 million.

	(€m)	
	CASH FLOW 2017	CASH FLOW 2016
- Profit for the year	694.2	627.9
- Amortisation, depreciation and impairment losses	526.5	508.7
- Net change in provisions	(28.8)	11.1
- Net losses/(gains) on sale of assets	(2.1)	(9.8)
Operating cash flow	1,189.8	1,137.9
- Change in Net Working Capital	408.3	112.8
- Other changes in non-current assets	137.5	63.0
- Change in investments	(2.7)	2.9
- Change in financial assets	(98.7)	(17.4)
Cash flow from operating activities	1,634.2	1,299.2
Total capital expenditure	(1,033.9)	(854.3)
Free cash flow	600.3	444.9
- Dividends paid to shareholders of the Parent Company	(418.4)	(406.2)
- Cash flow hedge reserve after taxation and other movements in equity attributable to owners of the Parent	(2.0)	(12.3)
Change in net debt	179.9	26.4

At the end of 2017, net debt totals €7,796.4 million, down €179.9 million on the €7,976.3 million of 2016.

The Group's reclassified statement of financial position

The Terna Group's financial position at 31 December 2017 and 31 December 2016 is summarised below in the reclassified statement of financial position, obtained by reclassifying amounts in the statutory consolidated statement of financial position.

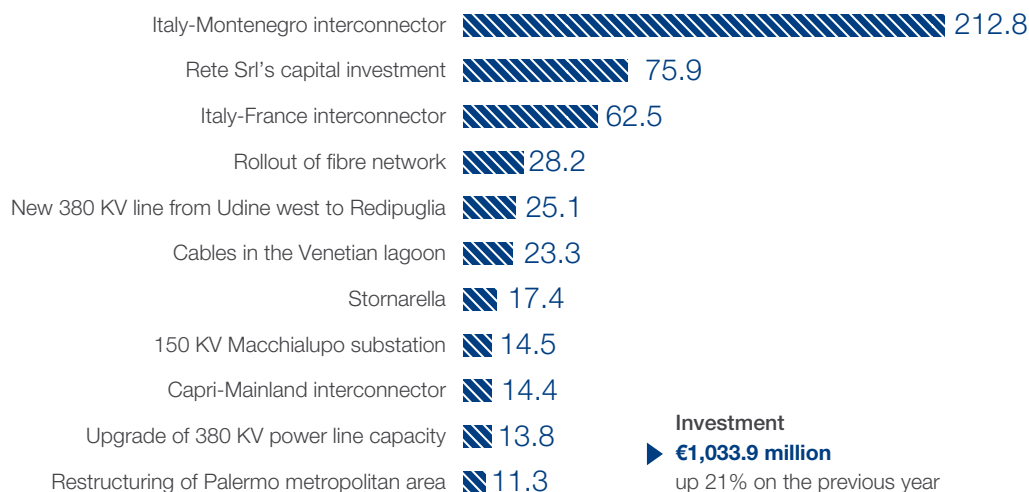
	(€m)		
	AT 31 DECEMBER 2017	AT 31 DECEMBER 2016	CHANGE
Total net non-current assets	13,466.4	12,991.4	475.0
- Intangible assets and goodwill	505.7	516.0	(10.3)
- Property, plant and equipment	12,752.8	12,368.9	383.9
- Financial assets*	207.9	106.5	101.4
Total Net Working Capital	(1,485.2)	(1,075.3)	(409.9)
- Net energy-related pass-through payables	(852.7)	(545.9)	(306.8)
- Net receivables resulting from Regulated Activities	335.1	342.0	(6.9)
- Net trade payables	(714.4)	(633.5)	(80.9)
- Net tax assets	105.9	52.0	53.9
- Other net liabilities	(359.1)	(289.9)	(69.2)
Gross invested capital	11,981.2	11,916.1	65.1
Sundry provisions	(355.8)	(384.6)	28.8
NET INVESTED CAPITAL	11,625.4	11,531.5	93.9
Equity attributable to owners of the Parent	3,803.3	3,535.4	267.9
Equity attributable to non-controlling interests	25.7	19.8	5.9
Net debt	7,796.4	7,976.3	(179.9)
TOTAL	11,625.4	11,531.5	93.9

* * Includes financial assets in Brazil recognised in application of IFRIC12, totalling €73.5 million, and provision for the Interconnector Guarantee Fund, amounting to €42.2 million at 31 December 2017.

The €475.0 million increase in **net non-current assets** compared with 31 December 2016 primarily reflects investment of €1,033.9 million during the year, as described below, offset by amortisation and depreciation for the year, totalling €515.6 million, and other movements during the year, resulting in a reduction of €134.3 million. The latter include grants related to assets (primarily to fund work on the Sorgente - Rizziconi project and projects financed by the MED and the EU) and the acquisition of a substation located in the Municipality of Ponti sul Mincio for €10.5 million. Disposals and impairment losses down €10.4 million.

The Group's **capital expenditure** totalled €1,033.9 million in 2017, up 21% on the €854.3 million of 2016.

KEY CAPITAL INVESTMENT* (€m)



* Amounts include financial expenses

Financial assets are up €101.4 million, essentially due to investment in infrastructure operated under concession in Brazil during the year, which is recognised in application of IFRIC 12 (up €73.5 million), and the provision for the Interconnector Guarantee Fund, set up to fund investment in interconnections by art. 32 of Law 99/09 (up €24.8 million).

Net Working Capital of €1,485.2 million generated liquidity of €409.9 million compared with 2016. This reflects the combined effect of:

Cash inflows

- an increase in net energy-related pass-through payables of €306.8 million, primarily reflecting the combined effect of:
 - a reduction in the receivable linked to uplift payments (€261.4 million), thanks to lower costs incurred in the third quarter of the year;
 - an increase in net payables resulting from provision of the dispatching service (up €106.1 million), primarily linked to increased purchases on the DSM due to local technical constraints and an increase in capacity reserves in November and December;
 - an increase in payables linked to plants that are essential for the security of the electricity system (€125.7 million), reflecting reduced payments at the end of the year;
 - a reduction in net payables relating to capacity payments (€174 million), reflecting the greater amount of payments made at the end of the year (in accordance with ARERA Resolutions 398/2017, 418/2017, 588/2017 and 844/2017) following collection of payments due to cover the cost of the service, broadly in line with the previous year;

- a €6.9 million reduction in net receivables resulting from Regulated Activities, due to a reduction in the amount receivable in the form of transmission charges (down €11.8 million), reflecting the changes introduced by Law Decree 50/17 regarding the mechanism for split payments²⁶, partially offset by recognition in full of the portion of the grid operated by the subsidiary, Rete Srl and an increase in the quantities of electricity transported. There has also been an increase in net receivables due from CSEA (up €6.9 million), largely relating to the positive performance of RENS during the year (€7.4 million, taking into account the result for 2016 and the overall results expected in the regulatory period 2016-2019);
- an increase of €80.9 million in **net trade payables**, largely due to the increase in capital investment towards the end of the year;
- an increase of €69.2 million in **other net liabilities**, primarily due to payments on account received from the entities financing the Italy-France Interconnector (€111.5 million) and an increase in the provision for the Interconnector Guarantee Fund set up by Terna SpA following the issue of the 2016 Stability Law (€23.7 million); partly offset by payments on account in relation to the start-up of operations in South America (€30.6 million) and a reduction in grants related to assets (€31.3 million, primarily reflecting the fact that the value of grants, amounting to €128.9 million, is deducted directly from the carrying amount of the related assets, after new payments on account received from third parties, above all the EU grants to fund the Sorgente-Rizziconi project), and an increase in inventories of €4.6 million, primarily relating to fibre cable for use in telecommunications projects.

Cash outflows

- An increase in **net tax assets** of €53.9 million, primarily due to an increase in refundable VAT due to the Group (up €29.7 million), largely reflecting increased payments on account in 2017 resulting from the Ministerial Decree of 27 June 2017; an increase in tax credits (up €25.3 million), essentially due to increased payments on account in 2017 and a reduction in tax payable (primarily reflecting a reduction in the rate of corporation tax - IRES - from 27.5% to 24%), and the adjustment to the IRES credit in accordance with Law Decree 16/2012 of 2 March 2012.

Gross invested capital thus amounts to €11,981.2 million, up €65.1 million on the figure for the previous year.

Sundry provisions are down €28.8 million, primarily due to:

- an adjustment to provisions for the energy discounts granted to pensioners (down €18.3 million), use of provisions for termination benefits (TFR) as a result of retirements (down €7.6 million) and adjustments to other provisions (up €30.4 million, primarily net provisions for early retirement schemes);
- provisions for net deferred tax liabilities (down €33.3 million), primarily due to the effect on taxation of amortisation and depreciation and movements in provisions for risks and charges.

Net invested capital of €11,625.4 million is up €93.9 million compared with 31 December 2016 and is financed by equity attributable to owners of the Parent, totalling €3,803.3 million (compared with €3,535.4 million at 31 December 2016), equity attributable to non-controlling interests of €25.7 million (€19.8 million at 31 December 2016) and net debt of €7,796.4 million (down €179.9 million compared with the €7,976.3 million of 31 December 2016).

²⁶ With effect from 1 July 2017, art. 1 of Law Decree 50 of 24 April 2017, converted into law by Law 96/2017, amended art. 17-ter of Presidential Decree 633/1972, extending split payment requirements to listed companies included in the FTSE-MIB index and to direct and indirect subsidiaries of the State or local authorities. From last 1 July, therefore, the amount due to Terna on transactions with the above entities subject to the split payment requirements no longer includes VAT, as the legislation requires the tax to be paid to the tax authorities directly by the purchaser.

Debt

The Group's financial policy

The key aspects of the Group's financial policy are diversification of the sources of funding, a balance between short- and medium/long-term forms of debt and the proactive management of debt.

Gross debt²⁷ at 31 December 2017 amounts to approximately €9.7 billion, including €7.3 billion in the form of bond issues and €2.4 billion in bank borrowings. The average term to maturity of debt, which is almost all fixed rate, is approximately 5.5 years.

Bonds have been issued in the form of both public and private placements under the €8 billion Euro Medium Term Notes (EMTN) Programme (in which a large number of Italian and overseas banks participate), in addition to a stand-alone issue of €800 million dating back to 2004. Focused specifically on qualified investors and listed on the Luxembourg Stock Exchange, Terna's bonds have a very diverse investor base, in terms of both sector and geographical profile.

The main provider of Terna's bank loans is the European Investment Bank (EIB). Total borrowings from the EIB at 31 December 2017 amount to almost €2.4 billion (including €0.2 billion yet to be drawn on). Thanks to its strong credit ratings, Terna is able to obtain financing from banks on extremely good terms, as shown by three committed, revolving back-up credit facilities, amounting to €2.05 billion

Net debt

The Group's net debt amounts to €7,796.4 million at 31 December 2017, down €179.9 million compared with 31 December 2016.

	(€m)		
NET DEBT (BY TERM)	AT 31 DECEMBER 2017	AT 31 DECEMBER 2016	CHANGE
Total medium/long-term debt	8,682.1	8,091.5	590.6
- Bond issues	6,541.9	6,420.5	121.4
- Borrowings	2,129.7	1,983.9	145.8
- Derivative financial instruments	10.5	(312.9)	323.4
Total short-term debt /(funds)	(885.7)	(115.2)	(770.5)
- Bond issues (current portions)	749.9	769.9	(20.0)
- Short-term borrowings	118.0	20.1	97.9
- Variable rate borrowings (current portions)	134.4	134.6	(0.2)
- Other current financial liabilities, net	101.2	95.9	5.3
- Cash and cash equivalents	(1,989.2)	(1,135.7)	(853.5)
Total net debt	7,796.4	7,976.3	(179.9)
NET DEBT (BY TYPE OF INSTRUMENT)			
- Bond issues	7,291.8	7,190.4	101.4
- Borrowings	2,264.1	2,118.5	145.6
- Derivative financial instruments	10.5	(312.9)	323.4
- Short-term borrowings and other financial liabilities	219.2	116.0	103.2
- Cash and cash equivalents	(1,989.2)	(1,135.7)	(853.5)
Total net debt	7,796.4	7,976.3	(179.9)

²⁷ Net debt is the sum of "Bond issues", "Borrowings" and "Short-term borrowings" shown in the Statement "Net debt".

Changes in the **Group's net debt** are as follows:

- an increase in bond issues (up €101.4 million), resulting from the combined effect of the repayment of bonds issued in 2012, totalling €770.0 million, and the issue of bonds worth €1,000.0 million on 26 July 2017, after adjusting for the amortised cost of the instruments (down €128.6 million);
- an increase in borrowings (up €145.6 million), primarily due to new borrowings;
- a reduction in the value of derivative financial instruments entered into to hedge the Group's borrowings (up €323.4 million), following simplification of the derivative portfolio during the fourth quarter of 2017;
- an increase in short-term borrowings and other financial liabilities (€103.2 million), primarily due to the use of short-term credit facilities by the Parent Company and the Tamini Group;
- an increase in cash and cash equivalents (€853.5 million). Cash amounts to €1,989.2 million at 31 December 2017, including €499.7 million invested in term deposits and €1,489.5 million deposited in bank current accounts.

Outlook

The electricity sector will be marked by increasingly rapid technological change, reducing costs and improving the performance of renewable production and storage, and bringing new opportunities linked to the digital transformation of the system and the grid and the introduction of more efficient systems, technologies and solutions.

In line with the guidance provided by the United Nations (COP21), EU guidelines and the objectives set out in the National Energy Strategy (NES), the TSO has a key role to play in enabling the integration of all the new resources and for planning and managing the system in order to ensure its security and efficiency.

Against this backdrop, Terna has stepped up the pace of investment, focusing on development of the national transmission grid in order to facilitate the integration of renewable sources and improve the system's security. At the same time, it intends to renew the Group's asset base in order to mitigate the risk of interruptions to supply, boost environmental sustainability and make it easier to carry out maintenance activities through the use of digital grid technologies.

In the coming months, the Terna Group will be engaged in implementing the Strategic Plan for the period 2018-2022, approved by the Board of Directors on 21 March 2018.

In supporting Strategic Plan delivery, the Sustainability Plan serves to contain ESG risks and to ensure, over the medium term, that the Group is capable of reducing its environmental footprint, has access to the necessary intangible capital and complies with the principles of integrity, responsibility and transparency underpinning its approach to doing business.

With specific regard to investment in the National Transmission Grid, Terna expects capital expenditure to total approximately €5.3 billion over the next 5 years, marking close to a 30% increase compared with the past. Capital expenditure is expected to total approximately €0.9 billion in 2018.

Key electricity infrastructure projects currently in progress include the interconnectors linking Italy with Montenegro and France, scheduled to enter service in 2019, and the Elba-Mainland and SACOI 3 projects. In addition, work is planned in order to boost interconnection capacity between the various zones within the electricity market (Paternò-Pantano-Priolo, Chiaramonte Gulfi-Ciminna) and to facilitate the connection of renewable energy sources located primarily in central and southern Italy (Foggia-Benevento, Bisaccia-Deliceto and Colunga-Calenzano).

In terms of our Non-Regulated Activities, the strategy aims to leverage the Group's distinctive competencies to increasingly position it as an Energy Solutions Provider. This will entail boosting our position in the energy efficiency market and embarking on a role as a high value added systems integrator, supporting the development of new technologies and fulfilment of our role as a TSO in the current energy transition.

In addition, the telecommunications business will focus on providing high value added services, exploiting the opportunities offered by development of the Group's infrastructure.

Overseas, 2018 will see work continue on the existing projects in Brazil, Uruguay and Peru, with the aim of leveraging the Group's distinctive competencies.

The process of scouting for further opportunities in overseas markets will also continue. This may take the form of partnerships and will involve the careful selection of projects with a view to ensuring a low risk profile and avoiding the need to tie up large amounts of capital.

To provide operational support for these initiatives, the Company plans to step up investment in innovation and digital solutions in order to manage the growing complexity of the system. Attention will also be paid to the development and insourcing of strategic competencies, to the expansion of the various departments to enable them to cope with projects of growing size and number and to strengthening the Group's project execution (both in Italy and abroad), systems planning and project control capabilities.

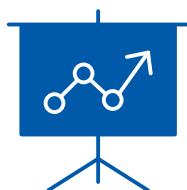
Terna's people will play a key role in implementing the Group's path to growth strategy, acting as the cornerstone for its successful delivery. The Group intends to focus on development and training, with programmes designed to build on existing expertise and develop new skills. This commitment will enable us to handle the growing complexities resulting from the current energy transition process and to achieve the targets set out in the new Strategic Plan.

The above objectives will be pursued whilst maintaining our commitment to maximising cash generation and ensuring a sound, balanced financial structure

Reconciliation of the Group's profit for the year and equity with the corresponding amounts for the Parent Company

The reconciliation of consolidated equity and consolidated profit for the year and the corresponding amounts for the Parent Company is shown below.

	(€/m)	
	PROFIT FOR 2017	EQUITY AT 12 31 2017
Parent Company's financial statements	640.0	3,675.3
Profit and equity contributed by Group companies:		
- Group companies - Regulated Activities	52.5	53.1
- Group companies - Non-Regulated Activities	(2.5)	77.0
- Group companies - International Activities	1.5	(6.7)
Companies accounted for using the equity method	2.7	30.3
Total consolidated financial statements	694.2	3,829.0
Share attributable to non-controlling interests - Non-Regulated Activities	5.9	25.7
Terna Group's consolidated financial statements	688.3	3,803.3



Terna's shares

Terna and the Financial Markets

Terna SpA has been listed on Borsa Italiana's (Mercato Telematico Azionario) since 23 June 2004. From the date of listing to the end of 2017, the share price has risen 185% (a capital gain), providing a Total Shareholder Return (TSR²⁸) of 514%, a value higher than both the Italian market (FTSE Mib +28%) and the European reference Index of the sector (DJ Stoxx Utilities +147%).

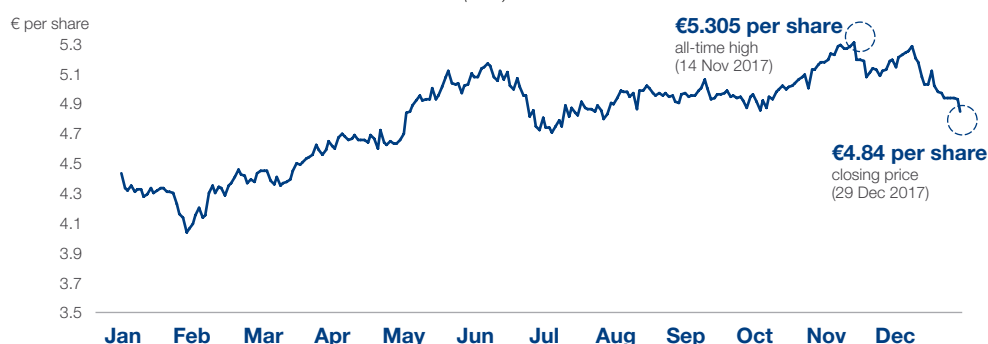
Europe's leading stock markets registered positive performances in 2017, driven above all by a strengthening of the European economy and the European Central Bank's expansionary monetary policy. Milan gained 13.6%, whilst Frankfurt and Paris close at +9.6% and +9.3%, respectively. London ended the year at + 7.6%, with Madrid at +7.4%.

Performance of Terna's Shares

Terna's stocks ended 2017 in positive territory, with an increase of 11.3% to €4.84 per share, outperforming the DJ Stoxx Utilities, which gained 5.5%. On 14 November, the share price reached an all-time high of €5.305 per share.

The daily average volume traded during the year amounted to approximately 6 million units per day. The ex-dividend date for the 2017 interim dividend of 7.4263 € cents per share, was 21 November 2017.

PERFORMANCE OF TERNA'S SHARES - Price (2017)

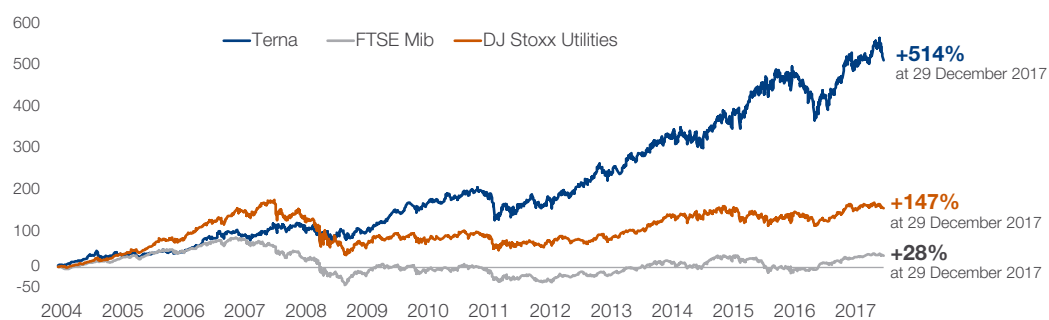


Source: Bloomberg

²⁸ Total Shareholder Return (TSR): total return on an equity investment, calculated as the sum of:

- the capital gain: the change in the share price (difference between the price at the end and at the beginning of the relevant period) as a percentage of the price at the beginning of the period;
- reinvested dividends: the ratio between dividends per share paid out during the period and the share price at the beginning of the period. Dividends are assumed to have been reinvested in the shares.

PERFORMANCE OF TERNA'S SHARES - Total Shareholder Return (from their listing to the end of 2017) (%)



Source: Bloomberg

KEY INDICATORS PER SHARE

	2017	2016	2015	2014	2013	2012
Number of shares (in millions)	2,010	2,010	2,010	2,010	2,010	2,010
Price at year end (€ per share)	4.84	4.35	4.76	3.76	3.63	3.02
Market capitalisation* (in millions)	9,668	9,367	8,482	7,718	6,713	5,688
Average price for year (€ per share)	4.81	4.66	4.22	3.84	3.34	2.83
Earnings per share (€)	0.339	0.315	0.296	0.271	0.256	0.231
Dividend per share (€)	0.220	0.206	0.200	0.200	0.200	0.200
Payout ratio	66.63%	77.32%	76.30%	89.30%	88.40%	86.80%
Dividend yield**	4.5%	4.7%	4.2%	5.3%	5.5%	6.6%
Total shareholder return	15.90%	-4.3%	32.5%	8.9%	27.6%	24.9%

* Based on the average price for the year.

** Dividend per share for the year as a percentage of the share price at year end.

WEIGHT OF TERNA'S SHARES	2017	2016
> on the FTSE MIB	1.94%	2.06%

Source: Borsa Italiana.

RATINGS

	SHORT-TERM	MEDIUM/ LONG-TERM	OUTLOOK
Terna S.p.A.*			
Standard & Poor's	A-2	BBB+	Stable
Moody's	Prime-2	Baa1	Negative
Fitch	F2	BBB+	Stable
Italian state*			
Standard & Poor's	A-2	BBB	Stable
Moody's	Prime-2	Baa2	Negative
Fitch	F2	BBB	Stable

* Data at 31 December 2017.

More information on the share price performance and the dividend policy is available in the Investor Relations section of Terna SpA's website at www.terna.it

Inclusion in stock exchange sustainability indices

Terna's commitment to measuring and improving its ESG (Environmental, Social and Governance) performance is reflected positively in the sustainability ratings assigned by specialist agencies, in the Company's inclusion in the leading stock exchange sustainability indices and in the appreciation shown by socially responsible investors.

Terna's inclusion in all the leading international stock exchange sustainability indices was confirmed in 2017.

In its "Sustainability Yearbook 2018", published in January 2018, RobecoSAM ranked Terna in the Bronze Class.

TERNA'S INCLUSION IN SUSTAINABILITY INDICES

INDEX	TERNA'S INCLUSION
DOW JONES SUSTAINABILITY INDEX	Included since 2009.
ECPI	Included since 2007.
ETHIBEL SUSTAINABILITY INDEX (ESI)	Included since 2009.
EURONEXT VIGEO	Included in the World 120, Eurozone 120 and Europe 120 baskets since 2012.
FTSE ECPI	Included since 2010.
FTSE4Good	Included in the index (Global and Europe baskets) every year since 2005.
MSCI GFLOBAL SUSTAINABILITY	Included regularly in the index since 2007.
STOXX® ESG	Included in the index since 2011.
STOXX® LOW CARBON	Included in the index since February 2016, the date the index was launched.
UNITED NATIONS GLOBAL COMPACT ("GC100")	Included in the index since 2013.

Terna has also been selected for inclusion in certain investment registers drawn up on the basis of sustainability criteria, which, particularly when of a public nature, provide a benchmark for investors who focus on ESG performance.





Terna SpA

A review of the operating performance and financial position of the Parent Company Terna SpA is provided below.

At 31 March 2017, the merger of the wholly owned subsidiaries, Terna Storage Srl and Terna Rete Italia Srl with and into Terna SpA became effective. The transaction was effective for accounting and tax purposes from 1 January 2017.

In order to clearly show movements during the year, a column with comparative "pro forma" amounts has been added. This takes into account the impact of the merger from the beginning of the previous year, used as the basis for the description of the principal changes over the year.

Terna SpA's reclassified income statement

Terna SpA's operating results for the years 2017 and 2016 are summarised in the following reclassified income statement, obtained by reclassifying amounts in the income statement.

(€m)						
	2017	2016	CHANGE	PRO-FORMA		
				2016	CHANGE	%CHANGE
TOTAL REVENUE	1,951.5	1,779.6	171.9	1,961.8	(10.3)	(0.5)
- Transmission revenue	1,674.5	1,497.4	177.1	1,670.6	3.9	0.2
- Dispatching and metering revenue	111.9	111.3	0.6	111.3	0.6	0.5
- Other operating income	144.0	149.7	(5.7)	158.7	(14.7)	(9.3)
- Revenue from construction services performed under concession*	21.1	21.2	(0.1)	21.2	(0.1)	(0.5)
TOTAL OPERATING COSTS	464.9	446.2	18.7	467.1	(2.2)	(0.5)
- Personnel expenses	65.7	82.0	(16.3)	82.2	(16.5)	(20.1)
- Cost of services, leases and rentals	332.1	322.4	9.7	341.4	(9.3)	(2.7)
- Materials	7.0	3.1	3.9	3.1	3.9	125.8
- Other costs	28.5	25.3	3.2	27.0	1.5	5.6
- Quality of service	10.5	(7.8)	18.3	(7.8)	18.3	-
- Cost of construction services performed under concession*	21.1	21.2	(0.1)	21.2	(0.1)	(0.5)
GROSS OPERATING PROFIT (EBITDA)	1,486.6	1,333.4	153.2	1,494.7	(8.1)	(0.5)
- Amortisation, depreciation and impairment losses	495.2	432.7	62.5	473.2	22.0	4.6
OPERATING PROFIT/(LOSS) (EBIT)	991.4	900.7	90.7	1,021.5	(30.1)	(2.9)
- Net financial income/(expenses)	(89.8)	(102.0)	12.2	(102.7)	12.9	(12.6)
PROFIT/(LOSS) BEFORE TAX	901.6	798.7	102.9	918.8	(17.2)	(1.9)
- Income tax expense	261.6	263.2	(1.6)	297.5	(35.9)	(12.1)
PROFIT FOR THE YEAR	640.0	535.5	104.5	621.3	18.7	3.0

* Recognised in application of interpretation "IFRIC 12 - Service Concession Arrangements".



The principal changes with respect to pro forma 2016 are described below.

Gross operating profit (EBITDA) for 2017 amounts to €1,486.6 million, down €8.1 million compared with the previous year. This primarily reflects the cost of quality of service, offset by a reduction in personnel expenses and savings on the cost of external services.

The reduction in **revenue** (amounting to €10.3 million) primarily reflects lower revenue from the quality of service (down €8 million, above all due to the impact of positive one-off items recognised in 2016), increased revenue generated in 2016 by the so-called "Copper Plan" (down €12.1 million) and a reduction in revenue resulting from the impact of renewal of the vehicle fleet in 2016 (down €4.2 million), offset by an increase in revenue from telecommunications, above all due to new contracts granting usage rights on certain fibre assets (up €11 million) and transmission, dispatching and metering revenue (up €4.5 million).

Operating costs are down €2.2 million, primarily due to a reduction in personnel expenses (down €16.5 million), reflecting the release of provisions for the energy discounts granted to pensioners and the higher amount of provisions made in 2016 for early retirement schemes, after increased provisions for management incentive schemes, as well as service cost savings (down €9.3 million), partially offset by increased costs incurred for the quality of service (up €18.3 million).

Amortisation, depreciation and impairment losses for the year amount to €495.2 million, up €22 million compared with 2016, primarily due to the entry into service of new plant.

Operating profit (**EBIT**) thus amounts to €991.4 million, down €30.1 million on the figure for 2016.

Net financial expenses for the year total €89.8 million. This figure is down €12.9 million compared with the €102.7 million of 2016, primarily due to the refinancing of debt on more competitive terms.

Income tax expense for the year amounts to €261.6 million, down €35.9 million on the figure for the previous year. This essentially reflects the impact of the reduction in the rate of corporation tax (IRES) from 27.5% to 24% (in accordance with Law 208/2015, the 2016 Stability Law), partially offset by the changes made to the tax relief designed to stimulate economic growth (ACE - Aiuto alla Crescita Economica) introduced by Law Decree 50/2017.

Profit for the year thus amounts to €640 million, up €18.7 million on the profit for 2016.

Cash flow

Cash flows in 2017 and 2016 are shown in the following statement.

			(€m)
	CASH FLOW 2017	PRO-FORMA CASH FLOW 2017	CASH FLOW 2016
- Profit for the year	640.0	640.0	535.5
- Amortisation, depreciation and impairment losses	495.2	495.2	432.7
- Net change in provisions	30.2	(18.5)	27.1
- Net losses/(gains) on sale of assets	(1.7)	(1.7)	(7.7)
Operating cash flow	1,163.7	1,115.0	987.6
- Change in net working capital	317.0	287.3	(37.2)
- Change in investments	529.7	(30.0)	(23.8)
- Other movements in non-current assets	(1,097.1)	95.3	47.3
Cash flow from operating activities	913.3	1,467.6	973.9
- Total capital investment	(851.9)	(851.9)	(706.4)
Free cash flow	61.4	615.7	267.5
- Dividends paid to shareholders	(418.4)	(418.4)	(406.2)
- Cash flow hedge reserve after taxation and other movements in equity	428.9	5.9	(12.6)
Change in net debt	71.9	203.2	(133.9)

Terna SpA's reclassified statement of financial position

Terna SpA's financial position at 31 December 2017 and 2016 is summarised in the following statement, obtained by reclassifying amounts in the statutory statement of financial position.

						(€m)
	AT 31 DECEMBER 2017	AT 31 DECEMBER 2016	CHANGE	PRO-FORMA AT 31 DECEMBER 2016	CHANGE	
Total net non-current assets	13,139.6	12,212.2	927.4	12,844.9	294.7	
- Intangible assets and goodwill	424.3	328.9	95.4	432.1	(7.8)	
- Property, plant and equipment	11,705.2	10,368.3	1,336.9	11,457.5	247.7	
- Financial assets	1,010.1	1,515.0	(504.9)	955.3	54.8	
Net Working Capital	(1,144.3)	(825.7)	(318.6)	(855.4)	(288.9)	
- Net energy-related pass-through payables	(874.4)	(576.4)	(298.0)	(550.0)	(324.4)	
- Net receivables resulting from Regulated Activities	335.1	342.0	(6.9)	342.0	(6.9)	
- Net trade payables	(424.5)	(354.8)	(69.7)	(378.9)	(45.6)	
- Net tax assets	106.8	28.6	78.2	34.5	72.3	
- Other net liabilities	(287.3)	(265.1)	(22.2)	(303.0)	15.7	
Gross invested capital	11,995.3	11,386.5	608.8	11,989.5	5.8	
Sundry provisions	(273.5)	(243.3)	(30.2)	(292.0)	18.5	
NET INVESTED CAPITAL	11,721.8	11,143.2	578.6	11,697.5	24.3	
Equity	3,675.3	3,024.8	650.5	3,447.8	227.5	
Net debt	8,046.5	8,118.4	(71.9)	8,249.7	(203.2)	
TOTAL	11,721.8	11,143.2	578.6	11,697.5	24.3	

The principal changes with respect to pro forma 2016 are described below.

Net invested capital amounts to €11,721.8 million at 31 December 2017, an increase of €24.3 million compared with the previous year. This reflects an increase in **net non-current assets** (€294.7 million), the cash generated by **Net Working Capital** (down €288.9 million), and a reduction in sundry provisions (€18.5 million).

The change in **Net Working Capital**, represented by a reduction of €288.9 million, is primarily due to an increase in net energy-related pass-through payables and trade-related items and a change in net tax assets.

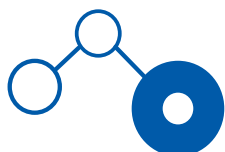
Net non-current assets are up €294.7 million, primarily due to capital expenditure during the year (€851.9 million), after grants deducted directly from the carrying amount of the related assets (€127.7 million, primarily the Sorgente-Rizziconi project and projects financed by the MED and the EU) and amortisation and depreciation for the year (€484.3 million), as well as the subscription of new shares issued by the subsidiary, Terna Crna Gora d.o.o. (€30 million) and the Interconnector Guarantee Fund, set up by art. 32 of Law 99/09 to fund investment in interconnections (up €24.8 million).

Sundry provisions are down €18.5 million, primarily due to provisions for net deferred tax liabilities (down €31.3 million), primarily reflecting the effect on taxation of amortisation and depreciation and movements in provisions for risks and charges, an adjustment to provisions for the energy discounts granted to pensioners (down €18.3 million) and other provisions (up €31.1 million).

Net debt of €8,046.5 million is down €203.2 million compared with 31 December 2016.

(€m)

NET DEBT (BY TYPE OF INSTRUMENT)	AT 31 DECEMBER 2017	AT 31 DECEMBER 2017	CHANGE	PRO-FORMA	
				AT 31 DECEMBER 2017	CHANGE
- Bond issues	7,291.8	7,190.4	101.4	7,190.4	101.4
- Borrowings	2,230.7	2,111.9	118.8	2,117.3	113.4
- Derivative financial instruments	9.9	(313.0)	322.9	(313.0)	322.9
- Short-term borrowings and other financial liabilities	192.3	56.9	135.4	56.9	135.4
- Cash and cash equivalents (including the net balance on intercompany current accounts)	(1,678.2)	(927.8)	(750.4)	(801.9)	(876.3)
Total net debt	8,046.5	8,118.4	(71.9)	8,249.7	(203.2)



Proposal

for the Annual General Meeting regarding the distribution of Terna SpA's profit for the year

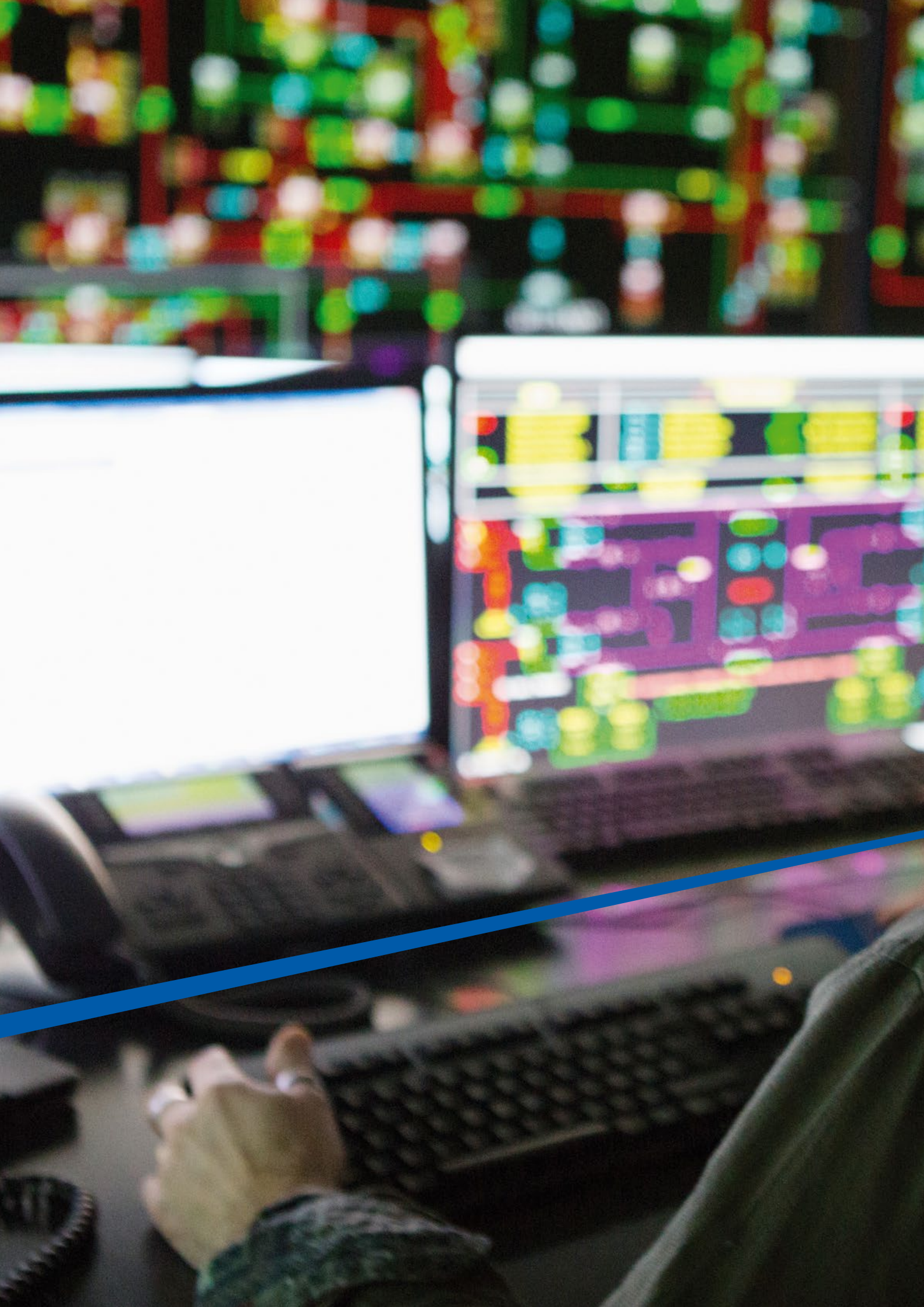
Proposal for appropriation of profit for the year

Terna SpA's Board of Directors proposes to pay a total dividend of €442,198,240.00 for 2017, equal to €0.22 per share, of which €0.074263 per share was declared in the form of an interim dividend on 10 November 2017.

The Board of Directors thus proposes to appropriate Terna SpA's profit for 2017, amounting to €640,042,877.77, as follows:

- €149,268,035.90 to cover payment of the interim dividend payable from 22 November 2017;
- €292,930,204.10 to pay a final dividend of €0.145737 to the holders of each of the 2,009,992,000 ordinary shares outstanding at the date of this Board of Directors' meeting. The final dividend will be payable on 20 June 2018, with an ex-dividend date for coupon 28 of 18 June 2018 and a record date (as defined by art.83-*terdecies* of Legislative Decree 58 of 24 February 1998, the Consolidated Law on Finance of 19 June 2018);
- €197,844,637.77 to be taken to retained earnings.





A man with a beard is seen from the side, sitting in a control room. He is looking at several computer monitors. The monitors display various colorful data visualizations, including bar charts and maps. The room is dimly lit, with the primary light source being the screens. A white diagonal banner is overlaid on the right side of the image, containing the text '05 Risk management'.

05 Risk management



Risk management

Introduction

In view of the distinctive and specific nature of the core business, regulated primarily through a government concession arrangement and by the Regulatory Authority for Energy, Networks and the Environment (ARERA, or the Autorità di Regolazione per Energia reti e Ambiente), Terna is exposed not to the usual price- and market-related risks (or is so only to a limited extent with regard to its non-regulated and overseas operations), but to regulatory and legislative risk.

Regulatory risk derives from potential changes in the criteria used to determine regulated revenue, particularly following a multi-year review of the regulatory framework. Legislative risk relates to potential changes in Italian and European laws governing matters relating to the environment, energy, tax and social aspects (above all labour and tenders).

Like all types of risk, these aspects are closely monitored by Terna, which has identified the main risks connected to its activities and has put in place specific safeguards, tools and organisational structures with a view to minimising such risks by reducing any impact to within acceptable limits.



From an organisational point of view, the Group has for some time structured itself in order to guarantee that its operations and the associated risks are managed and overseen in a thorough manner, as well as ensuring that roles and responsibilities are clearly assigned. In this sense, the key roles involved in this process are as follows:

- **Audit, Risk, Corporate Governance and Sustainability Committee** this committee consists of independent members of the Board of Directors and supports the Board of Directors in making assessments and decisions regarding the Internal Control and Risk Management System (ICRMS). Periodically, it is called on to assess the adequacy and efficacy of this system with respect to the nature of the Company and its risk profile;
- **Chief Risk Officer (CRO):** the CRO has two main tasks: to define the Company's risk assessment, management and control policies and coordinate all the entities involved in the ICRMS, to maximise efficiency and minimise the duplication of work. Finally, the CRO periodically reports to the above Committee on risk management outcomes and assists the Chief Executive Officer in defining risk appetite criteria and the risk objectives taken on by Terna;
- **Security and Services:** through its Risk Management unit, this department guarantees effective oversight and coordination of the various risk management processes used by the Group, including through dedicated organisational units. It covers aspects ranging from occupational health and safety, to the physical protection of traditional assets and cyber-physical or smart protection of the ICT ecosystem and its smart assets, and to the operational risks associated with business processes.

Analysis

The Terna Group has used Enterprise Risk Management (ERM) methodology for some time, appropriately tailored to its own situation as grid operator, to identify, assess, control and monitor its risks. Initially applied only to operational risk, ERM analysis has enabled the Group to create a detailed map of its operations and their inter-relations, which are associated with a catalogue of over a thousand operational risks of differing importance in terms of critical nature and impact. This has provided a significant body of information for use when assessing critical areas. With a view to continuous improvement, Terna has also developed its own risk management system, also applying ERM methodology to the various types of risk to which the Group is exposed, in order to ensure an integrated approach to managing such risks and to their assessment.

Alongside the adoption and application of an integrated risk management model, Terna has also developed an enterprise Governance, Risk and Compliance (eGRC) IT tool, allowing it to simplify and classify information to obtain a standardised and comparable representation of the Group's risks and produce an integrated report on the various levels of risk for each specialist area, for the benefit of senior management.

This complex structuring process risks has made it possible to categorise the risks to which the Terna Group is exposed on the basis of their nature, and to represent them based on the following groupings or macro-categories: **Governance & Compliance, Operations and Strategy & Financial**, whilst also identifying links between the various types of risk.

Over
1,000
mapped
operational risks

Management method



GOVERNANCE & COMPLIANCE

Governance and Compliance models

Conscious of the need to ensure correctness and transparency in conducting its affairs and doing business, with the aim of protecting its position and image, meeting the expectations of its shareholders and safeguarding the jobs of its employees, Terna takes continuous steps to protect against Governance, Integrity and Compliance risks.

Based on best governance and compliance practices, Terna:

- has adopted a Code of Ethics;
- has implemented an Organisational and Management Model, as provided for in Legislative Decree 231 of 2001, as amended;
- has approved "Compliance rules for the prevention of administrative offences and violations relating to market abuse";
- it has adopted "Anti-corruption Guidelines";
- has, as the Parent Company, adopted the "Global Compliance Program";
- has appointed a "Manager responsible for financial reporting";
- has adopted an Integrated Management System, laying down the criteria for the management of Quality, the Environment, Occupational Health and Safety, Energy, Anti-corruption efforts, Information Security, Multi-site Test Lab Security, Live-Line Working and the Calibration Centre;
- has developed an Information Security Governance Model;
- has implemented a Privacy Model within the Group's companies, and has begun the process of revising it, within the deadline of 25 May 2018, in order to comply with the new EU Regulation 2016/679 on data protection, which came into effect on 25 May 2016;
- is drawing up its own policy on overseas trade to help all Group companies to correctly apply the very many EU and extra-EU regulations governing international trade with countries subject to sanctions;
- has established a specific Fraud Management team, accompanied by an Anti-Fraud Model.

Relations with the institutional partners

Following an innovative approach to risk reduction policies, Terna has identified the institutional partners with which to share the risks resulting from its activities. This takes the form of cooperation with Italian and international regulatory bodies and authorities and the signing of memoranda of understanding: the Ministry of the Interior, the Italian tax authority, the Fire Service, the National Association of Italian Municipalities, Prefectures and CNAIPIC (the National Centre for Combating Cyber Crime and for the Protection of Critical Infrastructure).

"231" risk

The risks associated with 231 Compliance are explained in Organisational Models adopted by Terna Group companies and include most of the offences listed in Legislative Decree 231/01. By way of example but not limited thereto, this assumes that all areas of operation involving relations with the Public Administration are at risk, as are all activities with an impact on occupational health and safety and the environment.

Integrated Management System

The Integrated Management System primarily aims to ensure the effectiveness and efficiency of the Group's systems, highlighting the potential risks in the areas focused on and taking the necessary steps to mitigate such risks. The principal stages of the process of overseeing management systems involve:

- the implementation of new management systems and, if deemed appropriate, requests for certification or accreditation;
- oversight and revision of existing management systems;
- the implementation of internal controls on management systems;
- the reassessment of management systems;
- support for organisational units when preparing for external audits and for the certification or accreditation body in planning the audit and its conduct.

The Group's culture has always given primarily importance to the concept of integrated security, the implementation of which requires a constant commitment to identifying potential internal vulnerabilities, assessment and control of the causes and preparation of appropriate measures designed to resolve and prevent their occurrence.

For this purpose, Terna maintains ongoing relations with its institutional partners, whilst at the same time developing a model for identifying critical areas and monitoring potential organisational and operational issues that might give rise to the occurrence of fraud and, through systematic analysis of the root causes, devising a series of preventive measures.

The approach to combating fraud is based on the continuous monitoring of processes, in order to determine the level of exposure to the risk of fraud and the related risk factors. The aim is to adopt suitable governance measures and increasingly rigorous controls, such as, for example, the definition of new internal rules and procedures to improve the processes and mitigate compliance risk.

Fraud management



OPERATIONS

The analysis of operational risk using ERM methodology has enabled Terna to have a detailed map of the risks associated with all its core processes and key support processes. Each identified risk has been assigned a level of importance and, for those where the level of risk exceeds the chosen risk appetite, possible mitigation initiatives have been identified and implementation times estimated. The related action plans have been communicated to the relevant managers for implementation. The results are subject to continuous monitoring and periodic auditing to guarantee adequate risk assessment over time

Risk management for operational processes

Terna has established a Risk Observatory with the objective of ensuring proper application of the Company's Corporate Governance policies and the management of information flows to the CRO, as well as monitoring environmental, social and political issues that may impact on the Terna Group's plans for new projects and those currently in progress (including work on connections to the NTG). It also provides timely reports to senior management, the CRO and the Secretary to the supervisory boards set up pursuant to Legislative Decree 231/01 on any events that may occur. The Risk Observatory is a way of monitoring local issues in the areas in which projects are located, with the aim of taking preventive action or, where an event has occurred, identifying the most correct and appropriate response to mitigate the risk.

Environmental, social and political issues

OPERATIONS - *continued*

**Physical threats
to plant**

The complexity and multiplicity of physical threats to Terna's sites over the years has necessitated the adoption of various measures to contain the risk of forced entry, theft and damage to plant and, in so doing, to ensure the continuity of the electricity service.

The physical security of substations is assured by using devices, systems and units operating 24 hours a day, seven days a week. These arrangements have been further enhanced to enable them to carry out surveillance of a subset of substations, identified as critical on the basis of an indicator calculated following an assessment of multiple risk elements.

The safety of its people represents another ongoing and increasingly difficult challenge, given the continually changing nature of external threats and the new Non-Regulated Activities that Terna carries out and will carry out with growing frequency and intensity.

To safeguard the security of the Company's premises and plant (above all electricity substations), Terna has also developed a surveillance platform known as the Integrated Physical Security System for Terna Substations, which allows the dedicated surveillance centre - the Security Operations Centre or SOC - to continuously monitor any intrusion alarms and video from 189 substations.

Terna has partnered with the Italy's Carabinieri police force to further strengthen its new communications and rapid intervention system, which enables the SOC to quickly alert the police in the event of attempts at forced entry to critical substations, all equipped with video surveillance equipment. The new system has been called "O.D.I.N.O." (Operational Device for Information, Networking and Observation) and is connected, via a secure link, to the centralised operating system used by Carabinieri operations rooms throughout Italy. A rapidly installed light video surveillance system (VideoBox) is also used in parallel.

**Information
and Cyber Risk**

For some time, Terna has had an Information Security Governance Model, which enables it to identify the most significant cyber risks. It is based on policies and procedures, combined with a coordinated Information Risk Management ("IRM") operating programme, led and coordinated by the Group's CISO (Chief Information Security Officer).

In addition, the Security Operations Centre (SOC) is used to implement a structured process that aims to rapidly identify and contain security incidents, thereby minimising information loss and enabling restoration of the services involved.

Supplier risk

Terna uses a Supplier Qualification System, set up pursuant to the related EU directives (Legislative Decree 50 of 18 April 2016 "Public contracts code for the supply of works, services and goods"), for all the main core categories of goods, works and services that Terna intends to procure, established on the basis of strategic importance, degree of competitiveness and annual procurement volumes.

The qualification procedure enables Terna to assess the suitability of the contractor (supplier/undertaking), checking that they meet the necessary legal, financial, technical, organisational, training, environmental safety and ethical and social requirements.

During the three-year validity of the qualification, companies are monitored in order to verify their continued fulfilment of the requirements met at the time of qualification.

**Occupational injuries and
environmental incidents**

The Terna Group has put in place policies and guidelines designed to provide guidance regarding safety and the environment. It also conducts checks of compliance with existing legislation and the adopted procedures, via inspections of Terna's sites and infrastructure, in addition to developing awareness among its own personnel and the personnel employed by contractors.



STRATEGY & FINANCIAL

Terna adopts a dynamic approach to managing the various forms of financial risk, including market risk (interest rate, exchange rate and inflation risk), liquidity risk and credit risk. This approach includes constant monitoring of the financial markets, in order to carry out planned hedging operations under favourable market conditions, but also to take advantage of opportunities to improve existing hedges, when changes in market conditions or the hedged items make previous hedges unsuitable or excessively costly.

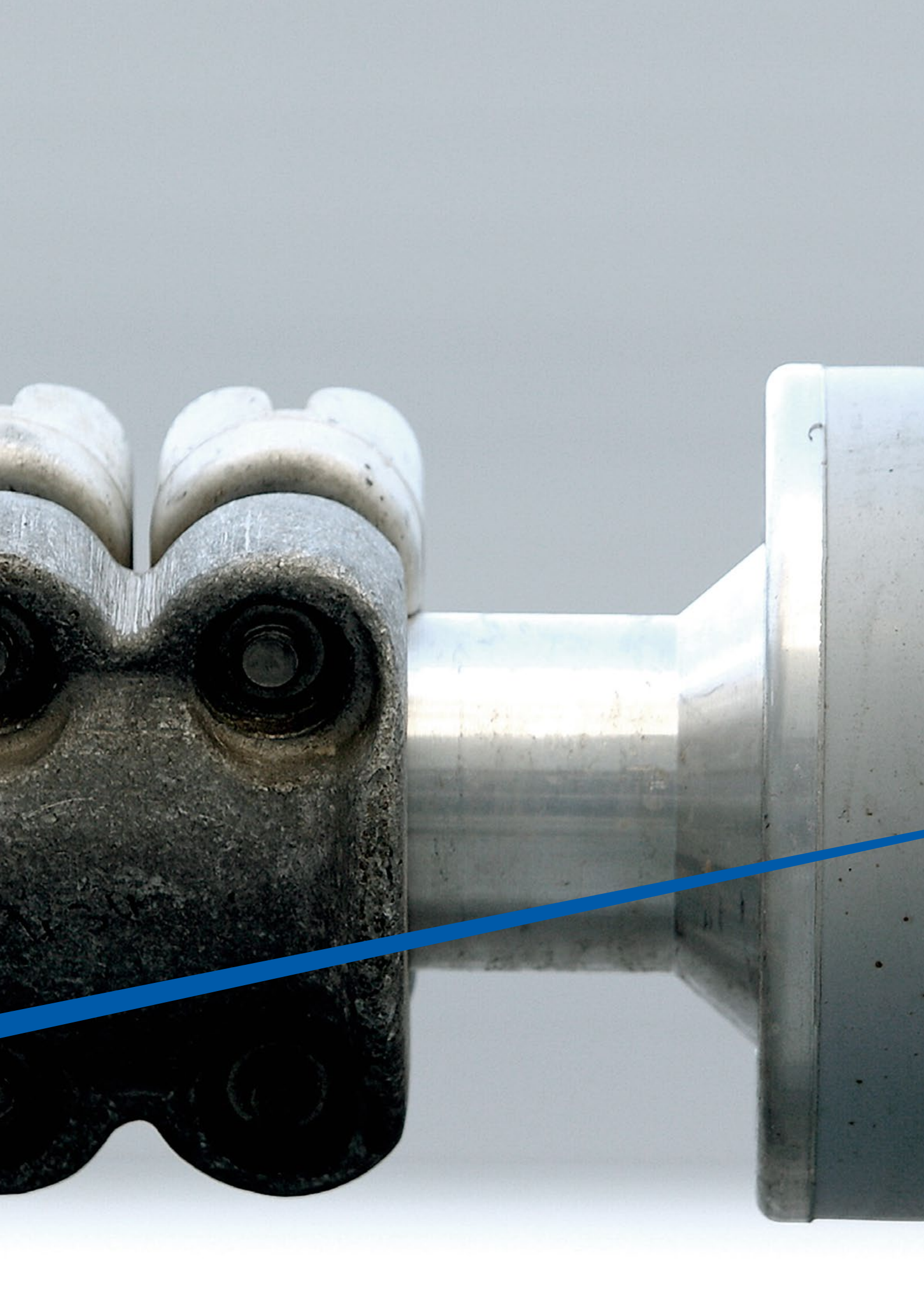
Financial risk

The transition to a new model of distributed generation from renewable sources is rapidly changing the market, with the rise of the prosumer (producer and consumer) model, which is progressively replacing the traditional consumer. This has resulted in an emerging risk linked to difficulties in maintaining observability of the grid in terms of injections and withdrawals of energy. This is having an impact on the ability to forecast demand and, as a result, on the correct management of generating resources.

Emerging risks

Other existing risks, which are thus already monitored and mitigated, are expected to assume greater significance due to the current process of digital transformation. These relate to the cyber risks that have led the Group to adopt specific measures, as described above.

Emerging risk	Description	Potential impact	Mitigation initiatives
Climate change	Extreme weather conditions may lead to prolonged malfunctions at local level.	ASSETS, REPUTATION	Resilience Plan
Management of renewable sources	The non-programmable nature of production from renewable sources makes dispatching activities more complicated.	DISPATCHING	Use of advanced forecasting and planning tools.
Traceability of injections into the grid in real time	The prosumer market model increases the complexity involved in measuring injections and withdrawals of energy.	DISPATCHING	Innovative data management & analytics solutions





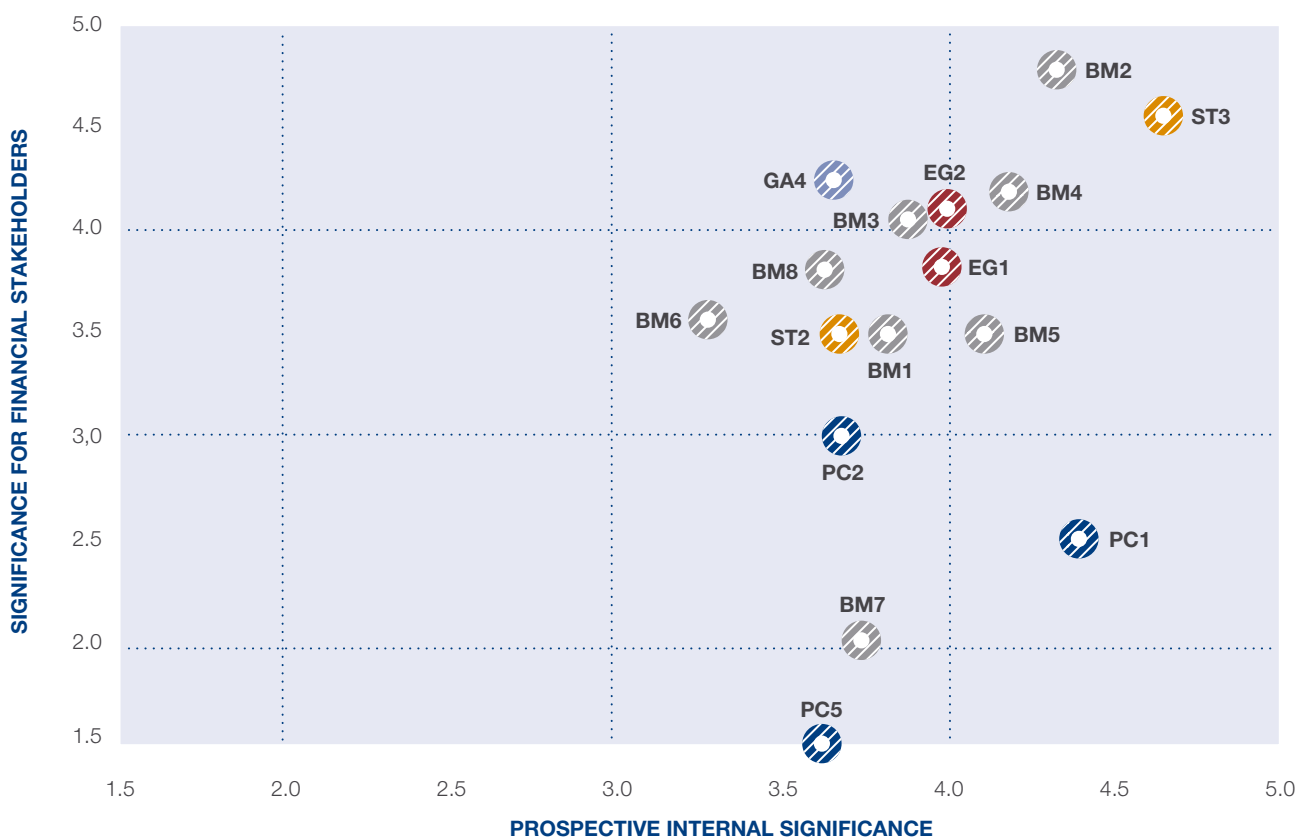
06 Annexes

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Materiality analysis

PROSPECTIVE MATERIALITY MATRIX



Ethics and governance model

EG1: Alignment with best governance practices

EG2: Business integrity



Transmission service

ST2: Electricity market integration

ST3: Quality, security and service continuity



People and community

PC1: Health and safety and correct labour practices

PC2: HR development

PC5: Social responsibility and positive impact on local communities



Business management

BM1: Strategic approach to stakeholder management

BM2: Compliance with financial targets

BM3: Prudent risk management

BM4: Choice of investments and conformity with plan

BM5: Engagement with local stakeholders

BM6: Business and development and diversification

BM7: Monitoring of environmental and social aspects of the supply chain

BM8: Innovation and research



Management of environmental impacts

GA4: Reduction of the Group's environmental footprint

In the preparation of its Integrated Report for 2017, Terna has taken into account the guiding principles in the Integrated Reporting Framework developed by the IIRC-International Integrated Reporting Council. One of these principles is materiality, which requires entities to consider, when selecting the matters to cover and the related KPIs, their effective relevance in terms of their role in value creation.

The matters covered in the Integrated Report for 2017 are consistent with the materiality matrix shown in the previous page. Construction of the matrix also played a part in the materiality analysis carried out during preparation of the Sustainability Report, which from this year also has the role of "Non-financial statement", now obligatory in accordance with Legislative Decree 254/2016 and also based on the materiality principle.

Key steps in this process are the following:

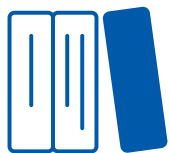
- selection of the main topics for which to determine their significance for Terna and for stakeholders. The selection was conducted in 2016 on the basis of an in-depth analysis of internal and external documents. 23 topics, belonging to 5 areas, were identified: ethics and the governance model; the transmission service; the management of environmental impacts; business management; people and communities. Terna's senior management has confirmed their validity for use in this year's materiality analysis;
- determination of significance for Terna. The selected topics have been classified according to their importance for Terna, assessed first of all via a survey involving 25 second-level heads of department and then in the course of a meeting with the senior management team. The process regarded the level of "active management" (the presence of policies, procedures, checks, objectives, etc.) relating to each topic, an aspect interpreted as effectively summing up the materiality of a topic and of the related impacts;
- determination of significance for stakeholders. Each topic was ranked by combining the significance of the topic for each category of stakeholder with the weighting assigned to that category in Terna's stakeholder map. In particular, the significance of each topic for a given category of stakeholder was assessed on the basis of a) the analysis of documents, b) the results of specific surveys (e.g. engagement surveys of personnel, questionnaires completed by customers of the Group's non-regulated business) and c) management's perception of the significance of topics for stakeholders with whom they have direct contact.

Further details are provided in the section on materiality in the Sustainability Report-Non-financial Statement.

The materiality matrix used for the Integrated Report differs from the one used for the Sustainability Report-Non-financial Statement as regards the following key aspects:

- the determination of significance for Terna was based on the prospective significance, with reference to the five-year period covered by the Business Plan for 2018-2022: starting from the current level of active management, the need for investment - in boosting management capabilities - in order to achieve the objectives in the Plan was assessed for each topic. The need to modify (or not) the way topics are dealt with was discussed with the Group's management in the same way as above;
- in determining significance for stakeholders, and again in line with IIRC principles, only the opinions of those belonging to the financial category, meaning "shareholders" (including financial analysts and institutional investors) and "credit providers" (e.g. banks), were taken into account;
- the topics placed in the matrix (16) are those for which, in the set of sources analysed, it was possible to identify the information of significance to financial stakeholders.

In the matrix, the most significant topics are those furthest away from the origin, for both axes.



Regulatory framework and other information

Summary of the principal legislative measures

A brief description is provided below of the principal legislation of interest to the Group issued during 2017 and, subsequently, up to the date of preparation of this Annual Report.

- **Law 232 of 11 December 2016, “Budget Law for the 2017 financial year and long-term budget for the three-year period 2017-2019”, published in Official Gazette no. 297 of 21 December 2016**

The Budget Law provides for tax breaks for businesses that purchase new capital goods (so-called super depreciation) or innovative goods as part of the National Industrial Plan 4.0 (hyper depreciation). It has also amended the regulations regarding tax credits for increases in R&D spending and exempted productivity bonuses from taxation. The legislation has also introduced a contributions holiday for new hires. Finally, it provides for forms of early retirement (“social” and “voluntary” early retirement scheme).

- **Ministry for Economic Development Decree 214 of 12 September 2017, containing “Regulations regarding the procedures for the establishment and financing of highly specialist skills centres, as part of measures relating to the National Industrial Plan 4.0, in implementation of article 1, paragraph 115, of Law 232 of 11 December 2016 (the 2017 Budget Law)”, published in Official Gazette no. 6. of 9 January 2018**

- **Presidential Decree 150 of 4 September 2017, “Implementing regulations relating to the provisions regarding financial advances to guarantee pensions (early retirement scheme)”, published in Official Gazette no. 243 of 17 October 2017**

- **Legislative Decree 56 of 19 April 2017, containing “Supplementary and corrective measures relating to Legislative Decree 50 of 18 April 2016”, published in Official Gazette no. 103 of 5 May 2017**

The Decree contains corrective measures relating to the new Procurement Code, introduced by Legislative Decree 50 of 18 April 2016, regarding the regulation of feasibility planning, design competitions in special sectors, the lowest price tenders, irregular tenders and public consultation.

- **Legislative Decree 104 of 16 June 2017, regarding implementation of Directive 2014/52/EU of the European Parliament and of the Council of 16 April 2014, which amends Directive 2011/92/EU, relating to assessments of the environmental impact of certain public and private projects, pursuant to articles 1 and 14 of Law 114 of 9 July 2015, published in Official Gazette no. 156 of 6 July 2017**

The Legislative Decree, approved in implementation of the delegation contained in Law 114 of 9 July 2015, implements Directive 2014/52/EU regarding environmental impact assessments, thereby extensively amending the national regulations. The Decree establishes a new preliminary technical committee, reporting to the Ministry of the Environment, which may use the EIA-SEA Commission to carry out its preliminary activities. It also introduces a pre-screening procedure to check with the competent authority which design changes will impact the environment to the extent of requiring a screening procedure or an EIA to be carried out. Two environmental impact

assessment procedures are then established: a simple EIA procedure, which leads to the issue of EIA clearance; and a procedure for obtaining all-inclusive clearance, including EIA clearance and other consents pertaining to environmental matters.

- **Law 124 of 4 August 2017, “Annual Markets and Competition Law”, published in Official Gazette no. 189 of 14 August 2017**

This Law regulates the deregulation process after 1 July 2019 and, with regard to wholesale energy products as per EU Regulation 1227/2011, has validated and confirmed the effectiveness of the close-out netting provision, even in the event of the launch of a turnaround procedure, a financial restructuring, or insolvency or pre-insolvency proceedings, with or without divestment of the debtor, involving one of the parties.

- **Decree issued by the Ministry for Economic Development and the Ministry of the Environment and Land and Sea Protection of 10 November 2017, regarding adoption of the National Energy Strategy**

In the Official Gazette of 11 December 2017, it was announced that the new National Energy Strategy had been adopted by the Decree of 10 November 2017. The document sets out energy and environmental policy objectives - in terms of competitiveness, cuts to emissions and security of supply - and sets out the consequent actions to be taken by 2030.

Other legislation

- *Legislative Decree 257 of 16 December 2016, which implements Directive 2014/94/EU regarding the creation of an alternative fuels infrastructure (DAFI), published in Official Gazette no. 10 of 13 January 2017.*
- *Law Decree 50 of 24 April 2017, “Urgent financial provisions, initiatives in favour of local authorities, further actions for areas affected by earthquakes and development measures”, published in Official Gazette no. 95 of 24 April 2017, and converted into Law 96 of 21 June 2017, published in Official Gazette no. 144 of 23 June 2017.*
- *Law Decree 91 of 20 June 2017 regarding “Urgent measures relating to economic growth in southern Italy”, published in Official Gazette no. 141 of 20 June 2017, converted into Law 123 of 20 June 2017, and published in Official Gazette no. 188 of 12 June 2017.*
- *Presidential Decree 120 of 13 June 2017, “Simplified regulations regarding the management of excavated earth and rocks”, pursuant to article 8 of Law Decree 133 of 12 September 2014, converted, with amendments, into Law 164 of 11 November 2014.*
- *Law 167 of 20 November 2017, “Provisions for the fulfilment of obligations deriving from Italy’s membership of the European Union - European Law 2017”, published in Official Gazette no. 277 of 27 November 2017.*
- *Minister for Economic Development Decree of 21 December 2017, entitled “Provisions regarding the reduction of tariffs to cover general system charges for energy-intensive companies”, published on the website of the Ministry for Economic Development, with notice published in Official Gazette no. 300 of 27 December 2017.*
- *Law 205 of 27 December 2017 (2018 Budget Law), published in Official Gazette no. 302 of 29 December 2017.*

Resolutions of the Italian Regulatory Authority for Energy, Networks and the Environment

A summary is provided below of the principal resolutions adopted by Italy's Regulatory Authority for Energy, Networks and the Environment (ARERA) during 2017 and, subsequently, up to the date of preparation of this Annual Report.

- **Resolution 300/2017/R/eel** - Initial opening up of the dispatching services market to electricity demand and generating units, including those from renewable sources that are not already enabled, as well as storage systems. Establishment of pilot projects to draw up the integrated electricity dispatching document in line with the European balancing code;
- **Resolution 372/2017/R/eel** - Approval of the regulations, prepared by Terna Spa pursuant to Resolution no. 300/2017/R/eel, regarding the pilot project relating to participation of demand in the dispatching services market. Amendments to Authority Resolution 300/2017/R/eel;
- **Resolution 583/2017/R/eel** - Approval of the regulations, prepared by Terna Spa pursuant to Resolution no. 300/2017/R/eel, regarding the pilot project relating to participation of distributed generation, as enabled virtual generating units, in the dispatching services market;
- **Resolution 419/2017/R/eel** - Transitional evaluation of effective imbalances pending the definition of the nodal pricing imbalances regime;
- **Resolution 696/2017/R/eel** and **Resolution 799/2017/R/eel** - Measures regarding essential plants in 2018. Amendments and additions to Authority resolution 111/06;
- **Resolution 852/2017/R/eel** - Update, for the three-year period 2018-2020, of the regulations governing procedures for the forward supply of interruptible electricity resources. Approval of the new regulations regarding procedures and the new standard contract relating to the provision of these services;
- **Resolution 856/2017/R/eel** - Amendments to Authority Resolutions 111/06, 653/2015/R/eel and 627/2016/R/eel. Verification of the compliance of the code relating to transmission, dispatching, and grid development and security, with regard to grid development and the quality of the electricity service;
- **Resolution 127/2017/R/eel** - Resilience of electricity transmission and distribution networks: extension of automatic compensation for end users, at the grid operator's expense;
- **Resolution 579/2017/R/eel** - Approval of the list of projects for development of the National Transmission Grid, eligible for the transitional investment incentives mechanism, for the period 2016-2019;
- **Resolution 654/2017/R/eel** - Provisions regarding the document describing scenarios for the 10-year National Transmission Grid development plan and coordination of the related activities between the electricity and natural gas sectors;
- **Opinion 862/2017/I/eel** - Assessment of the draft 2017 ten-year National Transmission Grid development plan;
- **Resolution 881/2017/R/eel** - Determination of the premium relating to output-based regulation of the electricity transmission service for 2016, and the efficiency premium pursuant to Authority Resolution 654/2015/R/eel;

-
- **Resolution 883/2017/R/eel** - Update of tariffs for the provision of electricity transmission services, for 2018;
 - **Resolution 884/2017/R/eel** - Initial implementing provisions regarding incentive mechanisms relating to transmission service outputs;
 - **Resolution 909/2017/R/eel** - Review of dispatching charges, from 1 January 2018
 - **922/2017/R/eel** - Completion of the tariff structure reform regarding general system charges for non-domestic customers in the electricity sector and coordination with the new system for granting subsidies to energy-intensive companies. Amendments and additions to the integrated provisions for the delivery of electricity transmission and distribution services, including with regard to household users.

Other information

Additional information is presented below in accordance with specific statutory or industry requirements.

Treasury shares

The Parent Company does not directly or indirectly hold any of its own shares or the shares of CDP Reti SpA or Cassa Depositi e Prestiti SpA, nor has it purchased or sold any such shares during the reporting period.

Related party transactions

Related party transactions entered into by the Terna Group in 2017 primarily regard services forming part of its ordinary activities and provided under normal market conditions, as described in greater detail in the consolidated financial statements for the year ended 31 December 2017²⁹.

The Parent Company's Corporate Governance rules ensure that such transactions are conducted in accordance with the rules governing procedural and substantial correctness and on an arm's length basis, and in keeping with the regulations for transparent reporting to the market.

No material transactions³⁰ were carried out in 2017, nor were any transactions subject to the reporting requirements applicable in the event of exemptions applied in accordance with the relevant regulations³¹.

Information on ownership structures

The disclosures required by art. 123-*bis* "Information on ownership structures" of the Consolidated Law on Financial Intermediation (Legislative Decree 58 of 24 February 1998) are provided in a separate document approved by Terna's Board of Directors ("Report on Corporate Governance and Ownership Structures" for 2017, available on Terna SpA's website (www.terna.it) - in the section "Investor Relations").

²⁹ Relations with members of the Parent Company's Board of Statutory Auditors, with particular regard to their remuneration, are described in the notes to the item, "Services" in the notes to the consolidated and separate financial statements for the year ended 31 December 2017. In addition, in implementation of CONSOB Resolution 18049 of 23 December 2011, disclosures regarding the remuneration of "*members of management and supervisory bodies and general managers*", and their shareholdings in the Company and those of the other persons referred to in the above article, are included in the annual Remuneration Report published in accordance with the law.

³⁰ These are related party transactions classified in compliance with Annex 3 to the "Regulations on related party transactions" (adopted with CONSOB Resolution 17221 of 12 March 2010, as amended by CONSOB Resolution 17389 of 23 June 2010).

³¹ As "*transactions falling within the scope of the ordinary activities of the Company or its subsidiaries or associates or of financing activities related thereto, provided that the transactions are conducted on equivalent to market or standard terms and conditions*".

Attestations pursuant to article 2.6.2, paragraphs 8 and 9 of the Regulations for the markets organised and managed by Borsa Italiana SpA, relating to the conditions described in articles 36 and 37 of the CONSOB's Markets Regulation (no. 16191/2007) as amended by resolution no. 20249 of 28 December 2017 in the O. G. no.1 of 2 January 2018.

With reference to article 36 of the Regulation implementing the provisions of Legislative Decree 58 of 24 February 1998 regarding markets, adopted with Resolution 16191/2007, as amended by the resolutions of art. 15 of the new Regulations mentioned above adopted with the Consob resolution no. 20249 of 28 December 2017 (the "CONSOB Markets Regulation"), Terna SpA does not hold any significant controlling interests, as defined in the above regulations, in companies incorporated and regulated under the laws of countries not belonging to the European Union.

With regard to the provisions of article 37 of the same CONSOB Markets Regulation, and to the related new resolutions of article 16 of the new Regulations mentioned above, Terna SpA is subject to the de facto control of Cassa Depositi e Prestiti SpA, exercised through CDP Reti SpA (a joint-stock company controlled by Cassa Depositi e Prestiti SpA), which holds a 29.851% interest in the Parent Company. The checks, providing confirmation of the above situation of control, were conducted by Cassa Depositi e Prestiti and notified to the Company and the CONSOB with effect from 19 April 2007 and, subsequently, by letter dated 30 October 2014 and 2 December 2014. At this time, there are no formal arrangements for the management and coordination of the Company, nor have any such rights been exercised. Terna SpA conducts its business either directly or through its subsidiaries in conditions of operational and contractual independence.

Participation in the regulatory simplification process introduced by CONSOB Resolution 18079 of 20 January 2012

Pursuant to art. 3 of CONSOB Resolution 18079 of 20 January 2012, Terna has elected to adopt the simplified regime provided for in articles 70, paragraph 8, and 71, paragraph 1-*bis* of CONSOB Regulation 11971 of 14 May 1999, as amended (the CONSOB Regulations for Issuers). As a result, Terna exercises the exemption from disclosure requirements provided for in the above Regulations in respect of transactions of a significant nature involving mergers, spin-offs, capital increases involving contributions in kind, acquisitions and disposals.



Changes in the dimensions of the NTG

Below are details of changes in the dimensions of the grid with respect to the situation at 31 December 2016.

DETAILS OF ELECTRICITY SUBSTATIONS OWNED BY THE TERNA GROUP*

(AT 31 DECEMBER)	UNIT OF MEASUREMENT	2017	2016	CHANGE	% CHANGE
380 kV					
Substations	no.	164	161	3	1.86
Power transformed	MVA	114,008	110,708	3,300	2.98
220 kV					
Substations	no.	150	150	0	0.00
Power transformed	MVA	31,317	30,837	480	1.56
Lower voltages (≤150 kV)					
Substations	no.	557	544	13	2.39
Power transformed	MVA	3,890	3,911	(21)	(0.52)
Total					
Substations	no.	871	855	16	1.87
Power transformed	MVA	149,215	145,456	3,760	2.58

* MVA are calculated to three decimal places and rounded to the nearest whole number. Percentages are calculated to five decimal places and rounded to two decimal places.

DETAILS OF POWER LINES OWNED BY THE TERNA GROUP*

(AT 31 DECEMBER)	UNIT OF MEASUREMENT	2017	2016	CHANGE	% CHANGE
380 kV					
Length of circuits	km	12,413	12,314	99	0.80
Length of lines	km	11,300	11,238	62	0.55
220 kV					
Length of circuits	km	11,667	11,698	(31)	(0.26)
Length of lines	km	9,338	9,363	(26)	(0.27)
Lower voltages (≤150 kV)					
Length of circuits	km	48,801	48,832	(31)	(0.06)
Length of lines	km	45,724	45,765	(41)	(0.09)
Totale					
Length of circuits	km	72,881	72,844	38	0.05
overhead	km	69,567	69,618	(51)	(0.07)
underground cables	km	1,852	1,804	48	2.64
submarine cables	km	1,463	1,422	41	2.86
Length of lines	km	66,362	66,366	(4)	(0.01)
overhead	km	63,047	63,140	(93)	(0.15)
underground cables	km	1,852	1,804	48	2.64
submarine cables	km	1,463	1,422	41	2.86
Incidence of direct current connections (200 - 380 - 500 kV)					
Circuits	km	2,077	2,066		
% of total	%	2.85	2.85		
Lines	km	1,757	1,746		
% of total	%	2.65	2.63		

* Km are calculated to three decimal places and rounded to the nearest whole number. Percentages are calculated to five decimal places.

PRINCIPAL CHANGES IN THE SIZE OF THE TERNA GROUP'S INFRASTRUCTURE

Substations

New plant:

The following substations **entered service**:

- transformer substation at Udine South [UD] (7 380 kV bays and 5 220 kV bays);
- transformer substation at Benevento III [BN] (3 380 kV bays and 2 150 kV bays);
- transformer substation on Capri [NA] (3 150 kV bays);
- switching substation at Milan Marcello [MI] (5 220 kV bays)
- switching substation at Oppido [PZ] (6 150 kV bays);
- switching substation at Foggia Rignano [FG] (4 150 kV bays);
- switching substations at Cirò [KR], Torre Annunziata [NA] and Tursi [MT] (3 150 kV bays each);
- switching substation at Vaglio [PZ] (2 150 kV bays);
- switching substation at Pietramala [FI] (4 132 kV bays);
- switching substation at Cornegliano [LO] (2 132 kV bays);

and the following were **acquisitions**:

- transformer substation at Ponti sul Mincio [MN] (5 220 kV bays and 11 132 kV bays);
- switching substation at Macchialupo [AV] (4 150 kV bays).

The Cedegolo [BS] substation was **decommissioned**.

Existing plant:

- reclassification from 220 kV to 380 kV of the Melilli substation (7 380 kV bays);
- 15 new line bays for the substations at Priolo (2 380 kV bays), Grugliasco (1 220 kV bay), Cardano (4 132 kV bays), Brescia San Bartolomeo (3 132 kV bays), Castelpagano, Genzano and Rome North (1 150 kV bay each), Baggio and Pian Camuno (1 132 kV bay each) entered service;
- 13 new machine and/or power factor correction bays in the substations of Palo del Colle (2 380 kV bays and 2 150 kV bays), Melfi (1 380 kV bay and 1 150 kV bay), Turbigio 1-2 (1 380 kV bay), Melilli (2 220 kV bays and 1 150 kV bay), Rotonda 150 (1 150 kV bay), Bistagno and Cappuccini (1 132 kV bay each) entered service;
- 6 new parallel and/or connector bays in the substations of Palo del Colle (1 150 kV bay), Bistagno and Pian Camuno (2 132 kV bays each), Marginone (1 132 kV bay);
- decommissioning and/or demolition of 31 bays at the substations of Porto Tolle (4 380 kV bays and 4 132 kV bays), Sarmato (3 220 kV bays), Livorno Marzocco (2 220 kV bays and 3 132 kV bays), Stura (1 220 kV bay), Rome North (2 150 kV bays and 4 60 kV bays), Rotonda 220 (2 150 kV bays), Ceprano (1 150 kV bay), Bistagno and Brescia San Bartolomeo (2 132 kV bays each), Ospitale (1 132 kV bay).

The subsidiary, **Rete S.r.l.** acquired 3 132 kV substations, 5 132 kV bays and 6 66 kV bays from RFI SpA.

Transformers

The following transformers **entered service**:

- 2 new 380/220 kV autotransformers of 400 MVA and 1 new 380 / 150 kV autotransformer of 250 MVA due to reclassification of the Melilli substation;
- 2 new 380/220 kV autotransformers of 400 MVA each due to the entry into service of the Udine South substation;
- 1 new 380/150 kV autotransformer of 400 MVA due to the entry into service of the Benevento III substation;
- 2 new 380/150 kV autotransformers of 400 MVA at the Palo del Colle substation;
- 1 new 380/150 kV autotransformer of 250 MVA at the Melfi substation;
- 1 new 220/15 kV transformer of 230 MVA due to the entry into service of the new Favara synchronous condenser;
- 1 new 150/20 kV transformer of 25 MVA at the Rotonda 150 substation;
- 1 new 150/6 kV transformer of 80 MVA at the Capri substation;

and the following **further changes** occurred:

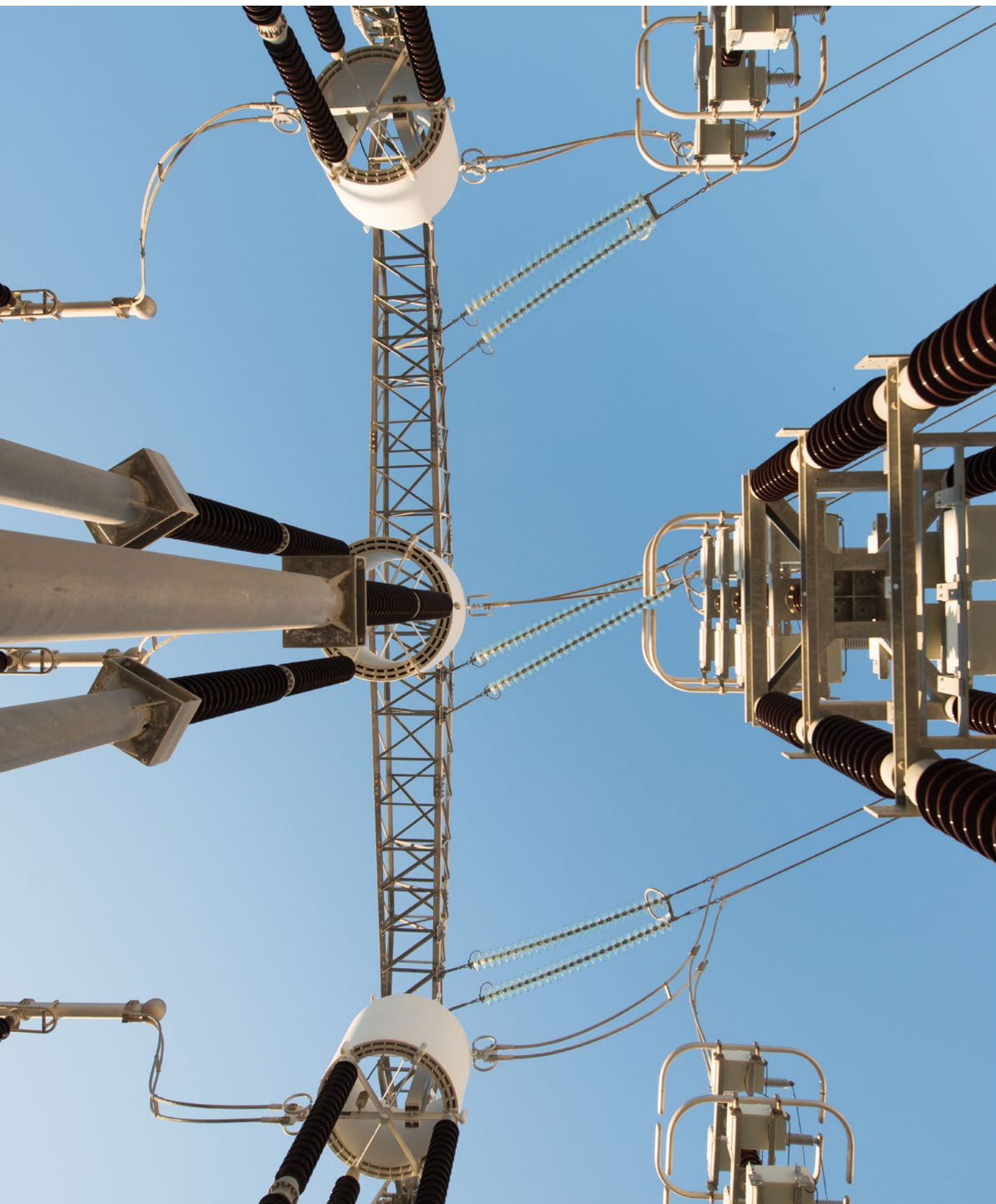
- replacement of 1 380/132 kV autotransformer of 250 MVA with similar equipment with the same capacity at the Parma Vigheffio substation;
 - replacement of 1 380/132 kV autotransformer of 250 MVA with similar equipment with the same capacity at the Parma Vigheffio substation;
 - decommissioning of 1 150/60/10 kV transformer of 100 MVA at the Rome North substation;
 - decommissioning of 2 150/20 kV transformers with a total of 22.5 MVA at the Rotonda 220 substation.
-

Power lines

- **entry into service** of 21 new power lines amounting to a total of 189.1 km of circuit: Redipuglia - Udine South 380 kV (2 connections of 20.9 km each, overhead line), Udine West - Udine South 380 kV (2 connections of 18.3 km each, overhead line), Melilli - Priolo 380 kV (2 connections of 3.2 km each in cable), Poggioreale - Secondigliano 220 kV (7.3 km in cable), Ricevitrice North - Milan Marcello 220 kV (6.8 km in cable), Milan Marcello - Gadio 220 kV (3.4 km in cable), Capri - Torre Annunziata 150 kV (30.5 km in cable, including 29.5 km submarine), Oppido Lucano - Genzano 150 kV (2 connections amounting to a total of 15.3 km, overhead line), Oppido Lucano - Vaglio 150 kV (19.7 km of overhead line), Roma North - Monterotondo 150 kV (6.3 km in cable and 4.2 km of overhead line), Santa Gilla - Porto Canale 150 kV (3.8 km in cable), Casuzze - Mulini primary substation 150 kV (3.2 km in cable), Villafranca Tirrena - Villafranca primary substation 150 kV (1.3 km in cable), San Bartolomeo - Brescia North 132 kV (0.3 km in cable), Capri - SIPPIC power station 6 kV (3 connections of 0.8 km each in cable);
- **acquisition from third parties** of 3 150 kV lines making a total of 55.2 km of circuit;
- **entry into service** of 2 short connections between adjacent plants (1 150 kV and 1 132 kV) amounting to a total of 0.1 km;
- **construction** of 12 in-out derivations on lines in operation, with an overall increase of the same number of circuits and a decrease of 2.1 km of circuits, of which: 4 more lines and 1.8 km at 150 kV and 8 more lines and a reduction of 3.9 km at 132 kV;
- **construction of variants, rigid derivations, re-routings and/or changes to grid distribution** with a total reduction of 36.4 km of circuits, of which: 3.3 km more at 380 kV, 19.9 km less at 220 kV, 0.2 km more at 150 kV, 1.0 km less at 132 kV, 13.0 km less at 60 kV, 6.0 km less at 50 kV;
- **decommissioning and/or demolition** of 11 lines in operation amounting to a total of 85.8 km of circuit, of which: 3 lines and 27.4 km at 220 kV, 2 lines and 33.2 km at 150 kV, 1 line and 0.1 km at 132 kV, 5 lines and 25.1 km at 60 kV.

With regard to the subsidiary, Rete Srl:

- 2 132 kV lines extending for 17.3 km if circuit was acquired from RFI SpA;
 - 3 in-out derivations on 132 kV lines in operation were built with a an overall increase of the same number of circuits and 5.2 km of circuit;
 - re-routings and/or changes to grid distribution with an overall reduction of 2 lines and 0.8 km of 66 kV circuit.
-



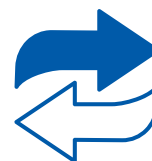


Alternative Performance Indicators (APIs)

In accordance with the guidelines in ESMA/2015/1415, the alternative performance indicators used in this Integrated Report are described below.

INDICATOR	DESCRIPTION
OPERATING RESULTS	
Operating profit/(loss) - EBIT	is an indicator of operating performance obtained by adding Net financial income/(expenses) to Profit/(Loss) before tax .
Gross operating profit/(loss) - EBITDA	is an indicator of operating performance obtained by adding Amortisation, depreciation and impairment losses to Operating profit/(loss) (EBIT) .
TAX RATE	is the amount of tax paid as a proportion of pre-tax profit and is based on the ratio of Income tax expense to Profit/(Loss) before tax .
FINANCIAL POSITION	
Net working capital	is an indicator of financial position, showing the entity's liquidity position; it is based on the difference between current assets and current liabilities of a non-financial nature, as presented in the statement of financial position
Gross invested capital	is an indicator of financial position, showing the entity's total assets and is obtained by adding Net non-current assets and Net working capital .
Net invested capital	is calculated by deducting Sundry provisions from gross invested capital
CASH FLOW	
Net debt	is an indicator of the entity's financial structure and is obtained by deducting Cash and cash equivalents and Financial assets from Short- and long-term financial liabilities and the related derivative instruments
Free cash flow	is the cash generated by operating activities less capital expenditure and is the difference between Cash flow from operating activities and Cash flow for investing activities

Reconciliations



In accordance with the guidelines in ESMA/2015/1415, reconciliations of the reclassified income statement and statement of financial position and of net debt and cash flow of the Terna Group and Terna SpA with the related statutory income statement and statement of financial position are shown below.

RECONCILIATION OF THE TERNA GROUP'S RECLASSIFIED INCOME STATEMENT AND STATEMENT OF FINANCIAL POSITION AND NET DEBT

THE GROUP'S RECLASSIFIED INCOME STATEMENT	€M	CONSOLIDATED INCOME STATEMENT
Regulated revenue	1,946.1	"Revenue from sales and services", totalling €2,081.9 million and "Other operating income", totalling €63.6 million
Non-regulated revenue	189.1	
Revenue from overseas activities	10.3	
Revenue from construction services performed under concession	102.5	"Revenue from sales and services", totalling €102.1 million and "Other operating income", totalling €0.4 million
Personnel expenses	252.8	"Personnel expenses" less cost of construction services performed under concession in accordance with IFRIC 12 (€4.4 million)
Cost of services, leases and rentals	170.5	"Services" less cost of construction services performed under concession in accordance with IFRIC 12 (€11.9 million)
Materials	75.4	"Raw and consumable materials used" less cost of construction services performed under concession in accordance with IFRIC 12 (€82.7 million)
Other costs	35.9	Other operating costs
Quality of service	10.5	
Cost of construction services performed under concession	4.4 11.9 82.7	
Net financial income/(expenses)	(88.8)	Points 1, 2 and 3 of letter C "Financial income and expenses"
Income tax expense	294.4	"Income tax expense"

(continued)

THE GROUP'S RECLASSIFIED STATEMENT OF FINANCIAL POSITION	€M	CONSOLIDATED STATEMENT OF FINANCIAL POSITION
Financial assets	207.9	"Investment accounted for using the equity method", "Other non-current assets" and "Non-current financial assets", excluding the value of accrued fees on available financing (€4.3 million)
Net energy-related pass-through payables	(852.7)	"Trade receivables" for the value of energy-related pass-through receivables (€745.9 million) and "Trade payables" for the value of energy-related pass-through payables (€1,598.6 million)
Net receivables resulting from Regulated Activities	335.1	"Trade receivables" relating to the value of receivables resulting from Regulated Activities (€339.1 million) and "Trade payables" relating to the value of payables resulting from Regulated Activities (€4 million)
Net trade payables	(714.4)	"Trade payables" less the value of energy-related pass-through payables (€1,598.6 million) and payables resulting from Regulated Activities (€4 million) and "Trade receivables" less the value of energy-related pass-through receivables (€745.9 million) and the value of receivables resulting from Regulated Activities (€339.1 million)
Net tax assets	105.9	"Tax assets", "Other current assets" for the value of other tax assets (€76.8 million), "Other current liabilities" for the value of other tax liabilities (€7.8 million) and "Tax liabilities"
Other liabilities, net	(359.1)	"Other non-current liabilities", "Other current liabilities" less other tax liabilities (€7.8 million), "Inventories" and "Other current assets" less other tax assets (€76.8 million)
Sundry provisions	(355.8)	"Employee benefits", "provisions for risks and charges" and "Deferred tax liabilities"
Net debt	7,796.4	"Long-term borrowings", "Current portion of long-term borrowings", "Non-current financial liabilities", "Short-term borrowings", "Cash and cash equivalents", "Non-current financial assets" for the value of accrued fees on available financing (€4.3 million), "Current financial assets" and "Current financial liabilities"

THE GROUP'S NET DEBT	€M	CONSOLIDATED STATEMENT OF FINANCIAL POSITION
"Bond issues" and "Borrowings"	8,671.6	Corresponds with "Long-term borrowings"
"Derivative financial instruments" - medium/long-term	10.5	Corresponds with "Non-current financial liabilities"
"Bond issues (current portions)" and "Variable rate borrowings (current portions)"	884.3	Corresponds with "Current portions of long-term borrowings"
Other current financial liabilities, net	101.2	Corresponds with "Current financial assets", "Current financial liabilities" and "Non-current financial assets" for the value of accrued fees on available financing (€4.3 million).

RECONCILIATION OF THE TERNA GROUP'S CASH FLOW

€M	CASH FLOW 2017	RECONCILIATION FINANCIAL STATEMENTS	CASH FLOW 2016	RECONCILIATION FINANCIAL STATEMENTS
- Profit for the year	694.2		627.9	
- Amortisation, depreciation and impairment losses	526.5		508.7	
- Net change in provisions	(28.8)		11.1	
Employee benefits		(23.4)		(1.4)
Provisions for risks and charges		27.9		39.8
Deferred tax liabilities		(33.3)		(27.3)
- Net losses/(gains) on sale of assets ⁽¹⁾	(2.1)		(9.8)	
Operating cash flow	1,189.8		1,137.9	
- Change in net working capital:	408.3		112.8	
Inventories		(4.8)		1.6
Trade receivables		176.0		(73.3)
Tax assets		(17.2)		14.3
Other current assets		(71.6)		67.6
Trade payables		217.2		136.8
Tax liabilities		(8.1)		(7.3)
Other liabilities		116.8		(26.9)
- Other changes in non-current assets	36.1		48.5	
Property, plant and equipment ⁽²⁾		137.5		65.5
Non-current financial assets		(98.3)		(17.5)
Other non-current assets		(0.4)		(2.5)
Investments accounted for using the equity method		(2.7)		3.0
Cash flow from operating activities	1,634.2		1,299.2	
Capital expenditure				
- Total Capital expenditure	(1,033.9)		(854.3)	
Property, plant and equipment ⁽²⁾		(993.8)		(812.8)
Intangible assets ⁽³⁾		(40.1)		(41.5)
Total cash flow from (for) investing activities	(1,033.9)		(854.3)	
Free cash flow	600.3		444.9	
- Cash flow hedge reserve after taxation and other movements in equity attributable to owners of the Parent ⁽⁴⁾	(2.0)		(12.3)	
- Dividends paid to Parent Company's shareholders ⁽⁴⁾	(418.4)		(406.2)	
Change in net debt	179.9		26.4	
- Change in borrowings	673.6		677.7	
Non-current financial assets		325.7		361.8
Current financial assets		26.0		38.1
Non-current financial liabilities		(2.3)		5.5
Long-term borrowings		267.2		(112.1)
Short-term borrowings		97.9		(396.5)
Current portion of long-term borrowings		(20.2)		781.6
Current financial liabilities		(20.7)		(0.7)
- Change in cash and cash equivalents	853.5		704.1	

¹ Included in "Other operating income" and "Other operating costs", respectively, in the consolidated financial statements.

² See note 12 to the financial statements.

³ See note 14 to the financial statements.

⁴ See the consolidated statement of changes in equity.

**RECONCILIATION OF THE TERNA SPA'S RECLASSIFIED INCOME STATEMENT
AND STATEMENT OF FINANCIAL POSITION AND NET DEBT**

TERNA'S RECLASSIFIED INCOME STATEMENT	€M	INCOME STATEMENT
Transmission revenue	1,674.5	"Revenue from sales and services"
Dispatching and metering revenue	111.9	"Revenue from sales and services"
Revenue from construction services performed under concession	21.1	"Revenue from sales and services"
Other operating income	144.0	"Revenue from sales and services", totalling €53.9 million and "Other operating income"
Personnel expenses	65.7	"Personnel expenses" less cost of construction services performed under concession in accordance with IFRIC 12 (€0.3 million)
Cost of services. leases and rentals	332.1	"Services" less cost of construction services performed under concession in accordance with IFRIC 12 (€17.7 million)
Materials	7.0	"Raw and consumable materials used" less cost of construction services performed under concession in accordance with IFRIC 12 (€3.1 million)
Other costs	28.5	Other operating costs
Quality of service	10.5	
Cost of construction services performed under concession	0.3	"Personnel expenses"
	17.7	"Services"
	3.1	"Raw and consumable materials used"
Net financial income/ (expenses)	(89.8)	Points 1 and 2 of letter C " Financial income and expenses"
Income tax expense	261.6	"Income tax expense"

TERNA'S RECLASSIFIED STATEMENT OF FINANCIAL POSITION	€M	INCOME STATEMENT
Financial assets	1,010.1	"Non-current financial assets" less the value of accrued fees on Revolving Credit Facility (€3.2 million) and "Other non-current assets"
Net energy-related pass-through payables	(874.4)	"Trade receivables" for the value of energy-related pass-through receivables (€745.9 million) and "Trade payables" for the value of energy-related pass-through payables (€1,620.3 million)
Net receivables resulting from Regulated Activities	335.1	"Trade receivables" relating to the value of receivables resulting from Regulated Activities (€339.1 million) and "Trade payables" relating to the value of payables resulting from Regulated Activities (€4 million)
Net trade payables	(424.5)	"Trade payables" less the value of energy-related pass-through payables (€1,620.3 million) and payables resulting from Regulated Activities (€4 million) and "Trade receivables" less the value of energy-related pass-through receivables (€745.9 million) and the value of receivables resulting from Regulated Activities (€339.1 million)
Net tax assets	106.8	"Tax assets", "Other current assets" for the value of other tax assets (€50.5 million), "Other current liabilities" for the value of other tax liabilities (€1.6 million) and "Tax liabilities"
Other liabilities, net	(287.3)	"Other non-current liabilities", "Other current liabilities" less other tax liabilities (€1.6 million), "Inventories" and "Other current assets" less other tax assets (€50.5 million)
Sundry provisions	(273.5)	"Employee benefits", "provisions for risks and charges" and "Deferred tax liabilities"
Net debt	8,046.5	"Long-term borrowings", "Current portion of long-term borrowings", "Non-current financial liabilities", "Short-term borrowings", "Cash and cash equivalents", "Non-current financial assets" for the value of accrued fees on Revolving Credit Facility (€3.2 million), "Current financial assets" and "Current financial liabilities"

TERNA'S NET DEBT	€M	STATEMENT OF FINANCIAL POSITION
"Bond issues" and "Borrowings"	9,522.5	Corresponds with "Long-term borrowings" and "Current portions of long-term borrowings"
"Derivative financial instruments"	9.9	Corresponds with "Non-current financial liabilities"
"Short-term borrowings and other financial liabilities"	192.3	Corresponds to "Short-term borrowings", "Current financial liabilities", "Current financial assets" and "Non-current financial assets" for the value of accrued fees on Revolving Credit Facility (€3.2 million)
"Net credit/debit balance on intercompany account " and "Cash and cash equivalents"	(1,678.2)	Corresponds to "Cash and cash equivalents"

RECONCILIATION OF THE TERNA SPA'S CASH FLOW

€M	CASH FLOW 2017	RECONCILIATION FINANCIAL STATEMENTS	CASH FLOW 2016	RECONCILIATION FINANCIAL STATEMENTS
- Profit for the year	640.0		535.5	
- Amortisation, depreciation and impairment losses	495.2		432.7	
- Net change in provisions	30.2		27.1	
<i>Employee benefits</i>		(17.0)		2.6
<i>Provisions for risks and charges</i>		31.5		54.2
<i>Deferred tax liabilities</i>		15.7		(29.7)
- Net losses/(gains) on sale of assets ⁽¹⁾	(1.7)		(7.7)	
Operating cash flow	1,163.7		987.6	
- Change in net working capital:	317.0		(37.2)	
<i>Inventories</i>		(5.4)		(0.1)
<i>Trade receivables</i>		229.2		(89.8)
<i>Tax assets</i>		(47.5)		11.6
<i>Other current assets</i>		13.8		35.9
<i>Trade payables</i>		144.0		4.5
<i>Tax liabilities</i>		(7.6)		(10.9)
<i>Other liabilities</i>		(9.5)		11.6
- Other changes in non-current assets	(567.4)		23.5	
<i>Property, plant and equipment</i> ⁽²⁾		(969.1)		64.7
<i>Intangible assets</i> ⁽³⁾		(1.6)		-
<i>Goodwill</i>		(101.6)		-
<i>Non-current financial assets</i>		504.9		(41.2)
Cash flow from operating activities	913.3		973.9	
Capital expenditure				
- Total Capital expenditure	(851.9)		(706.4)	
<i>Property, plant and equipment</i> ⁽²⁾		(813.4)		(667.1)
<i>Intangible assets</i> ⁽³⁾		(38.5)		(39.3)
Total cash flow from (for) investing activities	(851.9)		(706.4)	
Free cash flow	61.4		267.5	
- Dividends ⁽⁴⁾	(418.4)		(406.2)	
- Cash flow hedge reserve after taxation and other movements in equity ⁽⁴⁾	428.9		(12.6)	
Change in net debt	71.9		(151.3)	
- Change in borrowings	678.5		643.7	
Current financial assets		65.0		2.8
Non-current financial assets		326.8		361.8
Non-current financial liabilities		(2.8)		6.3
Long-term borrowings		238.5		(109.9)
Short-term borrowings		90.0		(398.2)
Current portion of long-term borrowings		(18.3)		781.6
Current financial liabilities		(20.7)		(0.7)
- Change in cash and cash equivalents	750.4		492.4	

⁽¹⁾ Included in "Other operating income" and "Other operating costs", respectively, in the financial statements.

⁽²⁾ See note 10 to the financial statements.

⁽³⁾ See note 12 to the financial statements.

⁽⁴⁾ See the statement of changes in equity.







Consolidated financial statements



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Consolidated financial statements

Consolidated income statement

		(€m)	
	NOTE	2017	2016
A - REVENUE			
1. Revenue from sales and services	1	2,184.0	2,032.6
<i>of which: related parties</i>		1,593.3	1,521.7
2. Other revenue and income	2	64.0	70.6
<i>of which: related parties</i>		6.7	-
Total revenue		2,248.0	2,103.2
B - OPERATING COSTS			
1. Raw and consumable materials	3	158.1	71.0
<i>of which: related parties</i>		0.1	-
2. Services	4	182.4	191.4
<i>of which: related parties</i>		25.7	43.0
3. Personnel expenses	5	257.2	268.0
- gross personnel expenses		321.0	325.1
- capitalised personnel expenses		(63.8)	(57.1)
<i>of which: related parties</i>		2.6	2.4
4. Amortisation, depreciation and impairment losses	6	526.5	508.7
5. Other operating costs	7	46.4	28.1
<i>of which: related parties</i>		0.2	0.1
Total costs		1,170.6	1,067.2
A-B OPERATING PROFIT/(LOSS)		1,077.4	1,036.0
C - FINANCIAL INCOME/(EXPENSES)			
1. Financial income	8	3.9	4.5
<i>of which: related parties</i>		-	-
2. Financial expenses	8	(96.5)	(105.5)
<i>of which: related parties</i>		(3.8)	(4.4)
3. Share of profit/(loss) of investees accounted for using the equity method	9	3.8	(1.8)
D - PROFIT/(LOSS) BEFORE TAX		988.6	933.2
E - INCOME TAX EXPENSE	10	294.4	305.3
F - PROFIT FOR THE YEAR		694.2	627.9
<i>Profit attributable to owners of the Parent</i>		688.3	633.1
<i>Profit attributable to non-controlling interests</i>		5.9	(5.2)
Earnings per share			
Basic earnings per share	11	0.342	0.315
Diluted earnings per share		0.342	0.315

Consolidated statement of comprehensive income

		(€m)	
	NOTE	2017	2016
PROFIT FOR THE YEAR		694.2	627.9
Other comprehensive income for the year reclassifiable to profit or loss			
- Cash flow hedges after taxation	22	5.5	(12.9)
- Gains/(Losses) from translation of financial statements in currencies other than the euro	22	(6.9)	-
Other comprehensive income for the year not reclassifiable to profit or loss			
- Actuarial gains/(losses) on provisions for employee benefits, after taxation	22	(0.4)	0.8
COMPREHENSIVE INCOME FOR THE YEAR		692.4	615.8
COMPREHENSIVE INCOME FOR THE YEAR ATTRIBUTABLE TO:			
<i>Owners of the Parent</i>		686.5	621.0
<i>Non-controlling interests</i>		5.9	(5.2)

Consolidated statement of financial position

		(€m)	
	NOTE	31 DECEMBER 2017	31 DECEMBER 2016
A - NON-CURRENT ASSETS			
1. Property, plant and equipment	12	12,752.8	12,368.9
<i>of which: related parties</i>		26.2	35.8
2. Goodwill	13	230.1	230.1
3. Intangible assets	14	275.6	285.9
4. Investments accounted for using the equity method	15	77.9	75.2
5. Non-current financial assets	16	120.1	347.5
<i>of which: related parties</i>		0.3	0.5
6. Other non-current assets	17	14.2	13.8
Total non-current assets		13,470.7	13,321.4
B - CURRENT ASSETS			
1. Inventories	18	14.8	10.2
2. Trade receivables	19	1,265.9	1,443.3
<i>of which: related parties</i>		407.1	291.7
3. Current financial assets	16	0.2	26.2
4. Cash and cash equivalents	20	1,989.2	1,135.7
<i>of which: related parties</i>		0.1	-
5. Income tax assets	21	36.9	19.7
6. Other current assets	17	139.1	67.5
Total current assets		3,446.1	2,702.6
TOTAL ASSETS		16,916.8	16,024.0

(€m)

	NOTE	31 DECEMBER 2017	31 DECEMBER 2016
C - EQUITY ATTRIBUTABLE TO OWNERS OF THE PARENT			
1. Share capital		442.2	442.2
2. Other reserves		820.4	815.3
3. Retained earnings/(accumulated losses)		2,001.7	1,789.7
4. Interim dividend		(149.3)	(144.9)
5. Profit for the year		688.3	633.1
Total equity attributable to owners of the Parent	22	3,803.3	3,535.4
D - EQUITY ATTRIBUTABLE TO NON-CONTROLLING INTERESTS			
Total equity attributable to owners of the Parent and non-controlling interests	22	25.7	19.8
E - NON-CURRENT LIABILITIES			
1. Long-term borrowings	23	8,671.6	8,404.4
<i>of which: related parties</i>		500.0	500.0
2. Employee benefits	24	80.7	104.1
3. Provisions for risks and charges	25	266.5	238.6
4. Deferred tax liabilities	26	8.6	41.9
5. Non-current financial liabilities	23	10.5	12.8
6. Other non-current liabilities	27	251.0	120.9
Total non-current liabilities		9,288.9	8,922.7
F - CURRENT LIABILITIES			
1. Short-term borrowings	23	118.0	20.1
2. Current portion of long-term borrowings	23	884.3	904.5
3. Trade payables	28	2,497.9	2,280.7
<i>of which: related parties</i>		46.1	69.8
4. Income tax assets	28	-	8.1
5. Current financial liabilities	23	105.7	126.4
<i>of which: related parties</i>		0.5	0.6
6. Other current liabilities	28	193.0	206.3
<i>of which: related parties</i>		5.6	4.6
Total current liabilities		3,798.9	3,546.1
TOTAL LIABILITIES AND EQUITY		16,916.8	16,024.0

Consolidated statement of changes in equity

31 DECEMBER 2016 - 31 DECEMBER 2017

SHARE CAPITAL AND RESERVES

	SHARE CAPITAL	LEGAL RESERVE	SHARE PREMIUM RESERVE	CASH FLOW HEDGE RESERVE
EQUITY AT 31 DECEMBER 2016	442.2	88.4	20.0	(18.2)
PROFIT FOR THE YEAR				
OTHER COMPREHENSIVE INCOME:				
- Change in fair value of cash flow hedges, net of tax effect				5.5
- Actuarial gains/(losses) on employee benefits, net of tax effect				
- Gains/(Losses) from translation of financial statements in currencies other than the euro				
Total other comprehensive income	-	-	-	5.5
COMPREHENSIVE INCOME	-	-	-	5.5
TRANSACTIONS WITH SHAREHOLDERS:				
- Appropriation of profit for 2016: <i>Retained earnings</i> <i>Dividends</i>				
- Interim dividend 2017				
Total transactions with shareholders	-	-	-	-
Other changes				
Total other changes	-	-	-	-
EQUITY AT 31 DECEMBER 2017	442.2	88.4	20.0	(12.7)

31 DECEMBER 2015 - 31 DECEMBER 2016

SHARE CAPITAL AND RESERVES

	SHARE CAPITAL	LEGAL RESERVE	SHARE PREMIUM RESERVE	CASH FLOW HEDGE RESERVE
EQUITY AT 31 DECEMBER 2015	442.2	88.4	20.0	(5.3)
PROFIT FOR THE YEAR				
OTHER COMPREHENSIVE INCOME:				
Change in fair value of cash flow hedges, net of tax effect				(12.9)
Actuarial gains/(losses) on employee benefits, net of tax effect				
Total other comprehensive income	-	-	-	(12.9)
COMPREHENSIVE INCOME	-	-	-	(12.9)
TRANSACTIONS WITH SHAREHOLDERS:				
- Appropriation of profit for 2015: <i>Retained earnings</i> <i>Dividends</i>				
- Interim dividend 2016				
Total transactions with shareholders	-	-	-	-
Other changes				
EQUITY AT 31 DECEMBER 2016	442.2	88.4	20.0	(18.2)

(€m)

OTHER RESERVES	RETAINED EARNINGS/ (ACCUMULATED LOSSES)	INTERIM DIVIDEND	PROFIT FOR THE YEAR	EQUITY ATTRIBUTABLE TO OWNERS OF THE PARENT	EQUITY ATTRIBUTABLE TO NON-CONTROLLING INTERESTS	EQUITY ATTRIBUTABLE TO OWNERS OF THE PARENT AND NON-CONTROLLING INTERESTS
725.1	1,789.7	(144.9)	633.1	3,535.4	19.8	3,555.2
			688.3	688.3	5.9	694.2
				5.5		5.5
(0.4)				(0.4)		(0.4)
	(6.9)			(6.9)		(6.9)
(0.4)	(6.9)	-	-	(1.8)	-	(1.8)
(0.4)	(6.9)	-	688.3	686.5	5.9	692.4
	219.1		(219.1)	-		-
		144.9	(414.0)	(269.1)		(269.1)
		(149.3)		(149.3)		(149.3)
-	219.1	(4.4)	(633.1)	(418.4)	-	(418.4)
-	(0.2)			(0.2)		(0.2)
-	(0.2)	-	-	(0.2)	-	(0.2)
724.7	2,001.7	(149.3)	688.3	3,803.3	25.7	3,829.0

(€m)

OTHER RESERVES	RETAINED EARNINGS/ (ACCUMULATED LOSSES)	INTERIM DIVIDEND	PROFIT FOR THE YEAR	EQUITY ATTRIBUTABLE TO OWNERS OF THE PARENT	EQUITY ATTRIBUTABLE TO NON-CONTROLLING INTERESTS	EQUITY ATTRIBUTABLE TO OWNERS OF THE PARENT AND NON-CONTROLLING INTERESTS
724.3	1,596.4	(140.7)	595.5	3,320.8	25.0	3,345.8
			633.1	633.1	(5.2)	627.9
				(12.9)		(12.9)
0.8				0.8		0.8
0.8	-	-	-	(12.1)	-	(12.1)
0.8	-	-	633.1	621.0	(5.2)	615.8
	193.5	140.7	(334.2)	-		-
			(261.3)	(261.3)		(261.3)
		(144.9)		(144.9)		(144.9)
-	193.5	(4.2)	(595.5)	(406.2)	-	(406.2)
	(0.2)			(0.2)		(0.2)
725.1	1,789.7	(144.9)	633.1	3,535.4	19.8	3,555.2

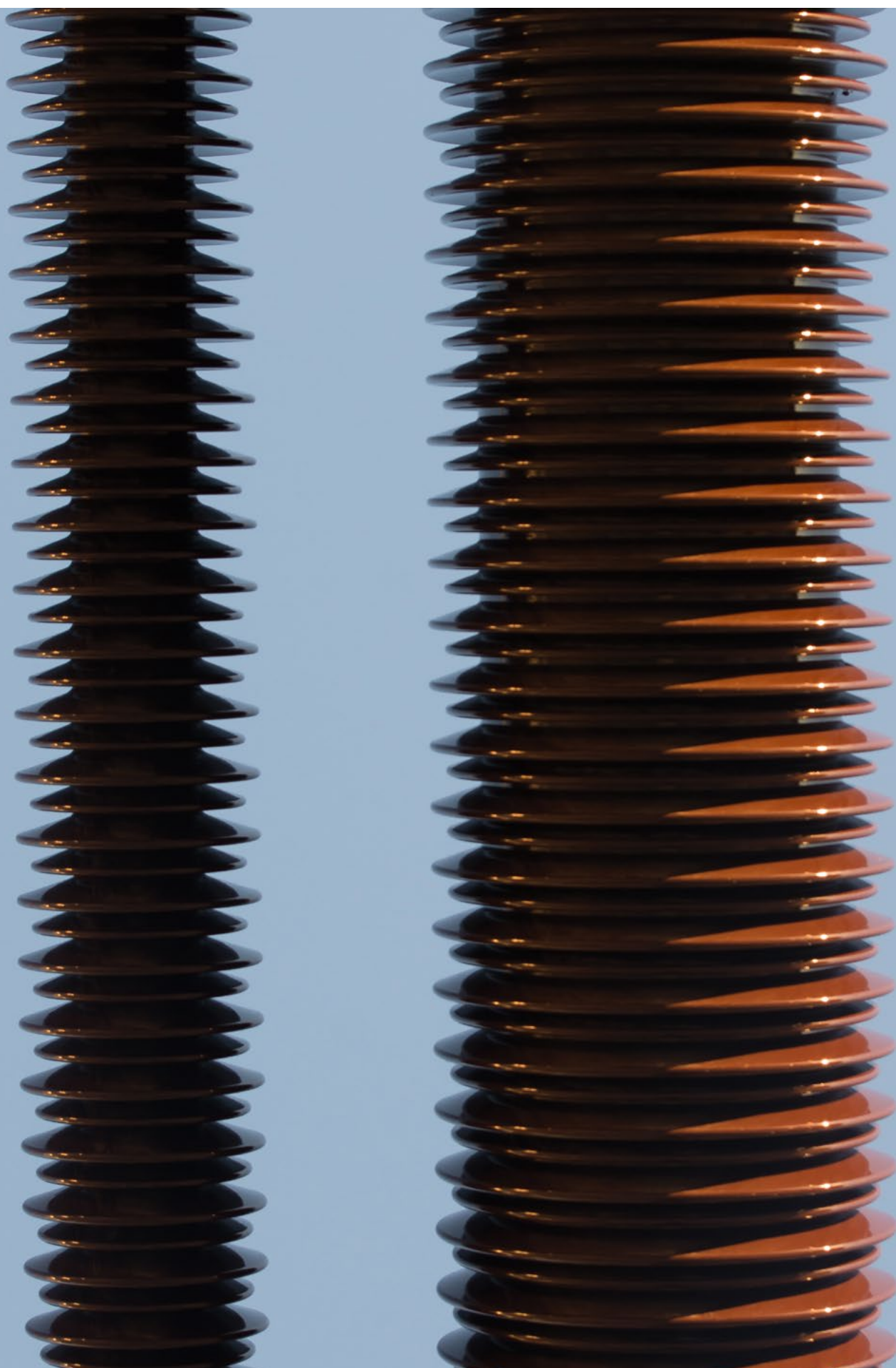
Consolidated statement of cash flows

	(€m)	
	2017	2016
PROFIT FOR THE YEAR	694.2	627.9
ADJUSTED BY:		
Amortisation, depreciation and impairment losses /(reversals of impairment losses) on non-current property, plant and equipment and intangible assets*	516.4	495.3
Accruals to provisions (including provisions for employee benefits) and impairment losses	74.1	60.6
(Gains)/Losses on sale of property, plant and equipment	(2.1)	(9.8)
Financial (income)/expense	82.8	100.7
Income tax expense	294.4	305.3
CASH FLOW FROM OPERATING ACTIVITIES BEFORE CHANGES IN NET WORKING CAPITAL	1,659.8	1,580.0
Increase/(decrease) in provisions (including provisions for employee benefits and taxation)	(69.2)	(17.6)
(Increase)/decrease in inventories	(4.8)	1.6
(Increase)/decrease in trade receivables and other current assets	89.7	(2.0)
Increase/(decrease) in trade payables and other current liabilities	200.2	99.0
Increase/(decrease) in other non-current liabilities	135.2	0.2
(Increase)/decrease in other non-current assets	(98.7)	(20.6)
Interest income and other financial income received**	352.0	479.1
Interest expense and other financial expenses paid**	(228.7)	(235.6)
Income tax paid	(343.8)	(324.1)
CASH FLOW FROM OPERATING ACTIVITIES [A]	1,691.7	1,560.0
- of which: related parties	(138)	31.3
Capital expenditure in non-current property, plant and equipment after grants received	(864.9)	(756.3)
Revenue from sale of non-current property, plant and equipment and intangible assets and other movements	9.4	12.4
Capitalised financial expenses	12.8	16.0
Capital expenditure in non-current intangible assets after grants received	(40.1)	(41.5)
(Increase)/decrease in investments in associates	(2.7)	3.0
(Increase)/decrease in other investments	-	(0.1)
CASH FLOW FOR INVESTING ACTIVITIES [B]	(885.5)	(766.5)
- of which: related parties	9.6	(2.2)
Dividends paid	(418.4)	(406.2)
Movements in short- and medium/long-term financial liabilities (including short-term portion)***	465.7	316.8
CASH FLOW FROM FINANCING ACTIVITIES [C]	47.3	(89.4)
INCREASE/(DECREASE) IN CASH AND EQUIVALENTS [A+B+C]	853.5	704.1
Cash and cash equivalents at beginning of year	1,135.7	431.6
Cash and cash equivalents at end of year	1,989.2	1,135.7

* After grants related to assets recognised in the income statement for the year

** Including cash flows generated from derivatives

*** After derivatives and impact of fair value adjustments



Notes

A. Accounting policies and measurement criteria

Introduction

Terna SpA's registered office is at Viale Egidio Galbani 70, Rome, Italy. The consolidated financial statements at and for the year ended 31 December 2017 include the Company's financial statements and those of its subsidiaries (the "Group"). The subsidiaries included within the scope of consolidation are listed below.

These consolidated financial statements were authorised for publication by the Board of Directors at the board meeting held on 21 March 2018.

The consolidated financial statements at and for the year ended 31 December 2017 are available for inspection on request at Terna SpA's registered office at Viale Egidio Galbani 70, Rome, or on the Company's website at www.terna.it.

The Board of Directors has also authorised the Chairwoman and the Chief Executive Officer to make any alterations to the form of the consolidated financial statements and any additions and adjustments to the sections concerning significant subsequent events.

The Terna Group is the largest independent transmission system operator in Europe and one of the leader operators in the world in terms of kilometres of line managed (more than 72 thousand km).

It is responsible for the transmission and management of power flows on the high-voltage (HV) and very high-voltage (VHV) grid throughout Italy, in order to guarantee a balance between demand and supply for energy (dispatching). It is also responsible for the planning, construction and maintenance of the grid. It acts as the Italian TSO (Transmission System Operator), having been granted a monopoly under a government concession, and is subject to regulation by Italy's Regulatory Authority for Energy, Networks and the Environment (ARERA) and the guidelines established by the Ministry for Economic Development. It ensures the security, quality and cost-effectiveness of the national electricity system and has the task of developing the grid and integrating it with the European grid. It ensures equal access for all grid users.

Compliance with IAS/IFRS

The consolidated financial statements at and for the year ended 31 December 2017 have been prepared in accordance with International Financial Reporting Standards (IFRS), International Accounting Standards (IAS) issued by the International Accounting Standards Board (IASB) and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC), as endorsed by the European Commission ("EU-IFRS").

This document has also been prepared taking into account the provisions of Legislative Decree 38 of 28 February 2005, of the Italian Civil Code and CONSOB Resolutions 15519 ("Provisions governing financial statements in implementation of art. 9, paragraph 3 of Legislative Decree 38/2005") and 15520 ("Amendments to the implementing rules for Legislative Decree 58/1998"), as well as CONSOB Communication DEM/6064293 ("Disclosure requirements for listed issuers and issuers of financial instruments that are widely held among the public pursuant to art. 116 of the Consolidated Law on Finance").

Basis of presentation

The consolidated financial statements consist of the statement of financial position, the income statement, the statement of comprehensive income, the statement of cash flows, the statement of changes in equity and the notes thereto.

In the statement of financial position, assets and liabilities are classified on a “current/non-current” basis, with separate reporting of assets and liabilities held for sale. Current assets, which include cash and cash equivalents, are those held for realisation, sale or consumption in the Group’s normal operating cycle; current liabilities are those expected to be settled in the Group’s normal operating cycle or within one year of the end of the financial year.

The income statement is classified on the basis of the nature of costs. The income statement is presented as two statements, the first of which (the income statement) presents revenue and expense items for the year; the second (the statement of comprehensive income) starts with the result for the year and then presents the revenue and expense items (including reclassification adjustments) that are recognised in equity rather than profit or loss for the year.

The statement of cash flows has been prepared using the indirect method.

The consolidated financial statements are accompanied by the Integrated Report for Terna SpA and the Group, which as from financial year 2008 has been prepared as a single document, exercising the option granted by Legislative Decree 32 of 2 February 2007, which amended art. 40 (Integrated Report) of Legislative Decree 127 of 9 April 1991.

These consolidated financial statements are presented in millions of euros, and all amounts are shown in millions of euros, unless otherwise indicated.

It should be noted that, for the purposes of comparison, certain amounts in the financial statements for the year ended 31 December 2016 have been restated, without, however, altering amounts in equity at 31 December 2016 or those in the income statement for 2016.

Use of estimates

Preparation of the consolidated financial statements requires the Group to use estimates and assumptions that affect the carrying amounts of assets and liabilities and the related disclosures, in addition to contingent assets and liabilities at the reporting date. These estimates and the associated assumptions are based on previous experience and various factors that are believed to be reasonable under the circumstances. The resulting estimates form the basis for making the judgements about the carrying amounts of assets and liabilities that are not readily apparent from other objective sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed periodically and the effects of any changes are recognised in the income statement for the year, if they relate solely to that period. In the case that the revision affects both current and future years, the change is recorded in the year in which the estimate is reviewed as well as in the relevant future years.

The assets and liabilities subject to key estimates and key assumptions used by the Group in applying the IFRS endorsed by the European Commission, and that could have a significant impact on the consolidated financial statements, or that could give rise to risks that would entail significant adjustments to the carrying amounts of assets and liabilities in subsequent years, are summarised below.

Impairment losses

Property, plant and equipment and intangible assets with finite useful lives are tested at least once a year to check for evidence of impairment. If there is evidence that an asset may be impaired, its recoverable amount is estimated.

The recoverable amount of goodwill and intangible assets with indefinite useful lives, where present, as well as intangible assets not yet available for use, is estimated at least annually. The recoverable amount is equal

to the greater of the fair value less costs to sell and value in use. Value in use is measured by discounting estimated future cash flows considering information available at the time of estimate and on the basis of estimates of the performance of future variables, such as prices, costs, demand growth rates, production profiles, and discounted at a pre-tax rate that reflects current market assessments of the time value of money for the investment period and risks specific to the asset. If the intangible asset does not generate cash inflows, the asset's recoverable amount is calculated as part of the Cash Generating Unit ("CGU") to which it belongs.

An impairment loss is recognised in the income statement when the asset's carrying amount, or the net invested capital of the CGU to which it belongs, is greater than its recoverable amount.

Impairment losses on CGUs are first taken as a reduction in the carrying amount of any allocated goodwill and then as a reduction in other assets allocated to the CGU on a pro rata basis. Except for goodwill, impairment losses may be reversed up to the recoverable amount or the original cost of the asset if there is an indication that the impairment loss no longer exists or when there is a change in the methods used to measure the recoverable amount.

Allowance for doubtful accounts

Trade receivables are initially recognised at fair value net of any losses relating to sums considered non-recoverable, for which specific provisions have been made in the allowance for doubtful accounts. Losses on receivables are measured on the basis of the present value of estimated future cash flows, discounted at the original effective interest rate.

Provisions for risks and charges

Provisions for risks and charges are allocated when a disbursement of cash, for an amount which can be reliably estimated, will be necessary to fulfil a legal or constructive obligation arising as a result of a past event. Where the time value of money is significant, provisions are discounted, using a rate that the Group believes to be appropriate (a rate is used that reflects current market conditions and the specific risks connected with the liability). After initial recognition, the value of the provisions for risks and charges is updated to reflect the passage of time and any changes in the estimate following alterations to the amounts forecast, the timing and the discount rates used. Any increase in provisions associated with the passage of time is recognised in the income statement under "Financial expenses".

Liabilities that can be associated with legal and tax disputes and liabilities associated with urban and environmental restoration projects are estimated by the Group. The measurement of provisions for legal disputes is based on the probability of incurring an expense, including through the use of external legal advisors supporting the Group companies; the estimate of provisions to be set aside for urban and environmental restoration projects, the "offsets" aimed at compensating for the environmental impact of the construction of new plant, is based on an analysis of the agreements entered into with the local authorities concerned and the progress of work on construction of the new plant.

Employee benefits

The liability for employee benefits paid upon or following termination of employment in relation to defined benefit plans or other long-term benefits is recognised net of any plan assets and is measured on the basis of actuarial assumptions, estimating the amount of future benefits that employees have vested at the reporting date. The actuarial valuations used to quantify employee benefits (of all plans except termination benefits TFR - *Trattamento di Fine Rapporto*) were based on "vested benefits", applying the projected unit credit method. These valuations are based on economic and demographic assumptions: the discount rate (used to determine the current value of the obligation, determined considering returns on high quality bonds in line with the duration of the group of workers measured), the inflation rate, the rate at which future salary levels are expected to rise, the rate of increase for average health reimbursements, rate of increase for electricity prices and demographic factors, such as mortality and invalidity, retirement, resignation, advances and household composition.

Subsidiaries and scope of consolidation

The scope of consolidation includes the Parent Company, Terna SpA, and the companies over which it has the power to directly or indirectly exercise control. Control exists when the Parent Company has the power or the ability to influence the relevant activities (having a substantial impact on the Parent Company's results), and is exposed to or has the right to variable returns from its involvement with the investee, and the ability to use its power over the subsidiaries to affect the amount of the investor's returns. The financial statements of subsidiaries are consolidated on a line-by-line basis from the date when the Parent Company gains control until the date when such control ceases. The companies included within the scope of consolidation are listed below:

NAME	REGISTERED OFFICE	CURRENCY	SHARE CAPITAL	% INTEREST	METHOD OF CONSOLIDATION
SUBSIDIARIES CONTROLLED DIRECTLY BY TERNA SpA					
Terna Rete Italia SpA	Rome	Euro	120,000	100%	Line-by-line
Business	Design, construction, management, development, operation and maintenance of power lines and grid infrastructure and other grid-related infrastructure, plant and equipment used in the above electricity transmission and dispatching activities and in similar, related and connected sectors.				
Terna Crna Gora d.o.o.	Podgorica (Montenegro)	Euro	114,000,000	100%	Line-by-line
Business	Authorisation, construction and operation of the transmission infrastructure forming the Italy-Montenegro interconnector on Montenegrin territory.				
Terna Plus Srl	Rome	Euro	16,050,000	100%	Line-by-line
Business	Design, construction, management, development, operation and maintenance of plant, equipment and infrastructure for grids and systems, including distributed storage and pumping and/or storage systems.				
Terna Interconnector Srl	Rome	Euro	10,000	65%*	Line-by-line
Business	Responsible for construction and operation of the private section of the Italy-France interconnector and civil works on the public section.				
Monita Interconnector Srl	Rome	Euro	10,000	95%**	Line-by-line
Business	Responsible for construction and operation of the private section of the Italy-Montenegro interconnector.				
Rete Srl	Rome	Euro	387,267,082	100%	Line-by-line
Business	Design, construction, management, development, operation and maintenance of high-voltage power lines.				
Difebal SA	Montevideo (Uruguay)	Uruguayan peso	140,000	100%	Line-by-line
Business	Design, construction and maintenance of electricity infrastructure in Uruguay.				

* 5% held by Terna Rete Italia SpA and 30% by Transenergia Srl

** 5% held by Terna Rete Italia SpA

NAME	REGISTERED OFFICE	CURRENCY	SHARE CAPITAL	% INTEREST	METHOD OF CONSOLIDATION
SUBSIDIARIES CONTROLLED THROUGH TERNA PLUS Srl					
Tamini Trasformatori Srl Business	Melegnano (MI) Construction, repair and trading in electrical equipment.	Euro	4,285,714	70%*	Line-by-line
Terna Chile SpA Business	Santiago (Chile) Design, construction, administration, development, operation and maintenance of any type of electricity system, plant, equipment and infrastructure, including interconnectors; provision of all types of product and service, construction, electrical and civil engineering work; research, consultancy and assistance in matters relating to the core business; any other activity capable of improving the use and development of plant, resources and expertise.	Chilean peso	1,000,000	100%	Line-by-line
SPE Santa Maria Trasmittora de Energia SA Business	Sao Paulo (Brazil) Provision of public electricity transmission services, including construction, operation and maintenance of electricity transmission infrastructure or any other activity necessary in order to fulfil the above purpose.	Real	76,474,716	99.99%**	Line-by-line
SPE Santa Lucia Trasmittora de Energia SA Business	Sao Paulo (Brazil) Provision of public electricity transmission services, including construction, operation and maintenance of electricity transmission infrastructure or any other activity necessary in order to fulfil the above purpose.	Real	227,214,431	99.99%**	Line-by-line
Terna Peru SAC. Business	Lima (Peru) Design, construction, administration, development, operation and maintenance of any type of electricity system, plant, equipment and infrastructure, including interconnectors; provision of all types of product and service, construction, electrical and civil engineering work; research, consultancy and assistance in matters relating to the core business; any other activity capable of improving the use and development of plant, resources and expertise.	Nuevo Sol	16,501,000	99.99%**	Line-by-line
Rete Verde 17 Srl Business	Rome Implementation and development of renewable energy projects.	Euro	10,000	100%	Line-by-line
Rete Verde 18 Srl Business	Rome Implementation and development of renewable energy projects.	Euro	10,000	100%	Line-by-line
Rete Verde 19 Srl Business	Rome Implementation and development of renewable energy projects.	Euro	10,000	100%	Line-by-line
Rete Verde 20 Srl Business	Rome Implementation and development of renewable energy projects.	Euro	10,000	100%	Line-by-line
SUBSIDIARIES CONTROLLED THROUGH TAMINI TRASFORMATORE Srl					
Tamini Transformers USA LLC Business	Oakbrook (Chicago - Illinois) Commercialisation of industrial-grade and high-power electricity transformers.	US dollar	52,089	100%	Line-by-line
Tes Transformer Electro Service Asia Private Limited Business	Maharashtra (India) Commercialisation of industrial-grade and high-power electricity transformers.	Indian rupee	15,000,000	100%	Line-by-line

* 30% Holdco TES (controlled by the Xenon Private Equity V fund, Riccardo Reboldi and Giorgio Gussago).

** 0.01% Terna Chile SpA.

The following changes in the structure of the Group have taken place with respect to 31 December 2016.

Acquisitions and the establishment of new companies:

- In relation to development of the renewable energy initiatives provided for in the partnership agreement between Terna and RFI signed in November 2016, the subsidiary, Terna Plus Srl, has established four limited liability companies: Rete Verde 17 Srl and Rete Verde 18 Srl (on 10 May 2017); Rete Verde 19 Srl and Rete Verde 20 Srl (on 14 July 2017).
- On 13 June 2017, the subsidiaries, Terna Plus Srl and Terna Chile SpA, established the Peruvian-registered company, Terna Peru SAC, with 99.99% and 0.01% interests respectively, in order to build a 138 kV power line (132 km).
- On 26 June 2017, the subsidiary, Terna Plus Srl, acquired two Brazilian-registered joint-stock companies called SPE Santa Maria Trasmittora de Energia SA and SPE Santa Lucia Trasmittora de Energia SA. Terna Plus Srl holds interests of 99.999998% and 99.999999% in the companies, whilst the remaining 0.000002% and 0.000001% are held by Terna Chile SpA.

- On 4 July 2017, Terna Interconnector Srl sold the Group's entire interest in Piemonte Savoia Srl to the Interconnector Italia Scpa consortium.

Mergers:

- On 31 March 2017, the merger of the wholly owned subsidiaries, Terna Storage Srl and Terna Rete Italia Srl, with and into Terna SpA became effective.
- Within the Tamini Group, on 8 June 2017, the merger of the wholly owned subsidiaries, T.E.S. Transformer Electro Service Srl and V.T.D. Trasformatori Srl, with and into Tamini Trasformatori Srl became effective.

Associates

Associates are investees over which the Terna Group exercises significant influence, being the ability to participate in the determination of these companies' financial and operating policies, without having control or joint control. In assessing whether or not Terna has significant influence, potential voting rights that are exercisable or convertible are also taken into account.

These investments are initially recognised at cost and subsequently measured using the equity method. The profits or losses attributable to the Group are recognised in the consolidated financial statements when significant influence begins and until that influence ceases. Based on application of the equity method, if there is evidence that the investment has been impaired, the Group determines the amount of the impairment based on the difference between the recoverable amount and the carrying amount of the investment in question. In the event that the loss attributable to the Group exceeds the carrying amount of the equity interest, the latter is written off and any excess is recognised in a specific provision, if the Parent Company is required to meet the legal or constructive obligations of the investee or, in any case, to cover its losses.

Joint ventures

Investments in joint ventures, in which the Group exercises joint control with other entities, are recognised initially at cost and subsequently measured using the equity method. The profits or losses attributable to the Group are recognised in the consolidated financial statements when significant influence begins and until that influence ceases.

In assessing the existence of joint control, it is ascertained whether the parties are bound by a contractual agreement and whether this agreement attributes to the parties the joint control of the agreement itself. Joint control exists when an entity has control over an arrangement on a contractual basis, and only when decisions relating to the relevant activities require the unanimous consent of all parties that jointly control the arrangement.

The list of associates and joint ventures included is shown below:

NAME	REGISTERED OFFICE	CURRENCY	SHARE CAPITAL	% INTEREST	METHOD OF CONSOLIDATION	CARRYING AMOUNT AT 31 DECEMBER 2017 (€M)
ASSOCIATES						
Cesi SpA	Milan	Euro	8,550,000	42.698%	Equity Method	47,6
Business	Experimental research and provision of services related to electro-technology.					
Coreso SA	Brussels (Belgium)	Euro	1,000,000	15.84%	Equity Method	0,3
Business	Technical centre owned by several electricity transmission operators, responsible for coordinating joint operations of TSOs, in order to improve and upgrade the security and coordination of the electricity system in central and western European.					
CGES A.D.	Podgorica (Montenegro)	Euro	155,108,283	22.0889%	Equity Method	30,0
Business	Provision of transmission and dispatching services in Montenegro.					
JOINT VENTURES						
ELMED Etudes SARl.	Tunis (Tunisia)	Tunisian dinar	2,700,000	50%	Equity Method	0,0
Business	Conduct of preparatory studies for construction of the infrastructure required to connect the Tunisian and Italian electricity systems.					

On 15 December 2017, following the entry of two new shareholders (the Irish companies SONI Ltd. and EirGrid PLC) in CORESO SA, Terna SpA's investment was reduced to 15.84% in the same proportion as the other shareholders, via the sale for consideration of a portion of its shareholding, without affecting its classification as an associate.

Basis of consolidation

All the separate financial statements of the investees used to prepare the consolidated financial statements were drafted as of 31 December 2017 and have been approved by their respective Boards of Directors and shareholders' meetings; they have been adjusted, where necessary, to align them with the Parent Company's accounting policies.

During preparation of the consolidated financial statements, intercompany balances, transactions, revenue and costs are fully eliminated, net of the related tax effect, where material ("consolidation on a line-by-line basis"). Unrealised gains and losses on transactions with associates and joint ventures are eliminated in proportion to the Group's interest therein. In both cases, unrealised losses are eliminated, unless they represent an impairment.

Translation of foreign currency items

In the Group's financial statements, all transactions in currencies other than the functional currency are recognised at the exchange rate prevailing on the date of the transaction. Monetary assets and liabilities in currencies other than the functional currency are subsequently adjusted at the exchange rate prevailing at year end. Any translation differences are taken to the income statement.

Non-monetary assets and liabilities in foreign currency stated at historical cost are converted at the exchange rate prevailing when the transaction was initially recognised. Non-monetary assets and liabilities in foreign currency stated at fair value are converted at the exchange rate prevailing when fair value was measured.

Property, plant and equipment

Property, plant and equipment is recognised at historical cost, including costs directly attributable to preparing the asset for its intended use. In the event of legal or constructive obligations, cost also includes the present value of the estimated cost of dismantling or removing the asset. The corresponding liability is recognised in provisions for risks and charges. Borrowing costs directly attributable to the purchase, construction or production of an asset that qualify for capitalisation pursuant to IAS 23 are capitalised as part of the cost of the asset. Costs incurred after purchase are recognised as an increase in the carrying amount of the asset to which they relate if it is probable that the future benefits of that cost will flow to the Group, and if the cost can be reliably measured. All other costs are expensed as incurred.

Each element of an item of property, plant and equipment of material value, with respect to the total value of the item to which it belongs, is recognised and depreciated separately.

Property, plant and equipment is shown net of accumulated depreciation and any impairment losses. Depreciation is calculated on a straight-line basis over the estimated useful economic life of the asset, which is reviewed annually, with revisions applied on a prospective basis. Depreciation of an asset begins when the asset becomes available for use.

Liabilities associated with items of property, plant and equipment are taken to a specific provision as a contra account of the related asset. The amount is taken to the income statement through the depreciation of the asset.

Property, plant and equipment is written off either at the time of disposal or when no future economic benefit is expected from their use or disposal. Any profit or loss, recognised in the income statement, is determined as the difference between the net proceeds deriving from disposal and the net carrying amount of the assets eliminated.

The main rates of depreciation, calculated on the basis of the useful lives of the relevant assets, are as follows:

RATES OF DEPRECIATION	
Civil and industrial buildings	2.50%
Transmission lines	2.22%
Transformer substations:	
- Electrical machinery	2.38%
- Electrical devices and equipment	3.13%
- Automation and control systems	6.70%
Central systems for remote management and control:	
- Devices, electrical equipment and ancillary plant	5.00%
- Computers	10.00%

Land, regardless of whether it is free of constructions or related to civil and industrial buildings, is not depreciated, since it has an indefinite useful life.

Property, plant and equipment obtained under finance leases - and through which the Group has substantially acquired all the risks and rewards of ownership - are recognised as the Group's assets at the lower of fair value and the present value of the minimum lease payments due, including any amounts to be paid to exercise the purchase option. The corresponding liability to the lessor is recognised as a financial liability. Assets are depreciated using the criteria and rates described above. If the Group is not reasonably certain that it will acquire ownership at the end of the lease, the asset is depreciated over the shorter of the term of the lease and the asset's useful life.

Leases in which the lessor maintains substantially all the risks and rewards of ownership are classified as operating leases. Costs related to operating leases are expensed out in equal instalments over the term of the lease.

Intangible assets

Intangible assets, which all have finite useful lives, are recognised at cost and shown net of accumulated amortisation and any impairment losses. Amortisation begins when the asset becomes available for use and is calculated on a straight-line basis over the estimated useful life of the related asset, which is reviewed annually. Any revisions to estimated figures are applied on a prospective basis.

Intangible assets essentially consist of the concession to exclusively provide electricity transmission and dispatching services, granted to the Parent Company, Terna SpA, on 1 November 2005, with the acquisition of the TSO business unit. As established in the Decree issued by the Ministry of Productive Activities on 20 April 2005, this concession has a 25-year term, renewable for another 25 years, from the date of effective transfer of the activities, functions, assets and legal arrangements of the concession from GSE (formerly GRTN) to Terna SpA. This intangible asset was initially recognised at cost, which reflected fair value.

Other intangible assets essentially refer to software developments and upgrades.

Development costs are capitalised by the Terna Group only if they can be reliably estimated and there is the technical possibility and intention to complete the intangible asset so that it will be available for use, and the asset can be used and it is possible to demonstrate that it will generate probable future economic benefits. Financial expenses directly attributable to the acquisition, construction or production of a non-current asset which justifies capitalisation pursuant to IAS 23 are capitalised to the asset as part of its cost.

All other development costs and research expenses are recognised in the income statement when incurred. These intangible assets are amortised over their estimated residual useful life, which is normally three years, given their rapid obsolescence.

Infrastructure rights

Infrastructure includes the property, plant and equipment and intangible assets employed in dispatching activities in Italy and in the operations in Peru. These activities are carried out under concession arrangements, which fall within the scope of application of IFRIC 12, since the services provided are regulated and control exists over the residual interest. More specifically, infrastructure rights have been recognised as an intangible asset, as valued on the basis of the Intangible Asset model, given the return generated by dispatching activities thanks to the charges paid by users.

The revenue and costs relating to investment in dispatching activities are recognised with reference to the contracts concerned on a stage-of-completion basis; revenue recognised during the construction phase is limited to the amount of the internal and external construction costs incurred, considering that the fair value of the construction services is equivalent to the construction cost paid to third-party contractors plus the internal cost of the technical personnel employed on such construction activities. The assets continue to be amortised and depreciated in accordance with the initial schedule.

By contrast, dispatching revenue continues to be recognised in accordance with IAS 18 and financial expenses continue to be capitalised pursuant to IAS 23.

IFRIC 12, instead, is not applicable to the Parent Company's concession for the part relating to the transmission activities, since neither the concession nor the related legislation envisage that the NTG will be handed over to the public grantor, without the provision of indemnification.

Goodwill

Goodwill, deriving from the acquisition of subsidiaries, is allocated to each of the cash generating units (CGU) identified, coinciding with Group companies that own electricity transmission grids. Goodwill is not amortised after initial recognition but is adjusted to reflect impairment losses, measured as described below. Goodwill relating to investments in associates and joint ventures is included in the carrying amount of those companies. Where negative goodwill arises, it is recognised in the income statement at the time of acquisition.

Inventories

Inventories are recognised and measured at the lower of purchase cost and net estimated realisable value. Cost is calculated as the weighted average, including accrued ancillary expenses. Net estimated realisable value means the estimated sale price under normal conditions net of completion costs and the estimated costs to sell.

Contract work in progress

When the result of work done to order can be reliably estimated, the related contract costs and revenue are recognised separately in the income statement on a percentage of completion basis. Progress is determined based on the work carried out and measured in proportion to the ratio of the cost for the works carried out up to the reporting date to the total cost of the contract (the cost-to-cost method). Differences between the value of completed contracts and payments on account received are recognised in the statement of financial position under assets or liabilities. Any impairment losses on the work carried out are taken to account, so as to recognise the risk of customers' refusal to accept the work performed. Expected contract losses are recognised immediately through profit or loss.

Contract costs include all costs that relate directly to the specific contract, as well as fixed and variable costs incurred by the Group in the course of ordinary operations.

Financial instruments

Financial assets

Any financial assets other than derivative financial instruments that Group companies have the positive intention and ability to hold to maturity are recognised at cost at the "settlement date", which is the fair value of the initial consideration given in exchange, including transaction costs. They are subsequently measured at amortised cost, using the effective interest method, net of any impairment losses, which are determined as the lower of the asset's carrying amount and the present value of its estimated future cash flows. Financial assets are derecognised when, following their transfer or settlement, Group companies are no longer involved in their management and are no longer exposed to the risks and rewards of the transferred or settled instruments.

Infrastructure rights

These include the property, plant and equipment and intangible assets employed in the operations in Brazil, carried out under concession arrangements, which fall within the scope of application of IFRIC 12, since the services provided are regulated and control exists over the residual interest. More specifically,

infrastructure rights have been recognised in financial assets, as valued on the basis of the Financial Asset model, given the return generated by the activities. This derives from an unconditional contractual right to receive cash or another financial asset from, or at the direction of, the grantor and the fact that the grantor cannot avoid payment.

The revenue and costs relating to investment are recognised with reference to the contracts concerned on a stage-of-completion basis; revenue recognised during the construction phase includes a profit margin on the work performed.

Trade receivables

Trade receivables are initially recognised at fair value and subsequently measured at amortised cost, using the effective interest method, and net of any losses relating to sums considered non-recoverable, for which specific provisions have been made in the allowance for doubtful accounts. Losses on receivables are measured on the basis of the present value of estimated future cash flows.

Receivables with due dates that reflect normal commercial terms are not discounted.

Cash and cash equivalents

Cash and cash equivalents are recognised at nominal value and include amounts that are available on demand or can be readily converted into a known amount of cash and are subject to an insignificant risk of changes in value.

Trade payables

Trade payables are initially recognised at fair value and subsequently stated at amortised cost. If their due dates reflect normal commercial terms, they are not discounted.

Financial liabilities

Financial liabilities other than derivative financial instruments are recognised at the settlement date and measured at fair value, net of directly related transaction costs. Subsequently, financial liabilities are measured at amortised cost, using the original effective interest method. If the liabilities are covered by fair value hedges, they are adjusted to reflect changes in fair value with respect to the hedged risk.

Derivative financial instruments

Derivatives are recognised at fair value at the trade date and classified as hedges if the relationship between the derivative and the hedged item is formally documented and the hedge is highly effective within a range of 80% to 125%, as initially verified and periodically checked. When derivatives cover the risk of changes in the cash flows of the hedged instruments (cash flow hedges), the portion of changes in the fair value qualifying as effective is initially recognised in "Other comprehensive income" (accumulated in equity) and subsequently in profit or loss, as the cash flows from the hedged item affects profit or loss. The portion of the fair value of the hedging instrument that does not qualify as effective is recognised in profit or loss.

When hedging derivatives cover the risk of changes in the fair value of hedged instruments (fair value hedges), they are recognised at fair value in profit or loss. Accordingly, the hedged items are adjusted to reflect changes in the fair value associated with the hedged risk.

Changes in the fair value of derivatives that do not meet hedge accounting requirements in accordance with the EU-IFRS are recognised in profit or loss.

Fair value is measured on the basis of official quotations for instruments traded in regulated markets. The fair value of instruments not traded in regulated markets is measured by discounting projected cash flows along a yield curve prevailing in the market at the reporting date, and by translating amounts in currencies other than the euro at closing exchange rates.

Financial and non-financial contracts (which are not already measured at fair value) are also analysed to identify any embedded derivatives, which must be separated and measured at fair value.

This analysis is conducted at the time the entity becomes party to the contract or when the contract is renegotiated in a manner that produces a material change in the original associated cash flows.

Employee benefits

The liability associated with employee benefits payable on or after termination of employment relate to defined benefit plans (deferred compensation benefits, additional months' pay, payment in lieu of notice, energy discounts, ASEM health cover and other benefits) or other long-term employee benefits (loyalty bonuses) and is recognised net of any plan assets. The liability is measured separately for each plan on the basis of actuarial calculations that estimate the amount of vested future benefits that employees have accrued at the reporting date. The liability is recognised on an accruals basis over the vesting period and is measured by independent actuaries.

Provisions for risks and charges

Provisions set aside for risks and charges are recognised when, at the reporting date, the Company has a legal or constructive obligation as the result of a past event and it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the disbursement. Where the effect is material, provisions are made by discounting estimated future cash flows using a discount rate that reflects current market rates and the specific risk applicable to the obligation, if any. Where discounting is used, the increase in the provisions due to the passage of time is recognised in the income statement as a financial expense. If it relates to property, plant and equipment (site disposal and restoration, for example), the provision is recognised as a contra entry to the asset to which it relates. The expense is recognised in the income statement through depreciation of the item of property, plant and equipment to which it relates.

Changes in the estimates are recognised in the income statement for the year in which the change occurs, except for the expected costs of dismantling, removal and restoration resulting from changes in the timing and use of the economic resources necessary to extinguish the obligation, or are attributable to a material change in the discount rate. These costs are recognised as an increase or reduction in the related assets and recognised in the income statement through depreciation.

Government grants

Government grants are recognised when there is a reasonable certainty that they will be received and that the Group will comply with all the conditions required for disbursement. Grants received in relation to specific assets whose value is recognised under non-current assets are recognised, in the case of plant already in operation at 31 December 2002, among other liabilities and taken to the income statement over the depreciation period for the assets in question. As of the 2003 financial year, grants related to new plant entering service are recognised as a direct reduction in the non-current asset concerned.

Grants related to income are recognised in the income statement when the conditions for recognition are met.

Revenue

Revenue is recognised when it is probable that the economic benefits associated with the transactions will flow to the Group. Depending on the type of transaction, revenue is recognised on the basis of the following specific criteria:

- revenue from the sale of goods is recognised when the material risks and rewards of ownership of the goods have been transferred to the buyer and their total amount can be reliably determined and collected;
- revenue from services rendered is recognised with reference to the stage of completion of the activity. If revenue cannot be reliably measured, it is recognised to the extent of recoverable costs;
- revenue accrued during the year in respect of contract work in progress is recognised on the basis of the payments agreed for the progress of works using the cost-to-cost method. In addition to contractual payments, project revenue includes any payments in respect of variations, price revisions and incentives, with the latter recognised where it is probable that they will actually be earned and can be reliably determined. Revenue may also decrease owing, among other things, to penalties for delays attributable to Group companies;
- when the recovery of an amount already recognised in revenue is uncertain, the non-recoverable value or the amount whose recovery is no longer probable is recorded as a cost, with recognition of a balancing entry in provisions for risks and charges;

- amounts collected on behalf of third parties, such as the fees paid to grid owners other than Terna, as well as revenue recognised for managing activities related to the balancing of the national electricity system, which do not increase equity, are reported net of the related costs (pass-through items). This reporting method, which reflects the substance of transactions by offsetting revenue with the related costs arising from the “same transaction”, is however discussed in full in the specific section of the notes to the consolidated financial statements (*Other energy-related items-pass-through revenues/expenses*).

Financial income and expenses

Financial expenses directly attributable to the acquisition, construction or production of an asset that qualify for capitalisation are capitalised as part of the cost of the asset. The property, plant and equipment and intangible assets involved are those that require at least one year in order to prepare them for use. The directly attributable financial expenses are expenses that would not have been incurred had the expenditure for the asset not been incurred.

Where funds are borrowed specifically, the costs eligible for capitalisation are the actual costs incurred less any income earned on the temporary investment of such borrowings. Where loans are obtained for general purposes, the eligible amount is determined by applying a capitalisation rate to the expenditure on that asset equal to the weighted average of the financial expenses applicable to the borrowings outstanding for the year, excluding any specifically borrowed funds. The amount of capitalised financial expenses during a year will in any case not exceed the amount of financial expenses incurred during that year.

Capitalisation commences as from the date all the following conditions are first met: (a) expenditure has been incurred for the asset; (b) financial expenses have been incurred; and (c) the activities involved in preparing the asset for its intended use or sale are in progress. Capitalisation ceases when the activities involved in preparing the asset for its intended use or sale are substantially complete.

The average capitalisation rate used for 2017 was 1.30% and the rate for 2016 was 1.38%.

Financial income and expenses other than capitalised amounts are recognised on an accruals basis in respect of the interest on the net value of the related financial assets and liabilities, using the effective interest rate.

Dividends

Dividends from investees are recognised when the shareholders' right to receive payment is established. Dividends and interim dividends payable to shareholders are shown as changes in equity at the date in which they are approved by the General Meeting of shareholders and the Board of Directors, respectively.

Earnings per share

Basic earnings per share is calculated by dividing the profit or loss for the year attributable to holders of the ordinary shares by the weighted average of ordinary shares outstanding during the year.

Income taxes

Current income taxes are recognised as “Tax liabilities”, net of advances paid, or “Tax assets” where the net balance of the items is positive. They are based on the estimated taxable income and in accordance with current legislation, taking account of applicable exemptions.

Deferred tax assets and liabilities are calculated on temporary differences between the carrying amounts of assets and liabilities recognised in the separate financial statements and the corresponding amounts recognised for tax purposes, using current tax rates or the rates expected to be in effect when the temporary differences reverse, based on rates approved at the reporting date.

Deferred tax assets are recognised when their recovery is considered probable, i.e. when future taxable income will be available against which the asset can be used. The recoverability of deferred tax assets is reviewed at the end of each year.

Deferred tax liabilities are recognised in any case if they exist. Taxes relating to items recognised directly in equity are also allocated to equity.

New accounting standards

International financial reporting standards effective as of 1 January 2017

On 1 January 2017, several amendments to already applicable IFRS came into force, but these had no impact for the Group. These included:

Amendment to IAS 12 - Recognition of Deferred Tax Assets for Unrealised Losses

On 6 November 2017, the European Commission endorsed an amendment to IAS 12, which permits recognition of deferred tax assets for unrealised losses on financial instruments measured at fair value, irrespective of whether the entity intends to recover the carrying amount of the instrument by holding it until maturity or by selling it.

Amendment to IAS 7 - Disclosure Initiative

In connection with the Disclosure Initiative, on 6 November 2016, the European Commission endorsed IAS 7, which clarifies certain disclosure requirements during preparation of the statement of cash flows.

Improvements to IFRS (2014-2016 Cycle)

Endorsed on 7 February 2018, the annual improvements related to the 2014-2016 cycle contain minor amendments, to be applied retrospectively as of 1 January 2017, for IFRS 12, and as of 1 January 2018, for IFRS 1 and IAS 28.

International financial reporting standards endorsed but not yet effective

IFRS 15 - Revenue from Contract with Customers

On 29 October 2016, the European Commission endorsed the new IFRS 15 on revenue recognition. The new standard introduced a five-step revenue recognition model to be applied to revenue from contracts with customers. The steps are as follows: 1) identification of the contract; 2) identification of the performance obligations in the contract; 3) determination of the transaction price; 4) allocation of the transaction price; 5) recognition of revenue when the performance obligation is satisfied. Under the standard, the obligation is satisfied when control over the goods or services underlying the performance obligation is transferred to the customer. Control is defined as the ability to direct the use of and obtain substantially all of the remaining benefits from the asset.

The purpose of the new standard is to provide a consistent, overall framework for revenue recognition, applicable to all contracts with customers (with the exception of leases, insurance contracts and financial instruments). The new standard will replace all existing revenue recognition requirements under IFRS. Specifically, it will replace the following standards:

IAS 11 - Construction Contracts;

IAS 18 - Revenue;

IFRIC 13 - Customer Loyalty Programmes;

IFRIC 15 - Agreements for the Construction of Real Estate;

IFRIC 18 - Transfers of Assets from Customers;

SIC 31 - Revenue - Barter Transactions Involving Advertising Services.

In addition, on 31 October 2016, the European Commission endorsed guidance to clarify certain practical aspects brought to the fore during discussion of the TRG (Transition Resource Group for Revenue Recognition) regarding the application of IFRS 15: identifying performance obligations, principal versus agent considerations and application guidance on licensing.

The new standard is effective from 1 January 2018, with early and retrospective application permitted.

Terna expects to apply the new standard from the effective date using the modified or retrospective approach, accounting for the cumulative effect of adoption of IFRS 15 from the date of first-time adoption, electing not to apply the standard to completed contracts. Analysis of the expected impact of first-time

adoption of IFRS 15 is nearing completion. This shows that application will have non-material quantitative effects for the Group, limited to minor aspects of its Regulated Activities (revenue from connections to the NTG) and certain contracts related to the Non-Regulated Activities (consolidated revenue generated by the Tamini Group).

IFRS 9 - Financial Instruments

On 22 November 2016, the European Commission approved IFRS 9 - Financial Instruments, in its final version of 24 July 2014, which starts the complex and detailed process of replacing IAS 39, divided into the following phases: classification and measurement, derecognition, impairment and hedge accounting. The new standard is effective from 1 January 2018. Early application is permitted. The main changes introduced by the new standard include, among other things, unified classification guidance for all types of financial instruments, including the requirements for recognition and measurement, impairment, derecognition and hedge accounting. Financial assets will therefore be classified as a whole and not subject to complex separation rules. The new classification criterion for financial instruments is based on the business model adopted by the Company to manage financial assets with reference to the collection of cash flows and to the characteristics of the contractual cash flows of the financial assets. As regards impairment, the model provided for in IAS 39 based on the criterion of incurred loss, which postponed the recognition of losses on receivables to the moment of occurrence of the trigger event, has been replaced, as it was considered a weakness. The new IFRS 9 provides for a model based on a prospective view, which requires the immediate recognition of losses on receivables expected over the life of the financial instrument, as a trigger event no longer needs to occur before the recognition of losses on receivables. The new standard has also completed the stage of the Hedge Accounting project, except for the rules on macro hedge accounting, which will be published at a later date. It provides, among the other changes, for a substantial revision of hedge accounting so as to better reflect risk management activities in the financial statements.

Analysis of the expected impact of first-time adoption of the new standard in 2018, which is close to completion -performed retrospectively with regard to classification and measurement, derecognition and impairment, with presentation of the cumulative effects of first-time adoption at the transition date (i.e., 1 January 2018) - shows that application will have non-material quantitative effects for the Group, essentially limited to the impairment of trade receivables. With regard to hedge accounting, application will be prospective from the date of first-time adoption. At that date, existing hedging relationships have not been modified and the new accounting rules, with specific regard to the time value of options and the forward elements of forward contracts, have not resulted in any differences.

IFRS 16 - Leases

Endorsed on 31 October 2017, the new IFRS 16 governs accounting for leases, replacing the previous IAS 17. Among the changes, the new standard, in dispensing with the distinction between operating and finance leases, bases the accounting presentation on the "right-of-use" approach, which for the lessee makes the accounting uniform for any type of lease. At the moment of initial measurement, that is at the date on which the lessor makes the asset available to the lessee, the latter must recognise an asset and a liability: the right to use the asset in assets, and the related lease liability in liabilities. IFRS 16 will be effective from 1 January 2019, but early application is permitted for companies that adopt IFRS 15 (Revenue from Contracts with Customers). The analysis in progress has not revealed any significant impact of the new standard on the financial statements.

Amendment to IFRS 2: Classification and Measurement of Share-based Payment Transactions

On 14 March 2018, the European Commission issued Regulation 2018/289, endorsing an amendment to IFRS 2 clarifying the classification and measurement of share-based payments. The amendment is effective from 1 January 2018.

Amendment to IAS 40: Transfers of Investment Property

On 14 March 2018, the European Commission issued Regulation 2018/289, endorsing an amendment to IAS 40, which aims to provide guidance related to the transfer of investment property when there is evidence of a change in use. The amendment is effective from 1 January 2018.

International financial reporting standards awaiting endorsement

For newly-issued amendments, standards and interpretations that have not yet been endorsed by the EU, but which address issues that affect or could affect the Terna Group, assessments are currently being conducted of the possible impact of their application on the financial statements, taking into account the date on which they will take effect. In particular:

IFRS 17 - Insurance Contracts

The new accounting standard for insurance contracts was published by the IASB on 18 May 2017, to replace the interim version of IFRS 4. The standard defines the new principles for the recognition, measurement, presentation and disclosure of insurance contracts. The General Model of reference is based on the discounting of expected cash flows, with the indication of a risk adjustment and upfront profits through the “contractual service margin”, which cannot be negative, released to income over the term of the contract.

IFRIC 22 - Foreign Currency Transactions and Advance Consideration

On 8 December 2016, the IASB published the interpretation for IAS 21, providing guidance in the selection of an exchange rate to be used when recording a transaction in a foreign currency, should the consideration in the foreign currency have been received or paid in advance of recognition of the related assets.

IFRIC 23 - Uncertainty over Income Tax Treatments

Published on 7 June 2017, the interpretation of IAS 12 provides guidance in accounting for income taxes in case of uncertainty over the income tax treatment.

Amendment to IFRS 9: Prepayment Features with Negative Compensation

Published by the IASB on 12 October 2017, the amendment to IFRS 9 allows the measurement of certain financial assets with a prepayment option with negative compensation features at amortised cost or at fair value through comprehensive income.

Amendment to IAS 28: Long-term Interests in Associates and Joint Ventures

Published by the IASB on 12 October 2017, the amendment to IAS 28 clarifies which long-term receivables are part of the net investment in the associate or joint venture.

Improvements to IFRS (2015-2017 Cycle)

Published by the IASB on 12 December 2017, the annual improvements related to the 2015-2017 cycle contain minor amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23.

Amendment to IAS 19: Plan Amendment, Curtailment or Settlement

Published by the IASB on 7 February 2018, the amendment to IAS 19 clarifies how pension costs should be calculated in the event of modifications to a defined-benefit plan.

B. Notes to the consolidated income statement

Revenue

1. REVENUE FROM SALES AND SERVICES - €2,184.0 MILLION

(€m)

FOR THE YEAR ENDED 31 DECEMBER	2017	2016	CHANGE
Transmission revenue	1,803.8	1,733.0	70.8
Back-billing of transmission charges for previous years	(0.2)	2.0	(2.2)
Other energy-related revenue and from services performed under concession	214.0	132.5	81.5
Quality of service bonuses/penalties	7.4	15.4	(8.0)
Other sales and services	159.0	149.7	9.3
TOTAL	2,184.0	2,032.6	151.4

Transmission revenue

The charges for use of the grid regard the revenue attributable to the Parent Company (€1,674.5 million) and to Rete Srl (€129.1 million).

The increase in transmission revenue (up €68.6 million) reflects the following:

- an increase in the amount receivable to RTNNTG, acquired from the FSI Group at the end of 2015 (up €65.9 million), which in the comparative period only covered operating costs;
- the increased charge due to the Parent Company (up €2.7 million, primarily due to revision of the related tariff after the one-off effects recognised in 2016).

Other energy-related revenue and from services performed under concession

This item regards dispatching and metering revenue (€111.8 million for the dispatching component and €0.1 million for the metering component) and revenue from infrastructure construction and upgrade services performed under concession, recognised in application of IFRIC 12 (€102.1 million). This includes revenue from activities in South America (€79.8 million in Brazil and €1.2 million in Peru).

The increase in "Other energy-related revenue and from services performed under concession" compared with the previous year, amounting to €81.5 million, reflects new investment in assets held under concession in South America.

(€m)

OTHER ENERGY-RELATED REVENUE AND FROM SERVICES PERFORMED UNDER CONCESSION FOR THE YEAR ENDED 31 DECEMBER	2017	2016	CHANGE
Dispatching and metering revenue	111.9	111.3	0.6
Revenue from services performed under concession (IFRIC 12)	102.1	21.2	80.9
- of which in Italy	21.1	21.2	(0.1)
- of which international	81.0	-	81.0
TOTAL OTHER ENERGY-RELATED REVENUE AND FROM SERVICES PERFORMED UNDER CONCESSION	214.0	132.5	81.5

Quality of service bonuses/(penalties)

This item, amounting to €7.4 million in 2017, regards the RENS incentive mechanism introduced by Resolution 653/2015/r/eel, calculated on a pro rata basis taking into account the estimated overall results expected in the 2016-2019 regulatory period.

Compared with the previous year, this item is down €8 million, due to:

- contingent assets recognised in 2016, as defined in Resolution 668/2016/r/eel, totalling €12.0 million, regarding certain major events occurring in central and northern Italy in 2015;
- a revised estimate of the results expected in the 2016-2019 period, taking into account certain events that occurred in central Italy at the beginning of the year.

Other sales and services

The item, "Other sales and services", amounting to €159.0 million, primarily regards revenue from the following:

- contract work and other Non-Regulated Activities carried out by the subsidiaries Tamini (€91.5 million) and Terna Plus (€9.2 million);
- construction of the power line in Uruguay (€7.2 million);
- the recognition of revenue from construction of the private Italy-France Interconnector (in accordance with Law 99/2009) (€16 million), representing the accrued portion of the revenue attributable to the Group for services provided during construction;
- specialist Non-Regulated Activities relating to HV and VHV power lines provided by Terna SpA and the subsidiary Terna Rete Italia SpA, to external customers, including maintenance services (€24.1 million);
- revenue from connections to the NTG (€5.2 million).

The increase of €9.3 million compared with the previous year primarily reflects the recognition of revenue from the private Italy-France Interconnector project (€16 million) and from increased activity in Uruguay (€7.2 million), as well as increased revenue from the connection of plants to the NTG (€2.8 million). These increases were partially offset by a reduction in revenue at the Tamini Group (down €11.4 million), a decline in sales of transformers during the year, in addition to a reduction in contract revenue (down €5 million), essentially due to the greater volume of connections and substation upgrades carried out for external customers in 2016.

Pass-through revenue/expenses

This item regards “pass-through” revenue and expenses (the balance of which amounts to zero) attributable solely to the Parent Company. These items result from daily purchases and sales of electricity from electricity market operators. Measurements for each point of injection and withdrawal are taken and the differences, with respect to energy market schedules are calculated. These differences, known as imbalances, are then measured using algorithms established by the regulatory framework. The net charge resulting from calculation of the imbalances and the purchases and sales, carried out by the Parent Company Terna on the DSM, is billed on a pro rata basis to each end consumer via a specific uplift payment. This item also reflects the portion of the transmission charge that the Parent Company passes on to other grid owners, not included in the scope of consolidation.

The components of these transactions are shown in greater detail below:

	(€m)		
FOR THE YEAR ENDED 31 DECEMBER	2017	2016	CHANGE
Total Power Exchange-related revenue items	4,039.8	4,007.6	32.2
- Uplift	2,093.5	2,420.9	(327.4)
- Electricity sales	434.6	327.8	106.8
- Imbalances	543.6	366.1	177.5
- Congestion revenue	368.0	278.0	90.0
- Charges for right to use transmission capacity and market coupling	297.6	249.5	48.1
- Interconnectors/shippers	75.1	73.7	1.4
- Load Profiling for public lighting	73.7	96.8	(23.1)
- Other Power Exchange-related pass-through revenue items	153.7	194.8	(41.1)
Total over-the-counter revenue items	1,260.2	1,590.9	(330.7)
- Transmission revenue passed on to other NTG owners	5.9	6.8	(0.9)
- Charge to cover cost of essential plants	327.5	685.3	(357.8)
- Charge to cover cost of energy delivery capacity	208.9	255.5	(46.6)
- Charge to cover cost of interruptibility service	359.8	331.8	28.0
- Charge to cover cost of LV capacity and protection service	267.6	274.4	(6.8)
- Other pass-through revenue for over-the-counter trades	90.5	37.1	53.4
TOTAL PASS-THROUGH REVENUE	5,300.0	5,598.5	(298.5)
Total Power Exchange-related cost items	4,039.8	4,007.6	32.2
- Electricity purchases	2,322.9	2,142.0	180.9
- Imbalances	771.3	816.9	(45.6)
- Congestion revenue	280.6	201.0	79.6
- Charges for right to use transmission capacity and market coupling	116.0	89.4	26.6
- Interconnectors/Shippers	330.8	364.0	(33.2)
- Load Profiling for public lighting	81.1	110.7	(29.6)
- Other Power Exchange-related pass-through cost items	137.1	283.6	(146.5)
Total over-the-counter cost items	1,260.2	1,590.9	(330.7)
- Transmission costs passed on to other NTG owners	5.9	6.8	(0.9)
- Fees paid for essential units	327.5	685.3	(357.8)
- Fees paid for energy delivery capacity	208.9	255.5	(46.6)
- Fees paid for interruptibility service	359.8	331.8	28.0
- Fees paid for LV capacity and protection service	267.6	274.4	(6.8)
- Other pass-through costs for over-the-counter trades	90.5	37.0	53.5
TOTAL PASS-THROUGH COSTS	5,300.0	5,598.5	(298.5)

The total uplift cost in 2017, amounting to €2,093.5 million, is down €327.4 million on the figure for the previous year, primarily reflecting reductions in the DSM cost and in the cost of imbalances (above all demand-side), linked partly to the effect of new regulations effective from August 2016 and from September 2017.

2. OTHER REVENUE AND INCOME - €64.0 MILLION

(€m)

FOR THE YEAR ENDED 31 DECEMBER	2017	2016	CHANGE
Rental income	23,3	22,6	0,7
Sales to external customers	13,5	11,6	1,9
Net contingent assets	9,1	12,4	(3,3)
Sundry grants	8,5	9,4	(0,9)
Other revenues	3,6	1,1	2,5
Compensation for damages	3,2	3,0	0,2
Gains on sale of components of plant	2,8	10,5	(7,7)
TOTAL	64,0	70,6	(6,6)

The most significant components of "Other operating income" primarily regard rental income (€23.3 million), mainly in the form of payment for housing the Wind group's fibre network on the grid, sales to external customers (€13.5 million), net contingent assets (€9.1 million) and sundry grants (€8.5 million).

The total of €64 million is down €6.6 million on the figure for the previous year (€70.6 million), primarily linked to the net reduction in gains on the sale of components of plant and in sales to external customers (down €5.8 million). This reflects:

- the increased revenue generated in 2016 by the so-called "Copper Plan" (down €11.6 million), consisting of the progressive replacement, and sale to third parties, of a number of copper conductors present on power lines with new aluminium conductors;
- an increase in revenue from telecommunications, above all due to new contracts granting usage rights on certain fibre assets (up €11 million);
- recognition, in 2016, of the impact of renewal of the vehicle fleet in 2016 (down €4.2 million).

There has also been a €3.3 million reduction in net contingent assets, mainly due to adjustment of the exposure to contractual obligations following the sale of a photovoltaic project (down €2.5 million) and an increase in other revenues (up €2.5 million), relating to penalties applied to suppliers of the Tamini Group.

Operating costs

3. RAW AND CONSUMABLE MATERIALS - €158.1 MILLION

This item includes the value of the various materials and equipment used in the ordinary operation and maintenance of the plant belonging to the Group and third parties, and the materials consumed in the performance of contract work by the Tamini Group and in South America.

The increase of €87.1 million compared with the previous year primarily reflects the increase in costs relating to the development of operations in South America, recognised in application of IFRIC 12 (up €77.8 million, above all with reference to Brazil) and increased activity in Uruguay, partially offset by the impact of completion of the contract in Chile (up €4.2 million).

There was also an increase in costs relating to performance of contracts for telecommunications services (up €3.4 million).

4. SERVICES - €182.4 MILLION

(€m)

FOR THE YEAR ENDED 31 DECEMBER	2017	2016	CHANGE	CHANGE WITH IFRIC 12	CHANGE WITHOUT IFRIC 12
Maintenance and sundry services	86.8	84.0	2.8	-	2.8
Tender costs for plant	42.8	54.8	(12.0)	0.3	(12.3)
IT services	16.4	17.0	(0.6)	(0.7)	0.1
Lease expense	13.2	13.8	(0.6)	-	(0.6)
Remote transmission and telecommunications	12.2	12.0	0.2	-	0.2
Insurance	11.0	9.8	1.2	-	1.2
TOTAL	182.4	191.4	(9.0)	(0.4)	(5.3)

This item is down €9 million compared with the previous year, largely due to savings resulting from the insourcing of maintenance work, primarily relating to management of Rete Srl's power lines, and reduced costs at the Tamini Group (down €3.3 million, primarily due to a decline in contract work).

5. PERSONNEL EXPENSES - €257.2 MILLION

(€m)

FOR THE YEAR ENDED 31 DECEMBER	2017	2016	CHANGE
Salaries, wages and other short-term benefits	293.2	272.8	20.4
Directors' remuneration	2.4	2.9	(0.5)
Termination benefits (<i>TFR</i>), energy discounts and other employee benefits	5.8	17.3	(11.5)
Early retirement incentives	19.6	32.1	(12.5)
Gross personnel expenses	321.0	325.1	(4.1)
Capitalised personnel expenses	(63.8)	(57.1)	(6.7)
TOTAL	257.2	268.0	(10.8)

Personnel expenses are down €10.8 million on the previous year, primarily reflecting the higher amount of provisions made in 2016 for early retirement schemes (down €12.5 million), the release of provisions for the energy discounts granted to pensioners (down €12.2 million, as a result of the agreement reached during the year), reduced costs at the Tamini Group (down €4.4 million, mainly due to a reduction in the average workforce), after increased provisions for management incentive schemes (up €8.4 million) and recruitment to meet the needs arising from expansion of the grid infrastructure operated by Rete Srl.

The following table shows the Group's workforce by category at the end of the year and as the average for the year.

	AVERAGE WORKFORCE		WORKFORCE AT	
	2017	2016	31 DECEMBER 2017	31 DECEMBER 2016
Senior managers	72	77	71	76
Middle managers	579	560	569	567
Office staff	2,024	1,952	2,021	1,978
Blue-collar workers	1,263	1,212	1,236	1,248
TOTAL	3,938	3,801	3,897	3,869

The net increase in the average workforce compared with 2016 amounts to 137.

At 31 December 2017, the Terna Group's workforce breaks down as follows:

	TERNA SPA	TERNA RETE ITALIA SPA	TERNA CRNA GORA D.O.O.	TERNA PLUS SRL	TERNA PERU S.A.C.	SPE SANTA LUCIA TRASMISSORA DE ENERGIA SA	SPE SANTA MARIA TRASMISSORA DE ENERGIA SA	TAMINI GROUP
Number	507	2,972	9*	29	3*	7*	2*	368

* Local staff.

6. AMORTISATION, DEPRECIATION AND IMPAIRMENT LOSSES - €526.5 MILLION

(€m)

FOR THE YEAR ENDED 31 DECEMBER	2017	2016	CHANGE
Amortisation of intangible assets	50.4	51.4	(1.0)
- of which rights on infrastructure	24.8	27.5	(2.7)
Depreciation of property, plant and equipment	465.2	449.2	16.0
Impairment losses on property, plant and equipment	9.3	0.5	8.8
Goodwill impairment	-	3.6	(3.6)
Impairment losses on current assets	1.6	4.0	(2.4)
TOTAL	526.5	508.7	17.8

Amortisation, depreciation and impairment losses, amounting to €526.5 million, is up €17.8 million compared with 2016, following the entry into service of new plant.

7. OTHER OPERATING COSTS - €46.4 MILLION

(€m)

FOR THE YEAR ENDED 31 DECEMBER	2017	2016	CHANGE
Quality of service costs	10.5	(7.8)	18.3
of which mitigation and sharing mechanisms	7.7	(5.3)	13.0
of which contributions to the Fund for Exceptional Events	2.4	(3.0)	5.4
of which compensation mechanisms for HV users	0.4	0.5	(0.1)
Provisions for litigation and disputes	10.5	5.5	5.0
Indirect taxes and local taxes and levies	7.1	15.3	(8.2)
Net contingent liabilities	0.2	2.2	(2.0)
Losses on sales/disposal of plant	0.7	0.7	-
Other	17.4	12.2	5.2
TOTAL	46.4	28.1	18.3

The Group's other operating costs, amounting to €46.4 million, are primarily attributable to the Parent Company (€39.0 million) and the Tamini Group (€3.3 million). They include net quality of service costs (€10.5 million), provisions for litigation and disputes set aside to cover outstanding liabilities that, at the end of the year, could result from court judgements and out-of-court settlements regarding the Group's activities (€10.5 million), and indirect taxes and local taxes and levies (€7.1 million), which primarily refer to *Tosap* (*Tassa per l'Occupazione del Suolo Pubblico*, a tax on the occupation of public land) and *Tares* (*Tassa Rifiuti e Servizi*, a tax on waste and municipal services), amounting to €4.2 million, and *IMU* (*Imposta Municipale Unica*, single council tax), amounting to €1.2 million. Other costs of €17.4 million regard membership dues and contributions to trade bodies and associations, donations and other expenses.

The increase of €18.3 million mainly regards the net impact of the mechanisms designed to regulate the quality of service. This reflects the higher costs incurred during the year (up €6.9 million and relating to events in Abruzzo and Marche at the beginning of the year) and the higher amount of contingent assets recognised in the previous year (€11.4 million) regarding contributions to the Fund for Exceptional Events and the sharing mechanism used to allocate the cost of certain major events in central and northern Italy in 2015.

8. NET FINANCIAL INCOME/(EXPENSES) - (€92.6) MILLION

(€m)

FOR THE YEAR ENDED 31 DECEMBER	2017	2016	CHANGE
FINANCIAL EXPENSES			
Financial expenses paid to Cassa Depositi e Prestiti	(3.7)	(4.5)	0.8
Interest expense on medium/long-term borrowings and related hedges	(94.0)	(101.0)	7.0
Restructuring of bond issues and related hedges	-	(13.2)	13.2
Discounting of termination benefits (TFR), other provisions for employee benefits and provisions for risks and charges	(1.1)	(2.0)	0.9
Capitalised financial expenses	12.8	16.0	(3.2)
Translation differences	(0.8)	(0.3)	(0.5)
Other financial expenses	(9.7)	(0.5)	(9.2)
Total expenses	(96.5)	(105.5)	9.0
FINANCIAL INCOME			
Interest income and other financial income	1.2	4.5	(3.3)
Restructuring of bond issues and related hedges	2.7	-	2.7
Total income	3.9	4.5	(0.6)
TOTAL	(92.6)	(101.0)	8.4

Net financial expenses of €92.6 million are essentially attributable to the Parent Company (€91.2 million) and reflect €96.5 million in financial expenses and €3.9 million in financial income. The reduction in net financial expenses compared with the previous year, amounting to €8.4 million, primarily reflects the following:

- a reduction in financial expenses on medium/long-term borrowings and the related hedges (€7.0 million), primarily due to a general fall in market interest rates during 2017;
- a decrease in the fair value of bond issues and the related hedges (€15.9 million) following a restructuring of the derivatives entered into in 2017;
- a reduction in capitalised financial expenses (down €3.2 million), due to the lower cost of debt in 2017 compared with 2016;
- a decrease in interest income and other financial income (down €3.3 million), reflecting the reduced amount of liquidity invested during the year and the general fall in market interest rates.

9. SHARE OF PROFIT/(LOSS) OF INVESTEEES ACCOUNTED FOR USING THE EQUITY METHOD - €3.8 MILLION

This item, amounting to €3.8 million, has improved on the previous year (€5.6 million), reflecting the impairment loss recognised in 2016 on the investment in the associate, CGES (€5.0 million), and the adjustment to the Group's share of equity in the associate, CESI (down €0.6 million).

10. INCOME TAX EXPENSE - €294.4 MILLION

(€m)

FOR THE YEAR ENDED 31 DECEMBER	2017	2016	CHANGE
Income tax for the year			
Current tax expense:			
- IRES (corporate income tax)	273.4	283.8	(10.4)
- IRAP (regional tax on productive activities)	60.2	55.2	5.0
Total current taxes	333.6	339.0	(5.4)
New temporary differences:			
- deferred tax assets	(27.9)	(22.9)	(5.0)
- deferred tax liabilities	0.9	0.6	0.3
Reversal of temporary differences:			
- deferred tax assets	22.8	25.3	(2.5)
- deferred tax liabilities	(31.2)	(29.7)	(1.5)
Adjustment of IRES rate	-	1.4	(1.4)
Total deferred tax assets and liabilities	(35.4)	(25.3)	(10.1)
Adjustments of taxes for previous years	(3.8)	(8.4)	4.6
TOTAL	294.4	305.3	(10.9)

Current income taxes of €333.6 million is down €5.4 million on the previous year, essentially reflecting the impact of the reduction in the IRES tax rate from 27.5% to 24% (in accordance with Law 208/2015, the 2016 Stability Law), partially offset by the changes made to the tax relief designed to stimulate economic growth (ACE - Aiuto alla Crescita Economica) introduced by Law Decree 50/2017.

Deferred tax income, amounting to €-35.4 million, has changed by €-10.1 million primarily due to the effect on taxation of amortisation and depreciation and movements in provisions for risks and charges and for employee benefits.

Adjustments to taxes for previous years, amounting to income of €3.8 million, reflect the overpayment of tax in previous years. The change in 2017 (up €4.6 million) is primarily attributable to the Parent Company.

The effective tax charge for the year (€294.4 million) results in a tax rate of 29.8%, compared with a rate of 32.7% for 2016.

For a clearer presentation of the differences between the theoretical and actual tax rates, the table below reconciles the profit before taxes with taxable income for IRES (corporate income tax) purposes.

(€m)

FOR THE YEAR ENDED 31 DECEMBER	2017	2016
Profit before tax	988.6	933.2
THEORETICAL TAX CHARGE	237.3	256.6
IRAP	60.2	55.2
Permanent differences	0.7	0.4
TAX (after adjustment for previous years and one-off changes)	298.2	312.3
TAX RATE	30.2%	33.5%
Adjustments of taxes for previous years	(3.8)	(8.4)
Adjustment to tax rate	-	1.4
INCOME TAX EXPENSE FOR THE YEAR	294.4	305.3
EFFECTIVE TAX RATE	29.8%	32.7%

11. EARNINGS PER SHARE

Earnings per share, which corresponds to diluted earnings per share, amounts to €0.342 (based on profit for the year attributable to owners of the Parent, totalling €688.3 million, divided by the number of shares outstanding, totalling 2,009,992.0 thousand).

C. Operating segments

In line with the Business Plan 2018-2022, and in compliance with IFRS 8, the Terna Group's identified operating segments are described below:

- **Regulated Activities**
- **Non-Regulated Activities**
- **International Activities**

The "Regulated Activities" segment includes the development, operation and maintenance of the National Transmission Grid, in addition to dispatching and metering, and the activities involved in the construction of storage systems. These activities have been included in one operating segment, as they are all regulated by ARERA and have similar characteristics, in terms of the remuneration model and the method for setting the related tariffs.

The "Non-Regulated Activities" segment includes deregulated activities and specific business initiatives, above all relating to the provision of services to external customers in the areas of Energy Solutions (the development of technical solutions and the supply of innovative services), Telecommunications (the housing of telecommunications equipment and maintenance services for fibre networks) and O&M (operation and maintenance of high-voltage and very high-voltage infrastructure). This segment also includes the activities carried out in relation to the private interconnectors launched by Law 99/2009, legislation that assigned Terna responsibility for selecting undertakings (the "selected undertakings"), on the basis of public tenders, willing to finance specific interconnectors in exchange for the benefits resulting from a decree granting a third-party access exemption with regard to the transmission capacity provided by the new infrastructure. The Non-Regulated Activities segment also includes the operations of the Tamini Group, relating essentially to the construction and commercialisation of electrical equipment, above all power transformers.

On the other hand, the "International Activities" segment includes the results deriving from opportunities for international expansion, which the Group aims to exploit by leveraging its core competencies developed in Italy as a TSO, where such competencies are of significant importance in its home country. Overseas investment focuses on countries with stable political and regulatory regimes and a need to develop their electricity infrastructure. This segment includes the results of the two Brazilian companies, SPE Santa Lucia Trasmisora de Energia SA and SPE Santa Maria Trasmisora de Energia SA, the Peruvian company, Terna Peru SAC, the Uruguayan subsidiary, Difebal SA, and the Chilean company, Terna Chile SpA.

(€m)

FOR THE YEAR ENDED 31 DECEMBER	2017	2016	CHANGE	% CHANGE
TOTAL REVENUE FROM REGULATED ACTIVITIES	1,967.2	1,916.6	50.6	2.6
TOTAL REVENUE FROM NON-REGULATED ACTIVITIES	189.1	182.4	6.7	3.7
TOTAL REVENUE FROM INTERNATIONAL ACTIVITIES	91.7	4.2	87.5	-
TOTAL REVENUE	2,248.0	2,103.2	144.8	6.9
GROSS OPERATING PROFIT (EBITDA)*	1,603.9	1,544.7	59.2	3.8
of which EBITDA from Regulated Activities **	1,541.7	1,495.5	46.2	3.1
of which EBITDA from Non-Regulated Activities	62.4	51.1	11.3	22.1
of which EBITDA from International Activities	(0.2)	(1.9)	1.7	(89.5)
Reconciliation of segment result with Group's pre-tax result				
Amortisation, depreciation and impairment losses	526.5	508.7		
OPERATING PROFIT/(LOSS) (EBIT)	1,077.4	1,036.0		
Financial income/(expenses)	(92.6)	(101.0)		
Share of profit/(loss) of investees accounted for using the equity method	3.8	(1.8)		
Profit/(Loss) before tax	988.6	933.2		

* Gross operating profit - EBITDA is an indicator of operating performance, obtained by adding "Amortisation, depreciation and impairment losses" to "Operating profit/(loss) (EBIT)".

** EBITDA including indirect costs.

The Group's revenue for 2017 amounts to €2,248.0 million, marking an increase of €144.8 million (6.9%) compared with 2016.

Gross operating profit (EBITDA) of €1,603.9 million is up €59.2 million (3.8%) on the €1,544.7 million of 2016.

EBITDA from **Regulated Activities** amounts to €1,541.7 million, an increase of €46.2 million compared with the figure for the previous year. This primarily reflects revenue growth resulting from the full recognition of revenue generated by transmission charges for the NTG acquired from the FSI Group.

EBITDA from **Non-Regulated Activities** amounts to €62.4 million, an increase of €11.3 million due to increased revenue from the private Italy-France interconnector, following the sale of Piemonte Savoia Srl.

Negative EBITDA from **International Activities** amounts to €0.2 million for 2017, which is of marginal significance in absolute terms given that construction work has only just begun in South America. This marks an improvement of €1.7 million compared with the previous year, primarily reflecting the contribution from construction services provided in Brazil (€3.1 million) and construction of the power line in Uruguay (€0.9 million). This was offset by the impact of substantial completion of the Chilean contract in 2016 and other costs incurred in providing support for overseas initiatives.

Revenue and costs in Brazil and Peru refer to concessions in the two countries and, in accordance with IFRIC 12, EBITDA is recognised as the effective profit on construction services.

Information on the financial position periodically reported to senior management is not provided directly on the basis of each individual segment, but based on the measurement and presentation of gross invested capital as a whole, given that the Non-Regulated and International Activities contribution is not material. The following table shows this indicator at 31 December 2017 and 31 December 2016.

	(€m)	
AT 31 DECEMBER	2017	2016
Net non-current assets *	13,466.4	12,991.4
<i>of which investments in associates and joint ventures</i>	77.9	75.2
Net working capital **	(1,485.2)	(1,075.3)
Gross invested capital ***	11,981.2	11,916.1

* Net non-current assets include the value of "property, plant and equipment", "Goodwill", "Intangible assets", "Investments accounted for using the equity method", "Other non-current assets" and "Non-current financial assets", excluding accrued fees on available financing (€4.3 million).

** Net working capital is the difference between total current assets less cash and the item, "Current financial assets", and total current liabilities, less the short-term portion of long-term borrowings and the items, "Short-term borrowings" and "Current financial liabilities", and the item, "Other non-current liabilities".

*** Gross invested capital is the sum of net non-current assets and net working capital.

With regard to Terna Group companies' dependence on external customers, it should be noted that, in 2017, transactions generating revenue from an individual customer, or from a company under common control, in excess of 10% of consolidated revenue are represented by related party transactions carried out within the scope of the Regulated Activities.

D. Notes to the consolidated statement of financial position

Assets

12. PROPERTY, PLANT AND EQUIPMENT - €12,752.8 MILLION

(€m)

	LAND	BUILDINGS	PLANT AND EQUIPMENT	INDUSTRIAL AND COMMERCIAL EQUIPMENT	OTHER ASSETS	ASSETS UNDER CONSTRUCTION AND PREPAYMENTS	TOTAL
COST AT 1 JANUARY 2017	189.6	1,777.5	16,265.6	97.0	138.3	1,450.0	19,918.0
Capital expenditure	0.2	0.7	0.5	3.0	0.9	988.5	993.8
Assets entering service	6.6	95.4	704.1	-	6.3	(812.4)	-
Change in scope of consolidation	-	-	-	-	-	(16.7)	(16.7)
Other additions	-	0.6	9.9	-	-	-	10.5
Disposals and impairments	-	(0.5)	(42.2)	-	(0.2)	(3.9)	(46.8)
Other movements	-	(33.0)	(107.0)	-	-	9.8	(130.2)
Reclassifications	(4.0)	4.0	-	-	-	-	-
COST AT 31 DECEMBER 2017	192.4	1,844.7	16,830.9	100.0	145.3	1,615.3	20,728.6
ACCUMULATED DEPRECIATION AND IMPAIRMENTS AT 1 JANUARY 2017	-	(482.3)	(6,891.6)	(76.7)	(98.5)	-	(7,549.1)
Depreciation for the year	-	(44.1)	(404.8)	(4.8)	(11.5)	-	(465.2)
Disposals	-	0.5	35.7	-	0.2	-	36.4
Other movements	-	-	2.1	-	-	-	2.1
ACCUMULATED DEPRECIATION AND IMPAIRMENTS AT 31 DECEMBER 2017	-	(525.9)	(7,258.6)	(81.5)	(109.8)	-	(7,975.8)
Carrying amount							
AT 31 DECEMBER 2017	192.4	1,318.8	9,572.3	18.5	35.5	1,615.3	12,752.8
AT 31 DECEMBER 2016	189.6	1,295.2	9,374.0	20.3	39.8	1,450.0	12,368.9
CHANGE	2.8	23.6	198.3	(1.8)	(4.3)	165.3	383.9

The category, "Plant and equipment" at 31 December 2017 includes the electricity transmission grid and transformer substations in Italy.

"Property, plant and equipment" is up €383.9 million compared with the previous year, reflecting ordinary movements during the year as a result of:

- capital expenditure of €993.8 million, including €931.9 million invested in the Group's Regulated Activities and €61.9 million in the Non-Regulated Activities, primarily with regard to the private "Italy-France" Interconnector (€45.1 million);
- depreciation for the year, amounting to €465.2 million;
- other changes during the year, resulting in a reduction of €134.3 million, including grants related to assets (primarily the Sorgente - Rizziconi line and projects financed by the Ministry for Economic Development and the EU) and the purchase of a substation located in the Municipality of Ponti sul Mincio for €10.5 million; and disposals and impairments of (€10.4 million).

A summary of movements in property, plant and equipment during the year is shown below.

	(€m)
Capital expenditure	
- Power lines	645.4
- Transformer substations	308.1
- Storage systems	2.7
- Other	37.6
Total Capital expenditure in property, plant and equipment	993.8
Depreciation for the year	(465.2)
Other changes	(134.3)
Disposals and impairments	(10.4)
TOTAL	383.9

The following information regards work on the principal projects during the year: progress on construction of the various overseas interconnections, consisting of the power lines linking Italy and Montenegro (€212.8 million) and Italy and France (€62.5 million), extension of the fibre network as part of the “Fibre Network Development” project (€28.2 million, including €1.2 million by the subsidiary, Rete Srl), the laying of cables in the Venetian lagoon (€23.3 million), completion of work on the 380 kV Udine West-Redipuglia line (€25.1 million), the purchase of the “Stornarella” cable (€17.4 million), the purchase of a 150 kV substation at Macchialupo (€14.5 million), completion of the “Capri-Mainland” interconnector (€14.4 million), the upgrade of the capacity of the North-West power lines (€13.8 million) and the restructuring of Palermo metropolitan area (€11.3 million). Investment also took place in the grid acquired from the FSI Group (€75.9 million), primarily relating to regulated investment without incentives, primarily in the functional separation of substations, totalling €47.4 million (111 substations, to add to the 61 separated in 2016), purchase of the three electricity substations needed to supply the Treviglio-Brescia railway line at a cost of €10.7 million and the renewal of lines, above all the Cesena-Riccione line, at a cost of €1.3 million.

13. GOODWILL - €230.1 MILLION

Goodwill regards the acquisition of Terna Rete Italia Srl, accounted for in the financial statements at a carrying amount of €101.6 million, the acquisition of RTL, with a carrying amount of €88.6 million, the acquisition of Rete Srl, with a carrying amount of €26.3 million, and the acquisition of TES- Transformer Electro Services within the Tamini Group, with a carrying amount of €13.6 million.

There are no changes in this item compared with the previous year.

Impairment testing

For the purposes of impairment testing, goodwill has been allocated to two groups of cash generating units (CGUs): the first group consisting of “Transmission activities” within the Group’s Regulated Activities, totalling €216.5 million, and the second relating to the “Production and commercialisation of transformers”, forming part of Non-Regulated Activities, totalling €13.6 million.

Disclosures regarding impairment testing of the goodwill allocated to the group of CGUs represented by the Group’s transmission activities is provided below. Measurement of the recoverable value of the goodwill was based on fair value less costs of disposal. This was determined taking into account Terna’s share price at 31 December 2017, after stripping out the fair value of assets and liabilities not attributable to the group of CGUs represented by transmission activities.

The resulting value is significantly higher than the carrying amount inclusive of goodwill.

14. INTANGIBLE ASSETS - €275.6 MILLION

(€m)

	INFRASTRUCTURE RIGHTS	CONCESSIONS	OTHER ASSETS	ASSETS UNDER DEVELOPMENT AND PREPAYMENTS	TOTAL
Cost	387.2	135.4	252.6	38.7	813.9
Accumulated amortisation	(283.4)	(62.5)	(182.1)	-	(528.0)
BALANCE AT 31 DECEMBER 2016	103.8	72.9	70.5	38.7	285.9
Capital expenditure	1.1	-	0.2	38.8	40.1
Assets entering service	23.8	-	19.1	(42.9)	-
Amortisation for the year	(24.8)	(5.6)	(20.0)	-	(50.4)
BALANCE AT 31 DECEMBER 2017	103.9	67.3	69.8	34.6	275.6
Cost	412.1	135.4	271.9	34.6	854.0
Accumulated amortisation	(308.2)	(68.1)	(202.1)	-	(578.4)
BALANCE AT 31 DECEMBER 2017	103.9	67.3	69.8	34.6	275.6
Change	0.1	(5.6)	(0.7)	(4.1)	(10.3)

Intangible assets amount to €275.6 million (€285.9 million at 31 December 2016); this item includes:

- the infrastructure used in provision of the dispatching service carried out under concession and accounted for in accordance with "IFRIC 12 - Service Concession Arrangements", with the carrying amount, at 31 December 2017, of infrastructure entering service during the year amounting to €103.9 million and of infrastructure under construction, included in the category "Assets under development and prepayments", amounting to €20.3 million (at 31 December 2016, the matching figures were €103.8 million and €22.9 million, respectively);
- the concession for electricity transmission and dispatching activities in Italy (with a carrying amount of €67.3 million at 31 December 2017); this 25-year concession was recognised in 2005, initially at fair value and subsequently at cost.

Other intangible assets primarily include software applications, products development internally or those purchased as part of systems development programmes. Investment in these assets during the year, primarily attributable to the Parent Company (€17.3 million), essentially regard internal development programmes.

The reduction compared with the previous year (down €10.3 million) reflects the net effect of amortisation (€50.4 million) and Capital expenditure (€40.1 million, including €22.3 million in infrastructure rights).

Investment in intangible assets during the year (€40.1 million, including €38.5 million invested in the Parent Company's Regulated Activities) included expenditure on the development of software applications for the Remote Management System for Dispatching (€9.6 million), the Power Exchange (€3.7 million) and for protection of the electricity system (€2.9 million), as well as software applications and generic licences (€14.4 million).

15. INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD - €77.9 MILLION

This item, amounting to €77.9 million, regards the Parent Company's investments in the associate, CESI SpA (€47.6 million), the associate, CORESO SA (€0.3 million) and the associate, CGES - CrnoGorski Elektroprenosni Sistem AD (€30.0 million).

The value of the shareholding in CESI has risen €2.7 million compared with the previous year, following an adjustment of the investment to reflect the Group's share of the associate's equity at the end of the year (€3.8 million), after deducting the dividend received during the year (€1.1 million).

16. FINANCIAL ASSETS

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Fair value hedges	-	325.7	(325.7)
Fees on available financing	4.3	4.3	-
Other investments	0.1	0.1	-
Assets under concession - IFRIC 12	73.5	-	73.5
Deposit in the Interconnector Guarantee Fund	42.2	17.4	24.8
NON-CURRENT FINANCIAL ASSETS	120.1	347.5	(227.4)
Deferred assets on fair value hedges	-	26.1	(26.1)
Other current financial assets	0.2	0.1	0.1
CURRENT FINANCIAL ASSETS	0.2	26.2	(26.0)

“Non-current financial assets” are down €227.4 million compared with the previous year, above all reflecting the reduction in the fair value of derivatives (down €325.7 million). This is primarily due to the unwinding of fair value hedges with a notional value of €1.35 billion (€0.55 billion maturing in 2021 and €0.8 billion maturing in 2024) following simplification of the derivative portfolio during the fourth quarter of 2017. This was offset by recognition of investments for infrastructure under concession in Brazil during the year in application of IFRIC 12 (up €73.5 million) and by an increase in the Interconnector Guarantee Fund, set up to fund investment in interconnections by art. 32 of Law 99/09 (up €24.8 million).

“Current financial assets” are down by €26.0 million compared with the previous year, primarily due to the unwinding of the above fair value hedges in 2017.

17. OTHER ASSETS

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Loans and advances to employees	9.3	9.0	0.3
Deposits with third parties	4.9	4.8	0.1
OTHER NON-CURRENT ASSETS	14.2	13.8	0.4
Other tax credits	76.8	47.1	29.7
Prepayments to suppliers	35.1	7.2	27.9
Prepayments of operating expenses and accrued operating income	18.5	6.6	11.9
Other current assets - Interconnector Guarantee Fund	4.1	2.0	2.1
Amounts due from others	4.6	4.6	-
OTHER CURRENT ASSETS	139.1	67.5	71.6

“Other non-current assets” amount to €14.2 million, broadly in line with the previous year (up €0.4 million, primarily due to loans and advances disbursed to employees).

“Other current assets” of €139.1 million are up €71.6 million compared with 31 December 2016, primarily due to:

- other tax credits (up €29.7 million), primarily reflecting an increase in the Group’s refundable VAT (up €30.4 million) due to increased payments on account during 2017 as a result of the Ministerial Decree of 27 June 2017;
- prepayments paid for the start-up of operations in South America (€30.6 million);
- expenses already paid for but accruing after 31 December 2017 (up €11.9 million), primarily due to the prepayment of costs relating to supply of the cable for the new Sardinia-Corsica-Italy - SACOI III connection (€9.5 million) and insurance premiums (€2.9 million).

18. INVENTORIES - €14.8 MILLION

Inventories included in current assets, amounting to €14.8 million, primarily consist of materials and equipment for use in the operation, maintenance and construction of plant.

This item is up €4.6 million compared with the previous year, primarily relating to fibre cable for use in telecommunications projects.

19. TRADE RECEIVABLES - €1,265.9 MILLION

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Energy-related receivables	772.8	997.8	(225.0)
Transmission charges receivable	312.2	324.0	(11.8)
Other trade receivables	180.9	121.5	59.4
TOTAL	1,265.9	1,443.3	(177.4)

Trade receivables amount to €1,265.9 million at 31 December 2017 and are accounted for less any losses on items deemed not to be recoverable and recognised in the allowance for doubtful accounts (€26.9 million for energy-related receivables and €12.6 million for other items in 2017, compared with €25.6 million for energy-related items and €13.4 million for other items in 2016). The carrying amount shown broadly approximates to fair value.

Energy-related/regulated receivables - €772.8 million

This item includes so-called "pass-through items" relating to the Parent Company's activities in accordance with Resolution 111/06 (€745.9 million) and receivables resulting from Regulated Activities (€16.1 million). It also includes the amount due from the Fund for Energy and Environmental Services (Cassa per i Servizi Energetici e Ambientali - CSEA), based on the RENS performance for the year (€10.8 million).

The balance is down €225.0 million overall compared with the previous year, essentially due to energy-related pass-through receivables (down €230.5 million), following a reduction of €261.4 million in the uplift, which benefitted from lower costs incurred in the third quarter of the year. This was partly offset by an increase in receivables deriving from effective imbalances. The decline in pass-through receivables also reflects a reduction in the amount receivable for plants that are essential for the security of the electricity system (UESS), reflecting termination of the essential service regime in Sicily.

Transmission charges receivable - €312.2 million

Transmission charges receivable, amounting to €312.2 million, represent the amount charged to electricity distributors for use of the National Transmission Grid. This amount is down €11.8 million compared with the previous year, primarily due to the changes introduced by Law Decree 50/17 regarding the mechanism for split payments³.

Other trade receivables - €180.9 million

Other trade receivables primarily regard amounts receivable from customers of the Non-Regulated Activities. These amounts derive from the provision of specialist services to external customers, primarily in relation to plant engineering services, the operation and maintenance of high-voltage and very high-voltage infrastructure, and the housing of telecommunications equipment and maintenance services for fibre networks.

This item is up €59.4 million compared with the previous year, primarily reflecting receivables due from Piemonte Savoia Srl in return for completing work on the Italy-France Interconnector Project following the achievement of a series of contract milestones (€49.3 million). These receivables were collected in January 2018.

³ With effect from 1 July 2017, art. 1 of Law Decree 50 of 24 April 2017, converted into law by Law 96/2017, amended art. 17-ter of Presidential Decree 633/1972, extending split payment requirements to listed companies included in the FTSE-MIB index and to direct and indirect subsidiaries of the State or local authorities. From last 1 July, therefore, the amount due to Terna on transactions with the above entities subject to the split payment requirements no longer includes VAT, as the legislation requires the tax to be paid to the tax authorities directly by the purchaser.

The following table shows receivables resulting from contract work in progress (€36.9 million), being carried out by the Group under multi-year contracts with external customers:

	PREPAYMENTS	VALUE OF THE CONTRACT	BALANCE AT 31 DECEMBER 2017	PREPAYMENTS	VALUE OF THE CONTRACT	BALANCE AT 31 DECEMBER 2016
Receivables resulting from contract work in progress	(23.6)	60.5	36.9	(32.1)	61.4	29.3

(€m)

The Group's receivables resulting from contract work in progress are up €7.6 million on the previous year, primarily in relation to the contract in Uruguay (€6.7 million).

The amount for guarantees given by the Parent Company to third parties at 31 December 2017 amounts to €126.2 million. This includes €44.3 million in surety bonds given in order to guarantee fulfilment of the Company's contractual obligations in performing its operating activities and €81.9 million as follows: €39.2 million in the interests of the subsidiary, Terna Interconnector Srl, €24.7 million in the interests of the subsidiary Terna Rete Italia SpA, €10.4 million in the interests of the subsidiary, Terna Plus Srl, €4.2 million in the interests of the subsidiary Difebal SA, €3.4 million in guarantees issued in the interests of the subsidiary Rete Srl. All the guarantees have been issued in relation to Terna SpA's credit facilities.

20. CASH AND CASH EQUIVALENTS - €1,989.2 MILLION

Cash amounts to €1,989.2 million at 31 December 2017, including €499.7 million in liquidity invested in readily convertible short-term deposits and €1,489.5 million in net deposits in bank current accounts.

21. INCOME TAX ASSETS - €36.9 MILLION

Income tax assets, amounting to €36.9 million, are up €17.2 million compared with the previous year. This essentially reflects an increase in payments on account during the year and a decrease in accrued income tax payable, primarily due to the reduction in the IRES tax rate from 27.5% to 24%, accounting for an increase of €11.6 million, with respect to the amount payable to the tax authorities at 31 December 2016 and recognised in "Tax liabilities". The increase also reflects adjustment of the IRES credit receivable in accordance with Law Decree 16/2012 of 2 March 2012, totalling €5.7 million.

Equity and liabilities

22. EQUITY ATTRIBUTABLE TO OWNERS OF THE PARENT - €3,803.3 MILLION

Share capital - €442.2 million

The Parent Company's share capital consists of 2,009,992,000 ordinary shares with a par value of €0.22 per share.

Legal reserve - €88.4 million

The legal reserve accounts for 20% of the Parent Company's share capital.

Other reserves - €732.0 million

The other reserves have risen €5.1 million compared with the previous year, primarily as a result of other components of comprehensive income. This reflects:

- fair value adjustments to the Parent Company's cash flow hedges (up €5.5 million, taking into account the related tax liability of €1.8 million);
- the recognition of actuarial gains and losses on provisions for employee benefits (a loss of €0.4 million, taking into account the related tax asset of €0.1 million).

Retained earnings and accumulated losses - €2,001.7 million

The increase in "Retained earnings and accumulated losses", amounting to €212.0 million, primarily regards the remaining portion of the Group's profit for 2016, following the Parent Company's payment of the dividend for 2016 (totalling €414.0 million).

Interim dividend for 2017

On 10 November 2017, the Parent Company's Board of Directors, having obtained the Independent Auditor's opinion required by article 2433-bis of the Italian Civil Code, decided to pay an interim dividend of €0.074263 per share, amounting to a total payout of €149.3 million. The dividend was payable from 22 November 2017, with an ex-dividend date for coupon 27 of 20 November 2017.

Equity attributable to non-controlling interests

Equity attributable to non-controlling interests, relating to the non-controlling shareholders of the Tamini Group and Terna Interconnector Srl, amounts to €25.7 million, an increase of €5.9 million compared with 31 December 2016, when the figure was €19.8 million. This reflects the net effect of the profit reported by Terna Interconnector Srl (€7.8 million) and the loss reported by the Tamini Group for 2017 (€-1.9 million).

23. BORROWINGS AND FINANCIAL LIABILITIES

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Bond issues	6,541.9	6,420.5	121.4
Non-current borrowings	2,129.7	1,983.9	145.8
LONG-TERM BORROWINGS	8,671.6	8,404.4	267.2
Cash flow hedges	10.5	12.8	(2.3)
NON-CURRENT FINANCIAL LIABILITIES	10.5	12.8	(2.3)
SHORT-TERM BORROWINGS	118.0	20.1	97.9
Bond issues	749.9	769.9	(20.0)
Variable rate borrowings (current portion)	134.4	134.6	(0.2)
CURRENT PORTION OF LONG-TERM BORROWINGS	884.3	904.5	(20.2)
TOTAL	9,684.4	9,341.8	342.6

Borrowings and financial liabilities have increased by €342.6 million compared with the previous year to €9,684.4 million.

The increase in bond issues (up €101.4 million) is attributable to the effects of the bonds issued on 26 July 2017, totalling €1,000 million, repayment of the bonds issued on 17 February 2012, amounting to €770 million, and the change in the fair value of the hedged item, amounting to €-128.6 million, after adjusting for amortised cost (€62.2 million).

The latest official prices at 31 December 2017 and 31 December 2016 for the bonds listed on the Luxembourg Stock Exchange are detailed below:

(€)

	PRICE AT 31 DECEMBER 2017	PRICE AT 31 DECEMBER 2016
Bond maturity 2024:	128.98	130.48
Bond maturity 2023:	135.46*	131.96
Bond maturity 2019:	108.74	113.07
Bond maturity 2026:	102.85	103.09
Bond maturity 2021:	114.80	118.33
Bond maturity 2018:	100.38	103.20
Bond maturity 2022:	102.50	101.61
Bond maturity 2028:	96.16	94.60
Bond maturity 2027:	100.51	-
Bond maturity 2017:	-	100.86

* Source BNP Paribas, in the absence of up-to-date prices sourced from Reuters and Bloomberg.

Compared to the previous year, non-current borrowings have decreased by €145.8 million, due mainly to the combined effect of:

- the drawdown of new EIB loans and a new loan disbursed to the subsidiary Difebal (totalling €281.2 million);
- repayments made to the EIB on falling due and lease payments totalling €134.4 million.

Long-term borrowings

(€m)

	MATURITY	AT 31 DECEMBER 2016	AT 31 DECEMBER 2017	PORTION FALLING DUE WITHIN 12 MONTHS	PORTION FALLING DUE AFTER 12 MONTHS	2019	2020	2021	2022	2023	BEYOND	AVERAGE INTEREST RATE AT 31 DECEMBER 2017	AVERAGE NET INTEREST RATE ON HEDGES AT 31 DECEMBER 2017
Bonds	2024	1,054.2	1,013.4	-	1,013.4	-	-	-	-	-	1,013.4	4.90%	0.33%
IL bonds	2023	710.2	692.9	-	692.9	-	-	-	-	692.9	-	2.73%	(0.24%)
PP bonds	2019	660.4	638.7	-	638.7	638.7	-	-	-	-	-	4.88%	1.15%
PP bonds	2026	78.7	78.8	-	78.8	-	-	-	-	-	78.8	1.60%	1.80%
1250 bonds	2021	1,432.5	1,388.7	-	1,388.7	-	-	1,388.7	-	-	-	4.75%	1.14%
1250 bonds	2017	769.9	-	-	-	-	-	-	-	-	-	4.13%	4.22%
1000 bonds	2022	996.1	996.8	-	996.8	-	-	-	996.8	-	-	0.88%	0.95%
750 bonds	2018	749.1	749.9	749.9	-	-	-	-	-	-	-	2.88%	2.98%
750 bonds	2028	739.3	740.1	-	740.1	-	-	-	-	-	740.1	1.00%	1.22%
1000 bonds	2027	-	992.5	-	992.5	-	-	-	-	-	992.5	1.38%	1.46%
EIB	2039	-	238.6	-	238.6	-	-	4.6	13.3	13.3	207.4	1.33%	1.33%
Total fixed rate		7,190.4	7,530.4	749.9	6,780.5	638.7	-	1,393.3	1,010.1	706.2	3,032.2		
EIB	2015-2030	1,611.9	1,488.3	132.4	1,355.9	96.8	96.8	92.2	83.5	83.5	903.1	0.27%	0.68%
CDP	2019	500.0	500.0	-	500.0	-	500.0	-	-	-	-	1.04%	1.14%
Difebal financing	2034	-	32.6	-	32.6	-	-	-	-	-	32.6	5.08%	5.41%
Leases	2019-2021-2022	6.6	4.6	2.0	2.6	2.0	0.3	0.2	0.1	-	-	0.73%	0.73%
Total variable rate		2,118.5	2,025.5	134.4	1,891.1	98.8	597.1	92.4	83.6	83.5	935.7		
TOTAL		9,308.9	9,555.9	884.3	8,671.6	737.5	597.1	1,485.7	1,093.7	789.7	3,967.9		

At 31 December 2017, the Terna Group's borrowings amount to €9,555.9 million (€884.3 million maturing within 12 months and €8,671.6 million maturing after 12 months), of which €3,967.9 million maturing after five years.

The table below shows movements in long-term debt during the year, including also the nominal amount:

(€m)

	AT 31 DECEMBER 2016			REPAYMENTS AND CAPITALISATIONS	DRAW- DOWNS	CHANGE IN FAIR VALUE 31 DEC 2016/ 31 DEC 2017	CHANGE IN CARRYING AMOUNT	AT 31 DECEMBER 2017		
	NOMINAL DEBT	CARRYING AMOUNT	FAIR VALUE					NOMINAL DEBT	CARRYING AMOUNT	FAIR VALUE
Bonds maturing 2024	800.0	1,054.2	1,043.8	-	-	(40.8)	(40.8)	800.0	1,013.4	1,031.8
IL bonds	565.4	710.2	746.1	(66.4)	-	49.1	(17.3)	570.5	692.9	677.3
Private Placement 2019	600.0	660.4	678.4	-	-	(21.7)	(21.7)	600.0	638.7	652.4
Private Placement 2026	80.0	78.7	82.5	-	-	0.1	0.1	80.0	78.8	82.3
Bonds maturing 2021	1,250.0	1,432.5	1,479.2	-	-	(43.8)	(43.8)	1,250.0	1,388.7	1,435.0
Bonds maturing 2017	770.0	769.9	776.6	(770.0)	-	0.1	(769.9)	-	-	-
Bonds maturing 2022	1,000.0	996.1	774.0	-	-	0.7	0.7	1,000.0	996.8	1,025.0
Bonds maturing 2018	750.0	749.1	1,016.1	-	-	0.8	0.8	750.0	749.9	752.8
Bonds maturing 2028	750.0	739.3	709.5	-	-	0.8	0.8	750.0	740.1	721.2
Bonds maturing 2027	-	-	-	-	1,000.0	(7.5)	992.5	1,000.0	992.5	1,005.2
Total bond issues	6,565.4	7,190.4	7,306.2	(836.4)	1,000.0	(62.2)	101.4	6,800.5	7,291.8	7,383.0
Loans	2,118.7	2,118.5	2,118.7	(134.4)	281.2	(1.2)	145.6	2,265.5	2,264.1	2,270.4
Total borrowings	2,118.7	2,118.5	2,118.7	(134.4)	281.2	(1.2)	145.6	2,265.5	2,264.1	2,270.4
Total debt	8,684.1	9,308.9	9,424.9	(970.8)	1,281.2	(63.4)	247.0	9,066.0	9,555.9	9,653.4

At 31 December 2017, the Group has access to additional financing of €2,050.0 million, represented by three revolving credit facilities entered into in December 2014, December 2015 and July 2016. In addition, the Group has uncommitted bank lines of credit totalling approximately €616.4 million.

In addition, as provided for in IFRS 7, the table shows the fair value of financial liabilities. In the case of bond issues, this is market value based on prices at the reporting date, whilst variable rate loans are shown substantially at the nominal amount to be repaid.

Non-current financial liabilities

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Cash flow hedges	10.5	12.8	(2.3)
TOTAL	10.5	12.8	(2.3)

Non-current financial liabilities, amounting to €10.5 million, reflect the fair value of cash flow hedges at 31 December 2017.

Fair value was measured by discounting the expected cash flows using the market yield curve at the reporting date. The change in the yield curve compared with 31 December 2016 resulted in a decrease of €2.3 million.

Short-term borrowings - €118.0 million

Short-term borrowings, amounting to €118.0 million, reflect the use of short-term lines of credit by the Parent Company (€90 million) and the Tamini Group (€28 million). The figure is up €97.9 million on the previous year.

Current financial liabilities

Current financial liabilities at 31 December 2017 include the value of net interest expense accrued on financial instruments and not yet paid. This item is down €20.7 million compared with the previous year.

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
DEFERRED LIABILITIES ON:			
Hedging derivatives	1.8	0.7	1.1
Bond issues	101.9	123.5	(21.6)
Borrowings	2.0	2.2	(0.2)
TOTAL	105.7	126.4	(20.7)

Net debt

Pursuant to CONSOB Communication of 28 July 2006 and in compliance with Recommendation ESMA/2011/81 of 23 March 2011, the Group's net debt is as follows:

	(€m)
	AT 31 DECEMBER 2017
A. Cash	1,489.5
B. Term deposits	499.7
C. Cash and cash equivalents (A) + (B)	1,989.2
D. Current portion of non-current borrowings	884.3
E. Short-term borrowings	118.0
F. Other net financial liabilities	101.2
<i>of which from related parties</i>	<i>0.2</i>
G. Current debt (D+E+F)	1,103.5
H. Current net debt (G) - (C)	(885.7)
I. Non-current borrowings	2,129.7
<i>of which from related parties</i>	<i>500.0</i>
J. Bond issues	6,541.9
K. Derivative financial instruments held in portfolio	10.5
L. Non-current net debt (I) + (J) + (K)	8,682.1
M. Net debt (H) + (L)	7,796.4

Default risk and debt covenants

This risk is associated with the possibility that the loan agreements or bond terms and conditions to which the Group is a party may contain provisions that, if certain events occur, authorise counterparties to call in such loans immediately, thereby generating liquidity risk.

Certain long-term loans obtained by the Parent Company, Terna SpA, contain covenants that are typical of international practice. The principal covenants relate to:

- the Company's bond issues, which consist of an €800.0 million issue in 2004 and eight issues as part of its EMTN Programme (the "€ 8,000,000,000 Medium Term Notes Programme");
- bank borrowings, consisting of a loan from Cassa Depositi e Prestiti (CDP) of €500.0 million that draws on EIB funds and three revolving credit facilities of €750.0, €800.0 and €500.0 million ("bank borrowings");
- a series of loans to the Company from the European Investment Bank (EIB), amounting to a total of €1,726.9 million.

The main covenants relating to the bond issues and the EMTN Programme involve clauses regarding i) "negative pledges", on the basis of which the Issuer or its Relevant Subsidiaries undertake not to create or maintain mortgages, pledges or other encumbrances on their assets or revenue, to guarantee listed bonds (with the exception of certain "permitted guarantees"); ii) "pari passu", on the basis of which the securities constitute a direct, unconditional and unsecured obligation by the Issuer, ranking equally among them and with at least the same level of seniority as other present and future unsecured and non- subordinated borrowings of the Issuer; iii) "event of default", on the basis of which if certain predetermined events occur (e.g., failure to make a repayment, the liquidation of the Issuer, the breach of contractual obligations, a cross-default, etc.) a situation of default is established and the loan is immediately called in.

The main covenants relating to bank borrowings involve clauses related to i) negative pledges, on the basis of which the Issuer or the Relevant Subsidiaries undertake not to create or maintain guarantees on their assets to secure borrowings, with the exception of “permitted guarantees”; ii) “pari passu” on the basis of which the Borrower’s payment obligations in relation to the loan agreements in question are not subordinated to any obligation related to other unsecured and non-subordinated creditors, without prejudice to privileges under the law; iii) “event of default”, on the basis of which if certain predetermined events occur (e.g. failure to make a repayment, serious inaccuracies in documents and/or declarations, insolvency, business discontinuation, substantially prejudicial effects, the breach of contractual obligations, including pari passu conditions, a cross-default, etc.) a situation of default is established and the loan is immediately called in; iv) accelerated repayment should the rating fall below investment grade (BBB-) for the majority of rating agencies or should the Company cease to be rated by at least one agency.

The main covenants related to the EIB loans involve clauses related to i) negative pledges, on the basis of which the Company cannot create encumbrances, with the exception of encumbrances granted in relation to borrowings below given amounts and under contractually specified circumstances; ii) the provision to the Bank, at its request, of new guarantees should ratings below BBB+/Baa1 be assigned by two ratings agencies out of three, or in the event that all of the agencies cease to publish ratings; iii) “pari passu”, on the basis of which the Company ensures that payment obligations rank equally with those related to all other unsecured, non-subordinated creditors; iv) cases of contract termination/application of the call provision/withdrawal (e.g. failure to make a repayment, serious inaccuracies in documents and/or declarations, insolvency, events that have a negative impact on financial commitments made by the Company, extraordinary administration, liquidation, substantial prejudicial changes, the breach of contractual commitments, etc.); v) accelerated loan payment following the occurrence of given events (e.g. change of control over the Company, loss of the concession, extraordinary corporate events, etc.).

The long-term loan executed by the Uruguayan subsidiary, Difebal, on 14th July 2017, contains certain covenants that are typical of international project finance standards.

To date, no covenant has been breached.

24. EMPLOYEE BENEFITS - €80.7 MILLION

The Group provides its employees with benefits during their period of employment (loyalty bonuses), on termination of employment (TFR, additional months’ pay and payment in lieu of notice) and after termination in the form of post-employment benefits (energy discounts and ASEM health cover).

Loyalty bonuses are payable to the Group’s employees and senior managers once certain requirements have been met regarding length of service (on completing 25 and 35 years of service).

Termination benefits (TFR) are payable to all employees, whilst senior managers recruited or appointed before 28 February 1999 receive payment in lieu of notice and employees (operational personnel, administrative personnel and middle managers) employed prior to 24 July 2001 are due additional months’ pay on termination.

Post-employment benefits consist of:

- reduced energy prices for household use by employees hired prior to 30 June 1996 (energy discounts);
- a form of supplementary health cover in addition to that provided by the Italian national health service, as provided for in the national collective contract for industrial managers (the ASEM health plan).

The following table shows the composition of provisions for *TFR* and other employee benefits and movements during the year ended 31 December 2017.

(€m)

	AT 31 DECEMBER 2016	PROVISIONS	INTEREST COST	USES AND OTHER MOVEMENTS	ACTUARIAL GAINS/ (LOSSES)	AT 31 DECEMBER 2017
Benefits during the period of employment						
Loyalty bonuses	4.5	0.2	0.1	(0.2)	-	4.6
Total	4.5	0.2	0.1	(0.2)	-	4.6
Termination benefits						
Deferred compensation benefits (<i>TFR</i>)	53.9	0.3	0.5	(8.1)	(0.2)	46.4
Additional months' pay	6.9	0.2	-	(0.1)	0.1	7.1
Payment in lieu of notice	0.6	-	-	(0.3)	-	0.3
Total	61.4	0.5	0.5	(8.5)	(0.1)	53.8
Post-employment benefits						
Energy discounts	28.8	0.3	0.4	(17.1)	0.6	13.0
ASEM health cover	9.4	0.3	0.1	(0.5)	-	9.3
Total	38.2	0.6	0.5	(17.6)	0.6	22.3
TOTAL	104.1	1.3	1.1	(26.3)	0.5	80.7

This item, amounting to €80.7 million at 31 December 2017, is down €23.4 million compared with the previous year. This reflects net uses and other movements during the year (down €25 million), above all due to an adjustment to provisions for the energy discounts granted to pensioners (down €18.3 million), and use of provisions for deferred compensation benefits (*TFR*) as a result of retirements (down €7.6 million). These reductions were offset by the impact of discounting to present value (up €1.1 million) and actuarial gains and losses (€0.5 million).

The following table shows the current service cost and interest income and expense.

(€m)

	LOYALTY BONUSES	TFR	ADDITIONAL MONTHS' PAY	PAYMENT IN LIEU OF NOTICE AND OTHER SIMILAR	ENERGY DISCOUNTS	ASEM HEALTH COVER	TOTAL
Net impact recognised in profit or loss							
- current service cost	0.2	0.3	0.2	-	0.3	0.3	1.3
- curtailment (revenue) and other costs	-	(0.5)	-	(0.3)	(11.0)	(0.3)	(12.1)
- interest income and expense	0.1	0.5	-	-	0.4	0.1	1.1
TOTAL RECOGNISED IN PROFIT OR LOSS	0.3	0.3	0.2	(0.3)	(10.3)	0.1	(9.7)

Revaluation of the net liability for employee benefits is shown in the following table, which provides details of the type of actuarial gain or loss recognised in other comprehensive income.

(€m)

	TFR	ADDITIONAL MONTHS' PAY	ENERGY DISCOUNTS	ASEM HEALTH COVER	TOTAL
Actuarial gain/losses					
- based on past experience	(0.1)	0.2	0.1	(0.1)	0.1
- due to changes in demographic assumptions	-	-	-	-	-
- due to changes in other economic assumptions	-	0.1	0.5	0.1	0.7
- due to changes in discount rate	(0.1)	(0.2)	-	-	(0.3)
TOTAL IMPACT ON OTHER COMPREHENSIVE INCOME	(0.2)	0.1	0.6	-	0.5

Finally, the following tables show the main actuarial assumptions applied, a sensitivity analysis of movements in the assumptions and the payment schedule for the plan. In line with 2016, the interest rate used to determine the present value of the obligation was calculated on the basis of the yield on the Iboxx Eurozone Corporates AA index at 31 December 2017, matching the duration of the relevant group of plan participants.

	LOYALTY BONUSES	TFR	ADDITIONAL MONTHS' PAY	PAYMENT IN LIEU OF NOTICE AND OTHER SIMILAR	ENERGY DISCOUNTS	ASEM HEALTH COVER
Discount rate	1.29%	0.91%	0.51%	0.21%	1.30%	1.37%
Inflation rate	1.50%	1.50%	0.00%	1.50%	1.50%	3.00%
Duration (in years)	10.8-12.7	9.3-10.2	5.2-6	4.7-7.8	20.7-21.1	10.4-18.5

(€m)

	LOYALTY BONUSES	TFR	ADDITIONAL MONTHS' PAY	PAYMENT IN LIEU OF NOTICE AND OTHER SIMILAR	ENERGY DISCOUNTS	ASEM HEALTH COVER	TOTAL
Discount rate +0.25%	4.4	45.6	6.9	0.3	12.3	8.9	78.4
Discount rate -0.25%	4.6	47.8	7.1	0.3	13.6	9.7	83.1
Inflation rate +0.25%	4.6	47.5	n/a	n/a	13.6	n/a	65.7
Inflation rate -0.25%	4.4	45.9	n/a	n/a	12.3	n/a	62.6
Annual rate of increase in health costs +3%	n/a	n/a	n/a	n/a	n/a	15.2	15.2
Annual rate of increase in health costs -3%	n/a	n/a	n/a	n/a	n/a	5.7	5.7
Conversion rate for KW/h +5%	n/a	n/a	n/a	n/a	13.5	n/a	13.5
Conversion rate for KW/h -5%	n/a	n/a	n/a	n/a	12.3	n/a	12.3

(€m)

	LOYALTY BONUSES	TFR	ADDITIONAL MONTHS' PAY	PAYMENT IN LIEU OF NOTICE AND OTHER SIMILAR	ENERGY DISCOUNTS	ASEM HEALTH COVER	TOTAL
By the end of 2018	0.1	2.6	1.6	-	0.8	0.2	5.3
By the end of 2019	0.1	1.7	0.5	0.1	0.8	0.3	3.5
By the end of 2020	0.2	2.8	0.5	-	0.8	0.3	4.6
By the end of 2021	0.4	3.1	0.6	0.1	0.8	0.4	5.4
By the end of 2022	0.5	3.9	0.7	-	0.8	0.4	6.3

25 - PROVISIONS FOR RISK AND CHARGES - €266.5 MILLION

(€m)

	PROVISIONS FOR LITIGATION AND DISPUTES	PROVISIONS FOR SUNDRY RISKS AND CHARGES	PROVISIONS FOR EARLY RETIREMENT INCENTIVES	TOTAL
Amount at 31 December 2016	14.6	167.4	56.6	238.6
New provisions	10.5	59.9	17.6	88.0
Uses and other movements	(1.2)	(47.7)	(11.2)	(60.1)
Amount at 31 December 2017	23.9	179.6	63.0	266.5

Provisions for litigation and disputes - €23.9 million

These provisions, set aside to cover outstanding liabilities that, at the end of the year, could result from court judgements and out-of-court settlements regarding the activities of Group companies, have been assessed partly on the basis of recommendations from internal and external legal advisors. The provisions are up €9.3 million compared with the previous year, due to net provisions made during the year.

Provisions for sundry risks and charges - €179.6 million

These provisions are up €12.2 million compared with the previous year, reflecting:

- net provisions for management incentive plans, totalling €9.5 million;
- a net increase of €5.4 million in provisions linked to regulation of the quality of the electricity service (the mitigation and sharing mechanism introduced by ARERA Resolution 653/2015/R/eel) which, after provisions for estimated penalties linked to outages during the year, reflects payments to distribution companies and releases following final determination of the penalties due to previous years.

Provisions for early retirement incentives - €63.0 million

Provisions for early retirement incentives reflects the estimated extraordinary expenses to be incurred in relation to the cost of the scheme for 2017, linked to the early retirement of Group employees who have reached pensionable age. This item has increased by a net €6.4 million, reflecting new provisions for the early retirement scheme of €17.6 million, offset by payments during the year (€11.2 million).

26. DEFERRED TAX LIABILITIES - €8.6 MILLION

(€m)

	AT 31 DECEMBER 2016	PROVISIONS	USES AND OTHER MOVEMENTS	EFFECTS RECOGNISED IN COMPREHENSIVE INCOME	AT 31 DECEMBER 2017
DEFERRED TAX LIABILITIES					
Property, plant and equipment	149.9	-	(35.1)	-	114.8
Other	-	0.8	0.6	-	1.4
Employee benefits and financial instruments	3.1	-	-	-	3.1
Total deferred tax liabilities	153.0	0.8	(34.5)	-	119.3
DEFERRED TAX ASSETS					
Provisions for risks and charges	(37.2)	(9.6)	7.7	-	(39.1)
Allowance for doubtful accounts	(3.2)	-	-	-	(3.2)
Employee benefits	(21.7)	(16.3)	15.9	(0.1)	(22.2)
Fair value and cash flow hedges	(5.8)	-	-	1.8	(4.0)
Tax relief on goodwill	(37.0)	-	2.6	-	(34.4)
Other	(6.2)	(2.0)	0.4	-	(7.8)
Total deferred tax assets	(111.1)	(27.9)	26.6	1.7	(110.7)
NET DEFERRED TAX LIABILITIES	41.9	(27.1)	(7.9)	1.7	8.6

The balance of this item, amounting to €8.6 million, includes the net impact of movements in the Group's deferred tax liabilities and deferred tax assets.

Deferred tax liabilities (€119.3 million) are down €33.7 million, essentially due to movements at the Parent Company, Terna (down €30.0 million) following the use of prior provisions for accelerated depreciation.

Deferred tax assets (€110.7 million) are broadly in line with the figure for 31 December 2016 (€111.1 million), but underwent the following movements during the year:

- net provisions for risks and charges (€1.9 million), primarily reflecting the tax effect of the release of provisions for a photovoltaic project (€1.5 million);
- net provisions for employee benefits (€0.4 million);
- net uses that did not impact profit or loss, totalling €1.7 million, reflecting the tax effect of movements in cash flow hedges and employee benefits;
- use of the accrued portion recognised in relation to tax relief on the goodwill resulting from the merger of RTL with and into the Parent Company (€2.6 million);
- provisions recognised by the subsidiary, Rete Srl, for the non-deductible portion of book depreciation recognised by the subsidiary, but not tax-deductible (€2.0 million).

27. OTHER NON-CURRENT LIABILITIES - €251.0 MILLION

This item, amounting to €251.0 million at 31 December 2017, regards accrued grants related to assets receivable by the Parent Company (€96.1 million), in addition to payments on account received from the entities financing the Italy-France Interconnector (€111.5 million).

This item also includes the Interconnector Guarantee Fund set up by Terna SpA following the issue of the 2016 Stability Law (€43.4 million), in order to fund investment in interconnections by art. 32 of Law 99/09.

The increase in this item compared with the previous year, amounting to €130.1 million, essentially reflects the recognition of payments on account received from the entities financing the Italy-France Interconnector (€111.5 million) and an increase in the Interconnector Guarantee Fund (€23.7 million).

28. CURRENT LIABILITIES

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Short-term borrowings *	118.0	20.1	97.9
Current portion of long-term borrowings *	884.3	904.5	(20.2)
Trade payables	2,497.9	2,280.7	217.2
Tax liabilities	-	8.1	(8.1)
Current financial liabilities *	105.7	126.4	(20.7)
Other current liabilities	193.0	206.3	(13.3)
TOTAL	3,798.9	3,546.1	252.8

(*) Information on these items is provided in note 23, "Borrowings and financial liabilities".

TRADE PAYABLES - €2,497.9 MILLION

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Suppliers:			
- Energy-related payables	1,602.6	1,525.8	76.8
- Non-energy-related payables	874.4	735.7	138.7
Amounts due to associates	14.9	10.1	4.8
Payables resulting from contract work in progress	6.0	9.1	(3.1)
TOTAL	2,497.9	2,280.7	217.2

Suppliers

Energy-related/regulated payables - €1,602.6 million

The increase in this item compared with the previous year, amounting to €76.8 million, essentially reflects energy-related pass-through payables (up €76.3 million). This is primarily due to:

- an increase in payables resulting from provision of the dispatching service (up €171.8 million), primarily linked to increased purchases on the DSM due to local technical constraints and an increase in capacity reserves in November and December;
- an increase in payables linked to plants that are essential for the security of the electricity system - *UESS* (€74.8 million), reflecting reduced payments at the end of the year;
- a reduction in payables relating to capacity payments (€-170 million), reflecting the greater amount of payments made at the end of the year (in accordance with ARERA Resolutions 398/2017, 418/2017, 588/2017 and 844/2017) following collection of payments due to cover the cost of the service, broadly in line with the previous year.

Non-energy-related payables

The exposure to suppliers regards invoices received and to be received for contract work, services and purchases of materials and equipment.

The balance at 31 December 2017 (€874.4 million) is up €138.7 million on the previous year, largely due to increased capital investment towards the end of the year. payables attributable to the Tamini Group are up €13.7 million.

Amounts due to associates

This item, amounting to €14.9 million, is up €4.8 million on the previous year and regards amounts payable to the associate CESI SpA, for services provided primarily to the Parent Company (€3.5 million) and to the subsidiary Terna Rete Italia SpA (€10.5 million), relating to electro technical studies and research.

Payables resulting from contract work in progress

Payables resulting from contract work in progress, amounting to €6.0 million at 31 December 2017, are down €3.1 million on the figure for 31 December 2016 (€9.1 million), essentially due to a reduction in amounts payable on contract work for Terna Plus (€2.6 million).

This item breaks down as follows.

						(€m)
	PREPAYMENTS	VALUE OF THE CONTRACT	BALANCE AT 31 DECEMBER 2017	PREPAYMENTS	VALUE OF THE CONTRACT	BALANCE AT 31 DECEMBER 2016
Payables resulting from contract work in progress	(19.0)	13.0	(6.0)	(28.0)	18.9	(9.1)

The carrying amount of trade payables broadly approximates to fair value.

The commitments assumed by the Group towards suppliers amount to approximately €2,698.8 million and regard purchase commitments linked to the normal “operating cycle” projected for the period 2018-2022.

Tax liabilities - €0 million

This item amounts to zero at 31 December 2017, having decreased by €8.1 million compared with previous year. This reflects an increase in payments on account during the year and a decrease in accrued income tax payable, primarily due to the reduction in the IRES tax rate from 27.5% to 24%. The resulting amount has been accounted for in “Tax assets”. At 31 December 2016, this item reflected the Group’s tax liability for that year after the related payments on account.

OTHER CURRENT LIABILITIES - €193.0 MILLION

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Prepayments	22.3	53.6	(31.3)
Other tax liabilities	7.8	6.7	1.1
Social security payables	24.2	23.6	0.6
Amounts due to personnel	47.0	34.3	12.7
Other amounts due to third parties	91.7	88.1	3.6
TOTAL	193.0	206.3	(13.3)

Prepayments

This item (€22.3 million) regards grants related to assets collected by the Group (€15.9 million attributable to the Parent Company, €2.7 million to Rete Srl and €1.9 million to Terna Rete Italia SpA) to fund the construction of non-current assets in progress at 31 December 2017.

Compared with to the balance at 31 December 2016 (€53.6 million), this item is down €31.3 million. This essentially reflects the net impact of grants deducted directly from the carrying amount of the related assets, totalling €128.9 million, and new grants received from third parties, above all EU grants for the Sorgente-Rizziconi project.

Other tax liabilities

Other tax liabilities, amounting to €7.8 million, are up €1.1 million compared with the previous year, primarily due to recognition in 2017, of VAT payable by the subsidiary Terna Interconnector Srl, which does not participate in the Group VAT arrangement⁴ (up €0.7 thousand), and an increase in withholding tax payable on salaries and deferred compensation (TFR) paid to employees (€0.4 million).

Social security payables

Social security payables, essentially relating to contributions payable to INPS (the National Institute of Social Security) by the Parent Company and the subsidiary Terna Rete Italia SpA, amount to €24.2 million. This is broadly in line with the previous year. This item also included the amount payable to the Fondo Previdenza Elettrici - F.P.E. (the Electricity Industry Pension Fund), amounting to €3.7 million.

Amounts due to personnel

Amounts due to personnel, amounting to €47.0 million, essentially regard the Parent Company and the subsidiary, Terna Rete Italia SpA. They primarily relate to:

- incentives payable in the subsequent year (€23.7 million);
- amounts due to employees in the form of accrued and unused annual leave and bank holiday entitlements (€10.7 million).

This item is up €12.7 million, primarily due to an increase in payables recognised in 2017 as a result of amounts payable to personnel who have opted for early retirement under the current scheme (€3.6 million), an increase in deferred compensation (TFR) (€5.5 million) and a rise in other incentives for personnel (€4.6 million).

Other payables due to third parties

Other payables due to third parties, amounting to €91.7 million, primarily regard guarantee deposits (€71.2 million) received from electricity market operators to guarantee their contractual obligations under dispatching and virtual interconnection contracts. This item also includes deferred income (€8.6 million, primarily attributable to the Group's Non-Regulated Activities).

This item is up by a total of €3.6 million, essentially due to an increase in guarantee deposits (up €4.5 million).

⁴ From 2018, the company has joined the Group VAT arrangement.

E. Commitments and risks

Risk management

The Group's financial and market risk

In the course of its operations, the Terna Group is exposed to different financial risks: market risk, liquidity risk and credit risk.

This section provides information regarding the Terna Group's exposure to all the above risks, along with a presentation of the objectives, policies and processes for managing those risks and the methods used to assess them, with further quantitative disclosures concerning the separate financial statements for 2017.

The Group's risk management policies seek to identify and analyse the risks that Group companies are exposed to, establishing appropriate limits and controls and monitoring the risks and compliance with such limits. These policies and the related systems are reviewed on a regular basis, in order to take account of any changes in market conditions or in the companies' operations.

The Terna Group's exposure to the aforementioned risks is substantially represented by the exposure of the Parent Company. As a part of the financial risk management policies approved by the Board of Directors, Terna has established the responsibilities and operating procedures for financial risk management, specifically as concerns the instruments to be used and the precise operating limits to apply in managing them.

(€m)

	AT 31 DECEMBER 2017			AT 31 DECEMBER 2016		
	RECEIVABLES AT AMORTISED COST	HEDGING DERIVATIVES	TOTAL	RECEIVABLES AT AMORTISED COST	HEDGING DERIVATIVES	TOTAL
Assets						
Derivative financial instruments	-	-	-	-	325.7	325.7
Cash in hand and deposits	1,989.2	-	1,989.2	1,135.7	-	1,135.7
Trade receivables	1,265.9	-	1,265.9	1,443.3	-	1,443.3
TOTAL	3,255.1	-	3,255.1	2,579.0	325.7	2,904.7

(€m)

	AT 31 DECEMBER 2017				AT 31 DECEMBER 2016			
	PAYABLES AT AMORTISED COST	BORROWINGS AT FAIR VALUE	HEDGING DERIVATIVES	TOTAL	PAYABLES AT AMORTISED COST	BORROWINGS AT FAIR VALUE	HEDGING DERIVATIVES	TOTAL
Liabilities								
Long-term debt	2,264.1	7,291.8	-	9,555.9	2,118.5	7,190.4	-	9,308.9
Derivative financial instruments	-	-	10.5	10.5	-	-	12.8	12.8
Trade payables	2,497.9	-	-	2,497.9	2,280.7	-	-	2,280.7
TOTAL	4,762.0	7,291.8	10.5	12,064.3	4,399.2	7,190.4	12.8	11,602.4

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument may fluctuate as a result of changes in financial market conditions. Market risk includes three types of risk: exchange rate risk, interest rate risk and inflation risk.

Risk management must be performed with the objective of minimising the related risks by selecting counterparties and instruments compatible with the Company's Risk Management Policy. Speculative activity is not form part of the Parent Company's activities.

The Terna Group seeks to adopt a dynamic approach to financial risk management. This approach is characterised by risk aversion, aimed at minimising risk through continuous monitoring of financial markets in order to carry out the planned hedging transactions in favourable market conditions.

The fair value of financial instruments is determined in accordance with the fair value hierarchy envisaged under IFRS 7 (Level 2), by means of appropriate valuation techniques for each category of financial instrument, using market data at the closing date (such as interest rates, exchange rates and volatility) and discounting projected cash flows on the basis of the market yield curve at the reporting date.

Interest rate risk

Interest rate risk is represented by the uncertainty associated with interest rate fluctuations. This is the risk that a change in market interest rates may produce effects on the fair value or future cash flows of financial instruments.

In the course of its operations, Terna is exposed to the risk of fluctuations in interest rates. Its main source of interest rate risk is associated with its borrowings and the related hedges in the form of derivative instruments that generate financial expenses. Terna's borrowing strategy focuses on long-term borrowings, whose term reflects the useful life of the Company's assets. It pursues an interest rate risk hedging policy that aims to guarantee that the percentage of debt represented by fixed rate liabilities is at least 40%, as provided for in the relevant policies. Considering the low level of interest rates, the Group has converted all its debt to fixed rate.

The financial assets and liabilities relating to outstanding derivative instruments during the year can be classified as:

- cash flow hedges, hedging the risk of changes in cash flows associated with long-term variable rate loans;
- fair value hedges, hedging the exposure to changes in the fair value of a financial asset or liability associated with fluctuations in interest rates (fixed rate bonds).

Below are the notional amounts and fair values of the derivative financial instruments entered into by the Terna Group:

(€m)

	AT 31 DECEMBER 2017		AT 31 DECEMBER 2016		CHANGE	
	NOTIONAL	FAIR VALUE	NOTIONAL	FAIR VALUE	NOTIONAL	FAIR VALUE
Fair value hedges	-	-	1,350.0	325.7	(1,350.0)	(325.7)
Cash flow hedges	2,566.0	(10.5)	2,974.1	(12.8)	(408.1)	2.3

The notional amount of outstanding cash flow hedges at 31 December 2017, amounting to €2,566.0 million, breaks down as follows:

- €1,166.4 million (fair value of -€0.8 million), relating to the Parent Company, maturing 2018;
- €1,379.9 million (fair value of -€9.1 million), relating to the Parent Company, maturing 2021;
- €19.7 million (fair value of -€0.6 million), relating to the subsidiary Difebal maturing 2032.

Sensitivity to interest rate risk

As regards the management of interest rate risk, following the restructuring of its portfolio, Terna has floating-to-fixed interest rate swaps (Cash Flow Hedges) in place to hedge the risk associated with the cash flows generated by the majority of its variable rate debt.

Since the hedging relationship between the derivative and the hedged item is formally documented and the effectiveness of the hedge, as verified initially and periodically over its life, is high (between 80% and 125%), the Company has elected to use hedge accounting to ensure a perfect match between the maturities of the hedge and the hedged item. The aim of hedge accounting is to recognise the effects of the hedges and the hedged items in profit or loss at the same time. Accordingly, in the case of fair value hedges, any changes in the fair value of the hedged item attributable to the risk being hedged must be recognised through profit or loss, thereby offsetting the changes in the fair value of the derivative, which are also recognised through profit or loss. In the case of cash flow hedges, any changes in the fair value of the derivative must be recognised in "Other comprehensive income" (in equity, recognising any ineffective portion of the hedge directly through profit or loss) and then recycled through profit or loss in the same period in which the cash flows of the hedged instrument materialise. The characteristics of the cash flow hedges mirror those of the

underlyings, with the result that the related cash flows will be generated on the interest date of the debt, with changes in fair value having no impact on profit or loss.

The following table reports the amounts recognised through profit or loss and in "Other comprehensive income" for positions that are sensitive to changes in interest rates, in addition to the theoretical value of the positions following a positive or negative shift in the yield curve and the differential impact of such changes recognised through profit or loss and in "Other Comprehensive Income". A hypothetical 10% movement in interest rates with respect to market interest rates at the reporting date was assumed:

	PROFIT OR LOSS			EQUITY		
	CURRENT RATES +10%	CURRENT AMOUNTS	CURRENT RATES -10%	CURRENT RATES +10%	CURRENT AMOUNTS	CURRENT RATES -10%
At 31 December 2017						
Positions sensitive to interest rate variations (FVHs, bonds, CFHs)	-	-	-	(12.3)	(12.8)	(13.3)
<i>Hypothetical change</i>	-	-	-	0.5	-	(0.5)
At 31 December 2016						
Positions sensitive to interest rate variations (FVHs, bonds, CFHs)	(11.1)	(11.2)	(11.3)	(12.3)	(12.8)	(13.3)
<i>Hypothetical change</i>	0.1	-	(0.1)	0.5	-	(0.5)

(€m)

Inflation risk

As regards inflation risk, the rates established by the regulator to provide a return on Terna SpA's activities are determined so as to cover the allowed costs. Such cost components are updated on an annual basis to take into account the impact of inflation. Having used an inflation-linked bond issue in 2007, the Company has put in place an effective hedge of net income; in fact, any decrease in expected revenue due to a decrease in the inflation rate would be offset by lower financial expenses.

Exchange rate risk

Generally, Terna hedges exchange rate risk through the forward sale or purchase of currencies (forward contracts) or the use of options. Currency options give Terna the right or the obligation to buy or sell predetermined amounts of a currency at a specific exchange rate at the end of a specific period of time. Normally, both forward contracts and options have maturities of no more than 12 months.

Such contracts have a notional amount and maturity date less than or equal to that of the underlying financial liability, or the expected cash flows, so that any change in the fair value and/or estimated cash flows deriving from a rise or fall in the euro against other currencies is fully offset by a corresponding change in the fair value and/or estimated cash flows of the underlying position.

At 31 December 2017, the component of financial instruments associated with exchange rate risk is residual in nature and attributable to the Tamini Group.

Liquidity risk

Liquidity risk is the risk that Terna might encounter difficulty in discharging its obligations in respect of its financial liabilities and operating cycle. Liquidity risk management seeks to ensure adequate coverage of borrowing requirements by obtaining adequate lines of credit and appropriate management of any surplus liquidity. At 31 December 2017, Terna had available short-term credit lines of approximately €-616,4 million and revolving credit lines of €2,050 million.

Credit risk

Credit risk is the risk a customer or one of the counterparties to a transaction in financial instruments could cause a financial loss by failing to discharge an obligation. It is mainly generated by the Group's trade receivables and financial investments.

The credit risk originated by open positions on transactions in derivatives is considered to be marginal since the counterparties, in compliance with the financial risk management policies adopted, are leading international banks with high ratings.

Terna provides its services essentially to counterparties considered solvent by the market, and therefore with a high credit standing, and does not have high concentrations of credit risk.

Credit risk management is driven by the provisions of ARERA Resolution 111/06, which, in art. 49, introduced instruments designed to limit the risks related to the insolvency of dispatching customers, both on a preventive basis and in the event of an actual insolvency. In particular, the Resolution establishes three instruments to safeguard the electricity market: a guarantee system (bank guarantees provided by individual dispatching customers, based on their turnover); the option of terminating dispatching contracts (in the event of insolvency or failure to replace enforced guarantees); and, finally, the possibility of recovering uncollected debts, after having taken all other possible collection actions, through a specific fee to be fixed by the regulator.

The following table summarises the exposure to such risk at the reporting date:

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Fair Value Hedges	-	325.7	(325.7)
Cash and cash equivalents	1,989.2	1,135.7	853.5
Trade receivables	1,265.9	1,443.3	(177.4)
TOTAL	3,255.1	2,904.7	350.4

The total value of the exposure to credit rate risk at 31 December 2017 is represented by the carrying amount of trade receivables and cash and cash equivalents.

The following tables provide qualitative information on trade receivables that are not past due and have not been impaired.

	31 DECEMBER 2017	31 DECEMBER 2016
Italy	1,166.9	1,398.7
Euro-area countries	75.5	27.1
Other countries	23.5	17.5
TOTAL	1,265.9	1,443.3

	31 DECEMBER 2017	31 DECEMBER 2016
Distributors	311.2	322.9
CSEA	95.3	73.8
Dispatching customers for injections	195.9	190.4
Dispatching customers for withdrawals	465.3	718.3
Parties which have signed virtual import contracts and virtual import services (interconnectors and shippers)	13.2	13.0
Sundry receivables	185.0	124.9
TOTAL	1,265.9	1,443.3

The following table breaks down customer receivables by due date, reporting any potential impairment.

	AT 31 DECEMBER 2017		AT 31 DECEMBER 2016	
	IMPAIRMENT	GROSS	IMPAIRMENT	GROSS
Current	-	1,159.3	-	1,337.2
0-30 days past due	-	43.8	-	55.2
31-120 days past due	-	17.8	-	16.5
Over 120 days past due	(39.5)	84.5	(39.0)	73.4
TOTAL	(39.5)	1,305.4	(39.0)	1,482.3

(€m)

Movements in the allowance for doubtful accounts in the course of the year were as follows.

	31 DECEMBER 2017	31 DECEMBER 2016
Balance at 1 January	(39.0)	(36.3)
Release of provisions	0.9	1.1
Impairments for the year	(1.4)	(3.8)
Balance	(39.5)	(39.0)

(€m)

The value of guarantees received from eligible electricity market operators is illustrated below.

	31 DECEMBER 2017	31 DECEMBER 2016
Dispatching - injections	236.6	215.4
Dispatching - withdrawals	1,185.2	1,015.4
Transmission charges due from distributors	302.4	287.3
Virtual imports	81.1	93.8
Balance	1,805.3	1,611.9

(€m)

In addition, Non-Regulated Activities are exposed to “counterparty risk”, in particular in relation to the entities with which sales contracts are entered into, in consideration of the credibility and solvency of the parties in question and the impact that their possible insolvency could have on the financial strength of the business. Counterparty risk is mitigated by implementing special procedures to assess counterparties, measuring operating, financial and reputational aspects of the counterparties in question.

Default risk and debt covenants

This risk is associated with the possibility that the loan agreements or bond terms and conditions to which the Parent Company is a party may contain provisions authorising counterparties to call in such loans immediately upon the occurrence of certain events, thereby generating liquidity risk. More information on the contractual provisions of outstanding borrowings at 31 December 2017 is provided in the section, “Borrowings and financial liabilities” in the notes to the Terna Group’s consolidated financial statements.

Litigation

The main commitments and risks not disclosed in the statement of financial position at and for the year ended 31 December 2017, relating to the Parent Company Terna, its subsidiary Terna Rete Italia SpA and the Tamini Group companies, are described below. There are no significant commitments or risks for the other subsidiaries at that date.

Environmental and urban planning litigation

Part of environmental litigation deriving from the construction and operation of Terna's power plants, consists of legal actions taken against the alleged negative effects of electric and magnetic fields generated by power lines.

In general, this litigation necessarily involves the Parent Company, which owns the infrastructure in question. Moreover, it cannot be ruled out that the parties concerned may also initiate legal proceedings against the subsidiary, Terna Rete Italia SpA, as the electromagnetism generated by power lines relates not only to ownership of the plant, but also to its operation and the quantity and quality of electricity it transports.

Regarding this matter, it should be noted that the issue of the Cabinet Office Decree of 8 July 2003 - which specifically set the values of the three parameters (exposure limits, safety thresholds and quality targets) provided for in Framework Law 36 of 22 February 2001, which electricity infrastructure must comply with - led to a significant reduction in any such litigation.

Other environmental and urban planning disputes, which do not relate to electromagnetic fields, are also pending with regard to Terna SpA. These disputes are connected with the operation of certain Terna-owned plant, which in the event of an unfavourable outcome could also generate immediate effects for Terna Rete Italia SpA (to date unforeseeable and therefore not included in "Provisions for litigation and sundry risks"), both as the entity appointed by Terna SpA to build the related infrastructure and as the entity responsible for its operation. In particular, charges may arise for Terna Rete Italia SpA connected with changes to the infrastructure involved in such disputes and its temporary unavailability. However, after examination of the disputes in question by Terna SpA and external counsel appointed by the Company, it appears that the possibility of any negative outcomes is remote.

Litigation regarding the legitimacy of construction permits and plant operations

Another aspect of litigation connected with the plant owned by the Parent Company derives from legal actions brought before the competent administrative courts, aimed at obtaining the annulment of decisions granting consent for the construction and operation of infrastructure.

Litigation relating to activities carried out under concession

As the operator of transmission and dispatching activities since 1 November 2005, the Parent Company has been a party in a number of court cases, most of which have contested determinations adopted by ARERA (Italy's Regulatory Authority for Energy, Networks and the Environment), and/or the Ministry for Economic Development, and/or Terna, in relation to these activities. In cases in which the plaintiffs have, in addition to inherent defects in the contested determinations, alleged violation of the regulations laid down by the aforementioned authorities, or in cases in which the determination has had an impact on Terna, the Company has also taken action to defend its interests through the legal system. Within the scope of such litigation - even though some cases have been concluded, at first and/or second instance, with the annulment of ARERA's resolutions and, when applicable, of the consequent determinations adopted by Terna - any negative outcomes for the Company itself may be deemed unlikely, as these disputes normally relate to pass-through items.

Litigation regarding supply contracts

This litigation only refers to Tamini Group companies and relates to supply contracts entered into between Tamini Group companies and its customers, regarding the supply of transformers and/or the related components.

It also concerns certain claims for damages brought against companies, regarding alleged damage caused by machinery and/or components supplied by them.

With regard to these judgements, it is impossible to exclude, in absolute terms, any unfavourable outcomes. Where such outcomes are deemed likely, specific provision is made to the provisions for risks and charges.

F. Business combinations

There were no business combinations of any significance in 2017.

More information on the acquisition of the Brazilian companies, SPE Santa Lucia Trasmissora de Energia SA and SPE Santa Maria Trasmissora de Energia SA is provided in the section on subsidiaries and the scope of consolidation in "Note A. Accounting policies and measurement criteria".

G. Related party transactions

Given that Terna SpA is subject to the de facto control of Cassa Depositi e Prestiti SpA, a situation ascertained in 2007, related party transactions entered into by Terna during the year include transactions with the associates, (Cesi SpA, CGES A.D. and Coreso SA) and employee pension funds (Fondenel and Fopen), as well as transactions with Cassa Depositi e Prestiti itself, with CDP Reti SpA and with the companies directly or indirectly controlled by the Ministry of the Economy and Finance ("MEF").

Given that Terna Group companies and the companies directly or indirectly controlled by the Ministry of the Economy and Finance meet the definition for classification as "government-related entities", in accordance with IAS 24 - Related Party Disclosures, the Group has elected to adopt the partial exemption - permitted by the standard - from the disclosure requirements in respect of other companies controlled, influenced or jointly controlled by the same government entity. The remainder of this section provides qualitative and quantitative disclosures on transactions with government-related entities having a significant impact on the Group's results. Amounts relating to pass-through items are not included in these disclosures.

Related party transactions in 2017 broadly regard the provision of services in the course of ordinary activities and conducted on an arm's length basis.

The nature of sales to and purchases from related parties by the Terna Group is shown below, followed by details of the revenue and costs resulting from such transactions during the year, and the related assets and liabilities outstanding at 31 December 2017.

RELATED PARTY	REVENUE-GENERATING TRANSACTIONS	COST-GENERATING TRANSACTIONS
Cassa Depositi e Prestiti SpA		Credit facilities.
Cesi SpA	Rental income on laboratories and other similar facilities for specific uses, dividends.	Technical studies and consultancy, research, design and experimentation.
CORESIO SA		Technical coordination service for the TSO.
GSE Group	Metering charge, dispatching charge.	Rental of spaces and workstations.
Enel Group	Transmission charge and aggregation of meter readings, dispatching charge, leases and rentals, power line maintenance, movement /re-routing of power lines, housing of fibre cable and maintenance of communications carried over proprietary power lines.	Recovery of energy discount, building services, MV power to new substations, specialist services for connection to Terna's control and protection systems.
Ferrovie Group	Dispatching charge, movement of power lines.	Right-of-way fees.
ENI Group	Dispatching charge.	Contributions for NTG connections, sundry services.
Poste Italiane		Sundry services.
ANAS SpA	Movement /re-routing of power lines.	Right-of-way fees.
Fondenel and Fopen		Pension contributions payable by the Terna Group.
Other related parties of the MEF		Contributions for NTG connections.

REVENUE AND COSTS

(€m)

	REVENUE COMPONENTS		COST COMPONENTS
	TRANSMISSION CHARGE AND OTHER REVENUE FROM REGULATED ACTIVITIES	NON-ENERGY-RELATED ITEMS	
De facto parent			
Cassa Depositi e Prestiti SpA	-	-	3.8
Total de facto parent	-	-	3.8
Associates:			
Cesi SpA	-	0.2	4.2
CORESO SA	-	-	1.6
Total associates	-	0.2	5.8
Other related parties:			
GSE Group	21.7	-	0.1
Enel Group	1,563.7	8.7	3.1
ENI Group	2.1	0.7	0.3
Ferrovie Group	2.3	0.5	16.6
Anas SpA	-	-	0.1
Other related parties of MEF	-	0.1	-
Total other related parties	1,589.8	10.0	20.2
Pensions funds:			
Fondenel	-	-	0.4
Fopen	-	-	2.2
Total pension funds	-	-	2.6
TOTAL	1,589.8	10.2	32.4

ASSETS AND LIABILITIES

(€m)

	PROPERTY, PLANT AND EQUIPMENT	RECEIVABLES AND OTHER ASSETS		PAYABLES AND OTHER LIABILITIES		CASH	GUARANTEES*
	CAPITALISED COSTS	OTHER	FINANCIAL	OTHER	FINANCIAL		
De facto parent							
Cassa Depositi e Prestiti SpA	-	-	0.3	-	500.5	-	-
Total de facto parent	-	-	0.3	-	500.5	-	-
Associates:							
Cesi SpA	18.3	0.1	-	14.7	-	-	1.2
CORESO SA	-	-	-	0.2	-	-	-
Total associates	18.3	0.1	-	14.9	-	-	1.2
Other related parties:							
GSE Group	0.4	3.7	-	0.3	-	-	-
Enel Group	7.5	397.6	-	21.6	-	-	591.0
ENI Group	-	1.3	-	1.0	-	-	20.0
Ferrovie Group	-	3.4	-	11.9	-	-	24.2
ANAS SpA	-	1.0	-	-	-	-	-
Poste Italiane Group	-	-	-	0.1	-	-	-
Other related parties of MEF	-	-	-	0.3	-	0.1	-
Total other related parties	7.9	407.0	-	35.2	-	0.1	635.2
Pensions funds:							
Fopen	-	-	-	1.6	-	-	-
Total pension funds	-	-	-	1.6	-	-	-
TOTAL	26.2	407.1	0.3	51.8	500.5	0.1	636.4

* Guarantees regard surety bonds received from contractors.

H. Significant non-recurring, atypical or unusual events and transactions

With the exception of the instances described above, no significant non-recurring, atypical or unusual events or transactions, involving either third or related parties, took place in 2017.

I. Notes to the statement of cash flows

Cash flow from continuing operations amounts to €1,691.7 million, with approximately €1,659.8 million in operating cash flow and approximately €31.9 million generated by changes in net working capital.

The cash outflow for investing activities totals €885.5 million and above all regards €864.9 million relating to investment in property, plant and equipment (totalling €993.8 million, after grants related to assets collected during the year, amounting to €128.9 million), investment in intangible assets (€40.1 million) and capitalised financial expenses (€12.8 million).

The net cash outflow for shareholder transactions amounts to €418.4 million, reflecting payment of the final dividend for 2016 (€269.1 million) and of the interim dividend for 2017 (€149.3 million).

As a result, net cash used in investing activities and to provide a return on equity during the year amounted to €1,303.9 million, covered entirely by cash flow from continuing operations of €1,691.7 million. Net debt declined during the year.

The following table shows the reconciliation of liabilities deriving from financing activities in the statement of cash flows:

	AT 31 DECEMBER 2016	CASH FLOW FROM FINANCING ACTIVITIES	CHANGE IN FV AND OTHER	(€m) AT 31 DECEMBER 2017
- Long-term borrowings (including current portion)	9,308.9	367.8	(120.8)	9,555.9
- Short-term borrowings	20.1	97.9	-	118,0
Total liabilities from financing activities	9,329.0	465.7	(120.8)	9,673.9

L. Events after 31 December 2017

Acquisition of 70% of a new company completed

On 15 February 2018, the acquisition of a 70% interest in a New. Co, in accordance with the agreement signed by Terna on 10 October 2017, via its subsidiary Terna Plus was completed. The principal assets of Avvenia, a leader in the energy efficiency sector and certified as an Energy Service Company (ESCO), are to be transferred to the new company. This transaction is part of the process of identifying and acting on new commercial opportunities for the provision of energy efficiency services and projects, in order to further strengthen Terna Plus's role as a supplier of comprehensive integrated energy services and expand its range of innovative solutions as an Energy Solutions Provider. This is in line with the strategy set out in the Business Plan for the Group's Non-Regulated Activities.

ARERA Resolution on output-based incentives

On 8 March 2018, ARERA published Resolution 129/2018 "Urgent measures relating to output-based incentives for the transmission service. Amendments to the provisions governing the recognition of high-risk projects", which has introduced a series of measures applicable to Terna, including: incentives for the resolution of congestion between internal zones and on interconnections, by investing up to €150 million in new transmission capacity in the period 2019-2023; incentives for development of the grid with the aim of resolving congestion within zones, constraints on the grid affecting voltage regulation and the provision of essential services (the general criteria for quantifying the incentives are based on the expected benefits in terms of potential savings on the DSM as a result of the above projects, whilst definition of the detailed criteria will be dealt with in a later resolution); the reinstatement of the return on work in progress (calculated by assuming a WACC with a debt-to-equity ratio of four) for highly complex and risky projects with a duration of over 3 years (between obtaining the necessary consents and entry into service) and when expenditure has not already exceeded 50%. The resolution puts off measures regarding other incentives relating to the following issues until later resolutions: grants from grid operators and overseas entities; additional measures designed to improve efficiency, promote market integration and security of supply and support the related research activities; the implementation of initiatives aimed at fostering stakeholder capabilities and building awareness among local authorities of the benefits of infrastructure.

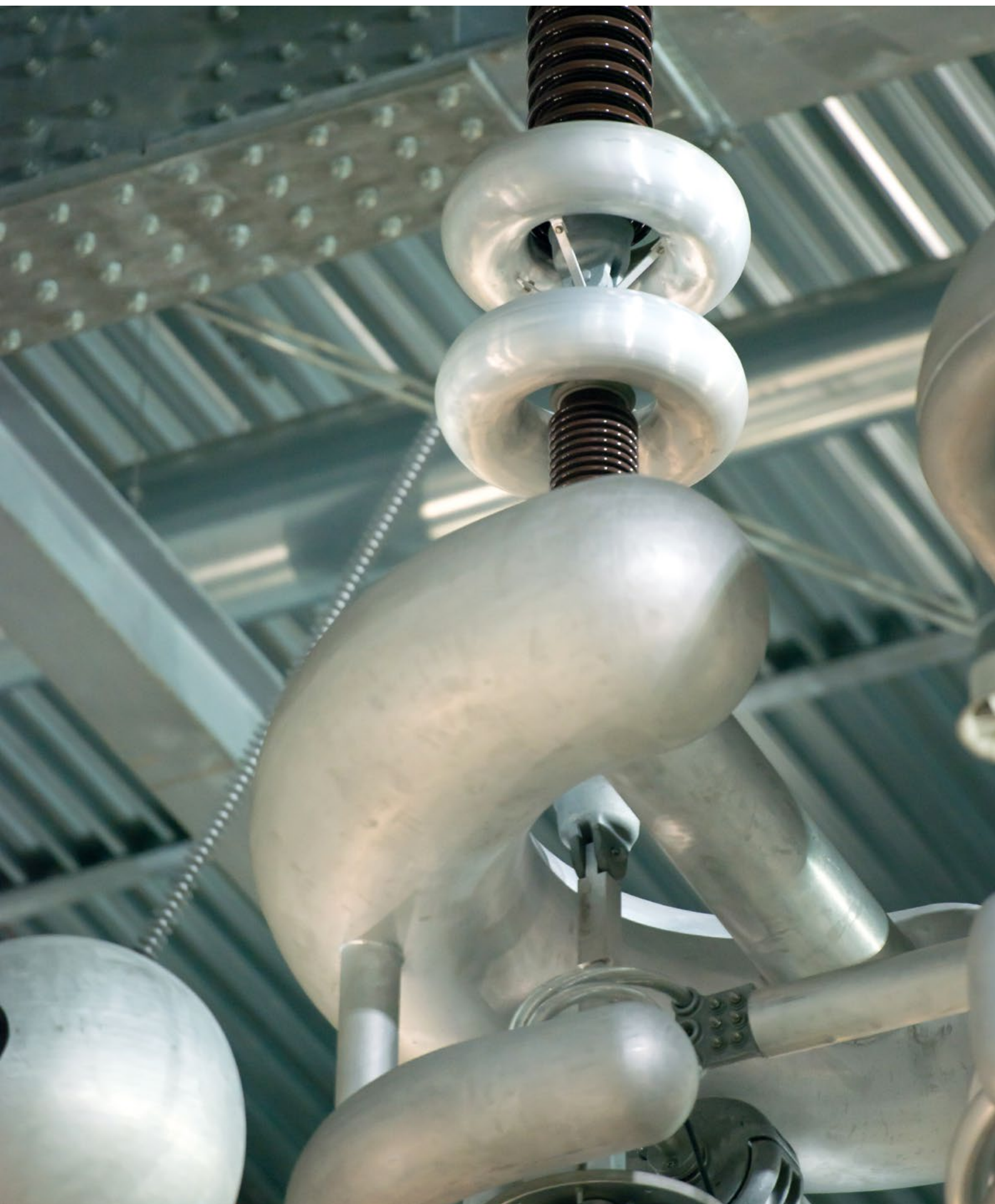
Disclosure

pursuant to art. 149-*duodecies*
of the CONSOB Regulations for Issuers

The following table, prepared pursuant to art. 149-*duodecies* of the CONSOB Regulations for Issuers, shows the fees paid for audit and other services provided by the Terna Group's independent auditors in 2017.

(€)

	ENTITY PROVIDING SERVICE	FEES DUE FOR THE YEAR
Audit of the accounts and financial statements	PwC	666,957
Attestation and other services	PwC	115,418
TOTAL		782,375



Attestation

of the consolidated financial statements pursuant to art. 81-*ter*
of CONSOB Regulation 11971 of 14 May 1999, as amended



“Terna Group”

1. The undersigned, Luigi Ferraris, as Chief Executive Officer, and Agostino Scornajenchi, as Manager responsible for Terna SpA's financial reporting, having also taken account of the provisions of art.154-*bis*, paragraphs 3 and 4 of Legislative Decree 58 of 24 February 1998, attest to:
 - the adequacy with regard to the nature of the Company, and
 - the effective application of the administrative and accounting procedures adopted in preparation of the consolidated financial statements during the year ended 31 December 2017.
2. The administrative and accounting procedures adopted in preparation of the consolidated financial statements for the year ended 31 December 2017 were drawn up, and their adequacy assessed, on the basis of the regulations and methods adopted by Terna SpA in accordance with the Internal Control-Integrated Framework model issued by the Committee of Sponsoring Organizations of the Treadway Commission. This Commission has established a body of general principles providing a standard for internal control and risk management systems that is generally accepted at international level.
3. We also attest that:
 - 3.1 the consolidated financial statements for the year ended 31 December 2017:
 - a. have been prepared in compliance with the International Financial Reporting Standards endorsed by the European Union through EC Regulation 1606/2002, issued by the European Parliament and by the Council on 19 July 2002 and the statutory requirements implementing the provisions of art. 9 of Legislative Decree 38/2005;
 - b. are consistent with the underlying accounting books and records;
 - c. provide a true and fair view of the financial position and results of operations of the issuer and the companies included in the scope of consolidation.
 - 3.2 the Directors' report on operations includes a reliable analysis of the operating and financial performance and situation of the issuer and the companies included in the scope of consolidation, as well as a description of the main risks and uncertainties to which they are exposed.

Rome, 21 March 2018

Chief Executive Officer
Luigi Ferraris

(original signed)

Manager responsible for financial reporting
Agostino Scornajenchi

(original signed)

Independent auditor's report

in accordance with article 14 of Legislative Decree 39
of 27 January 2010 and article 10 of Regulation (EU) 537/2014



Independent auditor's report

in accordance with article 14 of Legislative Decree 39 of 27 January 2010 and article 10 of Regulation (EU) 537/2014

To the shareholders of Terna SpA

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of Terna SpA and its subsidiaries (Terna group), which comprise the statement of financial position as of 31 December 2017, the income statement, the statement of comprehensive income, the statement of changes in shareholders' equity and the statement of cash flows for the year then ended, and the notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Terna group as of 31 December 2017, and of the result of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union, and with the regulations issued to implement article 9 of Legislative Decree 38/05.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISA Italia). Our responsibilities under those standards are further described in section Auditor's Responsibilities for the Audit of the Consolidated Financial Statements of this report. We are independent of Terna SpA (the Company) based on ethic and independence regulations and standards applicable to audits of financial statements under Italian law. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

PricewaterhouseCoopers SpA

Sede legale e amministrativa: Milano 20149 Via Monte Rosa 91 Tel. 0277851 Fax 027785240 Cap. Soc. Euro 6.890.000,00 i.v., C.F. e P.IVA e Reg. Imp. Milano 12979880155 Iscritta al n° 119644 del Registro dei Revisori Legali - Altri Uffici: **Ancona** 60131 Via Sandro Totti 1 Tel. 0712132311 - **Bari** 70122 Via Abate Gimma 72 Tel. 0805640211 - **Bologna** 40126 Via Angelo Finelli 8 Tel. 0516186211 - **Brescia** 25123 Via Borgo Pietro Wuhler 23 Tel. 0303697501 - **Catania** 95129 Corso Italia 302 Tel. 0957532311 - **Firenze** 50121 Viale Gramsci 15 Tel. 0552482811 - **Genova** 16121 Piazza Piccapietra 9 Tel. 01029041 - **Napoli** 80121 Via dei Mille 16 Tel. 08136181 - **Padova** 35138 Via Vicenza 4 Tel. 049873481 - **Palermo** 90141 Via Marchese Ugo 60 Tel. 091349737 - **Parma** 43121 Viale Tanara 20/A Tel. 0521275911 - **Pescara** 65127 Piazza Ettore Troilo 8 Tel. 0854545711 - **Roma** 00154 Largo Fochetti 29 Tel. 06570251 - **Torino** 10122 Corso Palestro 10 Tel. 011556771 - **Trento** 38122 Viale della Costituzione 33 Tel. 0461237004 - **Treviso** 31100 Viale Felissent 90 Tel. 0422696911 - **Trieste** 34125 Via Cesare Battisti 18 Tel. 0403480781 - **Udine** 33100 Via Poscolle 43 Tel. 043225789 - **Varese** 21100 Via Albuzzi 43 Tel. 0332285039 - **Verona** 37135 Via Francia 21/C Tel. 0458263001 - **Vicenza** 36100 Piazza Pontelandolfo 9 Tel. 0444393311

Key Audit Matters

Auditing procedures performed in response to key audit matters

Capital expenditure for the development and operation of the transmission grid

Section D – Notes to the consolidated statement of financial position – Note 12 Property, plant and equipment and Note 14 Intangible assets

Costs capitalised during the year as property, plant and equipment and intangible assets amount to Euro 1,034 million and mainly relate to capital expenditure for the development and operation of the transmission grid.

Revenue from transmission and dispatching activities (regulated activities) are determined each year in accordance with the regulatory approved tariffs which are based on a pre-established return on capital invested, plus amortisation and depreciation and operating costs.

Therefore, the capitalisation of costs for the operation and development of the transmission grid represented a key matter in the audit of the consolidated financial statements, also considering the magnitude and the high number of transactions.

We performed an understanding and evaluation of the system of internal control over the capital expenditure cycle, with particular reference to identification and testing of key controls.

We assessed the accounting policy adopted by the group in relation to the capitalisation of costs.

We also performed detailed tests analysing, on a sample basis, the supporting documentation of capitalised costs to verify the accuracy, completeness and the proper period.

Our tests also included the analysis of the disclosure presented in the notes to the consolidated financial statements.

Revenue from non-regulated activities

Section B – Notes to the consolidated income statement - Note 1 Revenue from sales and services and Note 2 Other revenue and income and Section C – Operating segments

Total revenue, amounting to Euro 2,248 million, include revenue from non-regulated activities of Euro 189 million equal to 8.4% of total revenue of the group.

Non-regulated activities mainly consist of the development, production and sale of power transformers, miscellaneous services in favour of third parties and the construction of a part of international interconnectors, with different types of contracts and different degree of complexity of underlying transactions.

Therefore, the recognition of revenue from non-regulated activities was a key matter in the audit of the consolidated financial statements.

With respect to the main revenue streams from non-regulated activities, we performed an understanding and evaluation of key controls implemented by the group.

We verified the revenue recognition through detailed tests, on a sample basis, of the supporting documentation, focusing on the contractual clauses underlying the revenue recognition earning process.

Key Audit Matters

Auditing procedures performed in response to key audit matters

Derivative financial instruments

Section D – Notes to the consolidated statement of financial position – Note 23 Long-term borrowings and Section E – Commitments and risks

The amount of borrowings in the consolidated financial statements at 31 December 2017 is Euro 9,674 million.

In accordance with the risk management policies, the group mitigates its exposure to the change in interest rates by entering into derivative financial instruments for hedging purposes.

The notional amount of derivatives at 31 December 2017 is Euro 2,566 million.

Considering the magnitude and the degree of complexity of the fair value measurement, the accounting for the derivative financial instruments was considered a key matter in the audit of the consolidated financial statements.

With the support of PwC network experts, we performed an understanding and evaluation of the system of internal control over the measurement process of the derivative financial instruments and related accounting treatment.

We re-calculated, on a sample basis, the fair value of derivatives and we verified the hedge effectiveness in accordance with IAS39.

We confirmed the evaluations performed by management with the information provided by the counterparties involved in the external confirmation process.

Our tests also included the adequacy and completeness of the disclosure presented in the notes to the consolidated financial statements.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the European Union, and with the regulations issued to implement article 9 of Legislative Decree 38/05 and, in the terms prescribed by law, for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Management is responsible for assessing the group ability to continue as a going concern and, in preparing the consolidated financial statements, for the appropriate application of the going concern basis of accounting, and for disclosing matters related to going concern. In preparing the consolidated financial statements, management uses the going concern basis of accounting unless management intends either to liquidate Terna SpA or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing, in the terms prescribed by law, the group financial reporting process.



Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (ISA Italia) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

As part of an audit conducted in accordance with International Standards on Auditing (ISA Italia), we exercise professional judgment and maintain professional scepticism throughout the audit. Furthermore:

- we identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error; we design and perform audit procedures responsive to those risks; we obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- we obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the group internal control;
- we evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;
- we conclude on the appropriateness of management use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the group ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the group to cease to continue as a going concern;
- we evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation;
- we obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion on the consolidated financial statements.

We communicate with those charged with governance, identified at an appropriate level as required by ISA Italia regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.



We also provide those charged with governance with a statement that we complied with the regulations and standards on ethics and independence applicable under Italian law and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence and, where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that are of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our report.

Additional Disclosures required by article 10 of Regulation (EU) 537/2014

We were appointed by the shareholders of Terna SpA at the general meeting held on 13 May 2011 to perform the audit of the Company separate and consolidated financial statements for the years ending 31 December 2011 through 31 December 2019.

We declare that we did not provide any prohibited non-audit services referred to in article 5, paragraph 1, of Regulation (EU) 537/2014 and that we remained independent of the Company in conducting the audit.

We confirm that the opinion on the consolidated financial statements expressed in this report is consistent with the additional report to those charged with governance, in their capacity as audit committee, prepared pursuant to article 11 of the aforementioned Regulation.

Report on Compliance with other Laws and Regulations

Opinion in accordance with article 14, paragraph 2, letter e), of Legislative Decree 39/10 and article 123-bis, paragraph 4, of Legislative Decree 58/98

Management of Terna SpA is responsible for preparing a report on operations and a report on the corporate governance and ownership structure of the Terna group as of 31 December 2017, including their consistency with the relevant consolidated financial statements and their compliance with the law.

We have performed the procedures required under auditing standard (SA Italia) 720B to express an opinion on the consistency of the report on operations and of the specific information included in the report on corporate governance and ownership structure referred to in article 123-bis, paragraph 4, of Legislative Decree 58/98, with the consolidated financial statements of the Terna group as of 31 December 2017 and on their compliance with the law, as well as to issue a statement on material misstatements, if any.

In our opinion, the report on operations and the specific information included in the report on corporate governance and ownership structure mentioned above are consistent with the consolidated financial statements of the Terna group as of 31 December 2017 and are prepared in compliance with the law.



With reference to the statement referred to in article 14, paragraph 2, letter e), of Legislative Decree 39/10, issued on the basis of our knowledge and understanding of the group obtained in the course of the audit, we have nothing to report.

Statement in accordance with article 4 of Consob Regulation implementing Legislative Decree 254 of 30 December 2016

Management of Terna SpA is responsible for the preparation of the non-financial disclosure pursuant to Legislative Decree 254 of 30 December 2016. We have verified that the non-financial disclosure was approved by the board of directors.

Pursuant to article 3, paragraph 10, of Legislative Decree 254 of 30 December 2016, the non-financial disclosure is subject to separate audit reporting by our firm.

Rome, 9 April 2018

PricewaterhouseCoopers SpA

Signed by

Paolo Caccini
(Partner)

This report has been translated from the original version which was issued in Italian language, solely for the convenience of international readers.





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Separate financial statements

Income statement of Terna SpA

(€)

	NOTE	2017	2016
A - REVENUE			
1. Revenue from sales and services	1	1,861,453,047	1,691,038,762
<i>of which: related parties</i>		1,618,317,512	1,543,904,897
2. Other revenue and income	2	90,053,148	88,519,126
<i>of which: related parties</i>		43,160,360	35,383,989
Total revenue		1,951,506,195	1,779,557,888
B - OPERATING COSTS			
1. Raw and consumable materials used	3	10,024,776	4,517,526
<i>of which: related parties</i>		119,063	-
2. Services	4	349,832,712	342,031,738
<i>of which: related parties</i>		300,498,593	281,119,665
3. Personnel expenses	5	65,987,971	82,158,300
- gross personnel expenses		69,027,451	85,208,740
- capitalised personnel expenses		(3,039,480)	(3,050,440)
<i>of which: related parties</i>		585,840	569,335
4. Amortisation, depreciation and impairment losses	6	495,192,305	432,751,165
5. Other operating costs	7	39,011,448	17,427,522
<i>of which: related parties</i>		98,418	66,338
Total costs		960,049,212	878,886,251
A-B OPERATING PROFIT/(LOSS)		991,456,983	900,671,637
C - FINANCIAL INCOME/(EXPENSES)			
1. Financial income	8	5,729,373	6,441,206
<i>of which: related parties</i>		1,951,401	2,162,151
2. Financial expenses	8	(95,554,625)	(108,458,669)
<i>of which: related parties</i>		(3,770,511)	(4,504,903)
D - PROFIT/(LOSS) BEFORE TAX		901,631,731	798,654,174
E - INCOME TAX EXPENSE	9	261,588,853	263,170,441
F - PROFIT FOR THE YEAR		640,042,878	535,483,733

Statement of comprehensive income of Terna SpA

(€)

	NOTE	2017	2016
PROFIT FOR THE YEAR		640,042,878	535,483,733
Other comprehensive income for the year reclassifiable to profit or loss			
- Cash flow hedges after taxation	19	5,904,878	(13,383,782)
Other comprehensive income for the year not reclassifiable to profit or loss			
- Actuarial gains/(losses) on provisions for employee benefits, after taxation	19	(24,536)	812,532
COMPREHENSIVE INCOME FOR THE YEAR		645,923,220	522,912,483

Statement of financial position of Terna SpA

(€)

	NOTE	31 DECEMBER 2017	31 DECEMBER 2016
A - NON-CURRENT ASSETS			
1. Property, plant and equipment	10	11,705,228,618	10,368,322,003
<i>of which: related parties</i>		66,973,041	58,617,887
2. Goodwill	11	190,228,231	88,577,142
3. Intangible assets	12	234,080,643	240,306,485
4. Non-current financial assets	13	1,009,659,871	1,841,416,160
<i>of which: related parties</i>		339,745	514,650
5. Other non-current assets	14	3,526,176	3,555,717
Total non-current assets		13,142,723,539	12,542,177,507
B - CURRENT ASSETS			
1. Inventories	15	5,307,324	126,030
2. Trade receivables	16	1,142,545,872	1,373,234,200
<i>of which: related parties</i>		426,736,699	305,205,581
3. Current financial assets	13	213,317	65,252,321
<i>of which: related parties</i>		-	39,001,896
4. Cash and cash equivalents	17	1,678,217,732	927,739,262
<i>of which: related parties</i>		(219,450,417)	(163,223,536)
5. Income tax assets	18	57,927,658	10,359,010
<i>of which: related parties</i>		9,910,413	-
6. Other current assets	14	63,226,507	77,027,375
<i>of which: related parties</i>		-	36,161,857
Total current assets		2,947,438,410	2,453,738,198
TOTAL ASSETS		16,090,161,949	14,995,915,705

			(€)
	NOTE	31 DECEMBER 2017	31 DECEMBER 2016
C - EQUITY			
1. Share capital		442,198,240	442,198,240
2. Other reserves		825,639,778	819,759,437
3. Retained earnings/(accumulated losses)		1,916,706,986	1,372,258,416
4. Interim dividend		(149,268,036)	(144,920,423)
5. Profit for the year		640,042,878	535,483,733
Total equity	19	3,675,319,846	3,024,779,403
E - NON-CURRENT LIABILITIES			
1. Long-term borrowings	20	8,638,448,258	8,400,030,058
<i>of which: related parties</i>		<i>500,000,000</i>	<i>500,000,000</i>
2. Employee benefits	21	12,744,530	29,717,025
3. Provisions for risks and charges	22	243,496,364	211,996,586
4. Deferred tax liabilities	23	17,258,091	1,558,803
5. Non-current financial liabilities	20	9,904,232	12,679,798
6. Other non-current liabilities	24	181,316,955	169,630,570
<i>of which: related parties</i>		<i>41,855,770</i>	<i>48,684,175</i>
Total non-current liabilities		9,103,168,430	8,825,612,840
E - CURRENT LIABILITIES			
1. Short-term borrowings	20	90,000,000	-
2. Current portion of long-term borrowings	20	884,039,788	902,300,551
3. Trade payables	25	2,106,382,361	1,962,379,672
<i>of which: related parties</i>		<i>403,564,166</i>	<i>352,519,640</i>
4. Tax expense	25	-	7,600,975
<i>of which: related parties</i>		-	<i>2,313,508</i>
5. Current financial liabilities	20	105,682,938	126,406,395
<i>of which: related parties</i>		<i>531,125</i>	<i>603,958</i>
6. Other current liabilities	25	125,568,586	146,835,869
<i>of which: related parties</i>		<i>4,646,208</i>	<i>1,829,562</i>
Total current liabilities		3,311,673,673	3,145,523,462
TOTAL LIABILITIES AND EQUITY		16,090,161,949	14,995,915,705

Statement of changes in equity

31 DECEMBER 2016 - 31 DECEMBER 2017
SHARE CAPITAL AND RESERVES OF TERNA SPA

(€m)

	SHARE CAPITAL	LEGAL RESERVE	SHARE PREMIUM RESERVE	CASH FLOW HEDGE RESERVE	OTHER RESERVES	RETAINED EARNINGS/ (ACCUMULATED LOSSES)	INTERIM DIVIDEND	PROFIT FOR THE YEAR	EQUITY
EQUITY AT 31 DECEMBER 2016	442.2	88.4	20.0	(18.1)	729.5	1,372.2	(144.9)	535.5	3,024.8
PROFIT FOR THE YEAR								640.0	640.0
OTHER COMPREHENSIVE INCOME:									
Change in fair value of cash flow hedges, net of tax effect				5.9					5.9
Total other comprehensive income	-	-	-	5.9	-	-	-	-	5.9
COMPREHENSIVE INCOME	-	-	-	5.9	-	-	-	640.0	645.9
TRANSACTIONS WITH SHAREHOLDERS:									
Appropriation of profit for 2016:									-
- Retained earnings						121.5		(121.5)	-
- Dividends							144.9	(414.0)	(269.1)
Merger contribution						423.0			423.0
Interim dividend 2017							(149.3)		(149.3)
Total transactions with shareholders and other transactions	-	-	-	-	-	544.5	(4.4)	(535.5)	4.6
EQUITY AT 31 DECEMBER 2017	442.2	88.4	20.0	(12.2)	729.5	1,916.7	(149.3)	640.0	3,675.3

31 DECEMBER 2015 - 31 DECEMBER 2016
SHARE CAPITAL AND RESERVES OF TERNA SPA

(€m)

	SHARE CAPITAL	LEGAL RESERVE	SHARE PREMIUM RESERVE	CASH FLOW HEDGE RESERVE	OTHER RESERVES	RETAINED EARNINGS/ (ACCUMULATED LOSSES)	INTERIM DIVIDEND	PROFIT FOR THE YEAR	EQUITY
EQUITY AT 31 DECEMBER 2015	442.2	88.4	20.0	(4.7)	728.7	1,247.1	(140.7)	527.1	2,908.1
PROFIT FOR THE YEAR								535.5	535.5
OTHER COMPREHENSIVE INCOME:									
Change in fair value of cash flow hedges, net of tax effect				(13.4)					(13.4)
Actuarial gains (losses) on provisions for employee benefits, after taxation					0.8				0.8
Total other comprehensive income	-	-	-	(13.4)	0.8	-	-	-	(12.6)
COMPREHENSIVE INCOME	-	-	-	(13.4)	0.8	-	-	535.5	522.9
TRANSACTIONS WITH SHAREHOLDERS:									
Appropriation of profit for 2015:									-
- Retained earnings						125.1		(386.4)	(261.3)
- Dividends							140.7	(140.7)	-
Interim dividend 2016							(144.9)		(144.9)
Total transactions with shareholders and other transactions	-	-	-	-	-	125.1	(4.2)	(527.1)	(406.2)
EQUITY AT 31 DECEMBER 2016	442.2	88.4	20.0	(18.1)	729.5	1,372.2	(144.9)	535.5	3,024.8

Statement of cash flows

	(€m)	
	2017	2016
PROFIT FOR THE YEAR	640.0	535.5
ADJUSTED BY:		
Amortisation, depreciation and impairment losses /(reversals of impairment losses) on non-current property, plant and equipment and intangible assets*	485.5	421.6
Accruals to provisions (including provisions for employee benefits) and impairment losses	64.3	53.4
(Gains)/Losses on sale of property, plant and equipment	(1.7)	(7.7)
Financial (income)/expense	80.1	102.0
Income tax expense	261.6	263.2
CASH FLOW FROM OPERATING ACTIVITIES BEFORE CHANGES IN NET WORKING CAPITAL	1,529.8	1,368.0
Increase/(decrease) in provisions (including provisions for employee benefits and taxation)	(2.1)	5.5
<i>of which merger contribution</i>	48.2	-
(Increase)/decrease in inventories	(5.4)	(0.1)
(Increase)/decrease in trade receivables and other current assets	230.2	(21.2)
Increase/(decrease) in trade payables and other current liabilities	125.7	6.3
Increase/(decrease) in other non-current assets	(23.7)	(18.1)
(Increase)/decrease in other non-current liabilities	16.9	(1.3)
Interest income and other financial income received **	352.4	480.2
Interest expense and other financial expenses paid **	(228.7)	(235.7)
Income tax paid	(337.1)	(317.2)
CASH FLOW FROM OPERATING ACTIVITIES [A]	1,658.0	1,266.4
<i>- of which: related parties</i>	<i>(50.5)</i>	<i>(141.7)</i>
Change in non-current property, plant and equipment	(1,774.9)	(611.6)
<i>of which Capital expenditure of non-current property, plant and equipment after grants collected</i>	<i>(685.7)</i>	-
<i>of which merger contribution</i>	<i>(1,089.2)</i>	-
Proceeds from the sale of non-current property, plant and equipment and other movements	(7.6)	9.2
Change in non-current intangible assets	(40.1)	(39.3)
<i>of which merger contribution</i>	<i>(1.6)</i>	-
Capitalised financial expenses	12.3	15.6
Goodwill resulting from merger	(101.6)	-
(Increase)/decrease in investments	529.7	(23.8)
<i>of which merger contribution</i>	<i>559.7</i>	-
CASH FLOW FOR INVESTING ACTIVITIES [B]	(1,382.2)	(649.9)
<i>- of which: related parties</i>	<i>(8.4)</i>	<i>15.2</i>
Changes in equity due to merger	423.0	-
Dividends paid	(418.4)	(406.2)
Movements in short- and medium/long-term financial liabilities (including short-term portion)***	341.0	317.4
Movement in short-term loans and borrowings	129.0	(35.3)
CASH FLOW FROM FINANCING ACTIVITIES [C]	474.6	(124.1)
<i>- of which: related parties</i>	<i>39.0</i>	<i>(35.1)</i>
INCREASE/(DECREASE) IN CASH AND EQUIVALENTS [A+B+C]	750.4	492.4
Cash and cash equivalents at beginning of year	927.8	435.4
Cash and cash equivalents at end of year	1,678.2	927.8

* After grants related to assets recognised in the income statement for the year.

** Including cash flows generated from derivatives.

*** After derivatives and impact of fair value adjustments.



Notes

A. Accounting policies and measurement criteria

Introduction

Terna SpA, which provides electricity transmission and dispatching services, is a joint-stock company and its registered office is at Viale Egidio Galbani 70, Rome, Italy.

These separate financial statements were authorised for publication by the Board of Directors at the board meeting held on 21 March 2018.

The separate financial statements at and for the year ended 31 December 2017 are available for inspection on request at Terna SpA's registered office at Viale Egidio Galbani 70, Rome, or on the Company's website at www.terna.it.

The Board of Directors has authorised the Chairwoman and the Chief Executive Officer to make any alterations to the form of the financial statements and any additions and adjustments to the sections concerning significant subsequent events.

Compliance with IAS/IFRS

The separate financial statements at and for the year ended 31 December 2017 have been prepared in accordance with International Financial Reporting Standards (IFRS), International Accounting Standards (IAS) issued by the International Accounting Standards Board (IASB) and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC), as endorsed by the European Commission ("EU-IFRS").

This document has also been prepared taking into account the provisions of Legislative Decree 38 of 28 February 2005 of the Italian Civil Code and CONSOB Resolutions 15519 (*"Provisions governing financial statements in implementation of art. 9, paragraph 3 of Legislative Decree 38/2005"*) and 15520 (*"Amendments to the implementing rules for Legislative Decree 58/1998"*), as well as CONSOB Communication DEM/6064293 (*"Disclosure requirements for listed issuers and issuers of financial instruments that are widely held among the public pursuant to art. 116 of the Consolidated Law on Finance"*).

The separate financial statements have been prepared on a historical cost basis, with the exception of certain financial instruments, and on a going concern basis.

Basis of presentation

The separate financial statements consist of the statement of financial position, the income statement, the statement of comprehensive income, the statement of cash flows, the statement of changes in equity and the notes thereto.

In the statement of financial position, assets and liabilities are classified on a "current/non-current" basis, with separate reporting of assets and liabilities held for sale. Current assets, which include cash and cash equivalents, are those held for realisation, sale or consumption in the Company's normal operating cycle; current liabilities are those expected to be settled in the Company's normal operating cycle or within one year of the end of the financial year.

The income statement is classified on the basis of the nature of costs. The income statement is presented as two statements, the first of which (the income statement) presents revenue and expense items for the year; the second (the statement of comprehensive income) starts with the result for the year and then presents the revenue and expense items (including reclassification adjustments) that are recognised in equity rather than profit or loss for the year.

The statement of cash flows has been prepared using the indirect method.

The separate financial statements are accompanied by the Integrated Report for Terna SpA and the Group, which as from financial year 2008 has been prepared as a single document, exercising the option granted by Legislative Decree 32 of 2 February 2007, which amended art. 40 (Integrated Report) of Legislative Decree 127 of 9 April 1991. The separate financial statements are presented in euros, whilst amounts in the notes are presented in millions of euros, unless otherwise stated.

The separate financial statements have been prepared on a historical cost basis, with the exception of certain items that, in accordance with EU-IFRS, are recognised at fair value, as indicated in the measurement criteria for individual items.

Following the merger of wholly owned subsidiaries Terna Storage Srl and Terna Rete Italia Srl with an into Terna SpA, effective for accounting and tax purposes from 1 January 2017, Terna SpA's income statement and statement of financial position at and for the year ended 31 December 2017 present the results of operations of the three companies participating in the merger, whilst the comparative statements at and for the year ended 31 December 2016 only refer to the acquirer Terna SpA.

However, with the aim of providing a clearer view of effective changes during the year, a "Pro forma 2016" column has been added to certain tables, showing the sum of the relevant carrying amounts in the financial statements of the three companies participating in the merger at and for the year ended 31 December 2016. In this case, effective changes during the year are shown in the comparison between amounts at 31 December 2017 and the above pro forma amounts for the previous year.

The principal effects regard the merger with Terna Rete Italia Srl, which has resulted in an increase of over €1.1 billion in the Company's assets, in addition to resulting in goodwill of €101.7 million.

Equity contributed by the acquired companies amounts to €423 million and benefits from tax relief on undistributed earnings designed to stimulate economic growth (ACE - *Aiuto alla Crescita Economica*), amounting to almost €5 million (the figure for 2016).

Goodwill is exempt from taxation, following the payment of substitute tax of approximately €16 million in 2011. Goodwill will be amortised for tax purposes from 2018.

It should be noted that, for the purposes of comparison, certain amounts in the financial statements for the year ended 31 December 2016 have been restated, without, however, altering amounts in equity at 31 December 2016 or those in the income statement for 2016.

Use of estimates

In application of EU-IFRS, preparation of the statement of financial position and the income statement requires the Company to use estimates and assumptions that affect the carrying amounts of assets and liabilities and the related disclosures, in addition to contingent assets and liabilities at the reporting date. These estimates and the associated assumptions are based on previous experience and various factors that are believed to be reasonable under the circumstances. The resulting estimates form the basis for making the judgements about the carrying amounts of assets and liabilities that are not readily apparent from other objective sources. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed periodically and the effects of any changes are recognised in the income statement for the year, if they relate solely to that period. In the case that the revision affects both current and future years, the change is recorded in the year in which the estimate is reviewed as well as in the relevant future years. The assets and liabilities subject to key estimates and assumptions used by the Company in applying the IFRS endorsed by the European Commission, and that could have a significant impact on the separate financial statements, or that could give rise to risks that would entail significant adjustments to the carrying amounts of assets and liabilities in subsequent years, are summarised below.

Impairment losses

Property, plant and equipment and intangible assets with finite useful lives are tested at least once a year to check for evidence of impairment. If there is evidence that an asset may be impaired, its recoverable amount is estimated.

The recoverable amount of goodwill and intangible assets with indefinite useful lives, where present, as well as intangible assets not yet available for use, is estimated at least annually. The recoverable amount is equal to the greater of the fair value less costs to sell and value in use. Value in use is measured by discounting estimated future cash flows considering information available at the time of estimate and on the basis of estimates of the performance of future variables, such as prices, costs, demand growth rates, production profiles, and discounted at a pre-tax rate that reflects current market assessments of the time value of money for the investment period and risks specific to the asset. If the intangible asset does not generate cash inflows that are largely independent, the asset's recoverable amount is calculated as part of the Cash Generating Unit ("CGU") to which it belongs.

An impairment loss is recognised in the income statement when the asset's carrying amount, or the net invested capital of the CGU to which it belongs, is greater than its recoverable amount.

Impairment losses on CGUs are first taken as a reduction in the carrying amount of any allocated goodwill and then as a reduction in other assets allocated to the CGU on a pro rata basis. Except for goodwill, impairment losses may be reversed up to the recoverable amount or the original cost of the asset if there is an indication that the impairment loss no longer exists or when there is a change in the methods used to measure the recoverable amount.

Allowance for doubtful accounts

Trade receivables are initially recognised at fair value net of any losses relating to sums considered non-recoverable, for which specific provisions have been made in the allowance for doubtful accounts. Losses on receivables are measured on the basis of the present value of estimated future cash flows, discounted at the original effective interest rate.

Provisions for risks and charges

Provisions for risks and charges are allocated when a disbursement of cash, for an amount which can be reliably estimated, will be necessary to fulfil a legal or constructive obligation arising as a result of a past event. Liabilities that can be associated with legal and tax disputes and liabilities associated with urban and environmental restoration projects are estimated by the Company. The measurement of provisions for legal disputes is based on the probability of incurring an expense, including through the use of external legal advisors supporting the Company; the estimate of provisions to be set aside for urban and environmental restoration projects, the "offsets" aimed at compensating for the environmental impact of the construction of new plant, is based on an analysis of the agreements entered into with the local authorities concerned and the progress of work on construction of the new plant. Where the time value of money is significant, provisions are discounted, using a rate that the Company believes to be appropriate (a rate is used gross of taxes, which reflects current market conditions and the specific risks connected with the liability). After initial recognition, the value of the provisions for risks and charges is updated to reflect the passage of time and any changes in the estimate following alterations to the amounts forecast, the timing and the discount rates used. Any increase in provisions associated with the passage of time is recognised in the income statement under "Financial expenses".

Employee benefits

The liability for employee benefits paid upon or following termination of employment in relation to defined benefit plans or other long-term benefits is recognised net of any plan assets and is measured on the basis of actuarial assumptions, estimating the amount of future benefits that employees have vested at the reporting date. The actuarial valuations used to quantify employee benefits (of all plans except termination benefits or TFR) were based on "vested benefits", applying the projected unit credit method. These valuations are based on economic and demographic assumptions: the discount rate (used to determine the current value of the obligation, determined considering returns on high quality bonds in line with the duration of the group

of workers measured), the inflation rate, the rate at which future salary levels are expected to rise, the rate of increase for average health reimbursements, rate of increase for electricity prices and demographic factors, such as mortality and invalidity, retirement, resignation, advances and household composition.

Investments in subsidiaries and associates

Investments in subsidiaries are investments where Terna has the power to directly or indirectly exercise the financial and operating policies of the investee so as to obtain benefits from its activities. Associates are investees over which Terna exercises significant influence.

In assessing whether or not Terna has control or significant influence, being the ability to participate in the determination of these companies' financial and operating policies, without having control or joint control, potential voting rights that are exercisable or convertible are also taken into account.

Investments in subsidiaries and associates are recognised at cost, written down in the event of an impairment loss. If the circumstances that gave rise to the impairment cease to exist, the value of the investment is restored to the extent of the impairment loss recognised and the reversal is recognised in the income statement.

In the event that the loss attributable to the Company exceeds the carrying amount of the equity interest, and the Company is required to meet the legal or constructive obligations of the investee or, in any case, to cover its losses, any excess is recognised in a specific provision.

Translation of foreign currency items

Terna's financial statements are prepared in euros, the Company's functional currency. In the financial statements, all transactions in currencies other than the functional currency are recognised at the exchange rate prevailing on the date of the transaction. Monetary assets and liabilities in currencies other than the functional currency are subsequently adjusted at the exchange rate prevailing at year end. Any translation differences are taken to the income statement.

Non-monetary assets and liabilities in foreign currency stated at historical cost are converted at the exchange rate prevailing when the transaction was initially recognised. Non-monetary assets and liabilities in foreign currency stated at fair value are converted at the exchange rate prevailing when fair value was measured.

Property, plant and equipment

Property, plant and equipment is recognised at historical cost, including costs directly attributable to preparing the asset for its intended use. In the event of legal or constructive obligations, cost also includes the present value of the estimated cost of dismantling or removing the asset. The corresponding liability is recognised in provisions for risks and charges. Borrowing costs directly attributable to the purchase, construction or production of an asset that qualify for capitalisation pursuant to IAS 23 are capitalised as part of the cost of the asset. Costs incurred after purchase are recognised as an increase in the carrying amount of the asset to which they relate if it is probable that the future benefits of that cost will flow to the Company, and if the cost can be reliably measured. All other costs are expensed as incurred.

Each element of an item of property, plant and equipment of material value, with respect to the total value of the item to which it belongs, is recognised and depreciated separately.

Certain assets that were revalued at 1 January 2005 (the transition date) or in previous periods, are recognised at their revalued amount, considered the deemed cost at the revaluation date.

Property, plant and equipment is shown net of accumulated depreciation and any impairment losses. Depreciation is calculated on a straight-line basis over the estimated useful economic life of the asset, which is reviewed annually, with revisions applied on a prospective basis. Depreciation of an asset begins when the asset becomes available for use.

Liabilities associated with items of property, plant and equipment are taken to a specific provision as a contra account of the related asset. The amount is taken to the income statement through the depreciation of the asset.

Property, plant and equipment is written off either at the time of disposal or when no future economic benefit is expected from their use or disposal. Any profit or loss, recognised in the income statement, is determined as the difference between the net proceeds deriving from disposal and the net carrying amount of the assets eliminated.

The main rates of depreciation, calculated on the basis of the useful lives of the relevant assets, are as follows

RATES OF DEPRECIATION

Civil and industrial buildings	2.50%
Transmission lines	2.22%
Transformer substations:	
- Electrical machinery	2.38%
- Electrical devices and equipment	3.13%
- Automation and control systems	6.70%
Central systems for remote management and control:	
- Devices, electrical equipment and ancillary plant	5.00%
- Computers	10.00%

The estimated useful life of transmission lines has been reviewed to take account of empirical evidence, primarily of physical deterioration and technical obsolescence. This process has resulted in the reasonable conclusion that the expected useful life of transmission lines should be raised to 45 years (from the 40 years previously used). Based on similar considerations, ARERA has conducted its own review of the useful life of the lines for regulatory purposes (see Resolution 654/2015/R/eel).

Land, regardless of whether it is free of constructions or related to civil and industrial buildings, is not depreciated, since it has an indefinite useful life.

Property, plant and equipment obtained under finance leases - and through which the Company has substantially acquired all the risks and rewards of ownership - are recognised as the Company's assets at the lower of fair value and the present value of the minimum lease payments due, including any amounts to be paid to exercise the purchase option. The corresponding liability to the lessor is recognised as a financial liability. Assets are depreciated using the criteria and rates described above. If the Company is not reasonably certain that it will acquire ownership at the end of the lease, the asset is depreciated over the shorter of the term of the lease and the asset's useful life.

Leases in which the lessor maintains substantially all the risks and rewards of ownership are classified as operating leases. Costs related to operating leases are expensed out in equal instalments over the term of the lease.

Intangible assets

Intangible assets, which all have finite useful lives, are recognised at cost, if necessary with the consent of the Board of Statutory Auditors, and shown net of accumulated amortisation and any impairment losses. Amortisation begins when the asset becomes available for use and is calculated on a straight-line basis over the estimated useful life of the related asset, which is reviewed annually. Any revisions to estimated figures are applied on a prospective basis.

Intangible assets essentially consist of the concession to exclusively provide electricity transmission and dispatching services, granted to Terna SpA, on 1 November 2005, with the acquisition of the TSO business unit. As established in the Decree issued by the Ministry of Productive Activities on 20 April 2005, this concession has a 25-year term, renewable for another 25 years, from the date of effective transfer of the activities, functions, assets and legal arrangements of the concession from GSE (formerly GRTN) to Terna SpA. This intangible asset was initially recognised at cost, which reflected fair value.

Other intangible assets essentially refer to software developments and upgrades.

Development costs are capitalised by the Company only if they can be reliably estimated and there is the technical possibility and intention to complete the intangible asset so that it will be available for use, and the asset can be used and it is possible to demonstrate that it will generate probable future economic benefits. Financial expenses directly attributable to the acquisition, construction or production of a non-current asset which justifies capitalisation pursuant to IAS 23 are capitalised to the asset as part of its cost.

All other development costs and research expenses are recognised in the income statement when incurred. These intangible assets are amortised over their estimated residual useful life, which is normally three years, given their rapid obsolescence.

Infrastructure rights

Infrastructure includes the property, plant and equipment and intangible assets employed in dispatching activities. These activities are carried out under concession arrangements, which fall within the scope of application of IFRIC 12, since the services provided are regulated and control exists over the residual interest. More specifically, infrastructure rights have been recognised as an intangible asset, as valued on the basis of the Intangible Asset model, given the return generated by dispatching activities thanks to the charges paid by users.

The revenue and costs relating to investment in dispatching activities are recognised with reference to the contracts concerned on a stage-of-completion basis; revenue recognised during the construction phase is limited to the amount of the internal and external construction costs incurred, considering that the fair value of the construction services is equivalent to the construction cost paid to third-party contractors plus the internal cost of the technical personnel employed on such construction activities. The assets continue to be amortised and depreciated in accordance with the initial schedule.

By contrast, dispatching revenue continues to be recognised in accordance with IAS 18 and financial expenses continue to be capitalised pursuant to IAS 23.

IFRIC 12, instead, is not applicable to the Company's concession for the part relating to the transmission activities, since neither the concession nor the related legislation envisage that the NTG will be handed over to the public grantor, without the provision of indemnification.

Goodwill

Goodwill, deriving from the acquisition of subsidiaries, is allocated to each of the identified cash generating units (CGU) or groups of CGUs, coinciding with Group companies that own electricity transmission grids. Goodwill is not amortised after initial recognition but is adjusted to reflect impairment losses, measured as described below. Goodwill relating to investments in associates and joint ventures is included in the carrying amount of those companies. Where negative goodwill arises, it is recognised in the income statement at the time of acquisition.

Inventories

Inventories are recognised and measured at the lower of purchase cost and net estimated realisable value. Cost is calculated as the weighted average, including accrued ancillary expenses. Net estimated realisable value means the estimated sale price under normal conditions net of completion costs and the estimated costs to sell.

Contract work in progress

When the result of work done to order can be reliably estimated, the related contract costs and revenue are recognised separately in the income statement on a percentage of completion basis. Progress is determined based on the work carried out and measured in proportion to the ratio of the cost for the works carried out up to the reporting date to the total cost of the contract (the cost-to-cost method). Differences between the value of completed contracts and payments on account received are recognised in the statement of financial position under assets or liabilities. Any impairment losses on the work carried out are taken to account, so as to recognise the risk of customers' refusal to accept the work performed. Expected contract losses are recognised immediately through profit or loss. Contract costs include all costs that relate directly to the specific contract, as well as fixed and variable costs incurred by the Company in the course of ordinary operations.

Financial instruments

Financial assets

Any financial assets other than derivative financial instruments that the Company has the positive intention and ability to hold to maturity are recognised at cost at the "settlement date", which is the fair value of the initial consideration given in exchange, including transaction costs. They are subsequently measured at amortised cost, using the effective interest method, net of any impairment losses, which are determined as the lower of the asset's carrying amount and the present value of its estimated future cash flows, discounted using the original effective interest rate. Financial assets are derecognised when, following their transfer or

settlement, the Company is no longer involved in their management and are no longer exposed to the risks and rewards of the transferred or settled instruments.

Trade receivables

Trade receivables are initially recognised at fair value and subsequently measured at amortised cost, using the effective interest method, and net of any losses relating to sums considered non-recoverable, for which specific provisions have been made in the allowance for doubtful accounts. Losses on receivables are measured on the basis of the present value of estimated future cash flows, discounted using the original effective interest rate.

Receivables with due dates that reflect normal commercial terms are not discounted.

Cash and cash equivalents

Cash and cash equivalents are recognised at nominal value and include amounts that are available on demand or can be readily converted into a known amount of cash and are subject to an insignificant risk of changes in value.

Trade payables

Trade payables are initially recognised at fair value and subsequently stated at amortised cost. If their due dates reflect normal commercial terms, they are not discounted.

Financial liabilities

Financial liabilities other than derivative financial instruments are recognised at the settlement date and measured at fair value, net of directly related transaction costs. Subsequently, financial liabilities are measured at amortised cost, using the original effective interest method. If the liabilities are covered by fair value hedges, they are adjusted to reflect changes in fair value with respect to the hedged risk.

Derivative financial instruments

Derivatives are recognised at fair value at the trade date and classified as hedges if the relationship between the derivative and the hedged item is formally documented and the hedge is highly effective within a range of 80% to 125%, as initially verified and periodically checked. When derivatives cover the risk of changes in the cash flows of the hedged instruments (cash flow hedges), the portion of changes in the fair value qualifying as effective is initially recognised in comprehensive income and subsequently in profit or loss, as the cash flows from the hedged item affects profit or loss. The portion of the fair value of the hedging instrument that does not qualify as effective is recognised in the income statement.

When hedging derivatives cover the risk of changes in the fair value of hedged instruments (fair value hedges), they are recognised at fair value in profit or loss. Accordingly, the hedged items are adjusted to reflect changes in the fair value associated with the hedged risk.

Changes in the fair value of derivatives that do not meet hedge accounting requirements in accordance with the EU-IFRS are recognised in profit or loss.

The fair value of instruments not traded in regulated markets is measured by discounting projected cash flows along a yield curve prevailing in the market at the reporting date, and by translating amounts in currencies other than the euro at closing exchange rates.

Financial and non-financial contracts (which are not already measured at fair value) are also analysed to identify any embedded derivatives, which must be separated and measured at fair value.

This analysis is conducted at the time the entity becomes party to the contract or when the contract is renegotiated in a manner that produces a material change in the original associated cash flows.

Employee benefits

The liability associated with employee benefits payable on or after termination of employment relate to defined benefit plans (deferred compensation benefits, additional months' pay, payment in lieu of notice, energy discounts, ASEM health cover and other benefits) or other long-term employee benefits (loyalty bonuses) and is recognised net of any plan assets. The liability is measured separately for each plan on the basis of actuarial calculations that estimate the amount of vested future benefits that employees have accrued at the reporting date. The liability is recognised on an accruals basis over the vesting period and is measured by independent actuaries.

Provisions for risks and charges

Provisions set aside for risks and charges are recognised when, at the reporting date, the Company has a legal or constructive obligation as the result of a past event and it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the disbursement. Where the effect is material, provisions are made by discounting estimated future cash flows using a discount rate that reflects current market rates and the specific risk applicable to the obligation, if any. Where discounting is used, the increase in the provisions due to the passage of time is recognised in the income statement as a financial expense. If it relates to property, plant and equipment (site disposal and restoration, for example), the provision is recognised as a contra entry to the asset to which it relates. The expense is recognised in the income statement through depreciation of the item of property, plant and equipment to which it relates.

Changes in the estimates are recognised in the income statement for the year in which the change occurs, except for the expected costs of dismantling, removal and restoration resulting from changes in the timing and use of the economic resources necessary to extinguish the obligation, or are attributable to a material change in the discount rate. These costs are recognised as an increase or reduction in the related assets and recognised in the income statement through depreciation.

Government grants

Government grants are recognised when there is a reasonable certainty that they will be received and that the Company will comply with all the conditions required for disbursement. Grants received in relation to specific assets whose value is recognised under non-current assets are recognised, in the case of plant already in operation at 31 December 2002, among other liabilities and taken to the income statement over the depreciation period for the assets in question. As of the 2003 financial year, grants related to new plant entering service are recognised as a direct reduction in the non-current asset concerned. Grants related to income are recognised in the income statement when the conditions for recognition are met.

Revenue

Revenue is recognised when it is probable that the economic benefits associated with the transactions will flow to the Company. Depending on the type of transaction, revenue is recognised on the basis of the following specific criteria:

- revenue from the sale of goods is recognised when the material risks and rewards of ownership of the goods have been transferred to the buyer and their total amount can be reliably determined and collected;
- revenue from services rendered is recognised with reference to the stage of completion of the activity. If revenue cannot be reliably measured, it is recognised to the extent of recoverable costs;
- revenue accrued during the year in respect of contract work in progress is recognised on the basis of the payments agreed for the progress of works using the cost-to-cost method. In addition to contractual payments, project revenue includes any payments in respect of variations, price revisions and incentives, with the latter recognised where it is probable that they will actually be earned and can be reliably determined. Revenue may also decrease owing, among other things, to penalties for delays attributable to the Company;
- when the recovery of an amount already recognised in revenue is uncertain, the non-recoverable value or the amount whose recovery is no longer probable is recorded as a cost, with recognition of a balancing entry in provisions for risks and charges;
- amounts collected on behalf of third parties, such as the fees paid to grid owners other than Terna, as well as revenue recognised for managing activities related to the balancing of the national electricity system, which do not increase equity, are reported net of the related costs (pass-through items). This reporting method, which reflects the substance of transactions by offsetting revenue with the related costs arising from the "same transaction", is however discussed in full in the specific section of the notes to the consolidated financial statements.

Financial income and expenses

Financial expenses directly attributable to the acquisition, construction or production of an asset that qualify for capitalisation are capitalised as part of the cost of the asset. The property, plant and equipment and intangible assets involved are those that require at least one year in order to prepare them for use. The directly attributable financial expenses are expenses that would not have been incurred had the expenditure for the asset not been incurred.

Where funds are borrowed specifically, the costs eligible for capitalisation are the actual costs incurred less any income earned on the temporary investment of such borrowings. Where loans are obtained for general purposes, the eligible amount is determined by applying a capitalisation rate to the expenditure on that asset equal to the weighted average of the financial expenses applicable to the borrowings outstanding for the year, excluding any specifically borrowed funds. The amount of capitalised financial expenses during a year will in any case not exceed the amount of financial expenses incurred during that year.

Capitalisation commences as from the date all the following conditions are first met: (a) expenditure has been incurred for the asset; (b) financial expenses have been incurred; and (c) the activities involved in preparing the asset for its intended use or sale are in progress. Capitalisation ceases when the activities involved in preparing the asset for its intended use or sale are substantially complete.

The average capitalisation rate used for 2017 was 1.30% and the rate for 2016 was 1.38%.

Financial income and expenses other than capitalised amounts are recognised on an accruals basis in respect of the interest on the net value of the related financial assets and liabilities, using the effective interest rate.

Dividends

Dividends from investees are recognised when the shareholders' right to receive payment is established. Dividends and interim dividends payable to shareholders are shown as changes in equity at the date in which they are approved by the General Meeting of shareholders and the Board of Directors, respectively.

Income taxes

Current income taxes are recognised as “Tax liabilities”, net of advances paid, or “Tax assets” where the net balance of the items is positive. They are based on the estimated taxable income and in accordance with current legislation, taking account of applicable exemptions.

Deferred tax assets and liabilities are calculated on temporary differences between the carrying amounts of assets and liabilities recognised in the separate financial statements and the corresponding amounts recognised for tax purposes, using current tax rates or the rates expected to be in effect when the temporary differences reverse, based on rates approved at the reporting date.

Deferred tax assets are recognised when their recovery is considered probable, i.e. when future taxable income will be available against which the asset can be used. The recoverability of deferred tax assets is reviewed at the end of each year.

Deferred tax liabilities are recognised in any case if they exist. Taxes relating to items recognised directly in the income statement are also allocated to the income statement.

New accounting standards

International financial reporting standards effective as of 1 January 2017

On 1 January 2017, several amendments to already applicable IFRS came into force, but these had no impact for the Company. These included:

Amendment to IAS 12 - Recognition of Deferred Tax Assets for Unrealised Losses

On 6 November 2017, the European Commission endorsed an amendment to IAS 12, which permits recognition of deferred tax assets for unrealised losses on financial instruments measured at fair value, irrespective of whether the entity intends to recover the carrying amount of the instrument by holding it until maturity or by selling it.

Amendment to IAS 7 - Disclosure Initiative

In connection with the Disclosure Initiative, on 6 November 2016, the European Commission endorsed IAS 7, which clarifies certain disclosure requirements during preparation of the statement of cash flows.

Improvements to IFRS (2014-2016 Cycle)

Endorsed on 7 February 2018, the annual improvements related to the 2014-2016 cycle contain minor amendments, to be applied retrospectively as of 1 January 2017, for IFRS 12, and as of 1 January 2018, for IFRS 1 and IAS 28.

International financial reporting standards endorsed but not yet effective

IFRS 15 - Revenue from Contracts with Customers

On 29 October 2016, the European Commission endorsed the new IFRS 15 on revenue recognition. The new standard introduced a five-step revenue recognition model to be applied to revenue from contracts with customers. The steps are as follows: 1) identification of the contract; 2) identification of the performance obligations in the contract; 3) determination of the transaction price; 4) allocation of the transaction price; 5) recognition of revenue when the performance obligation is satisfied. Under the standard, the obligation is satisfied when control over the goods or services underlying the performance obligation is transferred to the customer. Control is defined as the ability to direct the use of and obtain substantially all of the remaining benefits from the asset.

The purpose of the new standard is to provide a consistent, overall framework for revenue recognition, applicable to all contracts with customers (with the exception of leases, insurance contracts and financial instruments). The new standard will replace all existing revenue recognition requirements under IFRS. Specifically, it will replace the following standards:

- IAS 11 - Construction Contracts;
- IAS 18 - Revenue;
- IFRIC 13 - Customer Loyalty Programmes;

- IFRIC 15 - Agreements for the Construction of Real Estate;
- IFRIC 18 - Transfers of Assets from Customers;
- SIC 31 - Revenue - Barter Transactions Involving Advertising Services.

In addition, on 31 October 2016, the European Commission endorsed guidance to clarify certain practical aspects brought to the fore during discussion of the TRG (Transition Resource Group for Revenue Recognition) regarding the application of IFRS 15: identifying performance obligations, principal versus agent considerations and application guidance on licensing.

The new standard is effective from 1 January 2018, with early and retrospective application permitted. Terna expects to apply the new standard from the effective date using the modified or retrospective approach, accounting for the cumulative effect of adoption of IFRS 15 from the date of first-time adoption, electing not to apply the standard to completed contracts. Analysis of the expected impact of first-time adoption of IFRS 15 is nearing completion. This shows that application will have non-material quantitative effects for the Company, limited to minor aspects of its Regulated Activities (revenue from connections to the NTG) and certain contracts related to the Non-Regulated Activities.

IFRS 9 - Financial Instruments

On 22 November 2016, the European Commission approved IFRS 9 - Financial Instruments, in its final version of 24 July 2014, which starts the complex and detailed process of replacing IAS 39, divided into the following phases: classification and measurement, derecognition, impairment and hedge accounting. The new standard is effective from 1 January 2018. Early application is permitted. The main changes introduced by the new standard include, among other things, unified classification guidance for all types of financial instruments, including the requirements for recognition and measurement, impairment, derecognition and hedge accounting. Financial assets will therefore be classified as a whole and not subject to complex separation rules. The new classification criterion for financial instruments is based on the business model adopted by the Company to manage financial assets with reference to the collection of cash flows and to the characteristics of the contractual cash flows of the financial assets. As regards impairment, the model provided for in IAS 39 based on the criterion of incurred loss, which postponed the recognition of losses on receivables to the moment of occurrence of the trigger event, has been replaced, as it was considered a weakness. The new IFRS 9 provides for a model based on a prospective view, which requires the immediate recognition of losses on receivables expected over the life of the financial instrument, as a trigger event no longer needs to occur before the recognition of losses on receivables. The new standard has also completed the stage of the Hedge Accounting project, except for the rules on macro hedge accounting, which will be published at a later date. It provides, among the other changes, for a substantial revision of hedge accounting so as to better reflect risk management activities in the financial statements.

Analysis of the expected impact of first-time adoption of the new standard in 2018, which is close to completion - performed retrospectively with regard to classification and measurement, derecognition and impairment, with presentation of the cumulative effects of first-time adoption at the transition date (i.e. 1 January 2018) - shows that application will have non-material quantitative effects for the Company, essentially limited to the impairment of trade receivables. With regard to hedge accounting, application will be prospective from the date of first-time adoption. At that date, existing hedging relationships have not been modified and the new accounting rules, with specific regard to the time value of options and the forward elements of forward contracts, have not resulted in any differences.

IFRS 16 - Leases

Endorsed on 31 October 2017, the new IFRS 16 governs accounting for leases, replacing the previous IAS 17. Among the changes, the new standard, in dispensing with the distinction between operating and finance leases, bases the accounting presentation on the "right-of-use" approach, which for the lessee makes the accounting uniform for any type of lease. At the moment of initial measurement, that is at the date on which the lessor makes the asset available to the lessee, the latter must recognise an asset and a liability: the right to use the asset in assets, and the related lease liability in liabilities. IFRS 16 will be effective from 1 January 2019, but early application is permitted for companies that adopt IFRS 15 (Revenue from Contracts with Customers). The analysis in progress has not revealed any significant impact of the new standard on the financial statements.

Amendment to IFRS 2: Classification and Measurement of Share-based Payment Transactions

On 14 March 2018, the European Commission issued Regulation 2018/289, endorsing an amendment to IFRS 2 clarifying the classification and measurement of share-based payments. The amendment is effective from 1 January 2018.

Amendment to IAS 40: Transfers of Investment Property

On 14 March 2018, the European Commission issued Regulation 2018/289, endorsing an amendment to IAS 40, which aims to provide guidance related to the transfer of investment property when there is evidence of a change in use. The amendment is effective from 1 January 2018.

International financial reporting standards awaiting endorsement

For newly-issued amendments, standards and interpretations that have not yet been endorsed by the EU, but which address issues that affect or could affect the Terna Group, assessments are currently being conducted of the possible impact of their application on the financial statements, taking into account the date on which they will take effect. In particular:

IFRS 17 - Insurance Contracts

The new accounting standard for insurance contracts was published by the IASB on 18 May 2017, to replace the interim version of IFRS 4. The standard defines the new principles for the recognition, measurement, presentation and disclosure of insurance contracts. The General Model of reference is based on the discounting of expected cash flows, with the indication of a risk adjustment and upfront profits through the "contractual service margin", which cannot be negative, released to income over the term of the contract.

IFRIC 22 - Foreign Currency Transactions and Advance Consideration

On 8 December 2016, the IASB published the interpretation for IAS 21, providing guidance in the selection of an exchange rate to be used when recording a transaction in a foreign currency, should the consideration in the foreign currency have been received or paid in advance of recognition of the related assets.

IFRIC 23 - Uncertainty over Income Tax Treatments

Published on 7 June 2017, the interpretation of IAS 12 provides guidance in accounting for income taxes in case of uncertainty over the income tax treatment.

Amendment to IFRS 9: Prepayment Features with Negative Compensation

Published by the IASB on 12 October 2017, the amendment to IFRS 9 allows the measurement of certain financial assets with a prepayment option with negative compensation features at amortised cost or at fair value through comprehensive income.

Amendment to IAS 28: Long-term Interests in Associates and Joint Ventures

Published by the IASB on 12 October 2017, the amendment to IAS 28 clarifies which long-term receivables are part of the net investment in the associate or joint venture.

Improvements to IFRS (2015-2017 Cycle)

Published by the IASB on 12 December 2017, the annual improvements related to the 2015-2017 cycle contain minor amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23.

Amendment to IAS 19: Plan Amendment, Curtailment or Settlement

Published by the IASB on 7 February 2018, the amendment to IAS 19 clarifies how pension costs should be calculated in the event of modifications to a defined-benefit plan.

B. Notes to the income statement

Revenue

1. REVENUE FROM SALES AND SERVICES - €1,861.4 MILLION

				(€m)	
				PRO FORMA	
	2017	2016	CHANGE	2016	CHANGE
Transmission revenue	1,674.6	1,494.8	179.8	1,669.8	4.8
Back-billing of transmission charges for previous years	(0.1)	2.6	(2.7)	0.8	(0.9)
Quality of service bonuses/(penalties)	7.4	15.4	(8.0)	15.4	(8.0)
Other energy-related revenue	133.0	132.5	0.5	132.5	0.5
Other sales and services	46.5	45.8	0.7	45.9	0.6
TOTAL	1,861.4	1,691.1	170.3	1,864.4	(3.0)

Transmission revenue

This item, amounting to €1,674.5 million, includes revenue from the core business relating to the allowed return due to the Company for use of the National Transmission Grid.

The increase in transmission revenue (up €3.9 million) is due to revision of the related tariff, after the one-off positive effects recognised in 2016.

Quality of service bonuses/(penalties)

This item, amounting to €7.4 million in 2017, regards the RENS incentive mechanism introduced by Resolution 653/2015/r/eel, calculated on a pro rata basis taking into account the estimated overall results expected in the 2016-2019 regulatory period.

Compared with the previous year, this item is down €8 million, due primarily to the effects, in 2017 and 2016, of the regulatory treatment of certain major events occurring in central and northern Italy in the last years.

Other energy-related revenue

This item regards dispatching and metering revenue (€111.8 million for the dispatching component and €0.1 million for the metering component) and revenue from infrastructure construction and upgrade services performed under concession, recognised in application of IFRIC 12 (€21.1 million).

The increase of €0.5 million compared with the previous year broadly reflects revision of the tariff for the year.

Other sales and services

The item, "Other sales and services", amounting to €46.5 million, primarily regards revenue from the following:

- administrative services provided to subsidiaries (€25.5 million, including €23.2 million from services provided to Terna Rete Italia SpA);
- Non-Regulated Activities (approximately €14.2 million), with particular regard to specialist services relating to HV and VHV power lines provided to external customers;
- revenue from connections to the NTG (€5.8 million).

The reduction in this item (€0.6 million) compared with the previous year primarily reflects reduced revenue from the Company's Non-Regulated Activities.

Pass-through revenue/expenses

This item regards “pass-through” revenue and expenses (the balance of which amounts to zero). These items result from purchases and sales of electricity from electricity market operators carried out each day. Measurements for each point of injection and withdrawal are taken and the differences, with respect to energy market schedules are calculated. These differences, known as imbalances, are then measured using algorithms established by the regulatory framework. The net charge resulting from calculation of the imbalances and the purchases and sales, carried out by Terna, on the DSM, is billed on a pro rata basis to each end consumer via a specific uplift payment. This item also reflects the portion of the transmission charge that Terna passes on to other grid owners.

The components of these transactions are shown in greater detail below:

	(€m)		
	2017	2016	CHANGE
Total Power Exchange-related revenue items	4,039.8	4,007.6	32.2
- Uplift	2,093.5	2,420.9	(327.4)
- Electricity sales	434.6	327.8	106.8
- Imbalances	543.6	366.1	177.5
- Congestion revenue	368.0	278.0	90.0
- Load Profiling for public lighting	73.7	96.8	(23.1)
- Charges for right to use transmission capacity and market coupling	297.6	249.5	48.1
- Interconnectors/shippers	75.1	73.7	1.4
- Other Power Exchange-related pass-through revenue items	153.7	194.8	(41.1)
Total over-the-counter revenue items	1,389.4	1,814.5	(425.1)
- Transmission revenue passed on to other NTG owners	135.1	230.4	(95.3)
- Charge to cover cost of essential plants	327.5	685.3	(357.8)
- Charge to cover cost of energy delivery capacity	208.9	255.5	(46.6)
- Charge to cover cost of interruptibility service	359.8	331.8	28.0
- Charge to cover cost of LV capacity and protection service	267.6	274.4	(6.8)
- Other pass-through revenue for over-the-counter trades	90.5	37.1	53.4
TOTAL PASS-THROUGH REVENUE	5,429.2	5,822.1	(392.9)
Total Power Exchange-related cost items	4,039.8	4,007.6	32.2
- Electricity purchases	2,322.9	2,142.0	180.9
- Imbalances	771.3	816.9	(45.6)
- Congestion revenue	280.6	201.0	79.6
- Load Profiling for public lighting	81.1	110.7	(29.6)
- Charges for right to use transmission capacity and market coupling	116.0	89.4	26.6
- Interconnectors/Shippers	330.8	364.0	(33.2)
- Other Power Exchange-related pass-through cost items	137.1	283.6	(146.5)
Total over-the-counter cost items	1,389.4	1,814.5	(425.1)
- Transmission costs passed on to other NTG owners	135.1	230.4	(95.3)
- Fees paid for essential units	327.5	685.3	(357.8)
- Fees paid for energy delivery capacity	208.9	255.5	(46.6)
- Fees paid for interruptibility service	359.8	331.8	28.0
- Fees paid for LV capacity and protection service	267.6	274.4	(6.8)
- Other pass-through costs for over-the-counter trades	90.5	37.1	53.4
TOTAL PASS-THROUGH COSTS	5,429.2	5,822.1	(392.9)

The total uplift cost in 2017, amounting to €2,093.5 million, is down €327.4 million on the figure for the previous year, primarily reflecting reductions in the DSM cost and in the cost of imbalances (above all demand-side), linked partly to the effect of new regulations effective from August 2016 and from September 2017.

2. OTHER REVENUE AND INCOME - €90.1 MILLION

(€m)

	2017	2016	CHANGE	PRO FORMA	
				2016	CHANGE
Payment for lease of operations	33.6	33.0	0.6	33.0	0.6
Rental income	25.3	21.3	4.0	24.4	0.9
Sundry grants	8.1	8.7	(0.6)	9.2	(1.1)
Contingent assets	1.8	3.2	(1.4)	3.3	(1.5)
Sales to external customers	13.5	7.9	5.6	10.5	3.0
Gains on sale of components of plant	2.3	8.0	(5.7)	10.6	(8.3)
Compensation for damages	3.2	2.9	0.3	2.9	0.3
Other revenues	2.3	3.5	(1.2)	3.5	(1.2)
TOTAL	90.1	88.5	1.6	97.4	(7.3)

The most significant components of "Other revenue and income" primarily regard the revenue for 2017 received from the subsidiary Terna Rete Italia SpA under the agreement for the lease of certain operations (€33.6 million), rental income (€25.3 million), mainly in the form of payment for housing the Wind group's fibre network on the grid and new contracts granting usage rights on certain fibre assets, sales to external customers (€13.5 million) and sundry grants (€8.1 million), primarily in relation to the re-routing of lines for third parties.

The reduction of €7.3 million essentially reflects increased revenue generated in 2016 by the so-called "Copper Plan" (down €12.1 million), recognition, in 2016, of the impact of renewal of the vehicle fleet (down €4.2 million), and a reduction in grants in relation to the re-routing of lines at the request of third parties (down €1.1 million), after the increase in revenue from telecommunications, above all due to new contracts granting usage rights on certain fibre assets (up €11 million).

Operating costs**3. RAW AND CONSUMABLE MATERIALS USED - €10.1 MILLION**

This item, amounting to €10.1 million, includes the value of the various materials and supplies, including fuel for the Company's vehicle fleet. The increase of €5.6 million compared with the previous year is primarily due to fibre used by the Company for its telecommunications business.

4. SERVICES - €349.8 MILLION

(€m)

	2017	2016	CHANGE	PRO FORMA	
				2016	CHANGE
Intercompany services, including technical and administrative services	297.6	297.3	0.3	313.6	(16.0)
Maintenance and sundry services	32.0	26.7	5.3	27.1	4.9
Lease expense	9.6	9.1	0.5	10.4	(0.8)
Insurance	6.2	5.5	0.7	6.5	(0.3)
Remote transmission and telecommunications	0.3	0.5	(0.2)	0.5	(0.2)
IT services	2.4	1.8	0.6	1.8	0.6
Tender costs for plant	1.7	1.1	0.6	1.1	0.6
TOTAL	349.8	342.0	7.8	361.0	(11.2)

The most significant component of this item is "Intercompany services, including technical and administrative services". This regards the accrued costs incurred under specific intercompany contracts (€297.6 million), largely regarding the subsidiary Terna Rete Italia SpA which maintains and operates the infrastructure owned by the Company (€270.4 million), provides services relating to investment in the development of the Company's transmission and dispatching infrastructure (€20.3 million) and other activities and services relating to plant owned by third parties (€6.7 million). This item also includes penalties relating to the quality of the transmission service attributable to Terna Rete Italia SpA (€-3.1 million).

Fees payable to members of the Board of Statutory Auditors amount to €0.2 million.

After the costs recognised in application of IFRIC 12 for the development of dispatching infrastructure (down €1.9 million), the reduction in "Services" totals €9.3 million and primarily reflects the impact of the performance of the quality of service attributable to Terna Rete Italia SpA (a reduction of €13.1 million, given that, in 2017, Terna attributed a penalty of €3.1 million to the subsidiary, compared with a bonus of €10.0 million in 2016), partially offset by an increase in maintenance and other service costs (up €4.9 million).

Under the Terna Group's current organisational structure, responsibility for the activities involved in investment in the development and upgrade of dispatching infrastructure lies with both Terna SpA itself and the subsidiary Terna Rete Italia SpA. The related cost is charged in full to "Services" as a service received from the subsidiary. The following table shows details of the costs recognised in application of IFRIC 12 and within the scope of the item under review.

	(€m)		
	2017	2016	CHANGE
IT services	0.3	0.3	-
Tender costs for plant	0.3	-	0.3
Maintenance and sundry services	-	-	-
Remote transmission	-	-	-
Cost of services relating to investment in dispatching infrastructure (IFRIC 12)	0.6	0.3	0.3
Cost of services recognised in application of IFRIC 12 - Services from Terna Rete Italia SpA	17.1	19.3	(2.2)
Total cost of services relating to investment in dispatching infrastructure (IFRIC 12)	17.7	19.6	(1.9)

5. PERSONNEL EXPENSES - €66.0 MILLION

	(€m)				
	2017	2016	CHANGE	PRO FORMA	
				2016	CHANGE
Salaries, wages and other short-term benefits	56.4	48.1	8.3	48.3	8.1
Directors' remuneration	1.8	1.6	0.2	1.8	-
Termination benefits (<i>TFR</i>), energy discounts and other employee benefits	(8.8)	3.4	(12.2)	3.3	(12.1)
Early retirement incentives	19.6	32.1	(12.5)	32.1	(12.5)
Gross personnel expenses	69.0	85.2	(16.2)	85.5	(16.5)
Capitalised personnel expenses	(3.0)	(3.0)	-	(3.1)	0.1
TOTAL	66.0	82.2	(16.2)	82.4	(16.4)

Personnel expenses are down €16.4 million, primarily reflecting the release of provisions for the energy discounts granted to qualifying pensioners and the higher amount of provisions made in 2016 for early retirement schemes, after increased provisions for management incentive schemes.

The following table shows the Company's workforce by category at the end of the year and as the average for the year.

	AVERAGE WORKFORCE		WORKFORCE AT	
	2017	2016	31 DECEMBER 2017	31 DECEMBER 2016
Senior managers	33	35	34	36
Middle managers	173	168	175	170
Administrative personnel	277	254	298	259
TOTAL	483	457	507	465

6. AMORTISATION, DEPRECIATION AND IMPAIRMENT LOSSES - €495.2 MILLION

(€m)

	2017	2016	CHANGE	PRO FORMA	
				2016	CHANGE
Amortisation of intangible assets	46.3	46.7	(0.4)	47.2	(0.9)
- of which rights on infrastructure	24.8	27.5	(2.7)	27.5	(2.7)
Depreciation of property, plant and equipment	438.0	383.1	54.9	422.6	15.4
Impairment losses on property, plant and equipment	9.3	0.5	8.8	0.6	8.7
Losses on trade receivables	1.6	2.4	(0.8)	2.8	(1.2)
TOTAL	495.2	432.7	62.5	473.2	22.0

This item, totalling €495.2 million, is up €22.0 million, primarily following the entry into service of new plant.

7. OTHER OPERATING COSTS - €39.0 MILLION

(€m)

	2017	2016	CHANGE	PRO FORMA	
				2016	CHANGE
Quality of service costs	10.5	(7.8)	18.3	(7.8)	18.3
- of which mitigation and sharing mechanisms	7.7	(5.3)	13.0	(5.3)	13.0
- of which contributions to the Fund for Exceptional Events	2.4	(3.0)	5.4	(3.0)	5.4
- of which compensation mechanisms for HV users	0.4	0.5	(0.1)	0.5	(0.1)
Indirect taxes and local taxes and levies	4.5	12.6	(8.1)	13.5	(9.0)
Net contingent liabilities	(0.2)	0.9	(1.1)	1.1	(1.3)
Provisions for litigation and disputes	10.3	5.3	5.0	5.4	4.9
Losses on sales/disposal of plant	0.6	0.3	0.3	0.7	(0.1)
Other operating costs	13.3	6.2	7.1	6.3	7.0
TOTAL	39.0	17.5	21.5	19.2	19.8

The most significant components of this item regard net quality of service costs (€10.5 million), provisions for litigation and disputes set aside to cover outstanding liabilities that, at the end of the year, could result from court judgements and out-of-court settlements regarding the Company's activities (€10.3 million), and indirect taxes and local taxes and levies (€4.5 million, including €3.8 million in *Tosap*, *Tassa per l'Occupazione del Suolo Pubblico*, a tax on the occupation of public land, and *Tares*, *Tassa Rifiuti e Servizi*, a tax on waste and municipal services). Other operating costs of €13.3 million regard membership dues and contributions to trade bodies and associations, donations and other expenses.

The increase of €19.8 million mainly regards the net impact of the mechanisms designed to regulate the quality of service. This reflects the higher costs incurred during the year (up €6.9 million and relating to events in Abruzzo and Marche at the beginning of the year) and the higher amount of contingent assets recognised in the previous year (€11.4 million) regarding contributions to the Fund for Exceptional Events and the sharing mechanism used to allocate the cost of certain major events in central and northern Italy in 2015.

8. NET FINANCIAL INCOME/(EXPENSES) - (€89.8) MILLION

(€m)

	2017	2016	CHANGE
FINANCIAL EXPENSES			
Financial expenses paid to Cassa Depositi e Prestiti	(3.7)	(4.5)	0.8
Interest expense on medium/long-term borrowings and related hedges	(94.0)	(101.0)	7.0
Restructuring of bond issues and related hedges	-	(13.2)	13.2
Discounting of termination benefits (TFR) and other provisions for employee benefits	(0.4)	(0.6)	0.2
Capitalised financial expenses	12.3	15.6	(3.3)
Other financial expenses	(9.1)	(0.4)	(8.7)
Translation differences	(0.7)	-	(0.7)
Impairment loss on investment associate	-	(4.3)	4.3
Total expenses	(95.6)	(108.4)	12.8
FINANCIAL INCOME			
Dividends from associates	1.1	1.1	-
Financial income from subsidiaries	0.9	1.0	(0.1)
Restructuring of bond issues and related hedges	2.7	-	2.7
Interest income and other financial income	1.1	4.3	(3.2)
Total income	5.8	6.4	(0.6)
TOTAL	(89.8)	(102.0)	12.2

Net financial expenses for the year amount to €89.8 million, reflecting €95.6 million in financial expenses and €5.8 million in financial income. The reduction in net financial expenses compared with the previous year, amounting to €12.2 million, primarily reflects the following:

- a reduction in financial expenses on medium/long-term borrowings and the related hedges (€7.0 million), primarily due to a general fall in market interest rates during 2017;
- a decrease in the fair value of bond issues and the related hedges (€15.9 million) following a restructuring of the derivatives entered into in 2017;
- a reduction in capitalised financial expenses (down €3.3 million), due to the lower cost of debt in 2017 compared with 2016;
- a decrease in interest income and other financial income (down €3.2 million), reflecting the reduced amount of liquidity invested during the year and the general fall in market interest rates;
- the impairment loss on the investment in the associate CGES (€4.3 million) recognised in 2016.

9. INCOME TAX EXPENSE - €261.6 MILLION

(€m)

	2017	2016	CHANGE	PRO FORMA	
				2016	CHANGE
Income tax for the year					
Current tax expense:					
- IRES (corporate income tax)	243.2	247.7	(4.5)	280.2	(37.0)
- IRAP (regional tax on productive activities)	54.0	47.4	6.6	54.0	-
Total current tax expense	297.2	295.1	2.1	334.2	(37.0)
New temporary differences:					
- deferred tax assets	(18.6)	(14.0)	(4.6)	(14.0)	(4.6)
Reversal of temporary differences:					
- deferred tax assets	15.9	14.9	1.0	14.9	1.0
- deferred tax liabilities	(30.0)	(27.6)	(2.4)	(31.6)	1.6
Adjustment of IRES rate	-	1.5	(1.5)	1.4	(1.4)
Deferred tax income and expense. net	(32.7)	(25.2)	(7.5)	(29.3)	(3.4)
Adjustments of taxes for previous years	(2.9)	(6.7)	3.8	(7.4)	4.5
TOTAL	261.6	263.2	(1.6)	297.5	(35.9)

Current income tax expense for the year of €261.6 million is down €35.9 million compared with the previous year, essentially reflecting the impact of the reduction in the IRES tax rate from 27.5% to 24% (in accordance with Law 208/2015, the 2016 Stability Law), partially offset by the changes made to the tax relief designed to stimulate economic growth (ACE - *Aiuto alla Crescita Economica*) introduced by Law Decree 50/2017.

Deferred tax income, amounting to €-32.7 million, has changed by €-3.4 million primarily due to the effect on taxation of movements in provisions for risks and charges.

Adjustments to taxes for previous years, amounting to income of €2.9 million, reflect the overpayment of tax in previous years and are down €4.5 million.

The effective tax charge for the year (€261.6 million) results in a tax rate of 29.0%, compared with a rate of 33.0% for 2016. For a clearer presentation of the differences between the theoretical and actual tax rates, the table below reconciles the profit before taxes with taxable income for IRES (corporate income tax) purposes.

	(€m)		
	TAXABLE INCOME	TAX	% CHANGE
Profit before tax	901.6		
IRES - Theoretical tax charge (rate of 24.0%)		216.4	
IRAP - Theoretical tax charge (rate of 5.10% on operating profit of €991.4 million)		50.6	
		267.0	
THEORETICAL TAX RATE			29.6%
<i>Permanent differences in IRES</i>			
Employee benefits		0.6	0.1%
Contingencies		0.8	0.1%
Single council tax (<i>Imposta Municipale Unica</i> , IMU)		1.4	0.2%
Impairments		1.4	0.2%
Other increases/decreases		(1.0)	(0.1%)
Accelerated depreciation		(1.9)	(0.2%)
IRAP - art. 6 of Law 28/01/2009		(1.2)	(0.1%)
Tax relief (ACE - <i>Aiuto alla Crescita Economica</i>)		(3.2)	(0.4%)
Dividends		(0.3)	(0.0%)
<i>Permanent differences in IRAP</i>			
Personnel expenses		0.3	0.0%
Capitalised financial expenses and other changes		0.6	0.1%
Other increases/decreases		0.5	0.1%
Effective tax rate after adjustments of taxes for previous years			29.4%
Income tax for previous years and other one-off effects		(3.4)	(0.4%)
Total income taxes for the year and other one-off effects		261.6	
EFFECTIVE TAX RATE			29.0%

C. Operating segments

In line with the requirements of "IFRS 8 - Operating segments", companies that publish a Parent Company's consolidated financial statements in a single document, together with the Company's separate financial statements, only have to present segment information in the consolidated financial statements.

D. Notes to the statement of financial position

Assets

10. PROPERTY, PLANT AND EQUIPMENT - €11,705.2 MILLION

(€m)

	LAND	BUILDINGS	PLANT AND EQUIPMENT	INDUSTRIAL AND COMMERCIAL EQUIPMENT	OTHER ASSETS	ASSETS UNDER CONSTRUCTION AND PREPAYMENTS	TOTAL
COST AT JANUARY 2017	124.8	1,737.8	13,616.7	85.7	133.2	1,278.1	16,976.3
Capital expenditure	0.2	-	0.1	2.5	0.5	810.1	813.4
Assets entering service	6.7	86.6	664.3	-	6.2	(763.8)	-
Merger contribution	-	3.0	1,905.1	-	-	20.8	1,928.9
Other additions	-	0.6	9.9	-	-	-	10.5
Disposals and impairments	-	(0.5)	(42.0)	-	(0.1)	(3.9)	(46.5)
Other movements	-	(33.0)	(105.8)	-	-	9.0	(129.8)
Reclassifications	(4.1)	4.1	-	-	-	-	-
COST AT 31 DECEMBER 2017	127.6	1,798.6	16,048.3	88.2	139.8	1,350.3	19,552.8
ACCUMULATED DEPRECIATION AND IMPAIRMENTS AT 1 JANUARY 2017	-	(473.5)	(5,974.1)	(66.3)	(94.1)	-	(6,608.0)
Depreciation for the year	-	(42.9)	(379.7)	(4.4)	(11.0)	-	(438.0)
Merger contribution	-	(0.2)	(839.5)	-	-	-	(839.7)
Disposals	-	0.5	35.5	-	-	-	36.0
Other movements	-	-	2.1	-	-	-	2.1
ACCUMULATED DEPRECIATION AND IMPAIRMENTS AT 31 DECEMBER 2017	-	(516.1)	(7,155.7)	(70.7)	(105.1)	-	(7,847.6)
Carrying amount							
AT 31 DECEMBER 2017	127.6	1,282.5	8,892.6	17.5	34.7	1,350.3	11,705.2
AT 31 DECEMBER 2016	124.8	1,264.3	7,642.6	19.4	39.1	1,278.1	10,368.3
CHANGE	2.8	18.2	1,250.0	(1.9)	(4.4)	72.2	1,336.9

The category, "Plant and equipment", essentially includes the electricity transmission grid and transformer substations in Italy.

"Property, plant and equipment" is up €1,336.9 million compared with the previous year, essentially due to the contribution from the merger of the wholly owned subsidiary Terna Rete Italia Srl with and into Terna SpA (€1,089.2 million), in addition to investment during the year (€813.4 million), depreciation (€438.0 million), other movements (a reduction of €127.7 million) regarding grants related to assets (primarily the Sorgente - Rizziconi line and projects financed by the Ministry for Economic Development and the EU), the purchase of a substation located in the Municipality of Ponti sul Mincio for €-10.5 million, and disposals and impairments (€10.5 million).

As regards the progress of work on the principal projects during the year regarded the following: progress on construction of the various overseas interconnections, consisting of the power lines linking Italy and Montenegro (€157.7 million) and Italy and France (€62.5 million), extension of the fibre network as part of the "Fibre Network Development" project (€27 million), the laying of cables in the Venetian lagoon (€23.3 million), completion of work on the 380 kV Udine West-Redipuglia line (€25.1 million), the purchase of the "Stornarella" cable (€17.4 million), the purchase of a 150 kV substation at Macchialupo (€14.5 million), completion of the "Capri-Mainland" interconnector (€14.4 million), the upgrade of the capacity of the North-West power lines (€13.8 million) and the restructuring of Palermo metropolitan area (€11.3 million).

11. GOODWILL - €190.2 MILLION

Goodwill of €190.2 million regards the goodwill resulting from the mergers with the subsidiaries, RTL (€88.6 million, merged into the Company in 2008) and Terna Rete Italia Srl (€101.6 million) merged in 2017. The latter is the reason for the difference with respect to the previous year.

Impairment testing*CGU - Terna SpA's transmission activities*

For impairment testing purposes, Terna SpA's Regulated Activities was considered to be a cash generating unit (CGU). Measurement of the recoverable value was based on the fair value less costs to sell. This was determined taking into account Terna's share price at 31 December 2017, after stripping out the fair value of financial liabilities and the estimated fair value of the Non-Regulated Activities segment.

The resulting value is significantly higher than the carrying amount inclusive of goodwill.

12. INTANGIBLE ASSETS - €234.1 MILLION

(€m)

	INFRASTRUCTURE RIGHTS	CONCESSIONS	OTHER ASSETS	ASSETS UNDER DEVELOPMENT AND PREPAYMENTS	TOTAL
Cost	387.2	135.4	193.1	38.3	754.0
Accumulated amortisation	(283.4)	(62.5)	(167.8)	-	(513.7)
BALANCE AT 31 DECEMBER 2016	103.8	72.9	25.3	38.3	240.3
Capital expenditure	-	-	-	38.5	38.5
Assets entering service	23.9	-	18.6	(42.5)	-
Merger contribution	-	-	1.6	-	1.6
Amortisation for the year	(24.8)	(5.6)	(15.9)	-	(46.3)
BALANCE AT 31 DECEMBER 2017	102.9	67.3	29.6	34.3	234.1
Cost	411.0	135.4	221.0	34.3	801.7
Accumulated amortisation	(308.1)	(68.1)	(191.4)	-	(567.6)
BALANCE AT 31 DECEMBER 2017	102.9	67.3	29.6	34.3	234.1
CHANGE	(0.9)	(5.6)	4.3	(4.0)	(6.2)

Intangible assets amount to €234.1 million and include:

- the infrastructure used in provision of the dispatching service carried out under concession and accounted for in accordance with "IFRIC 12 - Service Concession Arrangements", with the carrying amount, at 31 December 2017, of infrastructure entering service during the year amounting to €102.9 million and of infrastructure under construction, included in the category "Assets under development and prepayments", amounting to €20.3 million (at 31 December 2016, the matching figures were €103.8 million and €22.9 million, respectively);
- the concession for electricity transmission and dispatching activities in Italy (with a carrying amount of €67.3 million at 31 December 2017); this 25-year concession was recognised in 2005, initially at fair value and subsequently at cost.

Other intangible assets primarily include software applications, products development internally or those purchased as part of systems development programmes. Investment in these assets during the year (€17.3 million) essentially regards internal development programmes.

The reduction compared with the previous year (down €6.2 million) reflects the net effect of amortisation (€46.3 million), capital expenditure (€38.5 million, including €21.2 million in infrastructure rights) and the merger contribution (up €1.6 million).

Investment in intangible assets during the year (€38.5 million) included expenditure on the development of software applications for the Remote Management System for Dispatching (€9.6 million), the Power Exchange (€3.7 million) and for protection of the electricity system (€2.9 million), as well as software applications and generic licences (€14.4 million).

13. FINANCIAL ASSETS

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Investments in subsidiaries	916.5	1,446.2	(529.7)
Investments in associates	47.8	47.8	-
Fair value hedges	-	325.7	(325.7)
Deposit in the Interconnector Guarantee Fund	42.2	17.4	24.8
Fees on Revolving Credit Facility	3.2	4.3	(1.1)
NON-CURRENT FINANCIAL ASSETS	1,009.7	1,841.4	(831.7)
Short-term loan to Terna Interconnector	-	39.0	(39.0)
Deferred assets on fair value hedges	-	26.1	(26.1)
Other current financial assets	0.2	0.1	0.1
CURRENT FINANCIAL ASSETS	0.2	65.2	(65.0)

“Non-current financial assets” includes the items described below.

The value of “Investments in subsidiaries” (€916.5 million) regards investments in Terna SpA's direct subsidiaries and is down €529.7 million compared with 31 December 2016. This reflects a reduction of €559.7 million due to the merger of the wholly owned subsidiaries Terna Rete Italia Srl and Terna Storage Srl, with and into Terna SpA, offset by the subscription for new shares issued by Terna Crna Gora d.o.o., totalling €30 million.

The value of “Investments in associates” (€47.8 million) is in line with the previous year and regards the investments in CGES - CrnoGorski Elektroprenosni Sistem AD (€30.0 million), CESI SpA (€17.6 million) and CORESO SA (€0.2 million).

The following table shows key information on investments in subsidiaries, associates and joint ventures owned directly by Terna SpA at 31 December 2017. Amounts relate to the latest approved financial statements.

NAME	REGISTERED OFFICE	CURRENCY	SHARE CAPITAL	% INTEREST	CARRYING AMOUNT (€)
SUBSIDIARIES CONTROLLED DIRECTLY BY TERNA SpA					
Terna Rete Italia S.p.A.	Rome	Euro	120,000	100%	3,120,000
Business	Design, construction, management, development, operation and maintenance of power lines and grid infrastructure and other grid-related infrastructure, plant and equipment used in the above electricity transmission and dispatching activities and in similar, related and connected sectors.				
Terna Crna Gora d.o.o.	Podgorica (Montenegro)	Euro	114,000,000	100%	114,000,000
Business	Authorisation, construction and operation of the transmission infrastructure forming the Italy-Montenegro interconnector on Montenegrin territory.				
Terna Plus S.r.l.	Rome	Euro	16,050,000	100%	29,143,709
Business	Design, construction, management, development, operation and maintenance of plant, equipment and infrastructure for grids and systems, including distributed storage and pumping and/or storage systems.				
Terna Interconnector S.r.l.	Rome	Euro	10,000	65%*	19,926
Business	Responsible for construction and operation of the private section of the Italy-France interconnector and civil works on the public section.				
Monita Interconnector S.r.l.	Rome	Euro	10,000	95%**	9,500
Business	Responsible for construction and operation of the private section of the Italy-Montenegro interconnector.				
Rete S.r.l.	Rome	Euro	387,267,082	100%	770,214,773
Business	Design, construction, management, development, operation and maintenance of high-voltage power lines.				
Difebal S.A.	Montevideo (Uruguay)	Uruguayan peso	140,000	100%	3,597
Business	Design, construction and maintenance of electricity infrastructure in Uruguay.				

* 5% held by Terna Rete Italia SpA and 30% by Transenergia Srl.

** 5% held by Terna Rete Italia SpA.

NAME	REGISTERED OFFICE	CURRENCY	SHARE CAPITAL	% INTEREST	CARRYING AMOUNT (€)
SUBSIDIARIES CONTROLLED THROUGH TERNA PLUS Srl					
Tamini Trasformatori S.r.l.	Melegnano (MI)	Euro	4,285,714	70%*	44,238,622
Business	Construction, repair and trading in electrical equipment.				
Terna Chile S.p.A.	Santiago (Chile)	Chilean peso	1,000,000	100%	1,378
Business	Design, construction, administration, development, operation and maintenance of any type of electricity system, plant, equipment and infrastructure, including interconnectors; provision of all types of product and service, construction, electrical and civil engineering work; research, consultancy and assistance in matters relating to the core business; any other activity capable of improving the use and development of plant, resources and expertise.				
SPE Santa Maria Transmissora de Energia S.A.	Sao Paulo (Brazil)	Real	76,474,716	99,99%**	20,952,484
Business	Provision of public electricity transmission services, including construction, operation and maintenance of electricity transmission infrastructure or any other activity necessary in order to fulfil the above purpose.				
SPE Santa Lucia Transmissora de Energia S.A.	Sao Paulo (Brazil)	Real	227,214,431	99,99%**	62,288,125
Business	Provision of public electricity transmission services, including construction, operation and maintenance of electricity transmission infrastructure or any other activity necessary in order to fulfil the above purpose.				
Terna Peru S.A.C.	Lima (Peru)	Nuovo Sol	16,501,000	99,99%**	4,192,695
Business	Design, construction, administration, development, operation and maintenance of any type of electricity system, plant, equipment and infrastructure, including interconnectors; provision of all types of product and service, construction, electrical and civil engineering work; research, consultancy and assistance in matters relating to the core business; any other activity capable of improving the use and development of plant, resources and expertise.				
Rete Verde 17 S.r.l.	Rome	Euro	10,000	100%	10,000
Business	Implementation and development of renewable energy projects.				
Rete Verde 18 S.r.l.	Rome	Euro	10,000	100%	10,000
Business	Implementation and development of renewable energy projects.				
Rete Verde 19 S.r.l.	Rome	Euro	10,000	100%	10,000
Business	Implementation and development of renewable energy projects.				
Rete Verde 20 S.r.l.	Rome	Euro	10,000	100%	10,000
Business	Implementation and development of renewable energy projects.				

SUBSIDIARIES CONTROLLED THROUGH TAMINI TRASFORMATORE S.r.l.

Tamini Transformers USA LLC	Oakbrook (Chicago - Illinois)	US dollar	52,089	100%	134,263
Business	Commercialisation of industrial-grade and high-power electricity transformers.				
Tes Transformer Electro Service Asia Private Limited	Maharashtra (India)	Indian rupee	15,000,000	100%	177,203
Business	Commercialisation of industrial-grade and high-power electricity transformers.				

* 30% Holdco TES (controlled by the Xenon Private Equity V fund, Riccardo Reboldi and Giorgio Gussago).

** 0.01% Terna Chile SpA.

NAME	REGISTERED OFFICE	CURRENCY	SHARE CAPITAL	% INTEREST	CARRYING AMOUNT (€)
ASSOCIATES					
Cesi S.p.A.	Milan	Euro	8,550,000	42.698%	17,563,381
Business	Experimental research and provision of services related to electro-technology.				
Coreso S.A.	Brussels (Belgium)	Euro	1,000,000	15.84%	210,742
Business	Technical centre owned by several electricity transmission operators, responsible for coordinating joint operations of TSOs, in order to improve and upgrade the security and coordination of the electricity system in central and western European.				
CGES A.D.	Podgorica (Montenegro)	Euro	155,108,283	22.0889%	29,960,779
Business	Provision of transmisssion and dispatching services in Montenegro.				
JOINT VENTURES					
ELMED Etudes S.a.r.l.	Tunis (Tunisia)	Tunisian dinar	2,700,000	50%	-
Business	Conduct of preparatory studies for construction of the infrastructure required to connect the Tunisian and Italian electricity systems.				

The reduction in the fair value of derivatives (down €325.7 million) compared with 31 December 2016 is primarily due to the unwinding of fair value hedges with a notional value of €1.35 billion (€0.55 billion maturing in 2021 and €0.8 billion maturing in 2024) following simplification of the derivative portfolio during the fourth quarter of 2017.

This item also includes the deposit in the Interconnector Guarantee Fund (€42.2 million), set up to fund investment in interconnections by art. 32 of Law 99/09 (up €24.8 million).

“Current financial assets” amount to €0.2 million, marking a reduction of €65 million compared with the previous year. This primarily reflects the unwinding of fair value hedges in 2017 (down €26.1 million) and repayment of the loan granted by Terna SpA to the subsidiary Terna Interconnector Srl, in 2016 (€39 million).

14. OTHER ASSETS

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Loans and advances to employees	3.0	3.1	(0.1)
Deposits with third parties	0.6	0.5	0.1
OTHER NON-CURRENT ASSETS	3.6	3.6	(0.0)
Amounts due from subsidiaries	-	36.2	(36.2)
Other tax credits	50.5	27.1	23.4
Interconnector Guarantee Fund	4.1	2.0	2.1
Prepayments to suppliers	0.8	5.2	(4.4)
Prepayments of operating expenses and accrued operating income	5.1	4.3	0.8
Amounts due from others	2.7	2.2	0.5
OTHER CURRENT ASSETS	63.2	77.0	(13.8)

“Other non-current assets” amount to €3.6 million, in line with the amount for the previous year, and primarily regard loans and advances to employees (€3.0 million).

“Other current assets” of €63.2 million are down €13.8 million compared with 31 December 2016, essentially reflecting:

- a reduction in “amounts due from subsidiaries” (down €36.2 million), reflecting recognition, in 2016, of receivables due from the subsidiaries Terna Rete Italia Srl (merged with and into the Company in 2017) and Terna Rete Italia SpA, in the form of payments of IRES on account made by the Company under the tax consolidation arrangement (€35.0 million and €1.2 million, respectively) and settled by the subsidiaries at the beginning of the year;
- an increase in “other tax credits” (up €23.4 million), primarily due to an increase in refundable VAT (up €24.3 million³) due to increased payments on account during 2017 as a result of the Ministerial Decree of 27 June 2017;
- the recognition, in 2016, of prepayments on the fibre housing contract with Cloudditalia, relating to the purchase of fibre cable for €4.8 million.

15. INVENTORIES - €5.3 MILLION

Inventories included in current assets, amounting to €5.3 million, have increased €5.2 million compared with the previous year, primarily relating to fibre cable for use in telecommunications projects.

16. TRADE RECEIVABLES - €1,142.6 MILLION

	(€m)		
	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Energy-related receivables	772.8	997.8	(225.0)
Transmission charges receivable	312.2	324.0	(11.8)
Other trade receivables	34.0	33.4	0.6
Amounts due from subsidiaries	23.6	18.0	5.6
TOTAL	1,142.6	1,373.2	(230.6)

Trade receivables amount to €1,142.6 million and are accounted for less any losses on items deemed not to be recoverable and recognised in the allowance for doubtful accounts (€27 million for energy-related receivables and €11.3 million for other items in 2017, compared with €25.6 million for energy-related items and €11.2 million for other items in 2016). The carrying amount shown broadly approximates to fair value.

Energy-related/regulated receivables - €772.8 million

This item includes so-called “pass-through items” relating to the Parent Company’s activities in accordance with Resolution 111/06 (€745.9 million) and receivables resulting from Regulated Activities (€16.1 million). It also includes the amount due from the Fund for Energy and Environmental Services (*Cassa per i Servizi Energetici e Ambientali* - CSEA), based on the RENS performance for the year (€10.8 million).

The balance is down €225 million overall compared with the previous year, essentially due to energy-related pass-through receivables (down €230.5 million), following a reduction of €261.4 million in the uplift. This was partly offset by an increase in receivables deriving from effective imbalances. The decline in pass-through receivables also reflects a reduction in the amount receivable for plants that are essential for the security of the electricity system, reflecting termination of the essential service regime in Sicily.

Transmission charges receivable - €312.2 million

Transmission charges receivable, amounting to €312.2 million, represent the amount charged to electricity distributors for use of the National Transmission Grid. This amount is down €11.8 million compared with the previous year, primarily due to the changes introduced by Law Decree 50/17 regarding the mechanism for split payments⁴.

³ Since 2015, the subsidiary, Terna Rete Italia SpA, has participated in the Group VAT arrangement.

⁴ With effect from 1 July 2017, art. 1 of Law Decree 50 of 24 April 2017, converted into law by Law 96/2017, amended art. 17-ter of Presidential Decree 633/1972, extending split payment requirements to listed companies included in the FTSE-MIB index and to direct and indirect subsidiaries of the State or local authorities. From last 1 July, therefore, the amount due to Terna on transactions with the above entities subject to the split payment requirements no longer includes VAT, as the legislation requires the tax to be paid to the tax authorities directly by the purchaser.

Other trade receivables - €34.0 million

Other trade receivables, totalling €34 million, are broadly in line with the previous year (up €0.6 million) and refer primarily to amounts receivable from external customers of the Company's non-regulated business.

Amounts due from subsidiaries - €23.6 million

This item, totalling €23.6 million, primarily regards the amount receivable from the subsidiary Terna Rete Italia SpA (€20.4 million). These receivables mainly relating to the provision of administrative services in the last quarter in accordance with the existing contract (€6 million), payment for the lease of certain operations (€10.1 million), the quality of service penalties described in the notes on costs (€3.1 million) and other receivables (€1.2 million), primarily regarding the subsidiary's sale to third parties, on behalf of the Company, of recycled copper. This item is up €5.6 million compared with the previous year, mainly due to the increase in amounts due from the subsidiary Terna Rete Italia SpA, as a result of the recognition of the quality of service penalties previously referred to (€3.1 million), and the provision of administrative services (up €2.1 million, largely reflecting the impact of the revised fee charged from the end of 2016).

The amount for guarantees given by Terna SpA to third parties at 31 December 2017 amounts to €126.2 million. This includes €44.3 million in surety bonds given in order to guarantee fulfilment of the Company's contractual obligations in performing its operating activities and €81.9 million as follows: €39.2 million in the interests of the subsidiary Terna Interconnector Srl, €24.7 million in the interests of the subsidiary Terna Rete Italia SpA, €10.4 million in the interests of the subsidiary Terna Plus Srl, €4.2 million in the interests of the subsidiary Difebal SA, €3.4 million in guarantees issued in the interests of the subsidiary Rete Srl. All the guarantees have been issued in relation to Terna SpA's credit facilities.

17. CASH AND CASH EQUIVALENTS - €1,678.2 MILLION

Cash amounts to €1,678.2 million at 31 December 2017, including €499.7 million in liquidity invested in readily convertible short-term deposits and €1,178.5 million in net deposits in bank current accounts (including a net balance of €-219.6 million on intercompany treasury accounts).

18. INCOME TAX ASSETS - €57.9 MILLION

Income tax assets, amounting to €57.9 million, are up €47.5 million compared with the previous year. This essentially reflects an increase in payments on account during the year, under the tax consolidation arrangement, and a decrease in accrued income tax payable, primarily due to the reduction in the IRES tax rate from 27.5% to 24%, accounting for an increase of €36.7 million, with respect to the amount payable to the tax authorities at 31 December 2016 and recognised in "Tax liabilities". The increase also reflects adjustment of the IRES credit receivable in accordance with Law Decree 16/2012 of 2 March 2012, totalling €5.7 million.

Equity and liabilities

19. EQUITY - €3,675.3 MILLION

Share capital - €442.2 million

Terna's share capital consists of 2,009,992,000 ordinary shares with a par value of €0.22 per share.

Legal reserve - €88.4 million

The legal reserve accounts for 20% of the Company's share capital and is unchanged with respect to the previous year.

Other reserves - €737.3 million

The other reserves have decreased €5.9 million, reflecting other comprehensive income fair value after adjustments to the Company's cash flow hedges (down €7.8 million, taking into account the related tax asset of €1.9 million).

Retained earnings and accumulated losses - €1,916.7 million

The increase in "Retained earnings and accumulated losses", amounting to €544.5 million, primarily regards the remaining portion of profit for 2016, following payment of the dividend for 2016 (totalling €414.0 million).

Interim dividend for 2017

On 10 November 2017, the Company's Board of Directors, having obtained the Independent Auditor's opinion required by article 2433-*bis* of the Italian Civil Code, decided to pay an interim dividend of €0.074263 per share, amounting to a total payout of €149.3 million. The dividend was payable from 22 November 2017, with an ex-dividend date for coupon 27 of 20 November 2017.

The individual components of equity at the end of the year are shown below, specifying their origin, availability and distributability.

	AT 31 DECEMBER 2017	POTENTIAL USE	AVAILABLE AMOUNT
Share capital	442.2	-	-
Legal reserve	88.4	B	88.4
Other reserves			
- capital reserves	416.1	A. B. C	416.1
- actuarial gains (losses) on employee benefits and cash flow hedges after taxation	(12.3)	-	-
- revenue reserves	333.5	A. B. C	333.5
Retained earnings	1,916.7	A. B. C	1,916.7
Interim dividend	(149.3)	A. B. C	-
TOTAL	3,035.3		

Key:

A - for capital increases

B - to cover losses

C - for distribution to shareholders

The available amount includes €535.5 million in untaxed revenue reserves.

20. BORROWINGS AND FINANCIAL LIABILITIES

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Bond issues	6,541.9	6,420.5	121.4
Non-current borrowings	2,096.6	1,979.5	117.1
LONG-TERM BORROWINGS	8,638.5	8,400.0	238.5
Cash flow hedges	9.9	12.7	(2.8)
NON-CURRENT FINANCIAL LIABILITIES	9.9	12.7	(2.8)
SHORT-TERM BORROWINGS	90.0	-	90.0
Bond issues	749.9	769.9	(20.0)
Variable rate borrowings (current portion)	134.1	132.4	1.7
CURRENT PORTION OF LONG-TERM BORROWINGS	884.0	902.3	(18.3)
TOTAL	9,622.4	9,315.0	307.4

Borrowings and financial liabilities have increased by €307.4 million compared with the previous year to €9,622.4 million.

The increase in bond issues (up €101.4 million) is attributable to the effects of the bonds issued on 26 July 2017, totalling €1,000 million, repayment of the bonds issued on 17 February 2012, amounting to €770 million, and the change in the fair value of the hedged item, amounting to €128.6 million, after adjusting for amortised cost (€62.2 million).

The latest official prices at 31 December 2017 and 31 December 2016 for the bonds listed on the Luxembourg Stock Exchange are detailed below:

(€)

	PRICE AT 31 DECEMBER 2017	PRICE AT 31 DECEMBER 2016
bond maturity 2024:	128.98	130.48
bond maturity 2023:	135.46*	131.96
bond maturity 2019:	108.74	113.07
bond maturity 2026:	102.85	103.09
bond maturity 2021:	114.80	118.33
bond maturity 2018:	100.38	103.20
bond maturity 2022:	102.50	101.61
bond maturity 2028:	96.16	94.60
bond maturity 2027:	100.51	-
bond maturity 2017:	-	100.86

* Source BNP Paribas, in the absence of up-to-date prices sourced from Reuters and Bloomberg.

Compared to the previous year, non-current borrowings have decreased by €118.8 million, due mainly to the combined effect of:

- the drawdown of new EIB loans, totalling €247.4 million;
- repayments made to the EIB on falling due and lease payments totalling €128.8 million.

Long-term borrowings

(€m)

	MATURITY	AT 31 DECEMBER 2016	AT 31 DECEMBER 2017	PORTION FALLING DUE WITHIN 12 MONTHS	PORTION FALLING DUE AFTER 12 MONTHS	2019	2020	2021	2022	2023	BEYOND	AVERAGE INTEREST RATE AT 31 DECEMBER 2017	AVERAGE NET INTEREST RATE ON HEDGES AT 31 DECEMBER 2017
Bonds	2024	1,054.2	1,013.4	-	1,013.4	-	-	-	-	-	1,013.4	4.90%	0.33%
IL bonds	2023	710.2	692.9	-	692.9	-	-	-	-	692.9	-	2.73%	(0.24%)
PP bonds	2019	660.4	638.7	-	638.7	638.7	-	-	-	-	-	4.88%	1.15%
PP bonds	2026	78.7	78.8	-	78.8	-	-	-	-	-	78.8	1.60%	1.80%
1250 bonds	2021	1,432.5	1,388.7	-	1,388.7	-	-	1,388.7	-	-	-	4.75%	1.14%
1250 bonds	2017	769.9	-	-	-	-	-	-	-	-	-	4.13%	4.22%
1000 bonds	2022	996.1	996.8	-	996.8	-	-	-	996.8	-	-	0.88%	0.95%
750 bonds	2018	749.1	749.9	749.9	-	-	-	-	-	-	-	2.88%	2.98%
750 bonds	2028	739.3	740.1	-	740.1	-	-	-	-	-	740.1	1.00%	1.22%
1000 bonds	2027	-	992.5	-	992.5	-	-	-	-	-	992.5	1.38%	1.46%
EIB	2039	-	238.6	-	238.6	-	-	4.6	13.3	13.3	207.4	1.33%	1.33%
Total fixed rate		7,190.4	7,530.4	749.9	6,780.5	638.7	-	1,393.3	1,010.1	706.2	3,032.2		
EIB	2015-2030	1,611.9	1,488.3	132.4	1,355.9	96.8	96.8	92.2	83.5	83.5	903.1	0.27%	0.68%
CDP	2019	500.0	500.0	-	500.0	-	500.0	-	-	-	-	1.04%	1.14%
Leases	2019-2022	-	3.8	1.7	2.1	1.8	0.2	0.1	-	-	-	0.73%	0.73%
Total variable rate		2,111.9	1,992.1	134.1	1,858.0	98.6	597.0	92.3	83.5	83.5	903.1		
TOTAL		9,302.3	9,522.5	884.0	8,638.5	737.3	597.0	1,485.6	1,093.6	789.7	3,935.3		

At 31 December 2017, Terna's borrowings amount to €9,522.5 million (€884.0 million maturing within 12 months and €8,638.5 million maturing after 12 months), of which €3,935.3 million maturing after five years.

The table below shows movements in long-term debt during the year, including also the nominal amount:

(€m)

	AT 31 DECEMBER 2016			REPAYMENTS AND CAPITALISATIONS	DRAW- DOWNS	CHANGE IN FAIR VALUE 31 DEC 2016/ 31 DEC 2017	CHANGE IN CARRYING AMOUNT	AT 31 DECEMBER 2017		
	NOMINAL DEBT	CARRYING AMOUNT	FAIR VALUE					NOMINAL DEBT	CARRYING AMOUNT	FAIR VALUE
Bonds maturing 2024	800.0	1,054.2	1,043.8	-	-	(40.8)	(40.8)	800.0	1,013.4	1,031.8
IL bonds	565.4	710.2	746.1	(66.4)	-	49.1	(17.3)	570.5	692.9	677.3
Private Placement 2019	600.0	660.4	678.4	-	-	(21.7)	(21.7)	600.0	638.7	652.4
Private Placement 2026	80.0	78.7	82.5	-	-	0.1	0.1	80.0	78.8	82.3
Bonds maturing 2021	1,250.0	1,432.5	1,479.2	-	-	(43.8)	(43.8)	1,250.0	1,388.7	1,435.0
Bonds maturing 2017	770.0	769.9	776.6	(770.0)	-	0.1	(769.9)	-	-	-
Bonds maturing 2022	1,000.0	996.1	774.0	-	-	0.7	0.7	1,000.0	996.8	1,025.0
Bonds maturing 2018	750.0	749.1	1,016.1	-	-	0.8	0.8	750.0	749.9	752.8
Bonds maturing 2028	750.0	739.3	709.5	-	-	0.8	0.8	750.0	740.1	721.2
Bonds maturing 2027	-	-	-	-	1,000.0	(7.5)	992.5	1,000.0	992.5	1,005.2
Total bond issues	6,565.4	7,190.4	7,306.2	(836.4)	1,000.0	(62.2)	101.4	6,800.5	7,291.8	7,383.0
Loans	2,111.9	2,111.9	2,111.9	(128.8)	247.4	0.2	118.8	2,230.7	2,230.7	2,235.5
Total borrowings	2,111.9	2,111.9	2,111.9	(128.8)	247.4	0.2	118.8	2,230.7	2,230.7	2,235.5
Total debt	8,677.3	9,302.3	9,418.1	(965.2)	1,247.4	(62.0)	220.2	9,031.2	9,522.5	9,618.5

At 31 December 2017, the Company has access to additional financing of €2,050.0 million, represented by three revolving credit facilities entered into in December 2014, December 2015 and July 2016. In addition, the Company has uncommitted bank lines of credit totalling approximately €602.3 million.

In addition, as provided for in IFRS 7, the table shows the fair value of financial liabilities. In the case of bond issues, this is market value based on prices at the reporting date, whilst variable rate loans are shown substantially at the nominal amount to be repaid.

Non-current financial liabilities

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Cash flow hedges	9.9	12.7	(2.8)
TOTAL	9.9	12.7	(2.8)

Non-current financial liabilities, amounting to €9.9 million, reflect the fair value of cash flow hedges at 31 December 2017.

Fair value was measured by discounting the expected cash flows using the market yield curve at the reporting date. The change in the yield curve compared with 31 December 2016 resulted in a decrease of €2.8 million.

Short-term borrowings

Short-term borrowings, amounting to €90.0 million, were not present at the end of 2016 and reflect the Company's use of short-term lines of credit.

Current financial liabilities

Current financial liabilities at 31 December 2017 include the value of net interest expense accrued on financial instruments and not yet paid. This item is down €20.7 million compared with the previous year.

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
DEFERRED LIABILITIES ON:			
Hedging derivatives	1.8	0.7	1.1
Bond issues	101.9	123.5	(21.6)
Borrowings	2.0	2.2	(0.2)
TOTAL	105.7	126.4	(20.7)

Net debt

Pursuant to the CONSOB Communication of 28 July 2006 and in compliance with ESMA Recommendation no. 319 of 2013, the Company's net debt is as follows:

(€m)

	AT 31 DECEMBER 2017
A. Cash	1,398.1
B. Term deposits	499.7
C. Net balance on intercompany treasury account	(219.6)
D. Cash and cash equivalents (A) + (B) + (C)	1,678.2
E. Current portion of non-current borrowings	884.0
F. Short-term borrowings	90.0
G. Other net financial liabilities	102.3
<i>of which: related parties</i>	0.2
H. Current debt (E) + (F) + (G)	1,076.3
I. Current net debt (H) - (D)	(601.9)
J. Non-current borrowings	2,096.6
<i>of which: related parties</i>	500.0
K. Bond issues	6,541.9
L. Derivative financial instruments held in portfolio	9.9
M. Non-current net debt (J) + (K) + (L)	8,648.4
N. Net debt (I) + (M)	8,046.5

Information on the provisions in outstanding loan agreements at 31 December 2017 is provided in the notes to the consolidated financial statements.

21. EMPLOYEE BENEFITS - €12.7 MILLION

Terna provides its employees with benefits during their period of employment (loyalty bonuses), on termination of employment (*TFR*, additional months' pay and payment in lieu of notice) and after termination in the form of post-employment benefits (energy discounts and ASEM health cover).

Loyalty bonuses are payable to the Company's employees and senior managers once certain requirements have been met regarding length of service (on completing 25 and 35 years of service).

Termination benefits (*TFR*) are payable to all employees, whilst senior managers recruited or appointed before 28 February 1999 receive payment in lieu of notice and employees (operational personnel, administrative personnel and middle managers) employed prior to 24 July 2001 are due additional months' pay on termination.

Post-employment benefits consist of:

- reduced energy prices for household use by employees hired prior to 30 June 1996 (energy discounts);
- a form of supplementary health cover in addition to that provided by the Italian National Health Service, as provided for in the national collective contract for industrial managers (the ASEM health plan).

The following table shows the composition of provisions for *TFR* and other employee benefits and movements during the year ended 31 December 2017.

(€m)

	AT 31 DECEMBER 2016	PROVISIONS	INTEREST COST	USES AND OTHER MOVEMENTS	ACTUARIAL GAINS/ (LOSSES)	AT 31 DECEMBER 2017
Benefits during the period of employment						
Loyalty bonuses	0.6	-	-	-	-	0.6
Total	0.6	-	-	-	-	0.6
Termination benefits						
Deferred compensation benefits (<i>TFR</i>)	4.4	-	0.1	(0.7)	-	3.8
Additional months' pay	0.3	-	-	0.1	-	0.4
Payment in lieu of notice	0.3	-	-	(0.2)	-	0.1
Total	5.0	-	0.1	(0.8)	-	4.3
Post-employment benefits						
Energy discounts	17.9	-	0.2	(16.3)	-	1.8
ASEM health cover	6.2	0.2	0.1	(0.5)	-	6.0
Total	24.1	0.2	0.3	(16.8)	-	7.8
Total	29.7	0.2	0.4	(17.6)	-	12.7

This item, amounting to €12.7 million at 31 December 2017, is down €17 million compared with the previous year. This reflects net uses and other movements during the year (down €17.4 million), above all due to an adjustment to provisions for the energy discounts granted to pensioners (down €16.6 million), offset by the impact of discounting to present value (up €0.4 million).

The following table shows the current service cost and interest income and expense.

(€m)

	TFR	ADDITIONAL MONTHS' PAY	PAYMENT IN LIEU OF NOTICE AND OTHER SIMILAR	ENERGY DISCOUNT	ASEM HEALTH COVER	TOTAL
Net impact recognised in profit or loss						
- current service cost	-	-	-	-	0.2	0.2
- curtailment (revenue) and other costs	-	0.1	(0.2)	(12.1)	(0.3)	(12.5)
- interest income and expense	0.1	-	-	0.2	0.1	0.4
TOTAL RECOGNISED IN PROFIT OR LOSS	0.1	0.1	(0.2)	(11.9)	-	(11.9)

Revaluation of the net liability for employee benefits had no impact at 31 December 2017.

Finally, the following tables show the main actuarial assumptions applied, a sensitivity analysis of movements in the assumptions and the payment schedule for the plan. In line with 2016, the interest rate used to determine the present value of the obligation was calculated on the basis of the yield on the Iboxx Eurozone Corporates AA index at 31 December 2017, matching the duration of the relevant group of plan participants.

	LOYALTY BONUSES	TFR	ADDITIONAL MONTHS' PAY	PAYMENT IN LIEU OF NOTICE AND OTHER SIMILAR	ENERGY DISCOUNTS	ASEM HEALTH COVER
Discount rate	1.30%	1.30%	0.51%	0.21%	1.30%	1.41%
Inflation rate	1.50%	1.50%	0.00%	1.50%	1.50%	3.00%
Duration (in years)	12.67	10.22	5.96	4.71	20.74	10.40

(€m)

	LOYALTY BONUSES	TFR	ADDITIONAL MONTHS' PAY	PAYMENT IN LIEU OF NOTICE AND OTHER SIMILAR	ENERGY DISCOUNTS	ASEM HEALTH COVER	TOTAL
Discount rate +0.25%	0.6	3.7	0.4	0.1	1.7	5.8	12.3
Discount rate -0.25%	0.7	3.9	0.4	0.1	1.7	6.2	13.0
Inflation rate +0.25%	0.7	3.8	n/a	n/a	1.7	n/a	6.2
Inflation rate -0.25%	0.6	3.7	n/a	n/a	1.7	n/a	6.0
Annual rate of increase in health costs +3%	n/a	n/a	n/a	n/a	n/a	9.2	9.2
Annual rate of increase in health costs -3%	n/a	n/a	n/a	n/a	n/a	3.9	3.9
Conversion rate for KW/h +5%	n/a	n/a	n/a	n/a	1.7	n/a	1.7
Conversion rate for KW/h -5%	n/a	n/a	n/a	n/a	1.7	n/a	1.7

(€m)

	TFR	ADDITIONAL MONTHS' PAY	PAYMENT IN LIEU OF NOTICE AND OTHER SIMILAR	ENERGY DISCOUNTS	ASEM HEALTH COVER	TOTAL
By the end of 2018	0.1	0.1	-	0.8	0.2	1.2
By the end of 2019	0.1	-	-	0.8	0.2	1.1
By the end of 2020	0.2	-	-	0.8	0.2	1.2
By the end of 2021	0.2	-	0.1	0.8	0.2	1.3
By the end of 2022	0.5	0.1	-	0.8	0.3	1.7

22. - PROVISIONS FOR RISKS AND CHARGES - €243.5 MILLION

(€m)

	PROVISIONS FOR LITIGATION AND DISPUTES	PROVISIONS FOR SUNDRY RISKS AND CHARGES	PROVISIONS FOR EARLY RETIREMENT INCENTIVES	TOTAL
Amount at 31 December 2016	12.8	142.6	56.6	212.0
Merger contribution - Terna Rete Italia Srl	1.4	0.3	-	1.7
New provisions	10.3	51.4	17.6	79.3
Uses and other movements	(1.1)	(37.2)	(11.2)	(49.5)
Amount at 31 December 2017	23.4	157.1	63.0	243.5

Provisions for litigation and disputes - €23.4 million

These provisions, set aside to cover outstanding liabilities that, at the end of the year, could result from court judgements and out-of-court settlements regarding the Company's activities, have been assessed partly on the basis of recommendations from internal and external legal advisors. The balance at 31 December 2017, amounting to €23.4 million, is up €10.6 million compared with the previous year, due to net provisions made during the period.

Provisions for sundry risks and charges - €157.1 million

These provisions amount to €157.1 million at 31 December 2017, an increase of €14.5 million compared with the previous year, reflecting:

- net provisions for management incentive plans, totalling €6.7 million;
- a net increase of €5.4 million in provisions linked to regulation of the quality of the electricity service (the mitigation and sharing mechanism introduced by ARERA Resolution 653/2015/R/eel) which, after provisions for estimated penalties linked to outages during the year, reflects payments to distribution companies and releases following final determination of the penalties due to previous years.

Provisions for early retirement incentives - €63.0 million

Provisions for early retirement incentives reflect the estimated extraordinary expenses linked to the early retirement of the Company's employees who have reached pensionable age. This item has increased by a net €6.4 million, reflecting new provisions for the early retirement scheme of €17.6 million, offset by payments during the year (€11.2 million).

23. DEFERRED TAX LIABILITIES - €17.3 MILLION

(€m)

	AT 31 DECEMBER 2016	EFFECTS RECOGNISED IN PROFIT OR LOSS			EFFECTS RECOGNISED IN COMPREHENSIVE INCOME	AT 31 DECEMBER 2017
		PROVISIONS	USES AND OTHER MOVEMENTS THROUGH EQUITY	MERGER CONTRIBUTION		
DEFERRED TAX LIABILITIES						
Property, plant and equipment	83.8	-	(30.0)	47.0	-	100.8
Employee benefits and financial instruments	3.1	-	-	-	-	3.1
Total deferred tax liabilities	86.9	-	(30.0)	47.0	-	103.9
DEFERRED TAX ASSETS						
Provisions for risks and charges	(32.5)	(8.3)	2.8	(0.5)	-	(38.5)
Allowance for doubtful accounts	(2.9)	-	-	-	-	(2.9)
Liability to employees	(7.1)	(10.3)	10.5	-	-	(6.9)
Cash flow hedges	(5.7)	-	-	-	1.9	(3.8)
Tax relief on goodwill	(37.1)	-	2.6	-	-	(34.5)
Total deferred tax assets	(85.3)	(18.6)	15.9	(0.5)	1.9	(86.6)
NET DEFERRED TAX LIABILITIES	1.6	(18.6)	(14.1)	46.5	1.9	17.3

The balance of this item, amounting to €17.3 million, includes the net impact of movements in the Company's deferred tax liabilities and deferred tax assets.

Deferred tax liabilities (€103.9 million) are up €17.0 million compared with the previous year, reflecting:

- the use of prior provisions for accelerated depreciation (€30.0 million), including the net release for depreciation in 2017, due to the difference resulting from reversal of the impact of the merger allocated to property, plant and equipment, following merger transactions in previous years (€3.1 million);
- the contribution from the merger of Terna Rete Italia Srl with and into the Company during the year (up €47.0 million).

Deferred tax assets (€86.6 million) are down by a net €1.3 million compared with the previous year, reflecting the following movements:

- uses that did not impact profit or loss, totalling €1.9 million, reflecting the tax effect of movements in cash flow hedges;
- net provisions of €5.5 million due to movements in provisions for risks and charges during the year, primarily with regard to litigation and disputes (up €2.7 million) and movements in provisions for the quality of service (up €1.6 million);
- the use of €2.6 million, representing the accrued portion recognised in relation to tax relief on the goodwill resulting from the merger of RTL with and into the Company.

24. OTHER NON-CURRENT LIABILITIES - €181.3 MILLION

This item, amounting to €181.3 million at 31 December 2017, regards the amount payable to Terna Rete Italia SpA, resulting from the transfer of net liabilities included in the operations leased to this subsidiary (€41.8 million), accrued grants related to assets receivable (€96.1 million) and the Interconnector Guarantee Fund (€43.4 million), set up by the 2016 Stability Law, in order to fund investment in interconnections by art. 32 of Law 99/09.

The increase in this item compared with the previous year, amounting to €11.7 million, essentially reflects a combination of movements in the Interconnector Guarantee Fund (up €23.7 million), offset by the settlement of a part of the liabilities included in the leased operations (down €6.8 million), referring to the termination benefits (*TFR*) payable to personnel taking early retirement, and the release of portions of grants related to assets (a reduction of €5.2 million).

25. CURRENT LIABILITIES

	(€m)		
	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Short-term borrowings *	90.0	-	90.0
Current portion of long-term borrowings *	884.0	902.3	(18.3)
Trade payables	2,106.4	1,962.4	144.0
Tax liabilities	-	7.6	(7.6)
Current financial liabilities *	105.7	126.4	(20.7)
Other current liabilities	125.6	146.8	(21.2)
TOTAL	3,311.7	3,145.5	166.2

(*) Information on these items is provided in note 20, "Borrowings and financial liabilities".

TRADE PAYABLES - €2,106.4 MILLION

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Suppliers:			
- Energy-related payables	1,624.3	1,556.2	68.1
- Non-energy-related payables	100.7	88.7	12.0
Non-energy-related payables due to subsidiaries	377.0	315.1	61.9
Amounts due to associates	3.6	1.6	2.0
Payables resulting from contract work in progress	0.8	0.8	-
TOTAL	2,106.4	1,962.4	144.0

Suppliers

- *Energy-related/regulated payables - €1,624.3 million*

The increase in this item compared with the previous year, amounting to €68.1 million, essentially reflects energy-related pass-through payables (up €67.5 million). This is primarily due to:

- an increase in payables resulting from provision of the dispatching service (up €171.8 million), primarily linked to increased purchases on the DSM due to local technical constraints and an increase in capacity reserves in November and December;
- an increase in payables linked to plants that are essential for the security of the electricity system - *UESS* (€74.8 million), reflecting reduced payments at the end of the year;
- a reduction in payables relating to capacity payments (€170 million), reflecting the greater amount of payments made at the end of the year (in accordance with ARERA Resolutions 398/2017, 418/2017, 588/2017 and 844/2017) following collection of payments due to cover the cost of the service, broadly in line with the previous year.

- *Non-energy-related payables*

The exposure to suppliers regards invoices received and to be received for contract work, services and purchases of materials and equipment.

The increase compared with the previous year (up €12.0 million) is largely due to increased capital investment towards the end of the year.

Non-energy-related payables due to subsidiaries

This item, totalling €377.0 million, is up €61.9 million compared with the previous year, primarily due to the increased amount payable to Terna Rete Italia SpA (up €63.5 million) as a result of the greater volume of capital investment carried out by the subsidiary towards the end of the year, compared with the same period of 2016.

Amounts due to associates

This item, amounting to €3.6 million, is up €2.0 million compared with the previous year, reflecting the increased amount payable to the associate, CESI SpA, for services provided to the Company, relating to electro technical studies and research.

The commitments assumed by the Company towards suppliers amount to approximately €289.6 million and regard purchase commitments linked to the normal "operating cycle" projected for the period 2018-2022.

Tax liabilities - €0 million

This item amounts to zero at 31 December 2017, having decreased by €7.6 million compared with the previous year. This reflects an increase in payments on account during the year and a decrease in accrued income tax payable, primarily due to the reduction in the IRES tax rate from 27.5% to 24%. The resulting amount has been accounted for in "Tax assets". At 31 December 2016, this item reflected the Company's tax liability for that year after the related payments on account.

OTHER CURRENT LIABILITIES - €125.6 MILLION

(€m)

	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Prepayments	15.9	46.6	(30.7)
Other tax liabilities	1.6	1.3	0.3
Social security payables	7.1	7.1	-
Amounts due to personnel	12.5	10.3	2.2
Amounts due to subsidiaries	1.7	0.8	0.9
Other amounts due to third parties	86.8	80.7	6.1
TOTAL	125.6	146.8	(21.2)

Prepayments

This item (€15.9 million) regards grants related to assets collected by the Company to fund the construction of non-current assets in progress at 31 December 2017.

Compared with 31 December 2016 (€46.6 million), this item is down €30.7 million. This essentially reflects the net impact of grants deducted directly from the carrying amount of the related assets, totalling €127.7 million, and new grants received from third parties above all EU grants for the Sorgente-Rizziconi project.

Other tax liabilities

Other tax liabilities, amounting to €1.6 million, regard withholding tax payable on salaries paid at the end of the year and are broadly in line with the figure for the previous year.

Social security payables

Social security payables, essentially relating to employee contributions payable to INPS (the National Institute of Social Security), amount to €7.1 million, in line with the figure for the previous year.

Amounts due to personnel

Amounts due to personnel, amounting to €12.5 million, primarily regard:

- incentives for personnel and early retirement incentives payable in the subsequent year (€8.9 million);
- amounts due to employees in the form of accrued and unused annual leave and bank holiday entitlements (€2.0 million).

The increase compared with the previous year (€2.2 million) primarily reflects amounts payable to personnel who have opted for early retirement under the current scheme (€2.6 million).

Other payables due to third parties

Other payables due to third parties, amounting to €86.8 million, primarily regard guarantee deposits (€70.8 million) received from electricity market operators to guarantee their contractual obligations under dispatching and virtual interconnection contracts. This item also includes deferred income (€7.4 million, primarily attributable to the non-regulated business).

This item is up by a total of €6.1 million, essentially due to an increase in guarantee deposits (up €4.5 million).

E. Commitments and risks

Risk management

Terna SpA's financial risk

In the course of its operations, Terna is exposed to different financial risks: market risk, liquidity risk and credit risk.

This section provides information regarding Terna's exposure to all the above risks, along with a presentation of the objectives, policies and processes for managing those risks and the methods used to assess them, with further quantitative disclosures concerning the separate financial statements for 2017.

Terna's risk management policies seek to identify and analyse the risks that the Company is exposed to, establishing appropriate limits and controls and monitoring the risks and compliance with such limits. These policies and the related systems are reviewed on a regular basis, in order to take account of any changes in market conditions or in the Company's operations.

As a part of the financial risk management policies approved by the Board of Directors, Terna SpA has established the responsibilities and operating procedures for financial risk management, specifically as concerns the instruments to be used and the precise operating limits to apply in managing them.

(€m)

	AT 31 DECEMBER 2017			AT 31 DECEMBER 2016		
	RECEIVABLES AT AMORTISED COST	HEDGING DERIVATIVES	TOTAL	RECEIVABLES AT AMORTISED COST	HEDGING DERIVATIVES	TOTAL
Assets						
Derivative financial instruments	-	-	-	-	325.7	325.7
Cash on hand and deposits	1,678.2	-	1,678.2	927.8	-	927.8
Trade receivables	1,142.6	-	1,142.6	1,373.2	-	1,373.2
TOTAL	2,820.8	-	2,820.8	2,301.0	325.7	2,626.7

(€m)

	AT 31 DECEMBER 2017				AT 31 DECEMBER 2016			
	PAYABLES AT AMORTISED COST	BORROWINGS AT FAIR VALUE	HEDGING DERIVATIVES	TOTAL	PAYABLES AT AMORTISED COST	BORROWINGS AT FAIR VALUE	HEDGING DERIVATIVES	TOTAL
Liabilities								
Long-term debt	2,230.7	7,291.8	-	9,522.5	2,111.9	7,190.4	-	9,302.3
Derivative financial instruments	-	-	9.9	9.9	-	-	12.7	12.7
Trade payables	2,106.4	-	-	2,106.4	1,962.4	-	-	1,962.4
TOTAL	4,337.1	7,291.8	9.9	11,638.8	4,074.3	7,190.4	12.7	11,277.4

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument may fluctuate as a result of changes in financial market conditions. Market risk includes three types of risk: exchange rate risk, interest rate risk and inflation risk.

Risk management must be performed with the objective of minimising the related risks by selecting counterparties and instruments compatible with the Company's Risk Management Policy. Speculative activity is not form part of the Company's activities.

Terna SpA seeks to adopt a dynamic approach to financial risk management. This approach is characterised by risk aversion, aimed at minimising risk through continuous monitoring of financial markets in order to carry out the planned hedging transactions in favourable market conditions.

The fair value of financial instruments is determined in accordance with the fair value hierarchy envisaged under IFRS 7 (Level 2), by means of appropriate valuation techniques for each category of financial instrument, using market data at the closing date (such as interest rates, exchange rates and volatility) and discounting projected cash flows on the basis of the market yield curve at the reporting date.

Interest rate risk

Interest rate risk is represented by the uncertainty associated with interest rate fluctuations. This is the risk that a change in market interest rates may produce effects on the fair value or future cash flows of financial instruments.

In the course of its operations, Terna is exposed to the risk of fluctuations in interest rates. Its main source of interest rate risk is associated with its borrowings and the related hedges in the form of derivative instruments that generate financial expenses. Terna's borrowing strategy focuses on long-term borrowings, whose term reflects the useful life of the Company's assets. It pursues an interest rate risk hedging policy that aims to guarantee that the percentage of debt represented by fixed rate liabilities is at least 40%, as provided for in the relevant policies. Considering the low level of interest rates and the new regulatory review, all debt is now fixed rate.

The financial assets and liabilities relating to outstanding derivative instruments during the year can be classified as:

- cash flow hedges, hedging the risk of changes in cash flows associated with long-term variable rate loans;
- fair value hedges, primarily hedging the exposure to changes in the fair value of a financial asset or liability associated with fluctuations in interest rates (fixed rate bonds).

Below are the notional amounts and fair values of the derivative financial instruments entered into by Terna:

	AT 31 DECEMBER 2017		AT 31 DECEMBER 2016		CHANGE	
	NOTIONAL	FAIR VALUE	NOTIONAL	FAIR VALUE	NOTIONAL	FAIR VALUE
Fair value hedges	-	-	1,350.0	325.7	(1,350.0)	(325.7)
Cash flow hedges	2,546.3	(9.9)	2,974.1	(12.7)	(427.8)	2.8

(€m)

The notional amount of outstanding cash flow hedges at 31 December 2017, amounting to €2,546.3 million, breaks down as follows:

- €1,166.4 million (fair value of -€0.8 million), maturing 2018;
- €1,379.9 million (fair value of -€9.1 million), maturing 2021.

Sensitivity to interest rate risk

As regards the management of interest rate risk, following the restructuring of its portfolio, Terna has floating-to-fixed interest rate swaps (cash flow hedges) in place to hedge the risk associated with the cash flows generated by the majority of its variable rate debt.

Since the hedging relationship between the derivative and the hedged item is formally documented and the effectiveness of the hedge, as verified initially and periodically over its life, is high (between 80% and 125%), the Company has elected to use hedge accounting to ensure a perfect match between the maturities of the hedge and the hedged item. The aim of hedge accounting is to recognise the effects of the hedges and the hedged items in profit or loss at the same time. Accordingly, in the case of fair value hedges, any changes in the fair value of the hedged item attributable to the risk being hedged must be recognised through profit or loss, thereby offsetting the changes in the fair value of the derivative, which are also recognised through profit or loss. In the case of cash flow hedges, any changes in the fair value of the derivative must be recognised in "Other comprehensive income" (in equity, recognising any ineffective portion of the hedge directly through profit or loss) and then recycled through profit or loss in the same period in which the cash flows of the hedged instrument materialise. The characteristics of the cash flow hedges mirror those of the underlyings, with the result that the related cash flows will be generated on the interest date of the debt, with changes in fair value having no impact on profit or loss.

The following table reports the amounts recognised through profit or loss and in "Other comprehensive income" for positions that are sensitive to changes in interest rates, in addition to the theoretical value of the positions following a positive or negative shift in the yield curve and the differential impact of such changes recognised through profit or loss and in "Other Comprehensive Income". A hypothetical 10% movement in interest rates with respect to market interest rates at the reporting date was assumed:

(€m)

	PROFIT OR LOSS			OCI		
	CURRENT RATES +10%	CURRENT AMOUNTS	CURRENT RATES -10%	CURRENT RATES +10%	CURRENT AMOUNTS	CURRENT RATES -10%
At 31 December 2017						
Positions sensitive to interest rate variations (FVHs, bonds, CFHs)	-	-	-	(9.1)	(9.9)	(10.7)
<i>Hypothetical change</i>	-	-	-	0.8	-	(0.8)
At 31 December 2016						
Positions sensitive to interest rate variations (FVHs, bonds, CFHs)	(11.1)	(11.2)	(11.3)	(12.3)	(12.8)	(13.3)
<i>Hypothetical change</i>	0.1	-	(0.1)	0.5	-	(0.5)

Inflation risk

As regards inflation risk, the rates established by the regulator to provide a return on Terna SpA's activities are determined so as to cover the allowed costs. Such cost components are updated on an annual basis to take into account the impact of inflation. Having used an inflation-linked bond issue in 2007, the Company has put in place a partial hedge of net income; in fact, any decrease in expected revenue due to a decrease in the inflation rate would be offset by lower financial expenses.

Exchange rate risk

Generally, Terna hedges exchange rate risk through the forward sale or purchase of currencies (forward contracts) or the use of options. Currency options give Terna the right or the obligation to buy or sell predetermined amounts of a currency at a specific exchange rate at the end of a specific period of time. Normally, both forward contracts and options have maturities of no more than 12 months.

Such contracts have a notional amount and maturity date less than or equal to that of the underlying financial liability, or the expected cash flows, so that any change in the fair value and/or estimated cash flows deriving from a rise or fall in the euro against other currencies is fully offset by a corresponding change in the fair value and/or estimated cash flows of the underlying position.

At 31 December 2017, as at 31 December 2016, the Company does not hold financial instruments exposed to exchange rate risk.

Liquidity risk

Liquidity risk is the risk that Terna might encounter difficulty in discharging its obligations in respect of its financial liabilities and operating cycle. Liquidity risk management seeks to ensure adequate coverage of borrowing requirements by obtaining adequate lines of credit and appropriate management of any surplus liquidity. At 31 December 2017, Terna has available short-term credit lines of approximately €602.3 million and revolving credit lines of €2,050 million.

Credit risk

Credit risk is the risk a customer or one of the counterparties to a transaction in financial instruments could cause a financial loss by failing to discharge an obligation. It is mainly generated by the Company's trade receivables and financial investments.

The credit risk originated by open positions on transactions in derivatives is considered to be marginal since the counterparties, in compliance with the financial risk management policies adopted, are leading international banks with high ratings.

Terna provides its services essentially to counterparties considered solvent by the market, and therefore with a high credit standing, and does not have high concentrations of credit risk.

Credit risk management is driven by the provisions of ARERA Resolution 111/06, which, in art. 49, introduced instruments designed to limit the risks related to the insolvency of dispatching customers, both on a preventive basis and in the event of an actual insolvency. In particular, the Resolution establishes three instruments to safeguard the electricity market: a guarantee system (bank guarantees provided by individual dispatching customers, based on their turnover); the option of terminating dispatching contracts (in the event of insolvency or failure to replace enforced guarantees); and, finally, the possibility of recovering uncollected debts, after having taken all other possible collection actions, through a specific fee to be fixed by the regulator.

The following table summarises the exposure to such risk at the reporting date:

	(€m)		
	31 DECEMBER 2017	31 DECEMBER 2016	CHANGE
Fair value hedges	-	325.7	(325.7)
Cash and cash equivalents	1,678.2	927.8	750.4
Trade receivables	1,142.6	1,373.2	(230.6)
TOTAL	2,820.8	2,626.7	194.1

The total value of the exposure to credit rate risk at 31 December 2017 is represented by the carrying amount of trade receivables and cash and cash equivalents.

The following tables provide qualitative information on trade receivables that are not past due and have not been impaired.

	(€m)	
	31 DECEMBER 2017	31 DECEMBER 2016
Italy	1,085.8	1,356.7
Euro-area countries	56.1	11.9
Other countries	0.7	4.6
TOTAL	1,142.6	1,373.2

	(€m)	
	31 DECEMBER 2017	31 DECEMBER 2016
Distributors	311.2	322.9
CSEA	95.3	73.8
Dispatching customers for injections	195.9	190.4
Dispatching customers for withdrawals	465.3	718.3
Parties which have signed virtual import contracts and virtual import services (interconnectors and shippers)	13.2	13.0
Sundry receivables	61.7	54.8
TOTAL	1,142.6	1,373.2

The following table breaks down customer receivables by due date, reporting any potential impairment.

	AT 31 DECEMBER 2017		AT 31 DECEMBER 2016	
	IMPAIRMENT	GROSS	IMPAIRMENT	GROSS
Current	-	1,057.7	-	1,322.4
0-30 days past due	-	32.4	-	31.7
31-120 days past due	-	27.9	-	4.9
Over 120 days past due	(38.3)	62.9	(36.8)	51.0
TOTAL	(38.3)	1,180.9	(36.8)	1,410.0

(€m)

Movements in the allowance for doubtful accounts in the course of the year were as follows.

	31 DECEMBER 2017	31 DECEMBER 2016
Balance at 1 January	(37.4)	(34.4)
Release of provisions	0.5	0.4
Impairments for the year	(1.4)	(2.8)
Balance at 31 December	(38.3)	(36.8)

(€m)

The value of guarantees received from eligible electricity market operators is illustrated below.

	31 DECEMBER 2017	31 DECEMBER 2016
Dispatching - injections	236.6	215.4
Dispatching - withdrawals	1,185.2	1,015.4
Transmission charges due from distributors	302.4	287.3
Virtual imports	81.1	93.8
Balance at 31 December	1,805.3	1,611.9

(€m)

In addition, Non-Regulated Activities are exposed to “counterparty risk”, in particular in relation to the entities with which sales contracts are entered into, in consideration of the credibility and solvency of the parties in question and the impact that their possible insolvency could have on the financial strength of the business. Counterparty risk is mitigated by implementing special procedures to assess counterparties, measuring operating, financial and reputational aspects of the counterparties in question.

Default risk and debt covenants

This risk is associated with the possibility that the loan agreements or bond terms and conditions to which the Company is a party may contain provisions authorising counterparties to call in such loans immediately upon the occurrence of certain events, thereby generating liquidity risk. More information on the contractual provisions of outstanding borrowings at 31 December 2017 is provided in the section, “Borrowings and financial liabilities” in the notes to Terna SpA's consolidated financial statements.

Parent company guarantees issued in favour of subsidiaries' suppliers

The Company has issued parent company guarantees in favour of third parties to guarantee fulfilment of a number of contractual obligations assumed by the subsidiaries, Terna Interconnector Srl, Terna Rete Italia SpA, Difebal SA and Terna Crna Gora d.o.o.. The Company's maximum exposure at 31 December 2017 amounts to €507.3 million, including €452.4 million relating to the private Italy-France Interconnector project.

In connection with the long-term loan executed by the Uruguayan subsidiary, Difebal, on 14th July 2017, Terna SpA signed a sponsor support agreement that include the commitment by the Parent Company to inject contingent equity for a maximum amount of USD 50mln.

Litigation

The main commitments and risks not disclosed in the statement of financial position at and for the year ended 31 December 2017, relating to the Company are described below.

Environmental and urban planning litigation

Part of environmental litigation deriving from the construction and operation of Terna's power plants, consists of legal actions taken against the alleged negative effects of electric and magnetic fields generated by power lines.

In general, this litigation necessarily involves the Company, which owns the infrastructure in question.

Moreover, it cannot be ruled out that the parties concerned may also initiate legal proceedings against the subsidiary Terna Rete Italia SpA, as the electromagnetism generated by power lines relates not only to ownership of the plant, but also to its operation and the quantity and quality of electricity it transports.

Regarding this matter, it should be noted that the issue of the Cabinet Office Decree of 8 July 2003 - which specifically set the values of the three parameters (exposure limits, safety thresholds and quality targets) provided for in Framework Law 36 of 22 February 2001, which electricity infrastructure must comply with - led to a significant reduction in any such litigation.

Other environmental and urban planning disputes, which do not relate to electromagnetic fields, are also pending with regard to Terna SpA. These disputes are connected with the operation of certain Terna-owned plant, which in the event of an unfavourable outcome could also generate immediate effects for Terna Rete Italia SpA (to date unforeseeable and therefore not included in "Provisions for litigation and sundry risks"), both as the entity appointed by Terna SpA to build the related infrastructure and as the entity responsible for its operation. In particular, charges may arise for the subsidiary Terna Rete Italia SpA, connected with changes to the infrastructure involved in such disputes and its temporary unavailability. However, after examination of the disputes in question by Terna SpA and external counsel appointed by the Company, it appears that the possibility of any negative outcomes is remote.

Litigation regarding the legitimacy of construction permits and plant operations

Another aspect of litigation connected with the plant owned by the Company derives from legal actions brought before the competent administrative courts, aimed at obtaining the annulment of decisions granting consent for the construction and operation of infrastructure.

Litigation relating to activities carried out under concession

As the operator of transmission and dispatching activities since 1 November 2005, the Company has been a party in a number of court cases, most of which have contested determinations adopted by ARERA (Italy's Regulatory Authority for Energy, Networks and the Environment), and/or the Ministry for Economic Development, and/or Terna, in relation to these activities. In cases in which the plaintiffs have, in addition to inherent defects in the contested determinations, alleged violation of the regulations laid down by the aforementioned authorities, or in cases in which the determination has had an impact on Terna, the Company has also taken action to defend its interests through the legal system. Within the scope of such litigation - even though some cases have been concluded, at first and/or second instance, with the annulment of ARERA's resolutions and, when applicable, of the consequent determinations adopted by Terna - any negative outcomes for the Company itself may be deemed unlikely, as these disputes normally relate to pass-through items.

F. Business combinations

There were no business combinations in 2017.

G. Related party transactions

Given that Terna SpA is subject to the de facto control of Cassa Depositi e Prestiti SpA, a situation ascertained in 2007, related party transactions entered into by Terna during the year include transactions with subsidiaries, associates (Cesi SpA, CGES A.D. and Coreso SA) and employee pension funds (Fondenel and Fopen), as well as transactions with Cassa Depositi e Prestiti itself, with CDP Reti SpA and with the companies directly or indirectly controlled by the Ministry of the Economy and Finance ("MEF").

Given that Terna SpA and the above companies meet the definition for classification as "government-related entities", in accordance with IAS 24 - Related Party Disclosures, the Group has elected to adopt the partial exemption - permitted by the standard - from the disclosure requirements in respect of other companies controlled, influenced or jointly controlled by the same government entity. The remainder of this section provides qualitative and quantitative disclosures on transactions with government-related entities having a significant impact on the Group's results. Amounts relating to pass-through items are not included in these disclosures.

Related party transactions in 2017 broadly regard the provision of services in the course of ordinary activities and conducted on an arm's length basis.

Under the Terna Group's current organisational structure, the subsidiary, Terna Rete Italia SpA, which has entered into an agreement with the Company covering the lease of certain operations and a number of related intercompany agreements. In accordance with these arrangements, the subsidiary is responsible for the traditional activities involved in operation and routine and extraordinary maintenance of the owned portion of the NTG, and for management and implementation of the grid development initiatives included in the related concession arrangement for transmission and dispatching operations, as set out in Terna's Development Plan.

Terna is responsible for managing the operations of all its subsidiaries under specific service agreements which, in addition to covering administrative and financial coordination and the coordination of relations with government bodies and other institutions, give the Company the right to act on behalf of its subsidiaries, or in their name and on their behalf.

The Company's Non-Regulated Activities are conducted through the subsidiary Terna Plus Srl, under the intercompany service agreement.

From a financial viewpoint, Terna is responsible for subsidiaries' cash management in accordance with specific treasury management arrangements. These cover the conduct and coordination of all the transactions carried out from time to time, in order to manage financial resources and meet subsidiaries' cash and treasury requirements, and the execution of any other related transaction.

The following table shows the contractual terms and conditions governing financial relations with subsidiaries.

	DEPOSITS*	WITHDRAWALS
Terna Rete Italia SpA	monthly average 1-month Euribor +0.30%	monthly average 1-month Euribor +0.80%
Terna Plus Srl	monthly average 1-month Euribor +0.30%	monthly average 1-month Euribor +0.80%
Rete Srl	monthly average 1-month Euribor +0.30%	monthly average 1-month Euribor +0.80%
Monita Interconnector Srl	monthly average 1-month Euribor +0.30%	monthly average 1-month Euribor +0.80%
Difebal SA	0.01%	monthly average 3-month Libor +1.30%
Rete Verde 17 Srl	monthly average 1-month Euribor +0.30%	monthly average 1-month Euribor +0.80%
Rete Verde 18 Srl	monthly average 1-month Euribor +0.30%	monthly average 1-month Euribor +0.80%
Rete Verde 19 Srl	monthly average 1-month Euribor +0.30%	monthly average 1-month Euribor +0.80%
Rete Verde 20 Srl	monthly average 1-month Euribor +0.30%	monthly average 1-month Euribor +0.80%

* If the sum of average 1-month Euribor and the spread of 0.30% is negative, the interest rate applied will be 0.01%.

Existing intercompany agreements at 31 December 2017 are summarised below.

COUNTERPARTY	TYPE	ANNUAL FEE
Terna Rete Italia S.p.A.	Service agreement:	
	<i>Operation & Maintenance</i>	€270,441,823
	<i>Upgrade and development</i>	equal to costs incurred + 5.82% of personnel expenses incurred
	<i>Administrative services, assistance and consultancy</i>	
	- from Terna SpA to Terna Rete Italia SpA (revenue-generating)	€23,156,791
	- from Terna Rete Italia SpA to Terna SpA (cost-generating)	€2,820,379
	Rental of workstations for staff	
	- from Terna SpA to Terna Rete Italia SpA (revenue-generating)	€1,700,721
	- from Terna Rete Italia SpA to Terna SpA (cost-generating)	€239,630
	Lease of operations	€33,606,000
Rete S.r.l.	Service agreement:	
	<i>Upgrade and development</i>	equal to costs incurred + 5.82% of personnel expenses incurred
	Admin., assistance and consultancy service agreement (revenue-generating)	€1,044,893
Terna Plus S.r.l.	Service agreement:	
	<i>Terna's non-traditional activities (cost-generating)</i>	€221,425
	<i>Management fee (revenue-generating)</i>	€713,528
	Rental of workstations for staff (revenue-generating)	€227,197
Tamini Group	Administrative service agreement (revenue-generating)	€289,109
Terna Interconnector S.r.l.	Administrative service agreement (revenue-generating)	€841,438
	<i>Management and coordination of civil works for Italy-France Interconnector (cost-generating)</i>	equal to costs incurred + 5.82% of personnel expenses incurred
Monita Interconnector S.r.l.	<i>Administrative, operational support and project preparation services</i>	€144,396
Difebal S.A.	Service agreement	€91,360
Terna Crna Gora d.o.o.	Service agreement:	
	<i>Technical services</i>	equal to costs incurred + 5.82%
	<i>Administrative services</i>	€90,074
Rete Verde 17 S.r.l. Rete Verde 18 S.r.l. Rete Verde 19 S.r.l. Rete Verde 20 S.r.l.	<i>Management fee (revenue-generating)</i>	€781 for each counterparty company

Terna SpA is the consolidating entity in a tax consolidation arrangement for the purposes of corporation tax (IRES), in which the following subsidiaries participate: Terna Rete Italia SpA, Rete Srl, Terna Plus Srl and Tamini Trasformatori Srl.

The nature of sales to and purchases from related parties⁵ by the Company is shown below, followed by details of the revenue and costs resulting from such transactions during the year, and the related assets and liabilities outstanding at 31 December 2017.

RELATED PARTY	REVENUE-GENERATING TRANSACTIONS	COST-GENERATING TRANSACTIONS
Parent		
Cassa Depositi e Prestiti S.p.A.		Credit facilities
Related parties: subsidiaries operating in the Regulated Activities		
Terna Rete Italia S.p.A.	Rental for leased operations, administrative services, rental of workstations and other services	Maintenance and other technical services, grid upgrade and development, quality of service allowance, administrative services, rental of workstations for staff
Rete S.r.l.	Provision of technical and administrative services	Transmission charge
Terna Crna Gora d.o.o.	Administrative services, services provided by seconded personnel and staff on temporary transfers	
Related parties: subsidiaries operating in the Non-Regulated Activities		
Terna Plus S.r.l.	Technical, administrative and financial services, rental of spaces and workstations	Operation of Non-Regulated Activities
Tamini Group	Administrative and other services	
Terna Interconnector S.r.l.	Administrative and consultancy services, loan agreements	Management and coordination of performance of civil works for Italy-France interconnector
Monita Interconnector S.r.l.	Administrative, operational support and preparation services in relation to interconnector project	
Difebal S.A.	Administrative and legal services	
Rete Verde 17 S.r.l.	Administrative services	
Rete Verde 18 S.r.l.		
Rete Verde 19 S.r.l.		
Rete Verde 20 S.r.l.		
Associates		
Cesi S.p.A.	Rental income on laboratories and other similar facilities for specific uses, dividends	Technical studies and consultancy, research, design and experimentation.
CORESIO S.A.		Technical coordination service for the TSO.
Other related parties		
GSE Group	Metering charge, dispatching charge	Rental of spaces and workstations.
Enel Group	Transmission charge and aggregation of meter readings, dispatching charge, leases and rentals, power line maintenance, movement / re-routing of power lines, housing of fibre cable and maintenance of communications carried over proprietary power lines	Recovery of energy discount, building services, MV power to new substations, specialist services for connection to Terna's control and protection systems.
Ferrovie Group	Dispatching charge, movement of power lines	Right-of-way fees.
ENI Group	Dispatching charge	Contributions for NTG connections, sundry services.
Poste Italiane		Sundry services.
ANAS S.p.A.	Movement /re-routing of power lines	Right-of-way fees.
Other related parties of the MEF		Sundry services.
Fondenel and Fopen		Pension contributions payable by the Terna Group.

⁵ The natures of the items related to centralised treasury management and the tax consolidation already described above are excluded from the table.

REVENUE AND COSTS

(€m)

	REVENUE COMPONENTS		COST COMPONENTS	
	TRANSMISSION CHARGE AND OTHER REVENUE FROM REGULATED ACTIVITIES	NON-ENERGY- RELATED ITEMS	DIVIDENDS	NON-ENERGY- RELATED ITEMS
Subsidiaries				
Terna Rete Italia S.p.A.	-	59.0	-	297.4
Gruppo Tamini	-	0.4	-	-
Terna Crna Gora d.o.o.	-	1.1	-	-
Terna Plus S.r.l.	-	1.3	-	0.2
Rete S.r.l.	-	1.2	-	-
Terna Interconnector S.r.l.	-	1.5	-	-
Monita Interconnector S.r.l.	-	0.1	-	-
Difebal S.A.	-	0.8	-	-
Rete Verde 17	-	0.1	-	-
Rete Verde 18	-	0.1	-	-
Rete Verde 19	-	0.1	-	-
Rete Verde 20	-	0.1	-	-
Total subsidiaries	-	65.8	-	297.6
De facto parent				
Cassa Depositi e Prestiti S.p.A.	-	-	-	3.8
Total de facto parent	-	-	-	3.8
Associates				
Cesi S.p.A.	-	0.1	1.1	0.8
CORESO S.A.	-	-	-	1.6
Total associates	-	0.1	1.1	2.4
Other related parties				
GSE Group	21.7	-	-	-
Enel Group	1,563.7	6.5	-	0.4
ENI Group	2.1	-	-	0.2
Ferrovie Group	2.3	0.1	-	-
ANAS S.p.A.	-	-	-	0.1
Total other related parties	1,589.8	6.6	-	0.7
Pension funds:				
Fondenel	-	-	-	0.3
Fopen	-	-	-	0.3
Total pension funds	-	-	-	0.6
TOTAL	1,589.8	72.5	1.1	305.1

ASSETS AND LIABILITIES

(€m)

	PROPERTY, PLANT AND EQUIPMENT	RECEIVABLES AND OTHER ASSETS		PAYABLES AND OTHER LIABILITIES		FINANCIAL AND BALANCE ON INTERCOMPANY TREASURY ACCOUNT	GUARANTEES**
	CAPITALISED COSTS	OTHER*	FINANCIAL	OTHER*	FINANCIAL		
Subsidiaries							
Terna Rete Italia SpA*	55.0	19.1	-	417.2	-	(218.3)	-
Tamini Group*	7.4	(6.4)	-	-	-	-	-
Terna Crna Gora d.o.o.	-	0.2	-	-	-	-	-
Terna Plus Srl*	-	(0.6)	-	-	-	62.2	-
Rete Srl*	-	19.2	-	21.7	-	(65.2)	-
Terna Interconnector Srl	-	0.7	-	3.3	-	-	-
Monita Interconnector Srl	-	-	-	-	-	0.4	-
Terna Chile SpA	-	0.2	-	-	-	-	-
Difebal S.A.	-	0.6	-	-	-	1.4	-
Rete Verde 17	-	0.1	-	-	-	-	-
Rete Verde 18	-	0.1	-	-	-	-	-
Rete Verde 19	-	0.2	-	-	-	-	-
Rete Verde 20	-	0.1	-	-	-	-	-
Total subsidiaries	62.4	33.5	-	442.2	-	(219.5)	-
De facto parent							
Cassa Depositi e Prestiti SpA	-	-	0.3	-	500.5	-	-
Total de facto parent	-	-	0.3	-	500.5	-	-
Associates:							
Cesi SpA	4.0	0.1	-	3.5	-	-	1.2
CORESIO SA	-	-	-	0.1	-	-	-
Total associates	4.0	0.1	-	3.6	-	-	1.2
Other related parties:							
GSE Group	0.4	3.7	-	0.4	-	-	-
Enel Group	0.2	396.1	-	0.8	-	-	591.0
ENI Group	-	0.1	-	1.0	-	-	20.0
Ferrovie Group	-	2.2	-	1.6	-	-	24.2
ANAS SpA	-	0.9	-	-	-	-	-
Other related parties of MEF	-	-	-	0.3	-	0.1	-
Total other related parties	0.6	403.0	-	4.1	-	0.1	635.2
Pension funds:							
Fopen	-	-	-	0.2	-	-	-
Total pension funds	-	-	-	0.2	-	-	-
TOTAL	67.0	436.6	0.3	450.1	500.5	(219.4)	636.4

* The balances for the item, "Other", include receivables and payables relating to the tax consolidation arrangement for IRES.

** Guarantees regard surety bonds received from contractors.

H. Significant non-recurring, atypical or unusual events and transactions

With the exception of the instances described above, no significant non-recurring, atypical or unusual events or transactions, involving either third or related parties, took place in 2017.

I. Notes to the statement of cash flows

Cash flow from **continuing operations** amounts to €1,658 million, with approximately €1,529.8 million in operating cash flow and approximately €128.2 million generated by changes in net working capital.

The cash outflow for **investing activities** totals €1,382.2 million and primarily regards property, plant and equipment contributed by the merger of the wholly owned subsidiary, Terna Rete Italia Srl, with and into Terna SpA (€1,089.2 million), in addition to investment (€685.7 million, after grants related to assets collected during the year, amounting to €127.7 million) and investment in intangible assets (€38.5 million).

The cash outflow for investing activities also reflects the change in the Company's investments, including a reduction of €559.7 million following the merger of the wholly owned subsidiaries, Terna Rete Italia Srl and Terna Storage Srl, with and into Terna SpA, offset by the subscription for new shares issued by Terna Crna Gora d.o.o., totalling €30 million.

The net cash outflow for **shareholder transactions** amounts to €418.4 million, reflecting payment of the final dividend for 2016 (€269.1 million) and of the interim dividend for 2017 (€149.3 million), and an increase resulting from the merger contribution (up €423 million).

As a result, net cash used in investing activities and to provide a return on equity during the year amounted to €1,800.6 million, covered entirely by cash flow from continuing operations of €1,658 million. Net debt declined during the year.

The following table shows the reconciliation of liabilities deriving from financing activities in the statement of cash flows:

	AT 31 DECEMBER 2016	CASH FLOW FROM FINANCING ACTIVITIES	CHANGE IN FV AND OTHER	AT 31 DECEMBER 2017
- Long-term borrowings (including current portion)	9,302.3	341.0	(120.8)	9,522.5
- Short-term borrowings	-	90.0	-	90.0
- Short-term loan to Terna Interconnector*	(39.0)	39.0	-	-
Total liabilities/assets from financing activities	9,263.3	470.0	(120.8)	9,612.5

* Included in "Current financial assets" in the statement of financial position.

L. Proposal for appropriation of profit for the year

Terna SpA's Board of Directors proposes to pay a total dividend of €442,198,240.00 for 2017, equal to €0.22 per share, of which €0.074263 per share was declared in the form of an interim dividend on 10 November 2017.

The Board of Directors thus proposes to appropriate Terna SpA's profit for 2017, amounting to €640,042,877.77, as follows:

- €149,268,035.90 to cover payment of the interim dividend payable from 22 November 2017;
- €292,930,204.10 to pay a final dividend of €0.145737 to the holders of each of the 2,009,992,000 ordinary shares outstanding at the date of this Board of Directors' meeting. The final dividend will be payable on 20 June 2018, with an ex-dividend date for coupon 28 of 18 June 2018 and a record date (as defined by art.83-*terdecies* of Legislative Decree 58 of 24 February 1998, the Consolidated Law on Finance of 19 June 2018);
- €197,844,637.77 to be taken to retained earnings.

M. Events after 31 December 2017

Acquisition of 70% of a new company completed

On **15 February 2018**, the acquisition of a 70% interest in a New. Co, in accordance with the agreement signed by Terna on 10 October 2017, via its subsidiary Terna Plus, was completed. The principal assets of Avvenia, a leader in the energy efficiency sector and certified as an Energy Service Company (ESCo), are to be transferred to the new company. This transaction is part of the process of identifying and acting on new commercial opportunities for the provision of energy efficiency services and projects, in order to further strengthen Terna Plus's role as a supplier of comprehensive integrated energy services and expand its range of innovative solutions as an Energy Solutions Provider. This is in line with the strategy set out in the Business Plan for the Group's Non-Regulated Activities.

ARERA Resolution on output-based incentives

On **8 March 2018**, ARERA published Resolution 129/2018, "Urgent measures relating to output-based incentives for the transmission service. Amendments to the provisions governing the recognition of high-risk projects", which has introduced a series of measures applicable to Terna, including: incentives for the resolution of congestion between internal zones and on interconnections, by investing up to €150 million in new transmission capacity in the period 2019-2023; incentives for development of the grid with the aim of resolving congestion within zones, constraints on the grid affecting voltage regulation and the provision of essential services (the general criteria for quantifying the incentives are based on the expected benefits in terms of potential savings on the DSM as a result of the above projects, whilst definition of the detailed criteria will be dealt with in a later resolution); the reinstatement of the return on work in progress (calculated by assuming a WACC with a debt-to-equity ratio of four) for highly complex and risky projects with a duration of over 3 years (between obtaining the necessary consents and entry into service) and when expenditure has not already exceeded 50%. The resolution puts off measures regarding other incentives relating to the following issues until later resolutions: grants from grid operators and overseas entities; additional measures designed to improve efficiency, promote market integration and security of supply and support the related research activities; the implementation of initiatives aimed at fostering stakeholder capabilities and building awareness among local authorities of the benefits of infrastructure.

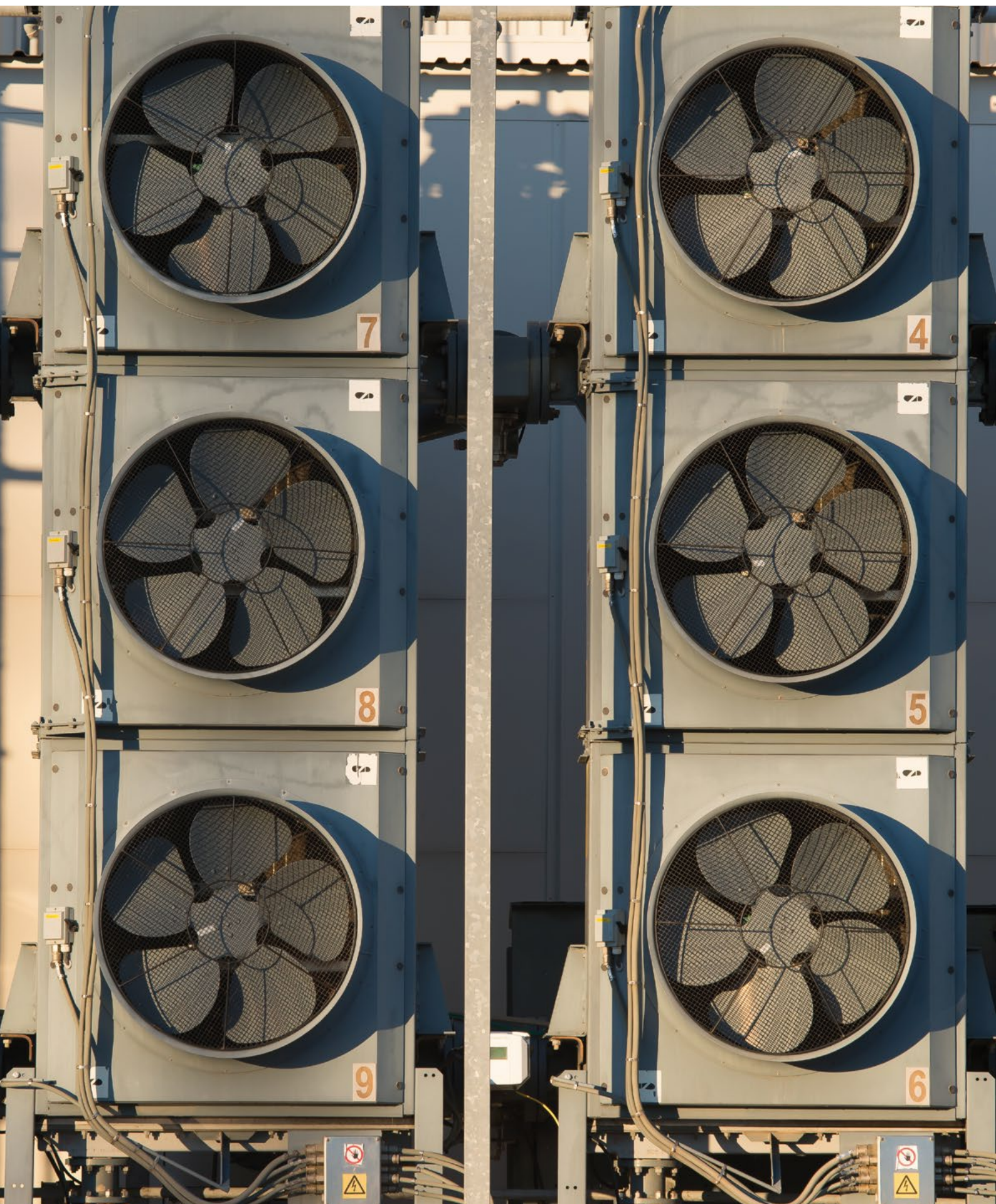
Disclosure

pursuant to art. 149-*duodecies*
of the CONSOB Regulations for Issuers

The following table, prepared pursuant to art. 149-*duodecies* of the CONSOB Regulations for Issuers, shows the fees paid for audit and other services provided by Terna SpA's independent auditors in 2017.

(€)

	ENTITY PROVIDING SERVICE	FEES DUE FOR THE YEAR
Audit of the accounts and financial statements	PwC	299,787
Attestation and other services	PwC	115,418
TOTAL		415,205



Attestation

of the separate financial statements pursuant to art. 81-ter
of CONSOB Regulation 11971 of 14 May 1999, as amended



"Terna SpA"

1. The undersigned, Luigi Ferraris, as Chief Executive Officer, and Agostino Scornajenchi, as Manager responsible for Terna SpA's financial reporting, having also taken account of the provisions of art. 154-bis, paragraphs 3 and 4 of Legislative Decree 58 of 24 February 1998, attest to:
 - the adequacy with regard to the nature of the Company, and
 - the effective application of the administrative and accounting procedures adopted in preparation of the separate financial statements during the year ended 31 December 2017.
2. The administrative and accounting procedures adopted in preparation of the separate financial statements for the year ended 31 December 2017 were drawn up, and their adequacy assessed, on the basis of the regulations and methods adopted by Terna SpA in accordance with the Internal Control-Integrated Framework model issued by the Committee of Sponsoring Organizations of the Treadway Commission. This Commission has established a body of general principles providing a standard for internal control and risk management systems that is generally accepted at international level.
3. We also attest that:
 - 3.1 the separate financial statements for the year ended 31 December 2017:
 - a. have been prepared in compliance with the International Financial Reporting Standards endorsed by the European Union through EC Regulation 1606/2002, issued by the European Parliament and by the Council on 19 July 2002 and the statutory requirements implementing the provisions of art. 9 of Legislative Decree 38/2005;
 - b. are consistent with the underlying accounting books and records;
 - c. provide a true and fair view of the financial position and results of operations of the issuer.
 - 3.2 the Directors' report on operations includes a reliable analysis of the operating and financial performance and situation of the issuer, as well as a description of the main risks and uncertainties to which it is exposed.

Rome, 21 March 2018

Chief Executive Officer
Luigi Ferraris

(original signed)

Manager responsible for financial reporting
Agostino Scornajenchi

(original signed)

Report

of the Board of Statutory Auditors
to the Annual General Meeting of Terna SpA's shareholders

Board of Statutory Auditors' Report to the Annual General Meeting of Terna SpA's shareholders pursuant to article 153 Legislative Decree 58 of 24 February 1998 (the Consolidated Law on Finance) and article 2429, paragraph three of the Italian Civil Code

Dear Shareholders,

During the year ended 31 December 2017, the Board of Statutory Auditors di Terna SpA (also the "Company") fulfilled its statutory duties in accordance with the law, complying with the code of conduct for the Statutory Auditors of listed companies issued by the Italian Accounting Profession (*Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili*), the recommendations of the CONSOB (the *Commissione Nazionale per le Società e la Borsa*, Italy's Securities and Exchange Commission) regarding corporate controls and the activities of the Board of Statutory Auditors and the guidelines in the Corporate Governance Code published by Borsa Italiana (the "Corporate Governance Code").

Responsibility for the statutory audit required by Legislative Decree 39 of 27 January 2010 (Legislative Decree 39/2010) has been assigned to the independent auditors, PricewaterhouseCoopers SpA, appointed by the Annual General Meeting of 13 May 2011 for nine years from 2011 to 2019.

The Board, which also took into account the indications contained in CONSOB announcement DEM/1025564 of 6 April 2001, as amended, reports the following.

- We verified compliance with the law and the By-laws.
- We attended the meetings of the Board of Directors and specific preparatory meetings regarding the agenda items, as well as meetings of the Audit and Risk, Corporate Governance and Sustainability Committee. We periodically obtained information from the Directors on the overall operating performance, the outlook for the Company and on the most significant transactions, in terms of their impact on the results of operations and financial position, carried out by the Company, satisfying ourselves that the decisions taken and implemented were compliant with the law and the By-laws and were not manifestly imprudent, risky or in potential conflict of interest or in contrast with resolutions approved by General Meeting, or such as to compromise the value of the Company. In the course of our activities, we found no evidence of transactions of an atypical and/or unusual nature. In carrying

out our duties, we analysed information flows from the various departments and also conducted interviews with the Company's senior management, with the independent auditors and with the oversight bodies of subsidiaries.

- At the meeting of 21 March 2018, the Board of Directors, on the recommendation of the Remuneration Committee, approved the "Annual Remuneration Report", prepared in accordance with article 123-ter of the Consolidated Law on Finance and in compliance with the provisions of article 6 of the Corporate Governance Code.
- We monitored compliance with and effective application of the "Procedure for Related Party Transactions", recently revised by the Board of Directors on 15 December 2016 and compliant with article 4 of the CONSOB Regulation referred to in Resolution 17221 of 12 March 2010, as amended.
- The Company has prepared the financial statements for the year ended 31 December 2017 in compliance with International Financial Reporting Accounting Standards (IFRS). These financial statements were audited by PricewaterhouseCoopers SpA, which issued its report on 9 April 2018 without any qualification or emphasis of matter. The financial statements, together with the Directors' report on operations, was made available to us within the deadline required by law and we have no particular comments in this regard.
- The Company also prepared the consolidated financial statements for the year ended 31 December 2017 in compliance with International Financial Reporting Accounting Standards (IFRS). These financial statements were also audited by PricewaterhouseCoopers SpA, which issued its report on 9 April 2018 without any qualification or emphasis of matter.
- Among the most significant transactions carried out in 2017, we note the following, referring you to the report on operations for more detailed information:
 - issue of bonds with a value of €1 billion at a rate of 1.375%;
 - the merger of the subsidiaries, Terna Rete Italia Srl and Terna Storage Srl, with and into Terna SpA;
 - renewal of the €8 billion Euro Medium Term Notes (EMTN) programme.
- We oversaw, within the scope of our responsibilities, the adequacy of the Company's organisational structure, compliance with the principles of good governance and the adequacy of the instructions issued by the Company to its subsidiaries pursuant to article 114, paragraph 2 of the Consolidated Law on Finance, by obtaining information from the heads of the relevant departments, through meetings with the independent auditors and with the oversight bodies of the most important subsidiaries in terms of size. With regard to the provisions of article 15, paragraph one of the Markets

Regulation adopted by CONSOB Resolution 20249 of 28 December 2017, the Company's non-EU subsidiaries are not of material importance as defined by the articles in Chapter II, Section VI, Part III of the Regulations for Issuers adopted by CONSOB Resolution 11971 of 14 May 1999, as amended.

- We monitored the adequacy of the administrative and accounting system, assessing its reliability in providing a true and fair view of operations; this activity was carried out by obtaining information from the heads of the various departments, by examining company documents and analysing the results of the work carried out by the independent auditors, PricewaterhouseCoopers SpA. The Chief Executive Officer and the Manager responsible for the Company's financial reporting have, with in reports attached to the financial statements for 2017, attested to: a) the adequacy and effective application of accounting and administrative procedures; b) the compliance of the financial reports with international financial reporting standards; c) the consistency of the documents with the underlying accounting books and records and their ability to provide a true and fair view of the financial position and results of operations of the Company. A similar attestation is attached to the Terna Group's consolidated financial statements.
- We assessed and oversaw the adequacy of the internal audit system through: a) examination of the report prepared by the Head of Internal Audit on the internal audit system; b) examination of the Internal Audit reports, as well as information on the results of monitoring; c) meetings with the oversight bodies of the most important subsidiaries pursuant to the first and second paragraphs of article 151 of the Consolidated Law on Finance; d) participation in the meetings of the Audit and Risk, Corporate Governance and Sustainability Committee and acquisition of the relevant documents; e) meetings with the Manager responsible for financial reporting and the Chief Risk Officer. Attending the Audit and Risk, Corporate Governance and Sustainability Committee meetings allowed the Board of Statutory Auditors to coordinate its activities with those of this Committee in performing our functions as the "Internal Audit and Accounting Committee", assigned to us on the basis of article 19 of Legislative Decree 39/2010 and, in particular, to oversee: a) the financial reporting process; b) the effectiveness of the internal quality control, risk management and internal audit systems; c) the statutory audit of the accounts; and d) matters relating to the independence of the audit firm.

On the basis of the activities carried out and considering the evolving nature of the Internal Audit System, in the view of the Board of Statutory Auditors the system is adequate overall and we have no observations to report to shareholders.

The independent auditors have notified their overall fees for auditing Terna SpA's separate and consolidated financial statements for the year ended 31 December

2017, and for their review of the half-year report, assessment of the regular nature of accounting systems, and for the other tasks assigned to them; the fees for these other tasks (inclusive of expenses) amount to €237,353, as follows:

– audit of the unbundling for ARERA (formerly AEEGSI)	40,535
– audit of the reporting packages	17,600
– opinion on payment of the interim dividend	35,200
– assurance of the sustainability report/non-financial statement	63,600
– issue of the EMTN comfort letter and other documents	76,330
– other tasks	3,888

Moreover, Pricewaterhouse Coopers has notified us that, based on the best information available, and taking into account the regulatory and statutory requirements for auditors, it has, in the period in question, maintained a position of independence and objectivity towards Terna SpA and that there have been no changes regarding the absence of any form of incompatibility with reference to the situations and persons provided for in article 17 of Legislative Decree 39/2010 and the articles referred to in Chapter I-*bis* of Section VI of the Regulations for Issuers.

- We held periodic meetings with representatives of the independent auditors, Pricewaterhouse Coopers SpA, pursuant to article 150, paragraph 3 of the Consolidated Law on Finance, and there are no matters worthy of mention in this Report. We also note that on 9 April 2018 the independent auditors issued its report pursuant to the third paragraph of article 19 of Legislative Decree 39/2010, and the additional report required by article 11 of the European Regulation (EU) 537/2014, in which the auditors do not report on significant issues or shortcomings relating to the system of internal controls over financial reporting and which we have submitted to the Board of Directors without observation.
- On 9 April 2018, the independent auditors issued their report on the consolidated non-financial statement prepared pursuant to article 3, paragraph ten of Legislative Decree 254 of 30 December 2016 and article 5 of CONSOB Regulation adopted with Resolution 20267 of 18 January 2018, which states that no matters have been brought to the attention of the independent auditors that would cause them to conclude that the Terna Group's consolidated non-financial statement for the year ended 31 December 2017 has not been prepared, in all material aspects, in compliance with the requirements of articles 3 and 4 of the above decree and the Global Reporting Initiative Standards (GRI Standards).
- The Terna Group's consolidated non-financial statement constitutes a separate report with respect to the Directors' report on operations, as permitted by article 5, paragraph three of the above decree.

- We monitored the procedures adopted to ensure effective implementation of the Corporate Governance Code adopted by the Company, as set forth in the Report on Corporate Governance and Ownership Structures approved by the Board of Directors on 21 March 2018. With reference to the recommendations falling within the purview of the Board of Statutory Auditors, we state that:
 - we have verified the correct application of the criteria and procedures for assessing independence, adopted by the Board of Directors;
 - with regard to the self-assessment of the independence requirements for members of the Board of Statutory Auditors, we have verified their existence during our meeting of 24 January 2018, in keeping with the procedures adopted by the Directors;
 - we have complied with the provisions of the regulation governing the management and handling of confidential and privileged company information.

Finally, it should be noted that the independent auditors has expressed its opinion regarding the consistency of the information provided, in accordance with paragraph 4 of article 123-*bis* of the Consolidated Law on Finance, in the Report on Corporate Governance and Ownership Structures with the separate and consolidated financial statements.

- With reference to Legislative Decree 231 of 8 June 2001, the Company has, for some time, adopted an organisational and management model, which is regularly revised and which is compliant with best practices. Similar models have been adopted by the subsidiaries. During the year, the Board of Statutory Auditors regularly exchanged information with members of the Supervisory Board. The information gathered did not reveal any critical issues with respect to the proper implementation of the organizational model, requiring mention in this report.
- We have not received any complaints pursuant to article 2408 of the Italian Civil Code, nor are we aware of any events or petitions requiring mention during the Annual General Meeting.
- We have verified compliance with the laws regarding the preparation of separate and consolidated financial statements and the report on operations, directly and with the collaboration of the heads of departments and through information obtained from the independent auditors, and we have nothing significant to report.
- We expressed the opinion required from the Board of Statutory Auditors by the third paragraph of article 2389 of the Italian Civil Code (the remuneration of executive Directors).
- The independent auditors issued the opinion referred to in paragraph 5 of article 2433-*bis* of the Italian Civil Code (the interim dividend).

- The members of the Board of Statutory Auditors have complied with the obligation to notify directorships and appointments as statutory auditors in Italian companies within the deadlines and according to the procedures provided for in article 148-*bis* of the Consolidated Law on Finance and the articles in Chapter II, Section V-*bis*, Part III of the Regulations for Issuers.
- During 2017, the Board of Statutory Auditors met eight times, attended the twelve meetings of the Board of Directors, the nine meetings of the Audit and Risk, Corporate Governance and Sustainability Committee and the general meetings of shareholders held on 23 March and 27 April 2017.

On the basis of our activities and the information obtained, the Board of Statutory Auditors is not aware of any omissions, shortcomings, irregularities or any other circumstances that require reporting to the supervisory authorities or mention in this report.

Having reviewed the financial statements for the year ended 31 December 2017, the Board of Statutory Auditors has no objections to raise as regards the proposed resolutions submitted by the Board of Directors.

Rome, 9 April 2018

For the Board of Statutory Auditors
The Chairman
Riccardo Schioppo



Independent auditor's report

in accordance with article 14 of Legislative Decree 39
of 27 January 2010 and article 10 of Regulation (EU) 537/2014



Independent auditor's report

in accordance with article 14 of Legislative Decree 39 of 27 January 2010 and article 10 of Regulation (EU) 537/2014

To the shareholders of Terna SpA

Report on the Audit of the Separate Financial Statements

Opinion

We have audited the separate financial statements of Terna SpA (the Company), which comprise the statement of financial position as of 31 December 2017, the income statement, the statement of comprehensive income, the statement of changes in shareholders' equity and the statement of cash flows for the year then ended, and the notes to the separate financial statements, including a summary of significant accounting policies.

In our opinion, the separate financial statements give a true and fair view of the financial position of the Company as of 31 December 2017, and of the result of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union, and with the regulations issued to implement article 9 of Legislative Decree 38/05.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISA Italia). Our responsibilities under those standards are further described in section Auditor's Responsibilities for the Audit of the Separate Financial Statements of this report. We are independent of the Company based on ethic and independence regulations and standards applicable to audits of financial statements under Italian law. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

PricewaterhouseCoopers SpA

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Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the separate financial statements of the current period. These matters were addressed in the context of our audit of the separate financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matters

Auditing procedures performed in response to key audit matters

Capital expenditure for the development and operation of the transmission grid

Section D – Notes to the statement of financial position – Note 10 Property, plant and equipment and Note 12 Intangible assets

Costs capitalised during the year as property, plant and equipment and intangible assets amount to Euro 852 million and mainly relate to capital expenditure for the development and operation of the transmission grid.

Revenue from transmission and dispatching activities (regulated activities) are determined each year in accordance with the regulatory approved tariffs which are based on a pre-established return on capital invested, plus amortisation and depreciation and operating costs.

Therefore, the capitalisation of costs for the operation and development of the transmission grid represented a key matter in the audit of the separate financial statements, also considering the magnitude and the high number of transactions.

We performed an understanding and evaluation of the system of internal control over the capital expenditure cycle, with particular reference to identification and testing of key controls.

We assessed the accounting policy adopted by the Company in relation to the capitalisation of costs.

We also performed detailed tests analysing, on a sample basis, the supporting documentation of capitalised costs to verify the accuracy, completeness and the proper period.

Our tests also included the analysis of the disclosure presented in the notes to the separate financial statements.

Key Audit Matters

Auditing procedures performed in response to key audit matters

Derivative financial instruments

Section D – Notes to the statement of financial position – Note 20 Long-term borrowings and Section E – Commitments and risks

The amount of borrowings in the consolidated financial statements at 31 December 2017 is Euro 9,612 million.

In accordance with the risk management policies, the Company mitigates its exposure to the change in interest rates by entering into derivative financial instruments for hedging purposes.

The notional amount of derivatives at 31 December 2017 is Euro 2,546 million.

Considering the magnitude and the degree of complexity of the fair value measurement, the accounting for the derivative financial instruments was considered a key matter in the audit of the separate financial statements.

With the support of PwC network experts, we performed an understanding and evaluation of the system of internal control over the measurement process of the derivative financial instruments and related accounting treatment.

We re-calculated, on a sample basis, the fair value of derivatives and we verified the hedge effectiveness in accordance with IAS39.

We confirmed the evaluations performed by management with the information provided by the counterparties involved in the external confirmation process.

Our tests also included the adequacy and completeness of the disclosure presented in the notes to the separate financial statements.

Responsibilities of Management and Those Charged with Governance for the Separate Financial Statements

Management is responsible for the preparation of separate financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the European Union, and with the regulations issued to implement article 9 of Legislative Decree 38/05 and, in the terms prescribed by law, for such internal control as management determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

Management is responsible for assessing the Company ability to continue as a going concern and, in preparing the separate financial statements, for the appropriate application of the going concern basis of accounting, and for disclosing matters related to going concern. In preparing the separate financial statements, management uses the going concern basis of accounting unless management intends either to liquidate the Company or to cease operations, or has no realistic alternative but to do so.



Those charged with governance are responsible for overseeing, in the terms prescribed by law, the Company financial reporting process.

Auditor's Responsibilities for the Audit of the Separate Financial Statements

Our objectives are to obtain reasonable assurance about whether the separate financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (ISA Italia) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the separate financial statements.

As part of an audit conducted in accordance with International Standards on Auditing (ISA Italia), we exercise professional judgment and maintain professional scepticism throughout the audit. Furthermore:

- we identify and assess the risks of material misstatement of the separate financial statements, whether due to fraud or error; we design and perform audit procedures responsive to those risks; we obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- we obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company internal control;
- we evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;
- we conclude on the appropriateness of management use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the separate financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern;
- we evaluate the overall presentation, structure and content of the separate financial statements, including the disclosures, and whether the separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance, identified at an appropriate level as required by ISA Italia regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.



We also provide those charged with governance with a statement that we complied with the regulations and standards on ethics and independence applicable under Italian law and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence and, where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that are of most significance in the audit of the separate financial statements of the current period and are therefore the key audit matters. We describe these matters in our report.

Additional Disclosures required by article 10 of Regulation (EU) 537/2014

We were appointed by the shareholders of Terna SpA at the general meeting held on 13 May 2011 to perform the audit of the Company separate and consolidated financial statements for the years ending 31 December 2011 through 31 December 2019.

We declare that we did not provide any prohibited non-audit services referred to in article 5, paragraph 1, of Regulation (EU) 537/2014 and that we remained independent of the Company in conducting the audit.

We confirm that the opinion on the separate financial statements expressed in this report is consistent with the additional report to those charged with governance, in their capacity as audit committee, prepared pursuant to article 11 of the aforementioned Regulation.

Report on Compliance with other Laws and Regulations

Opinion in accordance with article 14, paragraph 2, letter e), of Legislative Decree 39/10 and article 123-bis, paragraph 4, of Legislative Decree 58/98

Management of Terna SpA is responsible for preparing a report on operations and a report on the corporate governance and ownership structure of Terna SpA as of 31 December 2017, including their consistency with the relevant separate financial statements and their compliance with the law.

We have performed the procedures required under auditing standard (SA Italia) 720B to express an opinion on the consistency of the report on operations and of the specific information included in the report on corporate governance and ownership structure referred to in article 123-bis, paragraph 4, of Legislative Decree 58/98, with the separate financial statements of the Company as of 31 December 2017 and on their compliance with the law, as well as to issue a statement on material misstatements, if any.

In our opinion, the report on operations and the specific information included in the report on corporate governance and ownership structure mentioned above are consistent with the separate financial statements of the Company as of 31 December 2017 and are prepared in compliance with the law.



With reference to the statement referred to in article 14, paragraph 2, letter e), of Legislative Decree 39/10, issued on the basis of our knowledge and understanding of the Company obtained in the course of the audit, we have nothing to report.

Rome, 9 April 2018

PricewaterhouseCoopers SpA

Signed by

Paolo Caccini
(Partner)

This report has been translated from the original version which was issued in Italian language, solely for the convenience of international readers.



The reporting process 2017



The Reporting process

2017

The purpose of the reports is to provide Terna's internal and external stakeholders with **an understanding and overview of the Company and its businesses and operations.**

They are the end result of a series of **deliberate choices in terms of transparency, communication, accuracy, completeness and the linking of disclosures**, and mark the culmination of a sequence of complex processes involving a large number of people from across the Company.

TIMELINE

The **most important change this year regards inclusion of the Non-Financial Statement in the Sustainability Report**,

in accordance with the requirements of Legislative Decree 254/2016.

The aim of the Statement is to ensure an understanding of the Company's activities, performance, results and impact in terms of environmental, social, and personnel-related matters, respect for human rights, and the fight against active and passive corruption.

Planning process begins

16 November 2017

Internal kick-off meeting

14 December 2017

Production of first mock-up

Annual Report
9 January 2018

Sustainability Report and Non-Financial Statement:
9 January 2018



OUR REPORTS



Annual Report
Integrated Report



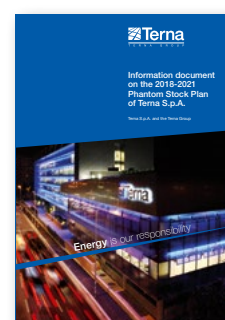
Sustainability Report
Non-Financial Statement



Report on Corporate
Governance
and Ownership
Structures



Annual
Remuneration
Report



Information Document
on the 2018-2021
Phantom Stock Plan
of Terna S.p.A.



Terna is a member of LifeGate's Zero Impact® project.
Carbon dioxide emissions generated by this publication are offset and used to create
and safeguard forests in Italy and developing countries.

www.impacttozero.it

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