ANNUAL REPORT

TERNA S.P.A. AND TERNA GROUP

2016

TERNA GROUP

Enabling Energy Transition

ANNUAL REPORT

TERNA S.P.A. AND TERNA GROUP

TERNA GROUP

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Letter from the Chairwoman and the Chief Executive Officer

Dear Shareholders,

We are proud to present you solid operating, financial and sustainability results for 2016, confirming that Terna is well on track to achieve 2017-2021 Strategic Plan targets.

As you know, the electricity market is changing rapidly driven by new challenges such as decarbonisation, market efficiency and security of supply, which have been included into specific targets by the European Commission to ensure that Europe will have secure, affordable and climate-friendly energy.

Terna, thanks to its positioning at the heart of the Italian electricity market, can play a strategic role, facilitating the energy transition towards a more efficient and cleaner energy production and guarantying security of supply at the lowest price for families and enterprises.

We have planned €4bn of investments in the next five years on the national electricity grid to enable this energy transition with an annual average increase of 30% vs the old plan. The new capex plan has been developed according to the new cost-benefit analysis (CBA 2.0) which includes significant Environmental and Social KPIs thus granting higher sharing of value creation with relevant stakeholders.
As a consequence, our regulated asset base (RAB) will continue to show a positive trend, with 2% annual growth, reaching €15.6bn in 2021.

Innovation will be crucial on this path and is becoming more and more significant within our business plan targets. Our commitment is taking up this challenge through the adoption of a model based on partnerships with start-ups & small enterprises, academy & research centres, and our suppliers.

We aim to turn these new market trends into strategic initiatives with a strong commitment to a sustainable approach and always leveraging on our core competencies and talents.

We are also enhancing our commitment to Non-Regulated Activities, where the annual EBITDA contribution will increase by 40% on average vs the old plan, for a cumulated target of €350mn in 5 years.

With regard to dividends, the policy presented in the previous Plan has been confirmed and extended to the broader 2017-2021 period, with an annual 3% dividend growth, in line with the expected earnings' evolution.

Those targets are based on solid results, as the past growth trend was confirmed also in 2016.
Indeed Revenues were up by 1% year on year - at €2.1bn and EBITDA and Group Net Income increased reaching €1,545mn and €633mn respectively.
Thanks to the strong cash flow generation, Net Debt decreased vs last year, and is now just below 8€bn. This is the first net debt reduction year-on-year since the IPO.

Financial performance is well supported by ESG results, which are strategic for our business model.
In 2016, Terna further improved its environmental and social performance. Most notably, the leakage rate of the greenhouse gas SF_6 dropped to an unprecedented 0.39%, contributing to a 7.2% reduction in the Group's direct CO_2 emissions. Grid development made it possible to remove 290 km of old lines (904 km since 2010) with positive effects on land use and improved visual impact. Investment in human capital is well represented by the level of employee training, which increased to 61 hours per capita (56 in 2015), well above the average for FTSE MIB listed companies. As for integrity in business conduct, Terna has become the first Italian company to be ISO37001 certified for its sound anticorruption practices.

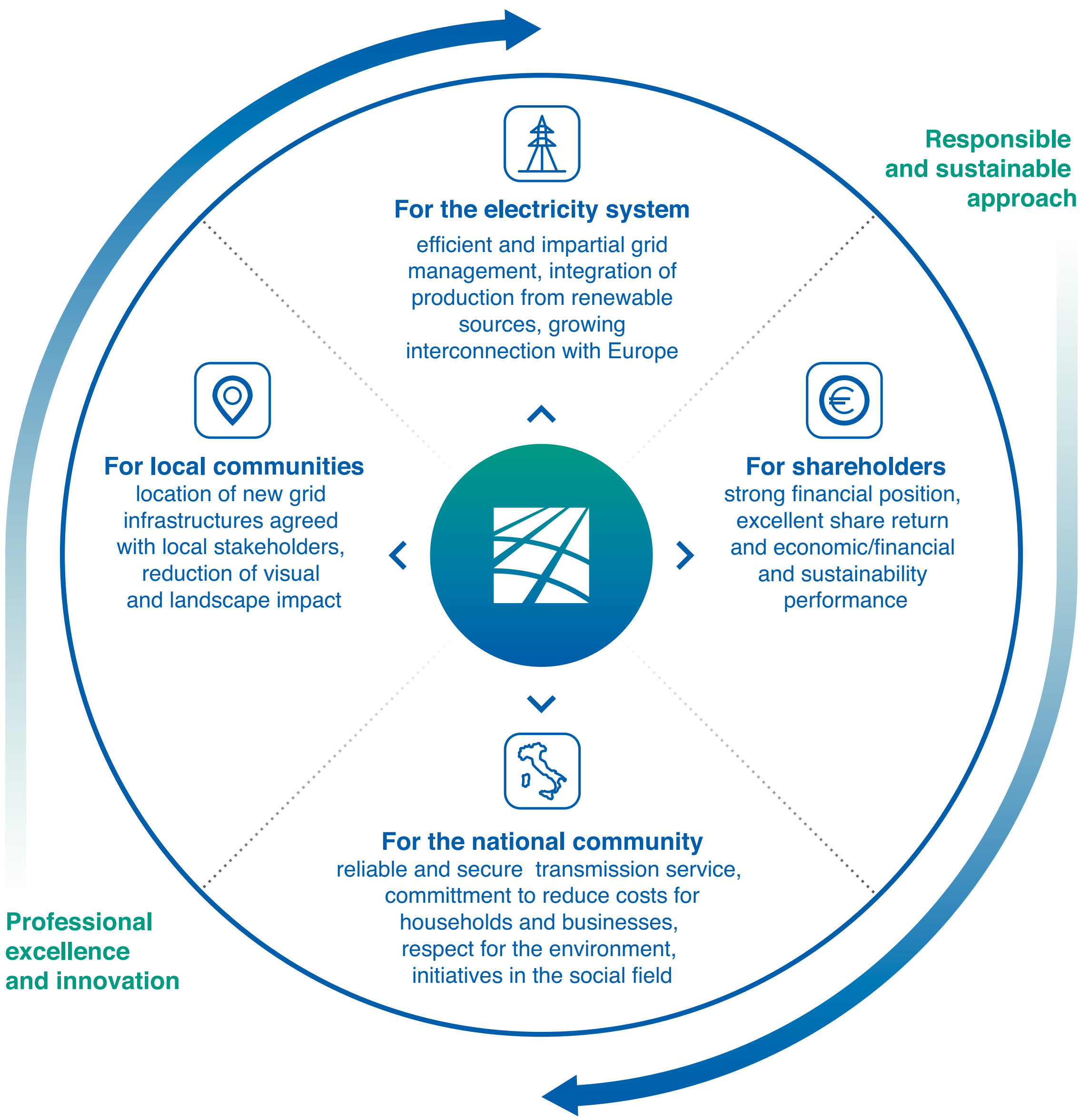
We are perfectly aware of the impacts of our decisions on communities. With its pivotal role in the Electricity System, Terna has to guarantee quality of service for final consumers at the lowest price. Our commitment is to reach this objective while improving our environmental and social performance as well. We communicate with all stakeholders, such as national authorities, municipalities, unions and associations, in order to align the interests of the Company to social needs. This is essential to drive long-term sustainable value creation for shareholders as well as growth and prosperity for all stakeholders.

The Chairwoman
CATIA BASTIOLI

The Chief Executive Officer
MATTEO DEL FANTE

The Group's Mission

Terna is a leading grid operator for energy transmission.
It is responsible for electricity transmission in Italy and guarantees operation of the electricity system according to criteria of security, quality and cost-effectiveness over time.
It pursues development of the national electricity transmission grid, ever-increasing operating efficiency and integration with the European grid. It ensures equal conditions of access for all grid users. It develops market activity and new business opportunities with the experience and technical skills gained in managing complex systems. It creates value for shareholders and stakeholders thanks to continual commitment in terms of professional excellence and a responsible approach to the community, fully respecting the environment and the areas in which it operates.



For the electricity system

Strategic Plan
2017-2021
“Enabling Energy Transition”
Commitment to grid development

€ 4 bln of investments in Regulated Activities

Main projects of the Strategic Plan

- Interconnections with Montenegro and France
- New SACOI 3 project
- “Italy – Austria” interconnection
- Investments for integrating renewable sources

For shareholders

Stock Exchange

Listed on the Italian Stock Exchange since 2004

**429%
Total Shareholder Return (TSR) since listing**

Results of the Market Performance including € 4.4 bln of dividends

€ 9 bln of Market capitalisation

For the national community

Single National Price (PUN) -27%

Average change from 2005 to 2016

Cumulated savings of Dispatching market (MSD) -6,7mld€ since 2008

Costs for dispatching services saved since 2008

Interconnection capacity with other countries (NTC*) +11%

NTC up from 8,240 MW in 2012 to 9,135 MW in 2016

For local communities

Grid development agreed at the local level

Voluntary process of prior involvement of local institutions starting from the early 2000s, in the last two years extended also to the populations directly affected

Consultation with local institutions

181 meetings with local administrations in 2016

Discussions with local communities

Terna meets and involves local populations: 17 dedicated events organised with local communities in 2015 and 2016

* NTC, Net Transfer Capacity, is the maximum exchange programme between two interconnected countries net of the margin for secure grid operation. Currently, Italy is interconnected with France, Switzerland, Austria, Slovenia, Greece and Malta.

Corporate bodies and Management

Board of Directors

CHAIRWOMAN

Catia Bastioli

CHIEF EXECUTIVE OFFICER

Matteo Del Fante

DIRECTORS

Cesare Calari
Carlo Cerami
Fabio Corsico
Luca Dal Fabbro
Yunpeng He
Gabriella Porcelli
Stefano Saglia

Board of Statutory Auditors

CHAIRMAN

Riccardo Enrico Maria Schioppo

STANDING AUDITORS

Vincenzo Simone
Maria Alessandra Zunino de Pignier

ALTERNATE AUDITORS

Raffaella Annamaria Pagani
Cesare Felice Mantegazza
Renata Maria Ricotti

Audit Company

PricewaterhouseCoopers S.p.A.

Catia Bastioli
Chairwoman

Matteo Del Fante
Chief Executive Officer

Luigi Michi
Head of Strategy and Development Division and CEO of Terna Plus

Giuseppe Lasco
Head of Corporate Affairs Division

Pier Francesco Zanuzzi
Chief Executive Officer Terna Rete Italia

Fulvio De Luca
Audit Manager

Tiziano Ceccarani
Chief Financial Officer

Highlights

Performance of stock and shareholder return

€ 4.35/share
Closing price at 30 December 2016

+ 429%
TSR from listing at 30 December 2016

€ 5.08/share
Maximum share price, reached on 30 March 2016

+ 491%
TSR from listing at 30 March 2016

Dow Jones Sustainability Index
97/100 for Terna for the environmental component;
this is the highest score in the Electric Utilities sector

Operating performance

May
Commissioning of the SORGENTE-RIZZICONI power line

This is the longest 380 kV AC undersea electrical connection in the world

114 km of old power lines dismantled and over 200 hectares benefiting from lower environmental impacts

Reduction of 700,000 tonnes of CO_2 emissions into the atmosphere each year

Savings of around € 600 million a year expected for the electricity system

Significant reduction in the price spread between Sicily and the South zone

January
Commissioning of the VILLANOVA-GISSI power line

Increased transfer capacity for renewables of 700 MW

Benefits for the security and efficiency of the system, savings for families and businesses

Reduction of 165,000 tonnes of CO_2 emissions into the atmosphere each year

Improvement of energy deficit in Abruzzo

PUN -18%

43 €/MWh: average zone price of electricity in 2016 (vs. 52 €/MWh in 2015)

Network costs 51.7 €/MWh

Lower than the European average of 53.27 €/MWh, residential segment

72,800 km

of lines inspected

Economic and financial performance

Revenue	EBITDA	Group net income	CAPEX	Net financial debt
2,103.2	**1,544.7**	**633.1**	**854.3**	**7,958.9**
+1.0%	+0.4%	+6.3%	(-22.6%)	(-0.5%)

Values in € millions compared to 2015

Sustainability performance

Environmental performance

Lines decommissioned (km)

290
(+195.9%)
More than 900 since 2010

Direct CO_2 emissions

61,991.7
(-7.2%)
in equivalent tonnes

Incidence of SF_6 leaks over total installed gas

0.39%
(-11.4%)
the lowest figure in the last 10 years

Social performance

Training: hours per capita

61
(+8.9%)
compared with an average of approximately 30 hours per capita in the FTSE-MIB (2015 figure).

Open Innovation
“NEXT ENERGY” PROJECT

The business ideas of 10 teams of researchers developed and 15 paid internships offered to young engineering graduates

Women holding managerial positions
(senior and junior executives) as a percentage of total managers: **17.3%** compared to a proportion of women out of the total - net of blue-collar workers - of **16.6%**

Significant events

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January

101 The “**Villanova-Gissi**” power line came into operation with the purpose of strengthening the security of the centre-south area and increasing the integration of renewable production.

133 Terna was included in the Gold Class of the **RobecoSAM 2016 Sustainability Yearbook** for its positioning as **industry leader** of the “Electric utilities” sector.

February

103 Approval was obtained for the construction of the “**Sacca Serenella Cabina Primaria – Cavallino Cabina Primaria**” and “**Fusina 2 – Sacca Fisola Cabina Primaria**” power lines to guarantee greater security and reliability to the power supply of the Venice lagoon.

On **17 February 2016**, the 2016-2019 Strategic Plan was approved.

April

Work began on demolishing lines in the context of restructuring and more sustainable development of the **electricity grid in the province of Naples** with the demolition of 46 km of old power lines.

Record for the coverage of Demand by renewable sources in 1h of 81%.

May

101 The “**Sorgente - Rizziconi**” undersea power line came into operation; this will make it possible to use the production plants of Southern Italy in a more efficient manner and to increase annual savings of the system (approx. € 600 mln).

Agreement was reached with the local authorities for optimisation of the “**Benevento II - Foggia**” power line with the aim of making the electricity system in Campania more efficient and cost-effective.

62 A **collaboration agreement was signed with Tesla Motors** for the development of cutting-edge projects and better integration between e-mobility and the electricity grid, and intelligent consumption.

107 A Memorandum of Understanding was signed between Terna Plus S.r.l., the **Municipality of Pantelleria** and S.Med.E. to create plants for the production of energy from renewable sources.

On 30 May 2016, the Shareholders' Meeting approved the Separate Financial Statements of Terna S.p.A. at 31 December 2015, defining a **dividend of 20 €/cent per share** and approving the 2016-2018 long-term monetary incentive plan.

June

99 The **Intraday Market Coupling** process on the border with Slovenia began: the project will enable a more efficient allocation of the Interconnection capacity between Italy and Slovenia.

99 The **D-2 Process** came into operation with the dual effect of strengthening the management of the security of foreign exchanges and optimising the NTC.

133 Terna **was confirmed among the leading companies at the global level** for sustainability performance in the FTSE4Good indices.

39 Memoranda of Understanding were signed with Legambiente, WWF and Greenpeace.

July

108 The Ministry of Economic Development issued the “**Decree of exemption for the private line of the interconnection power line**” in favour of the subsidiary Piemonte Savoia S.r.l. for creation of the Italy-France interconnection.

139 The **Confindustria and INAIL Safety Prize** was awarded for the degree of maturity reached by Terna in adopting the most effective best practices at the international level on the subject of safety.

56 A **back-up Revolving Credit Facility**, in the form of a “committed” line, was entered into for a total amount of € 500 mln with a pool of banks.

September

110 The tender called by UTE in **Uruguay** was won, for the construction of three new electricity infrastructures in the country, to increase the efficiency and security of the electricity grid. Investments expected at € 70 mln.

133 Terna was confirmed in the **Dow Jones Sustainability World Index**, obtaining a score of 97/100 for the environmental component, placing it at the top of the Electric Utilities sector.

133 Further recognition for sustainability was obtained with confirmation in the **STOXX Global ESG Leaders Indices**.

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October

105 Work began on the **underground cable of the Mon.Ita. Project**, a strategic project that represents the first electrical bridge between Italy and the Balkans.

56 A **€ 750 mln bond was issued, at an interest rate of 1%**.

76 A **Memorandum of Understanding** was signed **with Guardia di Finanza** to promote legality, security and environmental protection in the network.

78 The website **"Open, transparent works"** was developed; this enables citizens and businesses to check the progress of work on large infrastructures.

56 The **EMTN bond issue** program was renewed.

An offer was presented for **acquisition of 24% of the capital of ADMIE**, the Greek TSO. On **31 October 2016**, the PPC Board appointed State Grid as Preferred Strategic Investor.

November

109 **An agreement was signed by Terna and RFI** to identify initiatives on of renewable energies. The creation of photovoltaic plants up to a maximum of 200 MW is planned, to cover RFI's electricity consumption. This is the first large operation in the sector to be created in grid parity, without state incentives.

107 **In Sardinia, at Codrongianos, the most important battery plant in the world for number of technologies**: 250,000 square metres of research, innovation and hi-tech equipment, a globally unique hub of cutting-edge solutions with storage systems, synchronous compensators and undersea cables.

133 Terna: **fifth consecutive confirmation in the Euronext indices of the Vigeo Eiris rating agency**: further recognition of the results recorded in the Environment, Social and Governance sectors.

A new panorama for Sorrento: work started on demolishing the first 6 pylons, out of the 100 planned, in the municipalities of Sorrento and Sant'Agnello. For every 3 km of old power lines eliminated, only one new km of high-tech line.

December

56 **Agreement with the European Investment Bank** for a **€ 200 million** loan with a term of 22 years.

25 The **merger by incorporation** of Terna Rete Italia S.r.l. and Terna Storage S.r.l. into Terna S.p.A. was resolved.

56 **Moody's modified Terna's outlook** from stable to negative as a consequence of the change in the outlook on the ratings of Italian government bonds, which also went from stable to negative.

110 **Eni and Terna** signed a cooperation agreement for the development of sustainable and innovative energy systems.

2017

From **16 to 19 January 2017**, some areas in **Abruzzo** and **Marche** were hit by an intense wave of bad weather, with heavy and persistent snowfalls, which led to a blackout for users of the distribution and transmission grids. Terna, the distribution companies, the Civil Protection Agency and the Institutions acted quickly to end the blackouts and restore the service.

75 On **31 January 2017**, the Group became the first in Italy to obtain anti-corruption certification according to the new international standard ISO 37001:2016 – Anti-bribery management systems.

110 On **02 February 2017**, in Brazil, an agreement was signed with Planova, a Brazilian construction company, aimed at the **acquisition of two concessions to operate a total of around 500 km of electricity infrastructure in the South American Country**. Investment expected at € 180 mln.

102 On **14 February 2017**, the MED issued the new authorisation decree no. EL-146-*bis* "**Udine Ovest – Redipuglia**": benefits for the electricity system, environmental benefits as well as savings estimated over 100 €mln/year.

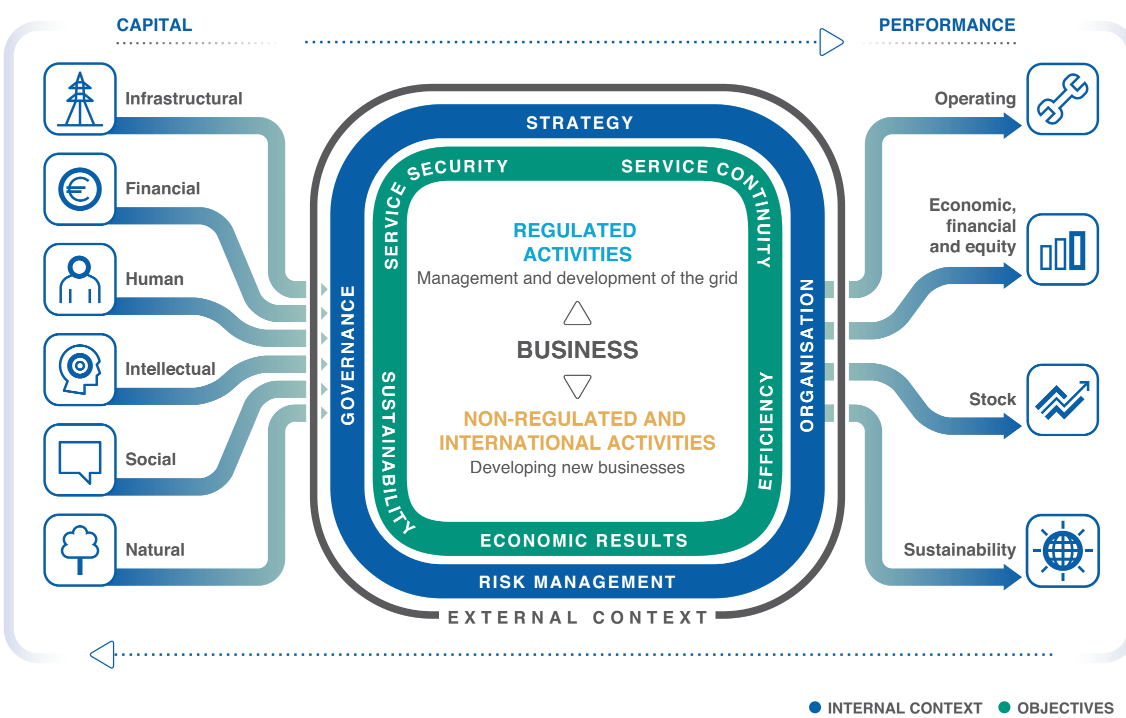
43 On **20 February 2017**, the Terna Group's 2017-2021 Strategic Plan was approved.

56 On **06 March 2017**, Fitch confirmed Terna's rating at "BBB+".

Introduction

The objective of this Integrated Report, which constitutes the Integrated Report of the Terna Group, is to provide a precise, complete and transparent account of **the Terna Group's ability to create value over time**, in response to the expectations of the markets and the stakeholders, above all the investors. The materiality analysis carried out[1] in 2016 made it possible to identify Key Performance Indicators - KPIs referred to the **Terna Group's priority objectives** highlighted in the context of the value-creation model.

Value-creation model



In a context characterised by elements external to the Company in rapid evolution (for example economic conditions, evolution of the electricity system, technological upgrades, social themes and environmental challenges) the **Group's general objectives** are pursued transforming the capital assets available through actions, in keeping with the business model, which generate the performance.

The Terna Group's **operating process** is characterised by Regulated, Non-Regulated and International Activities:

REGULATED ACTIVITIES – TSO SERVICES

Planning ▷	Carrying out development projects ▷	Dispatching ▷	Maintaining Infrastructure

NON-REGULATED AND INTERNATIONAL ACTIVITIES

Identifying potential initiatives ▷	Analysing and checking requirements ▷	Analysing return ▷	Developing new businesses

(1) For details on the process followed in the materiality analysis and on the results of the same please see the specific annex to the present report.

Structure of the Integrated Report

The Integrated Report describes the economic-financial and operational performance and sustainability of the Terna Group putting them into relation to the contexts in which it works and the capital available to it, highlighting its ability to create value over the short, medium and long term.
The Report follows the principles drawn up by the IIRC (International Integrated Reporting Council), which Terna has actively followed since 2011, and is based on a Materiality Analysis – updated at the end of 2016 – that identified the significant aspects for the Group and its stakeholders.

For easier reading, the contents of each single section are summarised below highlighting the elements that make up Terna's value-creation model, graphically summarised in the figure above.

The section "**The Company and the external context**" illustrates the Group's **Organisation**, presenting the Company and its history, its shareholding and corporate structure. It also contains information on **Governance** and ends with a presentation of the **External Context** in which the Group operates, divided into energy, regulatory, legislative and social context.

The "**Business and Capital**" section coincides with the presentation of the Group's business lines, characterised by two areas of the Group's operating process: the **Regulated Activities** and the **Non-Regulated and International Activities** aimed at achieving the **Objectives**, in line with the **Strategy** defined by the Strategic Plan.
This section ends with the chapter the **Capital**, which deals with the infrastructural capital particularly constituted by the National Transmission Grid.

The chapter "**Risk Management**" is focused on the analysis and monitoring tools put in place by Terna to eliminate or mitigate the risks of various kinds to which the Group is potentially exposed.

The chapter "**Performance**" illustrates the financial and sustainability results that the Terna Group has achieved through its organisation, highlighting the strong connection between service and operating objectives and economic, environmental and social responsibility performance.

THE COMPANY AND THE EXTERNAL CONTEXT

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THE COMPANY

Who we are

The main business of the Terna Group is the transmission and dispatching of electricity in Italy, playing the role of TSO (Transmission System Operator) and ISO (Independent System Operator), in a monopoly arrangement through a government concession. Terna manages all its activities focusing on their economic, social and environmental consequences and adopts a sustainable approach to business to create, maintain and consolidate a relationship of mutual trust with its stakeholders, needed for value creation for the Company and for the stakeholders themselves.

The business lines that characterise the activities and organisation of the Terna Group are presented below:

Electricity dispatching and transmission

Point of reference for the electricity sector and for the Italian System

The Terna Group owns 99.6% of the Italian National Transmission Grid.
It is the largest independent transmission system operator in Europe and among the leaders in the world in terms of kilometres of lines managed (more than 72 thousand km).
It is responsible for the transmission and management of power flows on the High-Voltage and Very-High-Voltage Grid throughout the national territory, in order to maintain the balance between demand and supply of energy (dispatching). It is also responsible for the planning, construction and maintenance of the grid.
It acts as the Italian TSO and ISO with a monopoly under government licence in accordance with the regulations of the Italian Regulatory Authority for Electricity, Gas and Water (AEEGSI) and the guidelines of the Ministry of Economic Development. It ensures the security, quality and cost efficiency of the national electricity system and pursues the development of the grid and its integration with the European grid. It ensures equal conditions of access for all Grid users.

Non-Regulated Activities

Energy Solution Provider on the domestic market

The Terna Group offers products and services mainly in the EPC, O&M and TLC business lines, pursuing new business opportunities with its experience, technical expertise and ability to innovate, all gained by managing complex systems.

International Activities

Operator on the International market

The Terna Group offers products and services in other countries, with a view to diversification with respect to the national business, carried on also in collaboration with energy operators with consolidated presence abroad.
The development activities focus on geographical areas requiring investments in transmission infrastructures and which, at the same time, have stable political and regulatory frameworks.

Our History

1999

Liberalisation of the electricity sector

Two new companies are created: Terna, owner of the Italian Electricity Grid, and the National Transmission Grid Operator.

2004

Listing on the stock exchange

50% of the Company's share capital listed on the market.

ENEL sells to CDP 29.99% of Terna's share capital and a further stake held of 13.86% is placed on the market via bookbuilding.

2005-2007

Unification of the Grid

Unification of the National Transmission Grid continues with acquisition of portions of NTG of ACEA, Edison, AEM and AEM TE.

Brazil
Listing of the subsidiary Terna Participações.

2009

Growth in value for shareholders

Terna included in the DJSI.

Supplement to dividend policy thanks to the capital gain generated by the sale of its Brazilian subsidiary Terna Participações.

Terna is Europe's largest TSO

18,600 km of High-Voltage Lines acquired by Enel.

2013

Consolidation, growth, innovation

Terna is best utility in Europe for the second time in a row in terms of total Shareholder return 2010/2012 ("EEI International Utility Award").

Work started on batteries for storage of electricity from renewable energy sources.

Value of the Terna Grid more than doubled.

2015

Acquisition of the FS electricity grid

Acquisition of the high-voltage grid of Gruppo Ferrovie dello Stato for € 757 million, consolidates Terna's European leadership with approximately 72,600 km of grid managed.

2016

Strategic power lines

Sorgente-Rizziconi and Villanova-Gissi in operation.

Uruguay
International tender won.

2017-2021

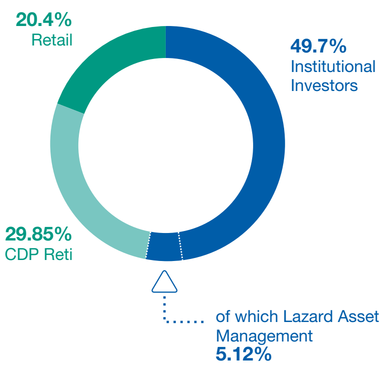
2017-2021 Strategic Plan "Enabling Energy Transition"

Commitment for Grid development, interconnection and integration of production from renewable sources.

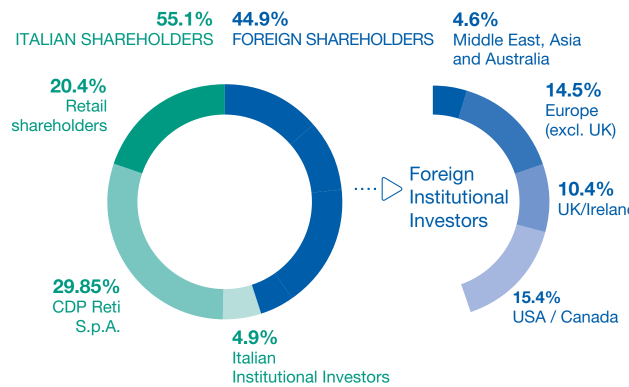
Shareholders

At the reporting date, Terna's share capital was € 442,198,240, represented by 2,009,992,000 ordinary shares, with a nominal value of € 0.22 each, fully paid-up.
On the basis of the shareholder register and other information available in February 2017, ownership of Terna S.p.A. is shown in the graph below.

SHAREHOLDING STRUCTURE BY TYPE



SHAREHOLDING STRUCTURE BY GEOGRAPHICAL AREA



On the basis of the periodic surveys carried out by Terna, it is believed that 55.1% of Terna shares are held by Italian investors and the remaining 44.9% by foreign institutional investors, primarily in the United States and in Europe.

Major shareholders[2]

CDP RETI S.p.A. (subsidiary of Cassa Depositi e Prestiti S.p.A.): **29.851%**
LAZARD ASSET MANAGEMENT LLC (as discretionary asset management): **5.122%**

Shareholders' Agreement

On 27 November 2014, a shareholders' agreement was signed by Cassa Depositi e Prestiti S.p.A. (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 S.p.A., SNAM S.p.A. e TERNA S.p.A.; this was subsequently amended and supplemented to extend its provisions also in relation to Italgas S.p.A..

Socially Responsible Investors

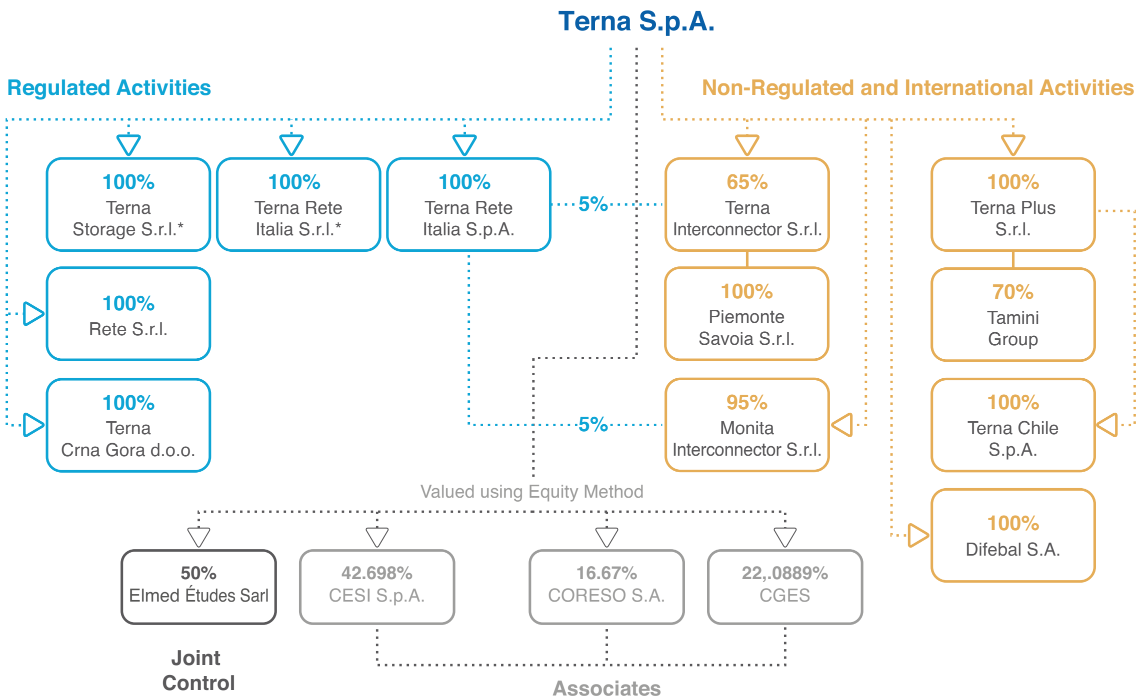
At the end of 2016, there were 113 SRIs (Socially Responsible Investors) who invested in Terna with a sustainable approach in mind, based on the consideration of ESG (Environmental, Social and Governance) aspects, of whom 30 asset owners (33 at the end of 2015), i.e. pension funds, sovereign funds and other institutional investors, representing the vast majority of SRI investment in Terna and 83 mutual investment funds (67 at the end of 2015). Overall, at the end of 2016, SRI investors accounted for 6.35% of Terna (6.24% at the end of 2015) and around 10% of the capital held by identified institutional investors, substantially in line with the figure for the end of 2015.

Information on ownership structures, restrictions on share transfer and shares granting special powers and restrictions on voting rights, as well as on shareholder agreements, is given in the "Report on Corporate Governance and Ownership Structure" related to FY 2016, available on the Terna S.p.A. website (www.terna.it - in the section "Investor Relations").

(2) These shareholders have a stake in the Terna S.p.A. share capital above the significance thresholds indicated in CONSOB Resolution no. 11971/99, based on the information available, and communications from CONSOB.

Corporate structure

The corporate structure of the Terna Group at 31 December 2016 is presented below:



* On 15 December 2016, the Board of Directors of Terna S.p.A. resolved the merger by incorporation into TERNA.

THE PARENT COMPANY

Terna S.p.A.

It holds the government concession for the transmission and dispatching of electricity and 80.13% of the NTG (considering the portions held by the subsidiaries Terna Rete Italia S.r.l. and Rete S.r.l., detailed below, the Group holds 99.6% of the NTG). It owns the infrastructures and is responsible for defining the NTG Development Plan and its Security Plan.

SUBSIDIARIES REGULATED ACTIVITIES

Company	Activity
Terna Rete Italia S.p.A. Revenue: € 405 million Employees: 2,986	Company responsible for carrying out regulated operating activities, ordinary and extraordinary maintenance, management of NTG grid-development works. It also performs Non-Regulated Activities of maintenance, engineering and sales of goods in relation to other Group companies and to third parties.
Terna Rete Italia S.r.l. Revenue: € 184.3 million Employees: -	Owner of 10.75% of the NTG infrastructures.
Rete S.r.l. Revenue: € 54.8 million Employees: -	Owner of 8.71% of the NTG infrastructures; it was acquired during 2015 from Ferrovie dello Stato Italiane Group (FSI Group).
Terna Storage S.r.l Revenue: € 0.8 million Employees: -	Responsible for the design and construction of energy storage systems.
Terna Crna Gora d.o.o. Revenue: - Employees: 5	Montenegrin company that manages in Montenegro the activities relating to the development and management of the Italy-Montenegro Interconnection.

SUBSIDIARIES NON-REGULATED AND INTERNATIONAL ACTIVITIES

Company	Activity
Terna Interconnector S.r.l. Revenue: € 37.6 million Employees: -	Company set up for the development and construction of the private infrastructures for interconnection between Italy and France.
Piemonte Savoia S.r.l. Revenue: - Employees: -	SPV for the development of the private Italy-France Interconnection, to be operated under the Interconnector system, as provided for in Italian Law 99/2009.
Monita Interconnector S.r.l Revenue: € 0.1 million Employees: -	SPV for the development of the private Italy-Balkans Interconnection and management of the Interconnector system, as provided for in Italian Law 99/2009.
Terna Plus S.r.l. Revenue: € 17.3 million Employees: 17	Development of new activities and business opportunities on the Italian Non-Regulated market and construction and management of High-Voltage infrastructures in Italy and abroad.
Gruppo Tamini Revenue: € 112.2 million Employees: 396	The Group operates in the production and sale of industrial and power electricity transformers using six manufacturing facilities, all situated in Italy, in Legnano (MI), Melegnano (MI), Novara, Valdagno (VI), Ospitaletto (BS) and Rodengo (BZ).
Terna Chile S.p.A Revenue: € 2.2 million Employees: -	Chilean company that manages the activities related to the planning, construction and maintenance of electrical infrastructures, including those for interconnection.
Difebal S.A Revenue: - Employees: -	Uruguayan company that manages the activities related to the planning, construction and maintenance of electrical infrastructures.

ASSOCIATES OR JOINT CONTROL

Company	Activity
CESI S.p.A. Revenue: € 119.0 million* Employees: 653 * figure for financial year 2015.	Independent center of expertise and global provider of technical and engineering services to customers throughout the energy value chain, including business and technical consultancy, engineering and operational support.
CORESO S.A. Revenue: € 9.2 million Employees: 35	Belgian company that manages the preparation of daily forecasts and real-time analyses of energy flows in Central and Western Europe, identifying possible critical issues and duly informing the TSOs in a timely manner.
CGES (Crnogorsk Elektroprenosmi Sistem Ad) Revenue: € 30.2 million Employees: 329	TSO and ISO of the Montenegro electricity market. Equity investment purchased under the scope of the Italy-Balkans Interconnection project.
Elmed Etudes Sarl Revenue: - Employees: -	Joint venture with the Tunisian company STEG for the creation of feasibility studies for the connection between the Tunisian electricity grid and the Italian one.

Corporate Governance

Governance system and structure of powers

Terna's Corporate Governance system is based on creating value for shareholders. This objective is pursued taking into account the social and environmental meaning of the Group's activities and the resulting need to adequately consider all stakeholders in the performance of those activities.
In this regard, the highest reference for matters of social responsibility and sustainability is the Code of Ethics[3], which, among other things, requires that evidence be provided each year, in the Sustainability Report, of the implementation of the social and environmental policy and the consistency between the objectives and the results achieved. The Code of Ethics also recalls the ten principles of the Global Compact, multi-stakeholder network of the United Nations on human rights, employment, the environment and anti-corruption policy, to which Terna has adhered since 2009.

SHAREHOLDERS' MEETING

Board of Directors

CHAIRWOMAN
Catia Bastioli

CHIEF EXECUTIVE OFFICER
Matteo Del Fante

SECRETARY
Filomena Passeggio

DIRECTORS
Cesare Calari
Carlo Cerami
Fabio Corsico
Luca Dal Fabbro
Yunpeng He
Gabriella Porcelli
Stefano Saglia

Remuneration Committee - Chairman
Audit and Risk, Corporate Governance and Sustainability Committee - Chairman
Appointments Committee - Chairman
Related-Party Transactions Committee - Chairman
Members of the Committees

Board of Statutory Auditors

CHAIRMAN
Riccardo Enrico Maria Schioppo

STANDING AUDITORS
Vincenzo Simone
Maria Alessandra Zunino de Pignier

ALTERNATE AUDITORS
Raffaella Annamaria Pagani
Cesare Felice Mantegazza
Renata Maria Ricotti

Audit Company

PricewaterhouseCoopers S.p.A.

For further details see the "Report on Corporate Governance and Ownership Structures", for financial year 2016, available on the Terna S.p.A. website (www.terna.it - in the section "Investor Relations").

(3) Consultable at: http://download.terna.it/terna/0000/0062/28.pdf

Remuneration policy

The remuneration of the Directors, especially those in executive positions, is a fundamental incentive and control tool for ensuring the integrity and effectiveness of the corporate governance mechanisms. In thus doing, the constant pursuit of value creation is ensured over time, creating convergence in this way between shareholder and management interests.
In particular, for the Chief Executive Officer who also holds the position of General Manager (GM), the total remuneration is made up of:

- a fixed component, both for the position of Chief Executive Officer and for the position of General Manager;
- a short-term variable component (MBO), both for the position of Chief Executive Officer and of GM, with disbursement subordinated to achieving predetermined business targets of particular significance;
- a long-term variable component (LTI), for the position of General Manager, subordinated to achieving multi-year performance targets;
- benefits, for the position of General Manager, recognised by the national collective contract of reference (CCNL of senior managers of companies producing goods and services).

Finally, in relation to non-renewal on expiry of the mandate or to early termination of the same, for the Chief Executive Officer, who is also General Manager, payment of the termination benefit and a severance indemnity is provided for.

On 1 January 2017 the Chief Executive Officer identified, in the context of the Group, four Senior Executives with Strategic Responsibilities; these are, specifically, the holders of the following organisational roles:

- Head of Corporate Affairs Division;
- Head of Strategy and Development Division;
- Chief Financial Officer;
- Chief Executive Officer of Terna Rete Italia S.p.A..

The Remuneration Policy for Senior Executives with Strategic Responsibilities provides for:

- an annual fixed component the amount of which is connected to the position held and the responsibilities attributed;
- a short-term variable component (MBO) and a long-term variable component (LTI), disbursement of which is related to achieving specific and predetermined performance targets;
- benefits according to the provisions of the national collective employment contract of reference and of the corporate policies and practices.

The annual managerial incentive plan (MBO), also includes a selection of the Group's Senior and Junior Executives.

The Long-Term Incentive (LTI) Plan is extended to the Group's senior executives who perform significant functions for the achievement of its strategic results.

For further details see the "Annual Remuneration Report", published in accordance with the law, available on the Terna S.p.A. website (www.terna.it - in the section "Investor Relations").

External Context

Legislative Context

A summary of the main legislative sources that govern the role and activities of the national electricity transmission grid operator is provided below.

LEGISLATIVE PILLARS

Unification of ownership and operation of the national electricity transmission grid

Implementing Italian Law Decree no. 239 of 29 August 2003, with the **Prime Ministerial Decree of 11 May 2004**, "*in order to improve the security and efficiency of operation of the national electricity transmission grid*", the methods were defined and the process launched to unify the ownership and operation of the national electricity transmission grid under a single independent operator, with the transfer to Terna of the related tasks and functions previously performed by the GRTN, to separate ownership from Enel S.p.A. and to privatise the entity resulting from the unification.

Concession

In implementation of the Concession issued with a decree of the Ministry of Production of 20 April 2005 and of the annexed Convention, most recently updated with the decree of the Ministry of Economic Development of 15 December 2010, Terna S.p.A. performs the activity of transmitting and dispatching electricity in Italy, including unified operation of the national transmission grid.

In pursuing the objectives of the Concession, Terna ensures that the service offers security, reliability and continuity in the short-, medium- and long-term, resolves the actions aimed at ensuring the efficiency and development of the electricity transmission system in Italy and completes the work within its remit, guarantees the impartiality and neutrality of the transmission and dispatching services, contributes to promoting, in the context of its duties and responsibilities, protection of the environment and security of the plants.

The internal electricity market

The European Union directives on the internal electricity market in the Italian legislation (the Third Energy Package), were transposed in Italian Legislative Decree no. 93 of 1 June 2011 and in **Italian Legislative Decree no. 79 of 16 March 1999**, amended several times. Article 36 of **Italian Legislative Decree 93/11**, in particular, describes the core activities of the electricity grid operator and establishes the methods with which the Authority for Electricity, Gas and Water issues the certification required for transmission system operators by the EU directive 2009/72/EC. In addition the decree governs the procedure for adopting and approving the National Transmission Grid Development Plan and the forms of regional cooperation in the electricity sector.

Energy Context

The late-2015 Paris climate agreement (COP21)[4] reinforced the international approach taken towards renewable energy sources, defining the commitment to limit global warming to within 2 degrees.
The European Union aims to lead the international transition to a cleaner and more efficient energy system, accepting the climate change challenge launched by COP21 in Paris, as stated by the European Commissioners when they presented, the legislative package "Clean Energy for all Europeans" ("Clean Energy Package") on 30 November 2016.

The package contains the proposals for new directives and regulations implementing the Union's Energy Strategy. In particular, there is a definition of the legislative and regulatory framework of the energy market to guide the energy transition towards implementing the European targets set in terms of CO_2 reduction, energy efficiency and development of renewable sources at 2030. A new design for the European markets is proposed with the aim of putting final consumers at the centre of the system and the organisation of the sector is also revised to guarantee the security of electricity procurement, by strengthening regional cooperation and coordination, coordinated medium-, long- and up to short-term adequacy assessments and the management of crisis situations. The legislative procedure on these measures will be launched in 2017 at the level of the EU Council and European Parliament.

EUROPEAN ENERGY POLICY				
Energy efficiency	**Consumption covered by Renewable Energy Sources**	**Energy Grid Development and Market Integration**	**Market Design, Security and Adequacy**	**Reduction of GHGs emissions**
• 2020 target: 20% increase compared to 1990 • 2030 target: 30% increase compared to 1990	• 2020 target: 20% of energy consumption from renewable sources • 2030 target: 27% of energy consumption from renewable sources	• 2020 target: 10% increase in interconnection capacity • 2030 target: 10% increase in interconnection capacity 15 to be translated into regional and national targets by 2030 • Creation and Development of Projects of Common Interest (PCIs) to achieve the European targets	• Reform of the markets (flexibility and innovation) • Security and Adequacy of the electricity system • Strengthening of regional cooperation and coordination • TSO-DSO relationship • Strengthening the ACER	• 2020 target: to reduce CO_2 by 20% from 1990 • 2030 target: to reduce CO_2 by 40% from the 1990 levels • Increased use of biofuels, solar energy, and use of hydrogen • Management of smart cities, capture and underground storage of CO_2

As a rule, the European and international energy context looks to be favourable for the electricity sector (production, transmission and distribution), in particular for the drive on infrastructures and renewables.

These challenges require significant efforts from Terna, aimed at developing the transmission grid in a situation that is constantly evolving, while simultaneously guaranteeing satisfactory standards of adequacy, quality and security, with the latter also meaning the ability of the electricity system to be resilient and able to deal with critical events that are external to the system. The continual evolution of the electricity supply chain also makes it necessary to take a new systemic and organic approach to innovation as discussed in detail in the paragraph "Intellectual Capital".

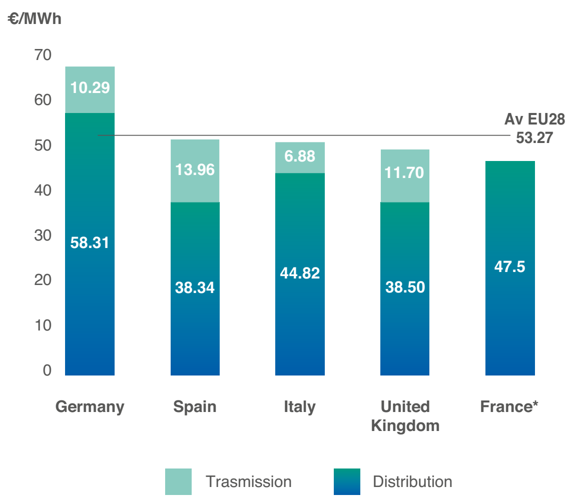
Italy immediately began implementing the European Energy Policy and the guidelines of climate conferences. The data and charts below clearly show how our country in general and Terna in particular are working in the direction hoped for by the International Bodies and the community.

(4) During 2016 the COP 22 conference was held in Marrakesh, alongside which Terna took part in two events organised by the MAECI and the Ministry of the Environment and Protection of Land and Sea. The company presented its activities in Africa, with particular reference to its skills in the field of Smart Grids ("Smart Island project") and electricity storage systems.

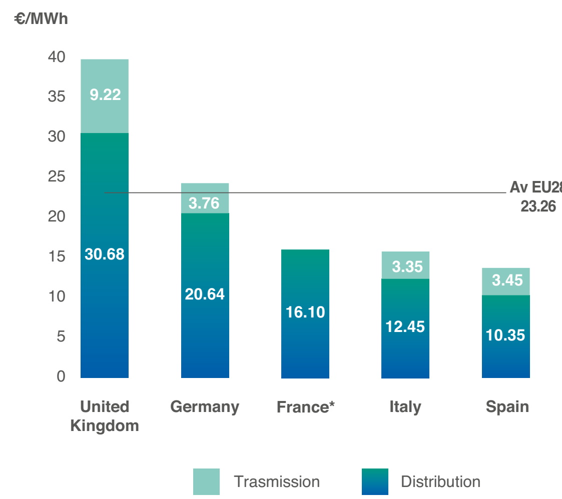
Network costs

From a study carried out by the European Commission on the 2015 data[5], it is found that - in both the residential and the industrial segments - the "network costs"[6] paid by Italian consumers are in line with the European average. In particular, in relation to the Transmission Grid segment, the Italian costs are the lowest compared to some of the most representative Countries of the sample analysed, as shown in the charts presented below.

Network costs - DC Household
(2,500 kWh < Annual consumption < 5,000 kWh)



Network costs - Industrial ID
(2,000 MWh < Annual consumption < 20,000 MWh)

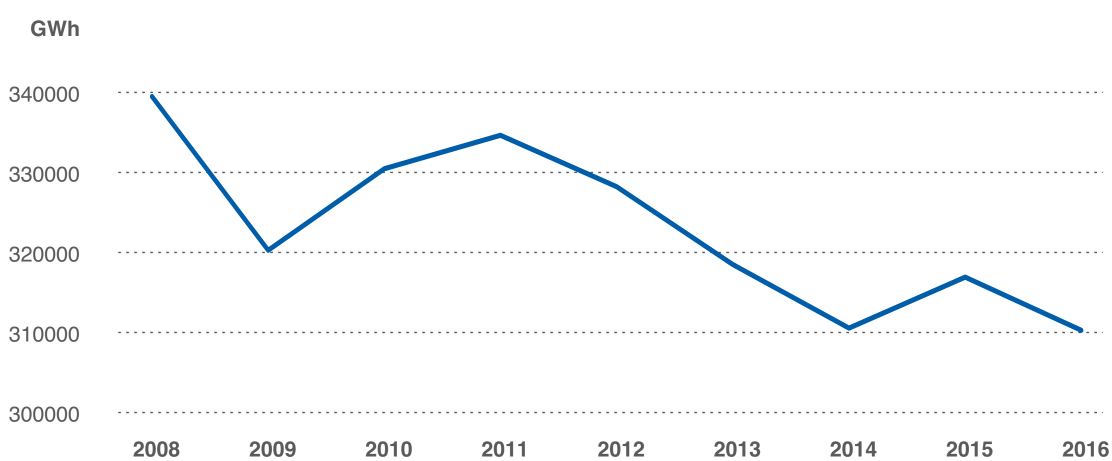


* Split not available

Source: Terna calculation on Eurostat data and EC Report "Energy prices and costs in Europe"

Electricity demand and production in Italy

ELECTRICITY DEMAND IN ITALY SINCE 2008



In 2016, the demand for electricity in Italy was 310,252 GWh (provisional data), a drop of -2.1% compared to 2015, which closed with an increase of 2% on the previous year.

(5) 2015 Data from Eurostat and the European Commission, "Energy prices and costs in Europe".
(6) "Network costs" include transmission and distribution tariffs, losses, measurement and systems costs.

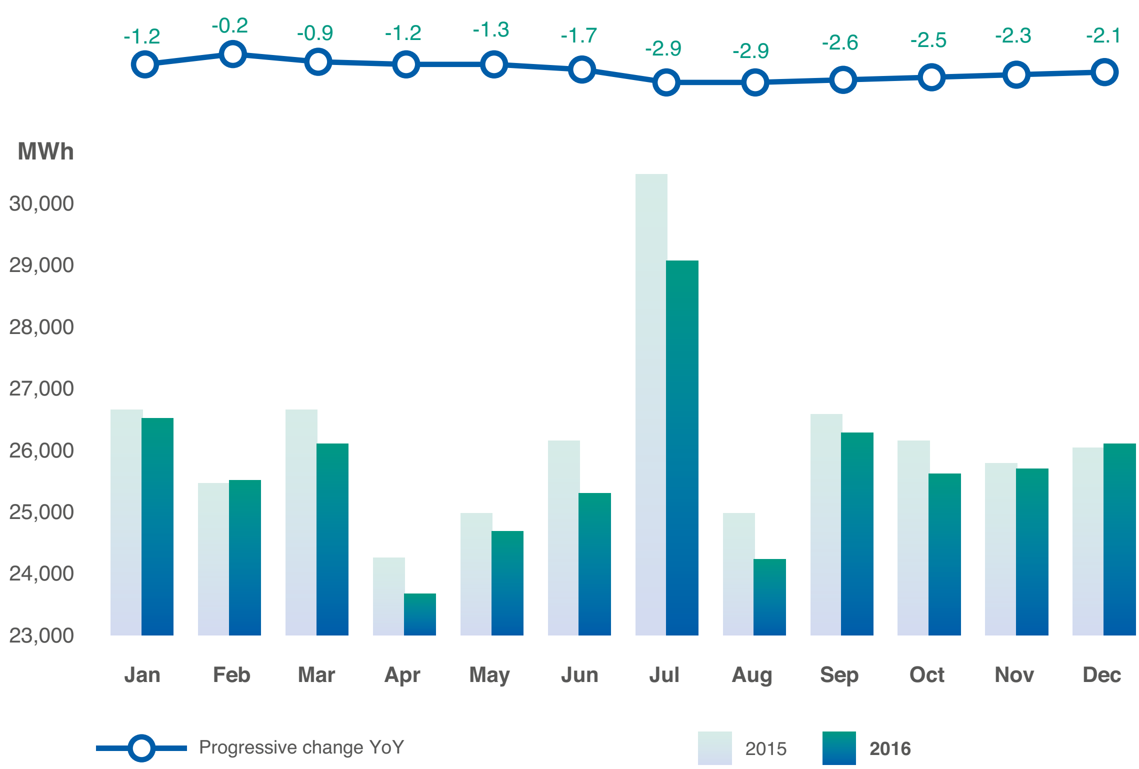
ELECTRICITY BALANCE SHEET FOR ITALY (GWH)

GWh	2016*	2015	Δ	Δ %
Net production**	275,649	272,428	3,221	1.2%
Import	43,181	50,849	(7,668)	(15.1%)
Export	(6,154)	(4,471)	(1,683)	37.6%
For pumping***	(2,424)	(1,909)	(515)	27.0%
Total demand in Italy	**310,252**	**316,897**	**(6,645)**	**(2.1%)**

* Provisional data.
** Does not include the demand for energy related to services auxiliary to electricity production activity.
*** Electricity used for lifting water by pumps, for the sole purpose of being used subsequently for electricity production.

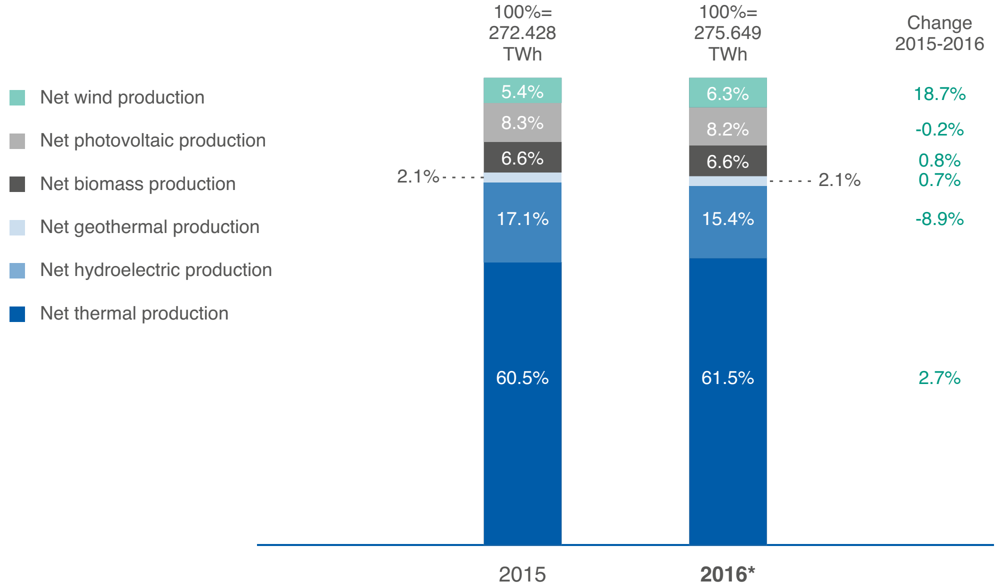
The trend of electricity Italy in 2016, compared to the previous year, shows a downward progression. February and December show an increase compared to the same months in 2015, due to the effect of the leap year and greater Exports, respectively.

MONTHLY ELECTRICITY DEMAND IN ITALY (2016 V. 2015)



As regards electricity production according to type of source, 2016 recorded an increase in the wind (+19%), biomass (+1%) and geothermal (+1%) production sources. Hydroelectric production, instead, fell (-9%), also owing to the different weather conditions recorded in the year. Photovoltaic production was stable, although slightly down (-0.2%). Thermal production increased.

NET ELECTRICITY PRODUCTION ACCORDING TO TYPE OF SOURCE

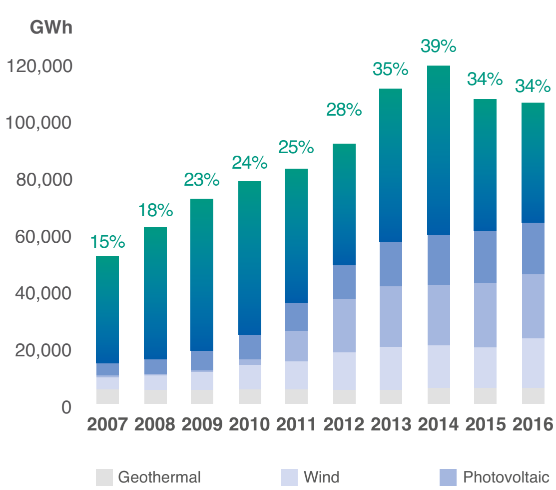


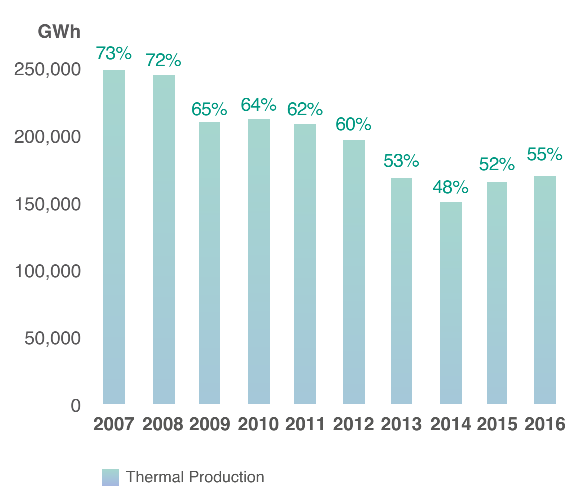
* Provisional Data

During 2016 **renewable sources** covered approximately 34% of the total energy demand. The trend of renewable production in Italy in the last 10 years is shown below with, as a comparison, over the same time period, the trend of Thermal Production.

As can clearly be seen from the charts, a constant and gradual increase in production from Renewable Sources corresponds to a specular reduction of production from Thermal Sources. This shows the commitment of our country to observing the European Community directives which set for 2020 coverage of Demand from Renewable Sources of more than 27%. A target achieved, maintained and improved by Italy already since 2012.

TREND OF PRODUCTION SOURCES AGAINST DEMAND[7]





(7) The percentages indicated in the two charts compared refer to the portion of demand covered by renewable sources (left) and thermal sources (right).

Regulatory Context

Regulatory structure for the fifth regulatory period (2016-2023)

Regulated revenue, which represents more than 90% of Group's total revenue, mostly derives from the transmission and dispatching activity, subject to regulation by the Regulatory Authority for Electricity, Gas and Water (AEEGSI).
With Resolutions no. 583/2015/R/com, no. 653/2015/R/eel, no. 654/2015/R/eel and no. 658/2015/R/eel, the AEEGSI set the tariff regulation for electricity transmission, distribution, measurement and dispatching services and the regulation regarding the quality of the transmission service for the 2016–2023 regulation period (fifth regulatory period).
The fifth regulatory period (or new regulatory period: - NRP) lasts for eight years and is divided into two sub-periods: NPR1 (2016-2019) and NPR2 (2020-2023), of 4 years each. Within the fifth regulatory period the Authority also introduced two regulatory semi-periods with the possibility to review the remuneration rate of Regulated Asset Base (RAB) every 3 years.

Regulation in NRP1 (2016-2019)

Regulation in effect for the first four years of the fifth regulatory period is essentially in line with the past, with some new elements and, more generally, a greater focus on output-based regulation. Below are some of the elements characterising regulation in the period in question.

Transmission service

Transmission revenue represents the most significant portion of regulated revenue and derives from application of the transmission fee (TF). This fee remunerates the transmission business carried on by all owners of the NTG, including owners of residual portions (outside the Terna Group), and – starting from 2016 – has a dual structure. It is in fact divided into the two components:

- **TF_P**: power component (expressed in cent.€/kW/year), remunerating 90% of the recognised transmission costs,
- **TF_E**: energy component (expressed in cent.€/kWh), representing remuneration of 10% of the recognised transmission costs.

The two components are paid to Terna by the distributors connected to the National Transmission Grid. The income deriving from application of the two components is entirely collected by Terna which, after deducting some items it is exclusively responsible for, divides it among all the NTG owners.
With Resolution 654/2015/R/eel, the Authority established the criteria and formulas used to calculate the two components TF_P and TF_E and for annual updating of the same from 2016-2019. Under the terms of the criteria pursuant to the said resolution 654/2015/R/eel, with Resolution 779/2016/R/eel the Authority updated the tariffs for the transmission service for 2017.

Dispatching service

The fee for the dispatching service (DIS) remunerates Terna for activities connected to the dispatching service, and it is invoiced by Terna to users that have concluded a contract with Terna for the dispatching service, in proportion to the respective quantities of energy dispatched. The related revenue is entirely due to Terna, as the only subject responsible for this service.

Resolution 658/2015/R/eel outlined the fee adjustment criteria for the dispatching service, making amendments and additions to resolution 351/07 and updating the dispatching unit fees for 2016. The annual update to the DIS fee is carried out using criteria and methods based on that foreseen in Resolution 654/2015/R/eel for the TF fee (with the exception of a few specific elements, detailed in the same resolution 658/2015/R/eel). Resolution 815/2016/R/eel defined the dispatching fees for 2017.

The recognised costs that combine to determine the TF and DIS components are attributable to three main categories: costs recognised to **cover the remuneration of capital** (RAB – Regulated Asset Base), costs recognised to **cover depreciation** and costs recognised to **cover operating expenses**.

THE THREE MAIN TYPES OF COSTS RECOGNISED

CAPITAL REMUNERATION (RAB)

In 2016, this represented approximately 50% of Terna's recognised costs.

The **Regulated Asset Base** (RAB) which represents invested regulatory capital, is revalued annually in accordance with ISTAT data on the change in the deflator of gross fixed investments and is updated on the basis of investment and disposal trends.

The rate of remuneration of the RAB, known as the **Weighted Average Cost of Capital** (**WACC**), is defined by the Authority. As of 2016, the Authority – with resolution 583/2015/R/com – introduced a specific WACC regulatory period of 6 years (PWACC), subdivided into two three-year sub-periods. The PWACC sets the basic WACC parameter levels applied to all infrastructure services in the electricity and gas sectors, excluding the specific parameters relative to each service. For the period 2016-2018 the WACC for the transmission service is set at 5.3% and an update is provided for, valid for the second three years (2019-2021), to take into account the change in specific parameters (e.g. risk-free rate, market risk premium, ß parameter).

With regard to **incentivised investments**, Resolution 654/2015/R/eel confirmed the effects of the incentive regulations from prior regulatory periods for all investments that came into operation by 31 December 2015 and provided for a new "transitional incentive" mechanism for the 2016–2019 period. Under this mechanism, the Authority is expected to approve a list of "O-NPR1" development works (not included in the I3 investments approved by Resolution 40/13) and a list of "I-NPR1" development projects (previously included in the I3 investments) and to recognise a 1% increase in the WACC for 12 years subject to certain conditions set out in Annex A to Resolution 654/2015/R/eel. For the projects included in the I-NPR1s and O-NPR1 clusters, the above Resolution also provides for the possibility of additional output-based premiums.

Additionally, as of 2016, with reference solely to remuneration of invested capital, the delay with which the tariff remunerates investments was reduced (the **time-lag**): the tariffs for the year "n" include the remuneration of investment capital up to year "n-1" and the recognition of depreciation of investments up to year "n-2". The 1% extra remuneration to offset the time lag, is therefore limited to investments entered into operation by 2015.

For 2017, the revenue recognised was set by the Authority – for the first time – approving a tariff proposal presented by Terna and prepared on the basis of data agreed with the Authority itself and with reference to the historical cost of Terna's investments.

DEPRECIATION

In 2016, this represented approximately 32% of Terna's recognised costs.

Depreciation is adjusted in accordance with the regulatory useful life of assets and new investments that have come into operation. It is also, as with RAB, re-evaluated annually according to changes in the deflator of gross fixed investments.

OPERATING EXPENSES

In 2016, this represented approximately 18% of Terna's recognised costs.

Operating expenses recognised represent operating costs (mainly external resource costs, cost of personnel and material purchases). Operating expenses recognised are determined by the AEEGSI at the beginning of the regulatory period, on the basis of operating expenses recognised during the reference year (which for NRP1 2016-2019 was 2014) supplemented by residual portions – temporarily left to Terna – of the extra-efficiency achieved in the two previous regulatory periods. The value obtained is revalued annually on the basis of inflation and reduced by an efficiency factor aimed at completing, over time, the transfer to the final users of the extra-efficiency achieved.

Volume mitigation mechanism

Every year, Terna invoices distributors and other users for the TF_E and TF_P components, as well as the DIS fee, applying the unit values for these fees as calculated by the Authority. This implies the exposure of the related revenue to a "volume effect", that is the possibility that the income consequent to invoicing will be higher or lower than the recognised revenue which was considered, in aggregate, for determining the unit fees. Unit fees are calculated on the basis of total volumes for the previous year for transmission fees and on the basis of Terna's estimates of the quantity of energy to be subject to payment of dispatching fees relative to the DIS component.

Terna is exposed to this volume effect only for the part of transmission revenue deriving from the TF_E component (10% costs recognised) and for dispatching revenue deriving from the DIS component, to which a volume mitigation mechanism applies (which limit the volatility only to differences falling within the spread of +/-0.5% of effective and forecast volumes in year "t" to Terna, whether positive or negative.

2016 Incentive schemes

The current regulations include premiums and penalty schemes aimed at encouraging service improvement, both in terms of technical reliability and cost. As it is implicit in incentive mechanisms, upon reaching objectives, the benefit to service users will be a multiple of the incentive paid. In the regulatory structure determined for 2016-2019, the incentive mechanisms can be essentially divided into two categories:

- for transmission service quality: non-tariff incentive mechanism;
- for selective promotion of investments of particular strategic importance: fee incentive mechanisms (as described previously: extra WACC potential and output based incentive potential).

The premiums/penalties connected to achievement of the objectives established in the incentive schemes are included in the total regulated revenue.

Quality of transmission service

The regulations in effect (established in particular by resolution no. 653/2015/R/eel) include various mechanisms aimed at regulating and incentivising improvements in the quality of service offered by Terna. Below are the main features of these mechanisms.

QUALITY OF SERVICE MECHANISMS

Premium/penalty mechanism

To encourage continuity of service there is a system of rewards and penalties based on the reduction in energy not supplied to the main power substations of distributor companies: this mechanism can generate penalties up to a maximum of € 12 million and incentives up to € 30 million annually.

Mitigation

In the case of specific types of power outages, distributor companies may power plants that are temporarily not served by the NTG and receive specific remuneration for this service (known as mitigation). The annual amounts paid by Terna for this service are subject to a maximum limit of € 18 million. For payments exceeding this annual maximum, Terna may request reimbursement from the Authority.

Sharing

Terna may be called on to share penalties/refunds applied to distribution companies when outages occur affecting customers connected to MV and LV distribution networks, which involve not complying with the specific standards established by the Authority (in terms of duration/number of outages).
Terna's share for exceeding the outage duration standards has a maximum annual limit of € 70 million (if exceeded, Terna may request that the Authority provides reimbursement for the amount exceeding the maximum), while that for exceeding the standards on the number of outages is contained in the limits foreseen in the distribution service quality regulations (Title 5 of Part I of the TIQE). In certain specific cases, Terna may request reimbursement of payments made from the Exceptional Events Fund. It should be noted also that with Resolution 127/17, the Authority made certain changes to the regulations, limiting the possibility for grid operators to access the exceptional events provision when the outage exceeds 72 hours. The same resolution increased the total amount payable to end customers in the event of outages that exceed set time thresholds.

Individual regulation of HV and VHV end customers

As of 2016, a specific regulation was introduced aimed at limiting the number of outages for HV and VHV end customers. In particular, Terna must make automatic payments to HV and VHV end customers if the specific standards are not complied with the number and duration of outages for which Terna is responsible.
Indemnities for non-compliance with the standards relative to the number of outages have a cap of three indemnifiable outages per year, per customer. Indemnities for lack of compliance with the duration standards, added to payments to the Exceptional Events Fund (pursuant to the section below) have a maximum annual cap of € 7 million.
With reference to HV and VHV end customers, the regulations also foresee the future introduction of an individual voltage quality regulation.

Payments to EEF

Terna must make an annual contribution to the Exceptional Events Fund, based on the duration of outages for which it is responsible and the relative quantity of energy not supplied. The sum of these reimbursements and the automatic payments made to HV and VHV end customers due to non-compliance with the standards on outage duration (as in the previous section) is subject to a maximum annual cap of € 7 million.

Relative to the mechanisms outlined above, current regulations also foresee certain peculiarities for the portion of the transmission grid previously owned by Ferrovie dello Stato Italiane S.p.A. (subsequently acquired by Terna), including exclusion of this portion of the grid from the premium/penalty mechanism for energy not supplied.

FSI grid remuneration

With Resolution 517/2015/R/eel the AEEGSI also set the rules for the remuneration recognised for the portion of the non-NTG HV/VHV electricity grids that Terna acquired from the FSI Group, and which - subsequent to the purchase - became part of the National Transmission Grid. In keeping with this resolution - and according to the methods indicated in it - the costs recognised in relation to the remuneration of capital and to cover depreciation are considered by the AEEGSI only starting from the 2017 tariff update, while the 2016 tariff update considered only the remuneration of the operating expenses recognised.

Pass-through items

Terna manages cost and revenue items connected to the transactions, completed with electricity market operators, to buy and sell the energy: these are the “pass through” items, i.e. those which do not influence the profitability of the Terna Group, as revenue is equal to cost. The regulation of these items is in particular established by AEEGSI resolutions no. 111/06 and no. 107/09 (the Integrated Settlement Rules) as subsequently amended and supplemented.
A significant proportion of pass-through items consists of uplift, a tariff component which includes costs incurred by Terna to procure resources on the Dispatching Service Market (DSM). These items also include payments such as the capacity payment which Terna collects from users and passes on to the producers who make the capacity available on the market. It also includes the payment that Terna collects from the users and passes on to the operators which supply the load interruption service, or again fees to cover the costs incurred by Terna to remunerate the production units essential for the electricity system.
In 2016, pass-through revenue and costs for the Terna Group totalled € 5,598.5 million.

Regulation in NRP2

With resolution 654/2015/R/eel, the Authority gave notice, for the second four years of the fifth regulatory period, of the adoption of a new methodological approach to regulating the transmission service, with an eye to recognising costs based on total expenses sustained (operating and investment costs), also known as the “TOTEX (Total Expenditure)” approach. This approach, which therefore provides for recognition of costs no longer separated between operating and investment costs, must be outlined by the Authority with specific resolutions.

Social Context

A description of the main elements of the social context is provided below.

THE THREE MAIN ELEMENTS OF THE SOCIAL CONTEXT	
Opposition to new initiatives	The most significant element of the social context for Terna regards a generalised opposition with regard to the inclusion of new infrastructures in the territory, expressed by the population of the areas involved and often identified by the expression “NIMBY (Not In My Backyard) syndrome”. The opposition stems from a great sensitivity to the defence of one’s own territorial - living - rural area, from interventions from which the local community does not immediately benefit. The purposes of security and functioning of the electrical service provided by Terna in the general interest - even if known and recognised - are not considered significant compared to the aim of protecting one’s own specific territory. To reduce to the minimum the social contrasts Terna has followed since 2002 a voluntary process of prior involvement of local institutions (regional and local administrations, park authorities, etc.) which since 2015 has also been extended to the population of the communities directly affected by Terna’s work through public meetings entitled “Terna meets”. These are events aimed at meeting the local populations and explaining to them the development needs of the grid which have led to the need for the work, illustrating the methods of implementing it, and the alternatives identified and, above all, making itself available to collect observations and requests for clarifications. During 2016 Terna held a total of 181 meetings with local administrations, involving approximately 270 Entities and created 7 “Terna meets” events.
Environmentalist associations	The role played by Terna in the electricity system is considered with interest by those who – like the main environmentalist associations, in their central structures – express concern over the effects of climate change, sustain the need for a rapid transition to the production of energy from renewable sources and see the development of the transmission grid and smart technologies as a factor able to allow for this energy transition both in Italy and worldwide. In 2016 Terna renewed and expanded its partnerships with Legambiente, the WWF and Greenpeace for a further strengthening of the existing collaborations. In particular, the new Memorandum of Understanding provides for cooperation articulated on several levels. In the stage of drafting the Development Plan the collaboration will regard future energy scenarios, development strategies for the electricity grid in relation to the national and European environmental objectives, and public discussion of the energy scenario at 2030 and 2050 subsequent to COP21 in Paris. In the area of Strategic Environmental Assessment the discussions will focus on the socio-environmental context in the areas affected by the interventions envisaged by the Development Plan to identify the environmental corridors relating to the works that will be executed.
Natural areas	Terna will continue to identify the route feasibility bands for the sections of the electricity lines and the environmental content for consultation with local authorities, so as to minimise interference with priority natural areas, and mitigate the impact arising from development work disrupting or bordering on priority natural areas and implementing environmental rehabilitation measures.

BUSINESS AND CAPITAL

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Business

Terna's business model is oriented to pursuing the Group's objectives and has as its central focus the **Regulated Activities** of transmission and dispatching of electricity. Leveraging the skills gained in the core business, **Non-Regulated and International Activities** boost growth, seizing the opportunities deriving from the technological discontinuities and from the trends characterising the energy sector in Italy and abroad.

Terna's strategic plan, which takes a multi-year view, defines targets, priorities and investments. This takes the form of analysing the medium- and long-term trends which could present challenges and consequently identifying the related solutions. As discussed in depth in the section on the external context, good examples are the changing energy scenarios and the consequent need to adapt the electricity transmission grid, or the increasing integration of grids at the European level.

The focus on stakeholders and the desire to maintain a relationship of trust with them fuels sustainability policies facilitating a more solid business model in the medium and long term.

Strategy

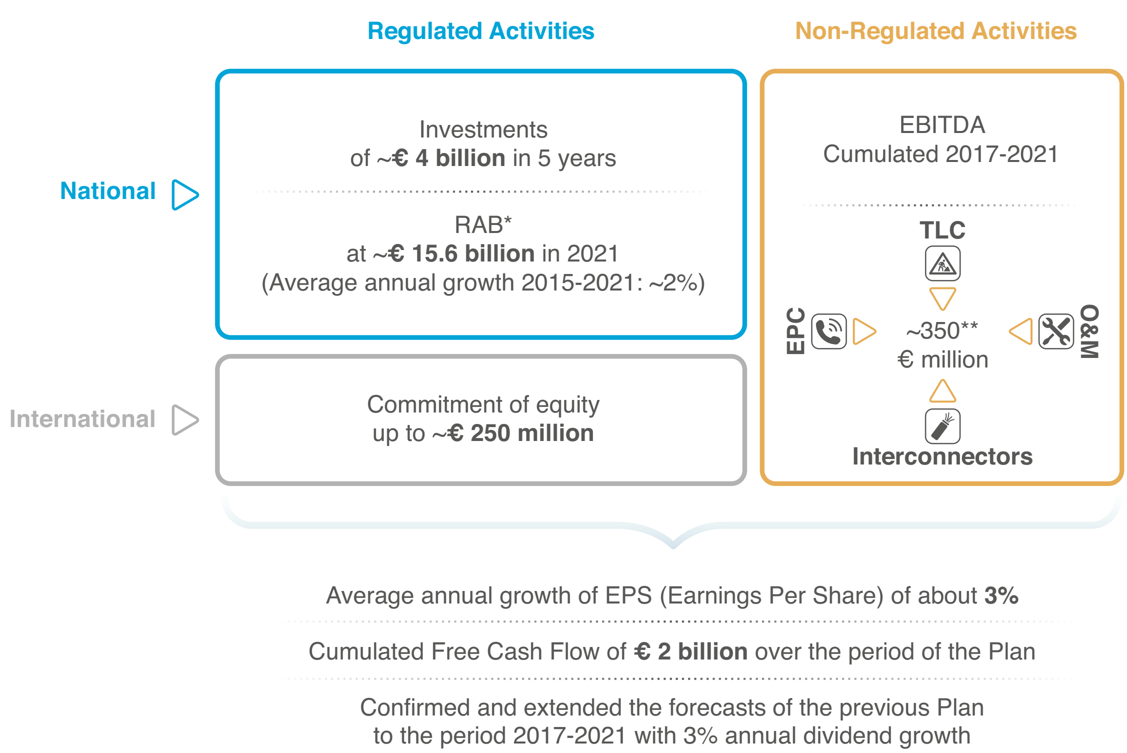
2017-2021 Strategic Plan

On 20 February 2017, Terna approved and presented to the market the Strategic Plan for the 2017-2021 period, which provides for acceleration of investments on the NTG (National Transmission Grid) to facilitate the energy transition in progress. In particular, the reference scenario of the electricity sector in Italy and in Europe, characterised by the continual growth of non-programmable renewable production sources and at the same time by the gradual decommissioning of traditional generation plants, makes appropriate development of the electricity grids necessary. This has led to undertaking strategic initiatives aimed at:

- Encouraging the integration of renewable sources and improving the security of the system;
- Creating infrastructures for interconnection with other countries.
- Expanding interconnections to reduce local congestions;
- Using cutting-edge technologies, with ever-increasing attention to environmental and sustainability aspects;

In addition, the 2017-2021 Strategic Plan includes consolidation in Non-Regulated Activities of an industrial approach, positioning Terna increasingly as an Energy Solution Provider, and an international strategy that goes to support growth and value creation over the long term.
Maintaining a solid capital structure thanks to robust cash generation will contribute, finally, to sustaining an attractive dividend policy.

MAIN TARGETS



* Calendar RAB including Work in Progress
** Domestic Non-Regulated Activities net of Tamini

TARGETS OF THE 2017-2021 STRATEGIC PLAN

Regulated Activities

Over the next 5 years the Terna Group plans investments of approximately € 4 billion, approximately 30% more than in the previous Strategic Plan. Among the main electrical infrastructures under construction are the interconnections with Montenegro and France, which are both expected to come into operation in 2019. In the period of the Plan the new SACOI3 project (Sardinia, Corsica and Italy connection) and the Italy-Austria interconnection will be started. In addition, several projects are planned with the aim of increasing the exchange capacity between the various zones of the Italian electricity market. The value of the regulated assets (RAB) will reach approximately € 15.6 billion in 2021, with a annual average growth rate (CAGR) of approximately 2%.

Non-Regulated Activities

The Plan provides for the development of services for third parties (EPC, TLC, O&M) and the creation of the interconnectors, which will be financed with third-party resources. It is expected that these activities will contribute to the Group's EBITDA for approximately € 350 million an accumulative basis over the Plan period, with an annual average growth of approximately 40% compared to the previous Plan. Furthermore, after the acquisition of the high-voltage electricity grid of Ferrovie dello Stato, the Group signed an agreement with Rete Ferroviaria Italiana (RFI) aimed at creating and selling photovoltaic plants for power of up to a maximum of 200 MW to RFI, without additional expense for households and businesses.

International development

In line with the past year, the 2017-2021 Strategic Plan provides for an equity commitment of up to approximately € 250 million for regulated activities abroad. These initiatives will be selected through assessment processes that can guarantee a low risk profile and an optimisation of the industrial role played by Terna and may also be developed as part of a partnership. We can note the tender awarded for the construction of more than 200 km of power lines in Uruguay (invested capital of approximately € 70 million) and the agreement for the acquisition of concessions for the construction and operation of two power lines in Brazil, for a total length of more than 500 km (invested capital of approximately € 180 million).

Consolidated results

The Plan foresees an increase in the Group's revenue to approximately € 2.3 billion and in EBITDA to approximately € 1.7 billion in 2021, with annual average growth of approximately 2% for both indicators starting from 2016, and an improvement in net profit, with annual average growth of approximately 3%. Thanks to these results Free Cash Flow of approximately € 2 billion will be guaranteed over the period of the Plan, which will contribute to the flexibility needed to sustain an attractive dividend policy. Terna's financial structure will remain solid and the net debt/RAB ratio will remain below 60%; in 2016 it was around 55%.

New dividend policy

With reference to the dividend policy the assumptions of the previous Plan were confirmed and extended to the longer period 2017-2021, with annual growth in the dividend of approximately 3% aligned with the expected evolution of earnings. This policy reflects an overall payout that, during the Plan period, will remain below 70%.

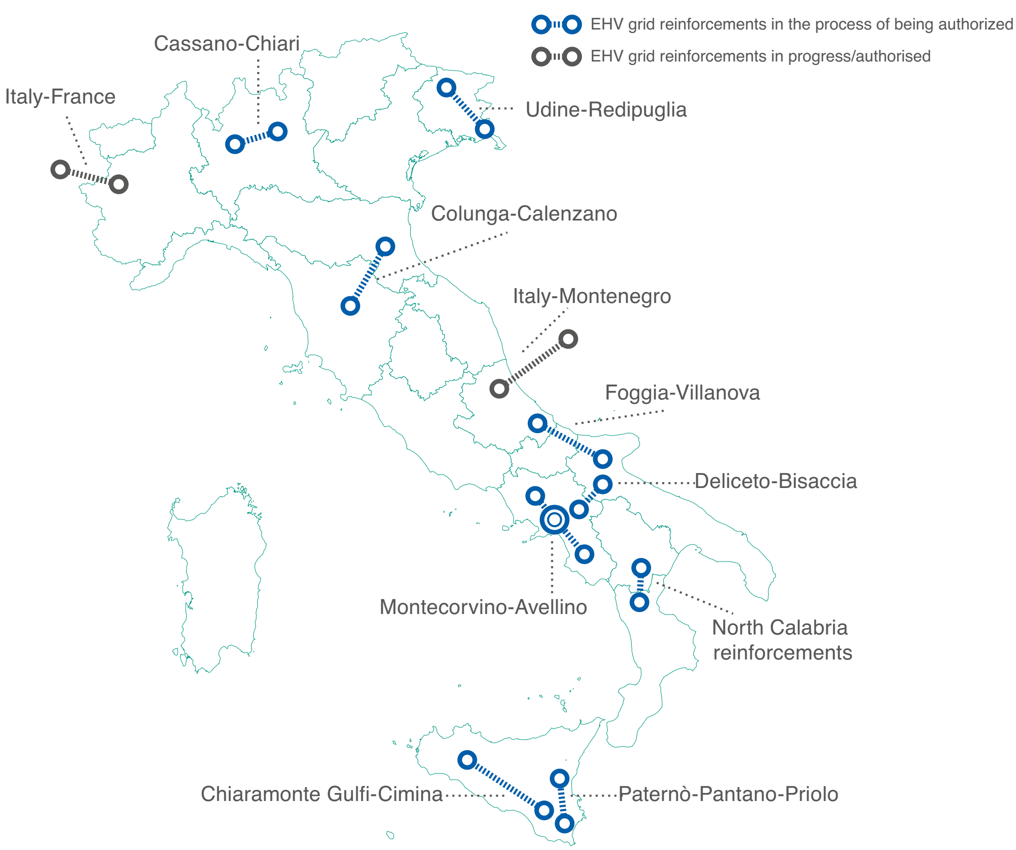
2017 ten-year Development Plan

The 2017 Development Plan (DP) foresees investments totalling approximately € 7.8 billion (of which 2.5 billion in the period 2017-2021), thanks to which savings will be achieved for the electricity system, as well as benefits, such as:

- higher interconnection capacity, estimated at up to 5,000 MW;
- higher power capacity by renewable sources of 4,500 MW.
- reduction of congestion for an amount of 3,000 MW;
- reduction of energy losses of 830 million kWh per year;
- reduction of CO_2 emissions of 7.7 million tonnes/year, as a result of the production mix and lower grid losses, corresponding to the equivalent emissions of approximately 6.5 million cars[8];

Implementing Directive 2009/28/EC and the National Action Plan (NAP) prepared by the Ministry of Economic Development in 2010 and AEEGSI Resolution 627/16[9], Terna included a specific section in the National DP which defines the action needed for full use of the energy deriving from the production of renewable source systems. The grid analyses carried out in order to facilitate the use and development of production from renewable sources have enabled us to identify action to be taken both on the primary 380-220 kV transmission grid, and on the 150-132 kV High-Voltage grid. For the above purpose, below is a figure showing an overview of the main development projects on the 380 kV Very-High-Voltage grid.

MAIN PROJECTS INCLUDED IN THE 2017 DP



(8) Average emissions of a car 120 g CO2/km, 10,000 km/year the average distance travelled by a car.
(9) Resolution 627/16/R/eel - Provisions for consultation of the ten-year National Electricity Transmission Grid Development Plan and approval of the minimum requirements of the Plan, assessments for which the Authority is responsible

During 2016, the Regulatory Authority for Electricity, Gas and Water (AEEGSI), with Res. 627/16//R/ee, approved the new provisions for preparing the Ten-Year National Transmission Grid Development Plan, starting from that of 2017. The resolution requires Terna to update Chapter 2 of the Grid Code and to prepare a new annex containing the cost-benefit analysis methodology for preparing the Development Plan. In particular, the resolution:

- defined minimum requirements for preparation of the Development Plan, in particular on the subject of completeness and transparency of information and cost-benefit analysis methodology in order to promote the planning of investments according to criteria of selectivity and usefulness for the electricity system;
- stated that, starting from the draft 2017 Development Plan, Terna must apply the minimum requirements of the cost-benefit analysis methodology at least to all grid development projects with an estimated investment cost equal or higher than € 25 million and, for the following draft Plans, at least to all development projects with an estimated investment cost equal or higher than € 15 million;
- stated that Terna must update every two years its forecasts on the electricity system development scenarios over a period of time of not less than twenty years;
- stated that Terna must transmit to the Authority by 30 April of each year a disclosure on the investment expenditure planned for each of the next five years.

Further details on the criteria for preparing and on the approval process for Terna's development plan are illustrated in the Annex "Criteria for preparing and approval process of the Development Plan".

Business outlook

In the next few months, the Terna Group will implement the 2017-2021 Strategic Plan that was approved by the Board of Directors and presented to the financial community on 20 February 2017.

In relation to the macro-trends that will affect the Terna Group's reference context, it is foreseen that the electrical sector in Italy and in Europe will be characterised by increasing growth of non-programmable renewable production sources and by the gradual decommissioning of traditional generation plants. In this scenario, in line with the EU's indications, projects aimed at decarbonisation of energy production, at seeking greater efficiency and at security of procurement will assume a central role. In order to facilitate the energy transition in progress, further development of the electricity grids becomes necessary; this should give priority to new electrical interconnections with bordering countries and within the country, with particular attention to innovative and smart technological solutions with low environmental impact.

In this context, the company has confirmed its strategic objectives with a focus on developing the grid to encourage the integration of renewable sources and improve the security of the system and, at the same time, accelerating the renewal of its assets with the objective of mitigating the risks of outages, increasing environmental sustainability and supporting maintenance through recourse to grid-digitalisation technologies.
With reference to Non-Regulated and International Activities, the new Strategic Plan provides for consolidation of an industrial approach based on the Group's distinctive skills positioning Terna increasingly as an Energy Solution Provider.

With specific reference to investments on the National Transmission Grid, over the next 5 years we estimate a total amount of approximately € 4 billion, an increase of approximately 30% compared to the previous Plan. As regards 2017 investments are expected of € 0.9 billion.

Among the main electrical infrastructures under construction it is worth to mention the interconnections with Montenegro and France, which are expected to come into operation in 2019. In addition, over the period of the plan, projects are envisaged with the aim of increasing the exchange capacity among the electricity market zones, facilitating the connection of renewable energy sources located mainly in central and southern Italy with demand more concentrated in the north of the country (Chiaramonte Gulfi-Ciminna, Colunga-Calenzano, Foggia-Gissi and Paterno-Pantano-Priolo), and increasing the interconnection capacity with other countries.

With reference to Non-Regulated Activities, the focus on value creation is confirmed, through activities for third-parties in the areas of engineering, maintenance services and optical fibre housing for the telecommunications business. The engineering and construction (EPC) activities in 2017 include, after the acquisition of the high-voltage electricity grid of Ferrovie dello Stato, the launch of a PV project for Rete Ferroviaria Italiana (RFI) for power of up to a maximum of 200 MW, which will guarantee clean energy production of up to approximately 300 GWh a year; progress on the Italy-France and Italy-Montenegro private interconnectors is also planned.

For what concerns international activities, during 2017 we will start the construction of lines in Uruguay and Brazil for a total length of more than 700 km and with an invested capital in the 2017 – 2019 period of approximately € 250 million. In addition, scouting activities will continue to identify further opportunities abroad, which may also be developed in partnerships and which will be selected through careful assessment processes to guarantee a low risk profile.

In continuity with the previous years, the Group will maintain its focus on the cost-excellent programmes, with a strong committment to improve its operating processes and rationalise costs, also as regards the integration of the grid acquired from the FSI Group.

The above objectives will be pursued whilst maintaining the commitment to maximise cash generation as necessary to ensure a healthy, balanced financial structure with the target ratio of net debt/RAB below 60%.

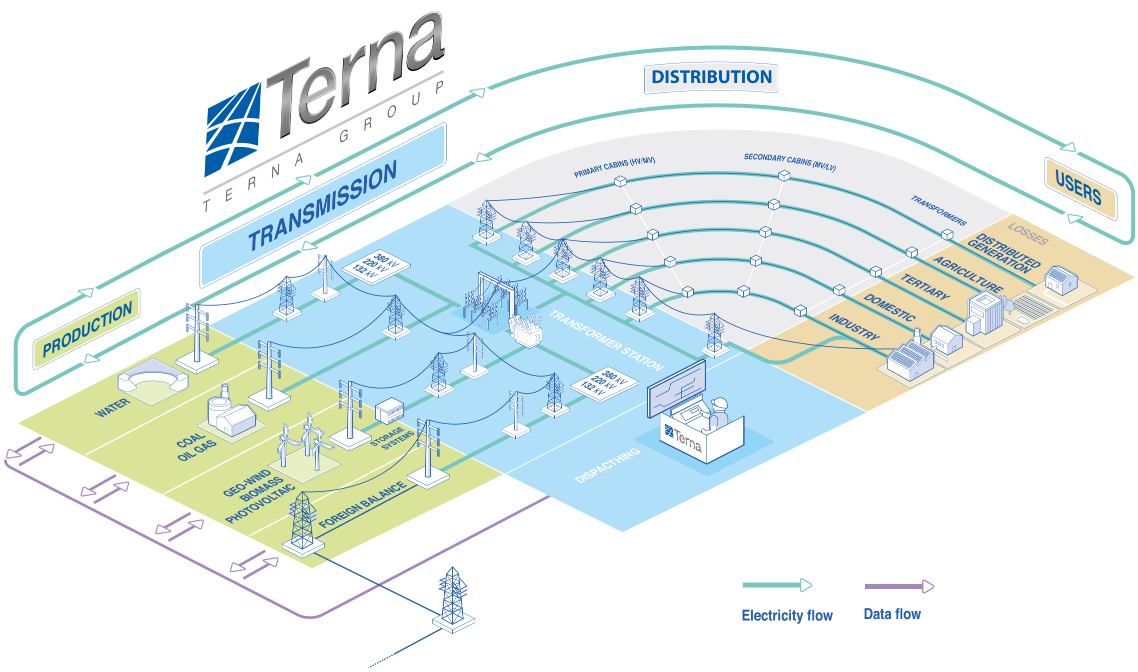
For 2017 we expect revenue of approximately € 2.25 billion, of which € 1.91 billion related to the transmission and dispatching tariff already approved by the AEEGSI; the EBITDA is expected to grow up to approximately € 1.58 billion.
Earnings Per Share (EPS) could reach € 34 cents.

Regulated Activities

Electricity transmission and dispatching activities in Italy

The Terna Group's main regulated activities are the transmission and dispatching of electricity in Italy. Terna performs these activities in its role as Italian TSO (Transmission System Operator) and ISO (Independent System Operator), in a monopoly arrangement and on the basis of a government concession.
The regulated revenue from these activities constitutes approximately 90% of the Group's total revenue (related to 2016) and is determined on the basis of rules by the AEEGSI.

TERNA'S ROLE IN THE ITALIAN ELECTRICITY SYSTEM SUPPLY CHAIN



The electricity system consists of:

- **PRODUCTION**: conversion of energy obtained from primary sources into electricity;
- **TRANSMISSION AND DISPATCHING**: transfer of electricity produced by the production centres to the consumption areas through high voltage lines, electrical and transformer substations and storage systems comprising the transmission grid, guaranteeing a constant balance of supply and demand of electricity; through the interconnection lines with abroad, the transmission system enables the interchange of electricity between Italy and the other countries;
- **DISTRIBUTION**: delivery of medium- and low-voltage electricity to end users.

Terna therefore operates in the central segment of the electricity system chain.

THE OPERATING PROCESS OF REGULATED ACTIVITIES

Planning

Analysing electricity flows in the grid and production and demand projections allow Terna to identify the critical points and, consequently, schedule the new projects to be developed in order to ensure that the system is adequate, also in the medium and long term in terms of balancing, safety of operations, reducing congestion, and improving service quality and continuity.
The growth of electricity production from renewable sources makes it indispensable to have all the existing regulatory resources available (including exchanges with other countries) together

with generation control tools. Grid planning must be consistent with the aim of maximising the integration of renewable sources in safe conditions.
New projects to be carried out are detailed in the NTG Development Plan, which is presented annually to the Ministry of Economic Development for approval. Terna is responsible for the authorisation process.

Carrying out development projects

Terna Rete Italia S.p.A.[10] is responsible for the projects pursuant to the Development Plan and in particular it supports the Parent Company in the authorisation process, defines the need for external resources and the budget, defines the construction solutions and the technical specifications of components and materials to be used, also making use of innovative technological solutions. It also defines the engineering standards for plants connected to the grid, particularly construction standards and the performance required from equipment, machinery, and substation and power line components.
Finally, through analysis, Terna S.p.A. also identifies the best ways of connecting to the transmission grid for operators who submitted a connection application.

Dispatching

The dispatching activity is managed by Terna Rete Italia S.p.A. through the "National Dispatching" Department and the Dispatching Areas of the Area Offices. "Dispatching" is simply the set of activities necessary to ensure that in the national electricity system the supply of electricity is always equal to demand. The high degree of complexity and coordination necessary to guarantee the correct operation of the system requires the identification of a central coordinator, the dispatching service in fact, equipped with the power of control over a high number of players, on the production side and on the demand side, and in the last few years also over production from "non-programmable" renewable sources. The dispatching activity includes planning unavailability (of the grid and of production plants) with different time horizons, forecasting national electricity demand, comparing demand for consistency with the production plan determined as the result of the free energy market (Electricity Market and contracts outside of the Electricity Market), acquisition of resources for dispatching, and verifying the power transits for all the grid lines.
In particular, the "real-time" control of the National Electricity System is ensured by the National Control Centre, the nerve centre of the Italian National Electricity System, which coordinates the other centres around the country, monitors the system and dispatches electricity, intervening, by communicating instructions to producers and Remote-Control Centres, in order to vary grid supply and distribution. To avoid the risk of prolonged power outages, it may also intervene in an emergency to reduce the demand.
This context also includes management of the Dispatching Services Market (DSM), through which the resources for the dispatching services are procured.

Maintaining Infrastructure

Terna Rete Italia S.p.A. also carries out the electricity grid maintenance activities through three Area Offices, which are divided into eight Operational Transmission Areas and which employ over 55% of the Group's human resources. The Area Offices also carry out extraordinary maintenance activities and renew the existing assets, in order to improve the reliability of the system, on the basis of criteria defined by the Engineering and Asset Management Department, which is also responsible for defining the methods and work tools for performance of the operating activities on the assets.

(10) Terna Rete Italia S.p.A. is tasked, within the Terna Group, through a business unit rental agreement, formalised in 2012, with performing operating activities, ordinary and extraordinary maintenance of the portion of the NTG owned, management and performance of work on developing the grid as provided for in the Concession for transmission and dispatching, and on the basis of the provisions of Terna S.p.A.'s Development Plan. The business unit rental agreement also assigns to the subsidiary the exclusive availability of the resources, assets and know-how necessary for performing the above activities.

Non-Regulated Activities

Strengthened by the skills developed in the core business, the Group's Non-Regulated Activities are divided into the following areas:

- PRIVATE INTERCONNECTORS PURSUANT TO ITALIAN LAW 99/2009
- TRANSFORMERS - TAMINI GROUP
- SERVICES FOR THIRD PARTIES (Engineering, Telecommunications, Operation of third-party plants, BOOT)

PRIVATE INTERCONNECTORS PURSUANT TO ITALIAN LAW 99/2009

In order to support the development of a single electricity market by expanding the infrastructure for interconnection with other countries, a EU law was introduced which defines guidelines for the creation of interconnections with other countries by subjects other than grid operators.

Italian legislation adopted the European indications in **Law 99/2009**, which assigned Terna the responsibility of carrying out public tenders to select the Companies (Selected Subjects) willing to finance specific interconnections, in exchange for the benefits for them from obtaining a Decree of exemption from access by third parties on the transfer capacity that the related infrastructures would make available. In particular, the law states that these Subjects, in exchange for a commitment to finance the projects, will give Terna a mandate for the engineering and construction of the interconnections.

A total of 5 interconnectors are planned with the borders of France, Switzerland, Montenegro, Austria and Slovenia, of which 2 at an advanced construction stage.

- **Italy – France Interconnector Project**

  The new "Italy-France" direct current interconnection, between the nodes of Piossasco and Grande Ile, will make the French electricity border the most important for Italy, increasing the cross-border interconnection capacity by 1200 MW (of which 350 MW available in exemption to private financial backers), which will rise from approximately 3 GW currently to more than 4 GW. The power line, currently under construction, which is 190 km long, will be the longest underground line in the world and will be characterised by very low impacts on the environment and the territory, thanks to a cutting-edge project.

- **Italy – Montenegro Interconnector Project**

  The project involves the creation of a direct-current connection, part in undersea cable and part in underground cable, between the stations of Villanova (IT) and Lastva (ME) for a total distance of approximately 445 km.

  The connection is a great opportunity for the Italian electricity system with a view to developing the interconnection between Italy and the Balkans. The connection, the construction work on which is currently in progress, involves technical engineering solutions capable of minimising notably the environmental impact.

  The creation of approximately 1200 MW of new cross-border interconnection capacity between Italy and Montenegro is planned (of which 300 MW available in exemption to private financial investors).

- **Italy – Austria Interconnector Project**

  The Italy-Austria Interconnector (Reschenpass project), currently being authorised, involves the creation of a new interconnection line in alternating current at 220 kV between the substations of Nauders (AT) and Glorenza (IT) with a route in underground cable approximately 25 km long and the necessary work on upgrading the domestic grid. The project will enable an increase in the cross-border interconnection capacity between Italy and Austria of approximately 300 MW which will substantially make it possible to double the capacity currently available.

- **Italy – Switzerland Interconnector Project**
  The project involves the development of new transmission lines between Italy and Switzerland in part in alternating current and in part in direct current. As far as the first type is concerned, a connection at 380 kV will be built between Airolo All'Acqua (CH) and the new substation of Pallanzeno (IT), to which will be connected a system in direct current up to the 380 kV Baggio node, for a total distance of more than 160 km. Currently, the project, being authorised on the Italian side, will make it possible to achieve a significant increase in the interconnection capacity between Italy and Switzerland, from the current 4 GW to approximately 5 GW.
- **Italy – Slovenia Interconnector Project**
  The creation of a direct current line is planned, in part in undersea cable, between the substations of Salgareda (IT) and Divaca/Bericevo (SL), together with some work on upgrading the domestic grid in Italy and in Slovenia. The project is currently being authorised on the Italian side. The expected increase in the cross-border capacity of approximately 1 GW will make it possible to bring the exchange capacity to a figure more than double the current one.

TRANSFORMERS – TAMINI GROUP

With a century of experience and a high degree of know-how, Tamini represents a historic industrial company, recognised in the electrical sector in Italy and abroad, as well as one of the most important groups in Europe in terms of designing, producing and selling industrial and power electrical transformers; a market that represents 23% of the global market for electrical components.
Tamini is a national hub of reference in the transformers sector recognised in the electrical sector in Italy and abroad with a Group of approximately 400 specialised employees, with customers located in more than 90 countries worldwide.
Tamini creates industrial machines with an artisan touch. On the basis of its customers' specific system requirements, manual labour combines with the perfection offered by the most sophisticated design and calculation techniques, thanks to the use of cutting edge software and simulation models.
With over 9,000 transformers produced, Tamini leads every other operator in the world in the sector of special transformers for steelworks. In addition, Tamini is the manufacturer of the most powerful transformer in the world for steelworks, located in Turkey. It owns 6 manufacturing plants, specialised in the construction of a different type of machine, all located in Italy, in Legnano, Melegnano, Ospitaletto, Valdagno, Novara and Rodengo.

SERVICES FOR THIRD PARTIES

In Italy, during 2016, Terna continued to perform activities for third parties in the area of **ENGINEERING** services (developing technical solutions and supplying innovative services), **TELECOMMUNICATIONS** (housing of telecommunication equipment and maintenance services involving fibre optic networks) and **OPERATING THIRD-PARTY PLANTS** (operating and maintaining High- and Very-High-Voltage plants and PV plants).
As regards Engineering services Terna obtained several **EPC** (Engineering, Procurement, Construction) orders: this model involves the design, development and implementation of solutions to satisfy the growing demand for infrastructures and grid connections.
As regards Telecommunications services, Terna increased the portfolio of assets managed acquiring the contract for housing and maintenance of the fibre-optic network of Basictel, in the context of the RFI operation. During 2016, Terna also concluded contracts with leading operators in the telecommunications sector for the concession of rights of use on stretches of its optical fibre network and the related maintenance. Finally Terna obtained pre-qualification for participation in the Infratel tender for backhaul networks in support of the national Ultra-Broadband plan.

International Activities

Investments abroad, focused on countries characterised by a stable political and regulatory framework and by the need to improve electricity infrastructures, represent a business opportunity for the Group, allowing it to take advantage of its world-class skills and best practices.

The initiatives abroad of interest to the Terna Group are:

- **CONCESSIONS**: this model envisages the acquisition and management of transmission systems abroad by taking part in international concession tenders.
- **EPC**: this involves the creation of Engineering, Procurement & Construction Projects regarding high-voltage transmission assets that the Terna Group will develop on behalf of third parties;
- **TECHNICAL ASSISTANCE**: this envisages the supply of engineering and regulatory consultancy services for third parties operating in the electricity sector, also 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 infrastructures and their ownership for a defined period of time; the BOT model involves exclusively design and construction and the transfer of ownership of the infrastructure.

INITIATIVES ABROAD

Terna pursues business in other countries with a view to diversification with respect to the national business, carried on also in collaboration with energy operators with consolidated presence abroad. These initiatives represent an option for the creation of value for the Group with the objective of diversifying risk and selecting opportunities with an attractive risk/return ratio.

As said, abroad Terna focuses on geographical areas requiring investments in transmission infrastructures and which, at the same time, have stable political and regulatory structures. In this context in September Terna won a Uruguayan tender for the creation of three electrical infrastructures: in particular, Terna will build a 500 kV electricity line 213 km long from Melo to Tacuarembo. We can also note that in February 2017 in Brazil, through Terna Plus S.r.l. an agreement was signed with Planova, a Brazilian construction company, aimed at the acquisition of two concessions to operate a total of around 500 km of electricity infrastructure in the South American country. For both the international activities please see the section “Operating performance” for more details on the subject.

Capital

The Terna Group's capital is strictly connected with the business model described above and, through strategies and Governance systems, tends to be transformed into actions functional to achieving the objectives, in the context of both Regulated Activities and Non-Regulated and International Activities.

CAPITAL	DIMENSIONS
Infrastructural NTG and other physical capital available (e.g. equipment)	855 electrical substations 66,366 km of lines 708 transformers 72,844 km of circuits 6,162 bays 6 production facilities specialised in the construction of transformers
Financial Funding sources available for use in the provision of services and goods	€ 7.2 billion made up of bond issues € 2.1 billion made up of bank loans (mainly EIB)
Human Skill, ability to innovate, experience and motivation of human resources	3,869 employees of the Group Average age in the company of 43 years 92% of employees holding degrees or diplomas
Intellectual Patents and intangible assets based on technical, technological and specialist knowledge and on processes	2017-2021 Innovation Plan Operational Research Centre in Florence (ORC) Open Innovation
Social Quality of the relationship with stakeholders and their satisfaction in relation to Terna, the Group's reputation	12 stakeholder categories 73 subcategories Annual monitoring of the quality of the relationship
Natural Natural and environmental resources used in the activities Biodiversity Impacts on the environment (external)	483 pylons with reduced visual impact 14,472 dissuaders to protect birdlife installed on the lines Programmes to limit SF_6 leaks and a constant commitment to limiting greenhouse gas emissions

Certain actions among those carried out by Terna could facilitate the generation of different kinds of capital from those that are utilised, this being the case mainly with development activities.

Infrastructural capital

The high-voltage and very-high-voltage NTG that exists in Italy represents the main infrastructural capital owned by the Terna Group.

The size of the Terna Group's NTG

At the end of 2016, the total electricity lines owned and managed by Terna amounted to 72,844 km, increasing by approximately 0.3% compared to the previous year. In this context it is worth to mention 25 interconnections with other countries, making Italy the most electrically-interconnected country in Europe, with a total cross-border interconnection capacity (NTC) of 9,135 MW.

GENERAL OVERVIEW OF THE NUMBER OF NTG PLANTS OWNED BY THE TERNA GROUP[11]

(at 31/12)		2016				2015	Δ
	Units of measurement	Terna S.p.A.	Terna Rete Italia S.r.l.	Rete S.r.l.	TOTAL	TOTAL	TOTAL
Electrical stations	No.	476	28	351	**855**	850	5
Transformers	No.	680	3	25	**708**	702	6
Transformers	Bays	143,917	720	819	**145,456**	144,015	1,441
Bays	No.	5,210	118	834	**6,162**	6,108	54
Lines	km	41,731	16,249	8,386	**66,366**	66,272	94
Circuits	No.	2,465	1,721	392	**4,578**	4,551	27
Circuits	km	46,838	17,313	8,693	**72,844**	72,599	245

Further details on the main changes in the figures of the NTG owned by the Terna Group are shown in the Annex "Evolution of the NTG".

The Tamini Group's production facilities

The Terna Group has through the Tamini Group 6 production facilities specialised in the construction of transformers, located in Italy at Ospitaletto (BS), Melegnano (MI), Legnano (MI), Valdagno (VI), Novara and Rodengo (BZ).

In particular, the Ospitaletto and Melegnano facilities are specialised in the **Industrial** sector while the Legnano and Valdagno facilities mainly in the **Power** sector.

The Rodengo facility is dedicated to **Service**, while in the Novara production site the activity associated with the winding department has been maintained, and it has also been configured as the service centre for all the other Tamini Group production sites.

(11) Km, MVA and Δ are calculated to three decimal places and rounded to the unit.

Financial capital

The Group's financial policy is focused on the diversification of financing sources, the balance between short- and medium/long-term instruments, and the proactive management of debt.

At 31 December 2016, gross debt[12] totalled approximately € 9.3 billion, of which € 7.2 billion made up of bonds and € 2.1 billion of bank loans. The average debt maturity is around 5 years; the proportion of net debt at fixed and floating rate to the total amounts to 93% and 7% respectively.

Bond debt consists of both public and private placement issues in the context of the € 8 billion EMTN Bond Issue Programme (with the involvement of a number of both Italian and foreign banking and financial institutions), combined with the stand-alone issue for € 800 million dating back to 2004. Focusing on a specific segment of qualified investors and listed on the Luxembourg Stock Exchange, Terna bonds present a significantly diverse investor base, in terms of both sector and geographical profile.

With regard to bank debt, Terna's main lender is the European Investment Bank (EIB); the total debt contracted with the EIB at 31 December 2016 stood at almost € 1.6 billion. Thanks to the solid nature of its credit profile, Terna is able to procure financial resources from banks at extremely favourable rates, as is testified by the three back-up revolving credit facilities in committed form (of which the latest entered into in July 2016) for a total amount of € 2.05 billion.

The following page contains an overview of the key financial events of financial year 2016 and the first few months of 2017, until the date of preparation of this Annual Financial Report.

(12) By gross debt is meant the sum of the items "Bond loans", "Floating-rate loans" and "Short-term loans" detailed in the Statement of Net Financial Debt presented in the paragraph Economic, Financial and Equity Performance, to which you are referred.

MAIN FINANCIAL EVENTS

2016

18 February 2016 ▷ Terna S.p.A. launched a bond issue in Euro, at a fixed rate of 1.60%, in the form of a private placement for a total of € 80 million as part of its EMTN Programme, to which has been attributed a "BBB" rating by Standard and Poor's, "(P)Baa1" by Moody's and "BBB+" by Fitch. The bonds, admitted to listing on the Luxembourg Stock Exchange, have a duration of 10 years (maturity 3 March 2026), were issued at a price of 99.087%, with a spread of 108 basis points with respect to the midswap.

26 July 2016 ▷ Terna S.p.A. entered into a back-up Revolving Credit Facility, in the form of a "committed" line, for a total amount of € 500 million with a pool of banks. The revolving credit facility will have a duration of 5 years and the amount available will be usable throughout the duration of the loan with prior notification. The interest rate is linked to the EURIBOR plus a spread between 0.70% and 1.10% depending on the portion used.

5 October 2016 ▷ Terna S.p.A. launched a bond issue in Euro, at fixed rate (coupon of 1.00%), for a total of € 750 million as part of its EMTN Programme, to which has been attributed a "BBB" rating by Standard and Poor's, "(P)Baa1" by Moody's and "BBB+" by Fitch. The bonds, admitted to listing on the Luxembourg Stock Exchange, have a duration of 12 years (maturity 11 October 2028) and were issued at a price of 98.882%, with a spread of 57 basis points with respect to the midswap.

19 October 2016 ▷ Terna S.p.A. renewed the EMTN programme, as resolved by the BoD on 4 May 2016.

6 December 2016 ▷ Terna S.p.A. signed an agreement with the EIB for a loan of € 200 million, with a term of 22 years, in support of the investments planned on the electricity transmission grid in Italy.

12 December 2016 ▷ Moody's Investors Service (Moody's) modified the outlook of Terna S.p.A. from stable to negative, as a consequence of the change in the outlook on the rating of Italian government bonds, considering the connection attributed to Terna with sovereign creditworthiness. Moody's then confirmed the issuer rating at the level Baa1, the rating assigned to Terna's € 8 billion EMTN programme at the level (P)Baa1 and the rating of the bonds issued in the context of the programme at the level Baa1. In addition it confirmed Terna's short-term rating at the levels P-2/(P)P-2.

2017

6 March 2017 ▷ Fitch Ratings confirmed the long-term rating of the issuer (IDR) and the rating of the senior unsecured debt of Terna S.p.A at 'BBB+', with Outlook Stable. At the same time, the Agency also confirmed the short-term rating of the issuer at 'F2'.

Human Capital

Human resources are at the same time an essential element of the company's activities and people whose worth and rights must be respected. Terna's approach to the relationship with its personnel is characterised by:

- **attention to safety and accident prevention**;
- design of management and development systems aimed at **improving performance and the development of individual skills**;
- **investments in training**, to ensure the opportunities for growth for the Company and its people;
- **remuneration and welfare policies** aimed at aligning individual performance with corporate targets and providing economic security to employees;
- articulated system of **industrial relations based on involving the Trade Unions**;
- **listening to employees** through tools for surveying their opinions.

Our people

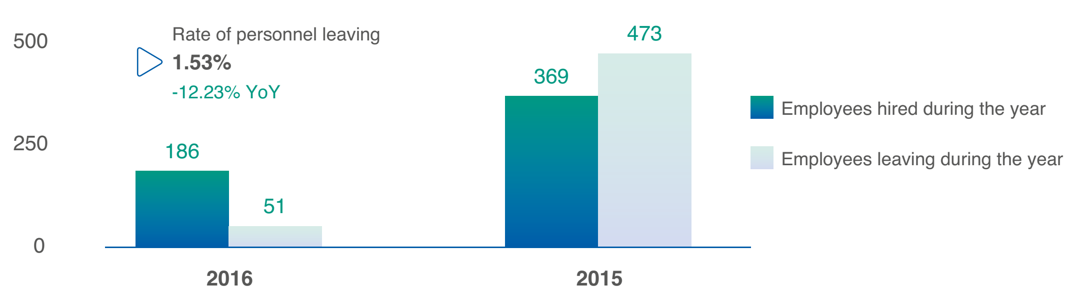
There were 3,869 Group employees at 31 December 2016, 102 units more than the previous year.

PERSONNEL NUMBERS

	at 31.12.2016	at 31.12.2015	Δ
Senior managers	76	76	-
Middle managers	567	514	53
Office staff	1,978	1,971	7
Blue-collar workers	1,248	1,206	42
Total	**3,869**	**3,767**	**102**

The increase in personnel numbers is due in particular to the hiring programme that the Group established following the acquisition of Rete S.r.l. and the electricity assets relative to FSI S.p.A.. More specifically, the need for new personnel is connected to the increase in the amount of assets under management which are expected to grow following enforcing of O&M activity currently performed by FS through a specific agreement.
At 31 December 2016, there were 70 employees of agencies providing temporary employment services to the Terna Group (58 in 2015).
The comments below make reference to the employees of the Terna Group, excluding employees of the Tamini Group and of the company Terna Crna Gora d.o.o..

PERSONNEL CHANGES



The change in incoming and outgoing personnel compared to 2015 can be attributed to the generational turnover project that the Terna Group during the last financial year.

PERSONNEL COMPOSITION

	2016	2015	Δ
Employees with a permanent contract	99.9%	99.9%	-
Average age of employees	43 years	43 years	-
Employees holding a degree or diploma	92%	91%	+1%

Regarding contract type, 3,466 employees out of 3,468 were appointed with a permanent contract (3,331 out of 3,333 in 2015). The average age of company personnel is 43, in line with the 2015 average. Employees holding a degree or diploma represent 92% of the total (91% in 2015).

New organisation

During 2016 the Group's organization changed with the definition of the new Strategy and Development Division, which took responsibility for Business Development, Strategy and Market Analysis, Grid Planning and Interconnection, Regulatory Affairs. In addition, the supervision of institutional relations and authorisation processes was allocated to the pre-existing Corporate Affairs Division, while the structure responsible for relations with institutional investors started reporting directly to the Chief Executive Officer.
The innovation and research process was strengthened, giving the Parent Company's Business Development Department the role of guidance and the responsibility for defining the Innovation Plan and establishing, under the Engineering and Asset Management Department of Terna Rete Italia S.p.A., the new Operational Research Centre, based in Florence.
In the territorial structures of Terna Rete Italia S.p.A., three new Remote-Control Centres (RCCs) were set up, based in Turin (North West Area), Scorzè – VE (North East Area) and Naples (Centre South Area), in relation to the process of integrating the grid control and plant remote control activities.

Recruitment

The personnel recruited are graduates – in particular engineers – and qualified people with diplomas from professional institutes, most with an electrical specialisation. Once employed, the new recruits expand their knowledge and the necessary specific skills through dedicated introductory training courses. The preferred recruitment channel for candidates is the "Working at Terna" section of the company website.
The Human Resource and Organisation Department also oversees relations with schools, universities and employment centres to support the process of finding new resources and create a virtuous circle of exchange with the Company. New agreements have been signed with the leading Italian universities and business schools and the creation of specialised Master's courses has been funded: in 2016 Terna sponsored 4 Master's, activated 33 traineeships, internships and project work and took part in 8 career days.

Developing human capital

The new Terna Group **Professional System** was implemented during 2016 to support human resource development activities, aimed at ensuring that positions are effectively covered and guarantee an adequate succession planning process. This system enhances the professions ("professional families"), identified according to the main core-business corporate processes and staff and the macro-roles ("duties"), transversal to the organisation, identified according to the complexity and nature of the contribution, divided according to seniority levels.
The professional system represents the framework on which HR strategies and policies are progressively introduced, and comprises an integrated management and development system that makes it possible, inter alia, to respond effectively and promptly to developments in business and the organisation, making the "duties" independent of the organisational structure, oversee and develop corporate know-how and optimise the mobility process for resources.
In the context of the aforesaid framework and in order to activate a process of acquiring in-depth knowledge of and enhancing the human capital, in 2016 a **skill enhancement** project was also launched; this involves approximately 160 managers and approximately 170 professionals of all the corporate structures and

analysed the skills necessary to support the Group's strategic objectives. The outputs of the project will enable the definition of targeted development pathways, also through job rotation and training initiatives, specific for the single professional families.

Training

Training at Terna continuously embraces all aspects of professional life. It is aimed at creating value for people, increasing and diversifying skills and employability and creating value for the company through the development of human capital in line with its mission and business strategy. Grid Experiences is the brand for all the training, provided according to a training model based on the transfer of specialist know-how entrusted to the most experienced staff of the internal Faculty and external collaborations (with universities and business schools) in order to ensure multiple teaching inputs.

BASIC STATISTICS ON TRAINING	
203,066	training hours provided (in constant growth +54% since 2014)
99%	of employees have attended at least one training course (in constant growth +8% since 2014)
61	training hours per capita (the highest figure in the last 10 years) compared to an average hours per capita provided by the 40 companies of the FTSE-MIB which in recent years has come out at around 30 hours per capita (30.2 in 2015, the latest figure available)
90	training hours per capita for operators (+3% compared to 2015)
9%	of training hours provided regarded the development of linguistic skills
89	hours of teaching by Terna employees at universities and business schools

Occupational safety

Safety and the prevention of injuries to guarantee the physical integrity of the personnel are priority objectives of the company. In 2016 no fatal or serious accidents were recorded and overall the occupational injuries were again at a low level (1%[13]). For an in-depth discussion of the subject please refer to the section "Sustainability Performance".

Equal opportunities

The majority of Terna Group employees are men (88.3% of personnel in 2016) because of the traditional scarcity of female labour supply in technical occupations. The presence of women (11.7% of personnel, in line with the 2015 figure) is growing, also as a reflection of the general trend in the employment market, which shows a greater female component (the percentage of women was 9.0% at the end of 2005). Furthermore, in 2016, 20.2% of hires, net of blue-collar workers, were women (16.2% in 2015).
With regard to equal opportunities, in 2016 the data confirm that the proportion of female managers out of total managers (17.3%) is higher than the proportion of women out of total employees net of blue-collar workers (16.6%). Salary and wage data also shows contained differences between white-collar workers and junior executives, which are more significant for senior managers. However, in the latter there are fewer individuals considered and the salary differentials are consequently more affected by limited numbers of inputs or outputs.

EQUAL OPPORTUNITIES INDICATORS

(Percentage values)	2016	2015	Δ
Women out of total employees	11.7	11.7	-
Women out of total net of blue-collar workers	16.6	16.5	(1)
Female senior managers and junior executives out of total senior and junior management	17.3	18.2	(5)

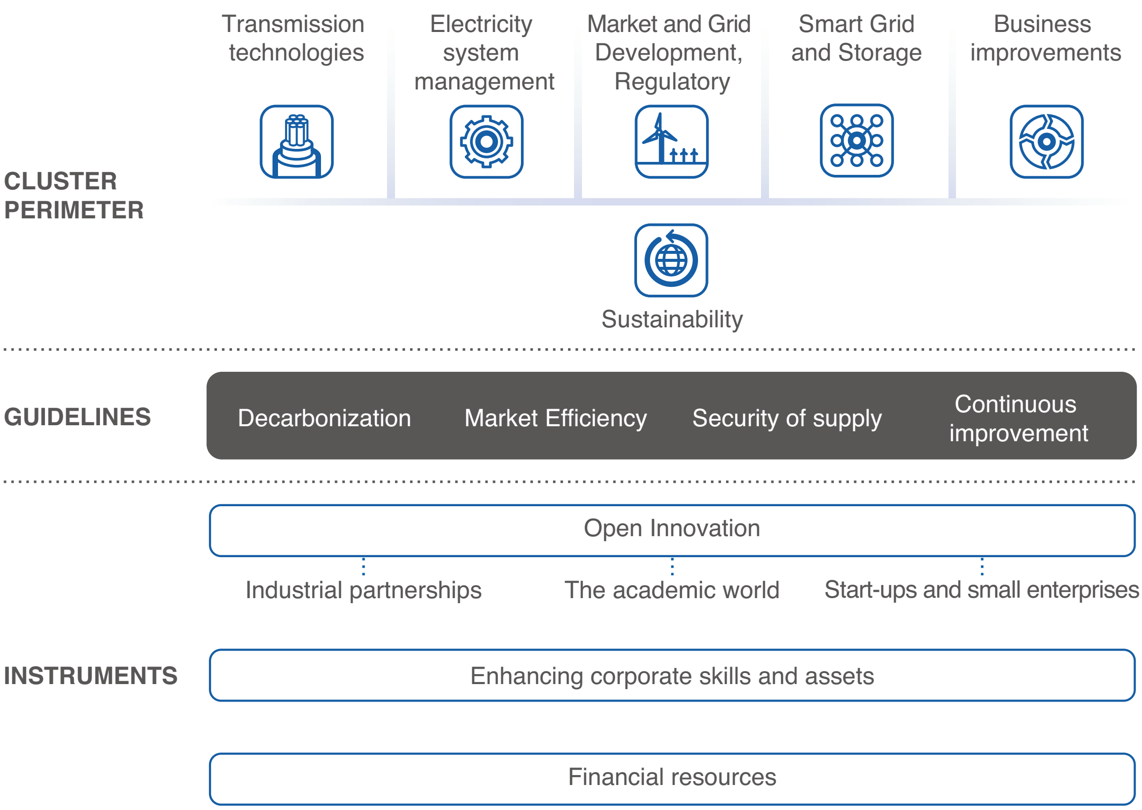
(13) This is the number of injuries with at least one day's absence from work divided by the number of hours worked during the year and multiplied by 200,000 (corresponding to 50 working weeks x 40 hours x 100 employees.

Intellectual capital

Innovation in Terna

The continual and significant evolution of the electricity supply chain requires a new approach of a systemic and organic type towards **innovation**, based on monitoring and strategic acceleration of the portfolio of Research, Development and Innovation initiatives of the various corporate departments in a structured manner. The centralised and coordinated vision of Group Innovation, which acts through a continual exchange of ideas and needs with all the corporate innovation ecosystems, therefore makes it possible to guarantee the full **consistency** of the initiatives with the strategic guidelines of the Company's **Strategic Plan**.
With these premises, the **Innovation Plan** (2017-2021) was therefore drawn up, with the aim of guiding and overseeing innovation in the company by identifying strategic guidelines, monitoring the projects and managing the support tools. The Plan includes initiatives on the main Research and Development themes, focused both on the "core" activities (tackled now with new perspectives and approaches) and on decidedly innovative sectors.
The initiatives are all defined on an innovation **framework** divided into **6 Clusters**, characterised by the centralised management of instruments aimed at promoting and accelerating corporate innovation.

INNOVATION FRAMEWORK IN TERNA



In all the "core" activities related to management of the Electricity System and of the National Transmission Grid, the Terna Group has always pursued the highest standards, starting from the design through to the management and maintenance of assets, and without compromising on the objectives of ongoing improvements in the areas of technologies and materials. Over the years, the highest quality standards have always been guaranteed thanks to applied research, interaction with suppliers, operational experience, and the assessments made by international benchmarks. More recently however, the natural and consolidated approach to research and the development of best practices has been overtaken by the need to find optimal solutions and guide the capacity to innovation towards carefully adapting to the requirements progressively imposed by the environment and surrounding world. In fact, the scenario in

which Terna operates is subject to continual change, in which certain key factors are leading to a total revolution in the management and operation of electricity systems.
The energy transition to *more sustainable* solutions has led to the transfer of most of the production capacity to renewable energy plants and to a transition to increasingly eco-compatible mobility solutions, with the strong boost given to the sector of electric and hybrid plug-in vehicles. In response to these macro trends, the electricity system is adopting a new increasingly *intelligent* and *flexible* management approach both at the level of grids, thanks to the use of efficient and innovative technologies (smart grids, storage, distributed generation, intelligent demand management…), and at the level of the Electricity Market, with a revolution without precedent which will lead in the short term to integration of distributed generation resources, storage and demand in the Services Market, and to integration of the national markets at the European level. Besides this, in the medium-term future an increasing integrability and interoperability between the electricity grid and the other networks (transport, gas, water, etc.) must be guaranteed, in order to make the Italian System and the European System more economic and eco-sustainable.

The 6 clusters of the Innovation Plan (2017-2021), described in brief in the table below, are based on these premises.

THE PERIMETER OF THE CLUSTERS OF THE INNOVATION PLAN

Cluster	Description
Transmission technologies	This brings together cutting-edge initiatives and solutions in the contexts of the operation and construction of transmission plants.
Electricity system management	This makes reference to technologies that permit better control and management of the National Electricity Transmission Grid, guaranteeing high standards of security and reliability.
Market and Grid Development, Regulatory	This includes the grid development initiatives, the definition of new market models, the analysis of regulatory and geoclimatic trends in the national and international context.
Smart Grids & Storage	This includes the development of new business models for Large Scale Storage, innovative projects on smart grids and new studies of innovative grid services.
Business improvements	This includes all initiatives aimed at improving management of the internal corporate procedures and operations.
Sustainability	This contains all the projects aimed at promoting a more sensitive approach in relation to environmental themes. It is an integral part of the corporate mission and is transversal to the other clusters.

Supporting and promoting innovation in the company occurs by means of many different tools and resources, mostly managed in a centralised manner, namely:

- **financial resources**: these regard access to incentive mechanisms and subsidised financing. Access to incentives (e.g. access to the "*tax credit*[14] for businesses that invest in research and development activities, or the provisions on the subject of patent boxes[15]) and to specific financing programmes for both international and national R&D themes (e.g. participation in institutional programmes and "calls for proposals") is facilitated;
- **enhancement of corporate skills and assets**: this includes the tools necessary to enhance the intellectual capital and to share corporate know-how and portfolio management tools;
- ***open innovation***: facilitating the opening to new development fronts both internal and external to the company, through dynamic interaction with universities and research centres, as well as collaborations with peers and large industrial players, and access to the ecosystem of start-ups and SMEs.

(14) subsidy introduced by Art. 1, paragraph 35 of Italian Law no. 190/2014.
(15) subsidy introduced by Art. 1, paragraphs from 37 to 45 of Italian Law no. 190/2014.

THE OPEN INNOVATION OF THE INNOVATION PLAN

Sector	Description
Energy sector peers & infrastructures	Signing of agreements and collaborations with players in the energy sector with which no competitive relationship exists (TSOs, DSOs, utilities, etc.). Membership and active participation in significant international associations and committees in the electrical sector and in that of innovation. *Examples: RTE, ENI, RFI, ENTSO-E, EASE*
Universities and Research Centres	Collaborations for the purpose of promoting and coordinating studies and research with Italian universities and research centres of excellence on sectors of strategic interest, contributing to the preparation of expert researchers in the sector and promoting and encouraging initiatives aimed at teaching and training in the Energy sector. *Examples: RSE, ENSIEL*
Large Companies and Industries	Signing of agreements and collaborations with supplier companies or companies with which there could be a competitive relationship, on the subject of fields of common interest in the electrical sector or of applications aimed at guaranteeing greater sustainability, cost-effectiveness and security in operating grids. *Examples: Tesla Motors*
Start-ups, SMEs & Venture Capital	Scouting of start-ups and mature businesses in order to seize opportunities to develop specific initiatives of interest to Terna and/or industrial partnerships. Examples: “NEXT ENERGY*” Programme

* *For more details on the “NEXT ENERGY” Programme please refer to the section “Sustainability Performance”.*

As regards open innovation with the academy we can note the **Memorandum of Understanding** (MoU) signed in July 2016 with *ENSIEL*, for the purpose of promoting and coordinating studies and research in the Energy field, contributing to the preparation of expert researchers in the sector and promoting and favouring initiatives aimed at education and training in the Energy sector.

For **corporate open innovation** of an industrial kind, we can note the prestigious collaboration agreed between Terna and Tesla Motors through a MoU on areas of absolute interest in the electrical sector, such as green islands and grid to vehicles applications, that is applications aimed at guaranteeing greater sustainability, cost-effectiveness and safety in the management of grids.

With these premises, research and development is undertaken organically and systematically, taking advantage of the in-house skills, and seeking leverage from the technical know-how and capacity also to develop opportunities beyond the regulated framework.

Alongside these initiatives, the increasing value of the human capital in the company is stimulated by increasingly active participation in international associations and committees of significance in the electrical and innovation sector. We can note on this point the engagement in the EASE (European Association for Storage of Energy), testified also by the organisation of a workshop held at the Storage Lab plant in Codrongianos, in which a demonstration was given of the benefits achievable from the implementation in the TSO’s systems of new resources for management of the Electricity System.

THE NEW OPERATIONAL RESEARCH CENTRE

The Operational Research Centre (O.R.C.) was also set up in Terna Rete Italia S.p.A., with the objective of identifying, developing and testing innovative technological solutions within the sector of Electricity Transmission, guaranteeing the annual preparation and updating of the Research Plan.
The areas of research and innovation of the Centre regard studies, definition of test protocols and analyses aimed mainly at the following sectors: Power Electronics and HVDC, Sustainability, Asset Management and Smart Grids, Resilience of the Transmission Grid. The Centre is based in Florence.

Among the main projects carried out by the Research area in 2016, we can note:

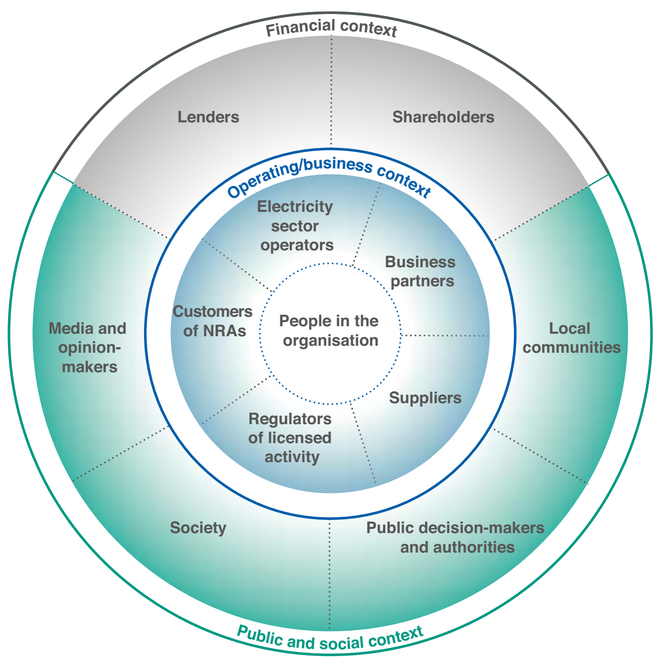
RESEARCH AREAS OF THE O.R.C.	
LCA *Life Cycle Assessment*	The LCA method is a standardised procedure which makes it possible to estimate the environmental impacts of a product, a process or a service, through the identification and quantification of polluting emissions and of consumption of resources associated with its life cycle. The activity involved, specifically, an LCA study of HVDC lines, taking into consideration the stages of production, installation, operation, decommissioning and end of life of the system.
LANPRIS *Experimental insulator testing laboratory*	This, which came into operation in November 2016, is the new experimental testing ground that Terna has created in the Sulcis electrical substation, in Sardinia. The laboratory is dedicated to monitoring the effects of saline and atmospheric pollution on the insulating components for external environments, with the intention of testing in the open air the various technical improvement solutions to be adopted on line and substation components.
PHYSICAL AGENTS *Mitigation of electrical and magnetic fields and noise.*	The research activity on magnetic fields made it possible to draw up guidelines for the design of compensation circuits by means of “passive loops”, to be used in cases in which, in the design or operating stage, it becomes necessary to reduce the magnetic field generated by power lines. In the field of noise, the activities regarded the testing in the field of electronic devices for the reduction of the noise generated by static machinery, in particular on reactors installed at electrical substations, by means of passive or active systems for cancelling the same.

Social capital

A relationship of reciprocal trust between Terna and its stakeholders is fundamental for achieving the Group's strategic objectives. The criteria and methods with which this can be achieved are described in specific Guidelines, the "Stakeholder Management Model", defined in 2015 and in keeping with the standard AA1000 Stakeholder Engagement Standard (SES) developed by AccountAbility[16].
The model is made up of a number of fundamental parts, updated periodically, namely the Stakeholder Map, the Stakeholder Significance Ranking, which reflects the degree of dependency and influence of each of them with respect to Terna, the Optimal Relationship Method Matrix which orients Terna's approach in relation to stakeholder engagement activities, the Monitoring System which concretely creates the engagement activities and makes it possible to find out the stakeholders' opinions and expectations, and their degree of satisfaction about the relationship with Terna.

Every year a specific engagement programme identifies the actions to be carried out, both to bring the effective relationship methods nearer to the optimal ones, and to listen cyclically to the most influential stakeholders. In 2016 the first annual monitoring was carried out. The work involved all the corporate Departments and provided for a number of direct stakeholder engagement initiatives - such as the survey on customers of the non-regulated business.

STAKEHOLDERS



Overall the Stakeholder Management Model is a set of tools aimed at providing Terna with a thermometer of the evolution of its relational capital, at avoiding the risk of not perceiving in time any problems that may arise and at creating value through the participatory contribution of the stakeholders.

The activities in 2016, only for certain categories of stakeholders, are presented below. For further information, please see the chapter "Relations with stakeholders" in the 2016 Sustainability Report, available on the Terna S.p.A. website (www.terna.it - in the section "*Sustainability*").

(16) The 2011 version of the AA1000SES standard was taken into account when drafting the model, because the most recent update to the standard was published in November 2015, when the Guideline had already been issued.

MAIN STAKEHOLDERS

Local communities	Terna's approach to local communities, which is especially important when new lines must be constructed, consists of a voluntary process of prior engagement with local institutions. This process involves the sharing of NTG development needs, a willingness to listen to stakeholder opinions and the search for a shared solution regarding the positioning of new infrastructures and the reorganisation of existing ones. During 2016 Terna held a total of 181 meetings with local administrations, involving approximately 270 entities. Starting in the last few years, Terna has extended this approach also to the population of communities directly affected by its projects through public meetings entitled "Terna meets". Although Terna is authorised by law to use an expropriation procedure to obtain land, Terna prefers solutions based on mutual consent for the right of way of the power line through private property, except in cases of purchase of the necessary land (e.g. for substations).
Media and opinion-makers	These stakeholders have a mediation role between Terna and other stakeholders. The media indirectly influences the public in general, as well as public decision-makers and authorities. It can directly impact Terna's reputation or indirectly affect the operational and business environment, as well as energy policy decisions. In 2016 media communication work accompanied the transition that is taking place in the energy sector, mainly aiming to support the importance of electrical infrastructures as an enabling factor in the change that is under way. Terna has contacts with over 300 media professionals within Italy and abroad. The communication activity is increasingly focused on interventions of greater relevance and across a broader range of media (TV, radio, print and web). Moreover, it has made a different approach necessary, supported by the planning and preparation of increasingly accurate content and in-depth analysis, which led to the publication of 522 stories and articles focused on Terna, ad hoc videos and articles/interviews dedicated to top management. 116 press releases were issued in Italy (+41% v. 2015) and 79 regional memos; 54 presentations and speeches were prepared for top management and 78 events were created and managed (including corporate and territorial events, national and international workshops, stands and internal events), 29 of which received media coverage. Overall, between traditional media (newspapers, magazines, radio and TV) and on line, Terna totalled more than 17,000 releases, thanks to more than 3,000 direct contacts by the Press Office with editorial offices. The corporate site www.terna.it has totalled over 3,800,000 page views and 1,700,000 visits (+40% compared to 2015) and was ranked within Webranking Italia's Top Ten of 100 of the largest listed companies.

European and international relations

EUROPEAN RELATIONS

Stakeholders	Profile and relations in the year
ENTSO-E	This is the European association of grid operators committed to the process of integrating and coordinating electricity grids being implemented under the EU Third Energy Package. Since 2015, the Deputy Chair of Entso-E has been entrusted to the Chief Executive Officer of Terna. Objective of Entso-E: to prepare European network codes, ensure the coordinated development of the electricity grid at European level, with the drafting of the Ten-Year Network Development Plan (TYNDP) at European level and the related reference scenarios. The TYNDP represents the reference for the European Commission in identifying projects of common interest in implementing Regulation (EU) no. 347/2013.
EASE (European Association for Storage of Energy	Terna collaborates with the European association EASE to encourage research and industrial development in the field of storage systems, and promotes this technology for the transition towards a stable, flexible, eco-sustainable and less costly continental energy system.
RGI (Renewables Grid Initiative)	The Association has the objective of encouraging, by developing electricity networks, the integration of renewable energy sources arising from both distributed generation and plants.

INTERNATIONAL RELATIONS

Stakeholders	Profile and relations in the year
CIGRE *(Conseil International des Grands Réseaux Electriques)*	An international non-profit organisation in the research sector relating to High-Voltage grids. There are 57 member countries of the association; Terna currently chairs the Italian Committee.
GO15 (Reliable and Sustainable Power Grids)	An association that brings together the 18 largest TSOs in the world; Terna chairs Committee 2 which is concerned with the reliability and security of the electricity grid.
Med-TSO (Mediterranean Transmission System Operators)	This brings TSOs from 18 countries around the Mediterranean Sea. Terna hosts the operational base of the Association in Rome and chairs Technical Committee 1, which is concerned with planning the Mediterranean electricity grid.
RES4MED (Mediterranean Transmission System Operators)	In 2016, RES4MED launched the new initiative *Renewable Energy Solutions for Africa* (RES4Africa), a platform of stakeholders in the energy sector to facilitate discussions with the countries of Sub-Saharan Africa on subjects related to developing renewables, in which Terna took part chairing the discussion panel on the subject: *Integration of renewable energy in the electricity grids*.

During 2016 Terna strengthened its presence in industrial associations dedicated in particular to the Mediterranean basin, namely Res4Med and Med-TSO as well as, at the global level, in GO 15 and in the Italian Committee of the World Energy Council. The company also forged associative relationships with organisations with a wider scope, so as to monitor the social, political and economic contexts in which to develop its business. In addition, at the bilateral level, Terna and RTE, the French TSO, implemented the content of the Memorandum of Understanding signed in 2015, for collaborations in the areas of interest (grid development, the development of non-regulated activities, research and technological innovation).

Natural capital

A description of the main elements making up the natural capital is provided below.

THE MAIN ELEMENTS MAKING UP THE NATURAL CAPITAL	
Land Availability	One of the elements that make up natural capital, and which Terna uses directly in order to implement its business is the availability of land. Given the restrictions that apply to erecting electricity infrastructure in residential areas, the land occupied by substations and the base of pylons is often on rural and agricultural land, and sometimes falls under protected areas, The construction of new power lines, in particular, involves the use of between approximately 30 and 250 square meters of land for each pylon.
Biodiversity (birdlife) and landscape	The existence of infrastructure could require interventions that mitigate the risk of potential impacts (albeit contained) on biodiversity (avifauna). In a broader sense, it could be complicit in the enjoyment of the natural environment due to the impact that infrastructure has on the landscape. As discussed in depth in the section “Sustainability performance”, during 2016, the progress on the work provided for in the Development Plan made possible the demolition of 290 km of obsolete lines; in addition 14,472 dissuaders are installed on the lines to protect birdlife and there are 483 pylons with reduced visual impact on the landscape.
Greenhouse effect	Terna’s production cycle does not directly utilise biological or mineral raw materials or water, and excludes the production of electricity, consequently limiting the quantity of greenhouse gases emitted, with a downward trend as confirmed by the 2016 data, provided in detail in “Sustainability performance”.

RISK MANAGEMENT

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INTRODUCTION

Electricity transmission is the core business of Terna, regulated primarily through government concession and by the provisions established by the AEEGSI, which include the definition of remuneration of the Terna service and of the corresponding tariff system.
As a result, Terna is exposed not to common price- and market-related risks (or is so only to a limited extent in regard to Non-Regulated and International Activities), but to a regulatory and normative risk.
The regulatory risk derives from potential changes in the parameters used to determine regulated income, particularly following the multi-year review of the regulatory framework (see the paragraph on outcomes from the latest review, taking effect as of 2016). The normative risk is related to possible changes in Italian and European laws in relation to environmental, energy, tax and social (work and contract) matters.
These aspects, like all types of risk, are closely analysed by Terna, which has identified the main risks connected to its activities and has provided for specific safeguards, instruments and organisational structures with a view to minimising such risks by reducing any impacts to within tolerable limits.

RISK MANAGEMENT

Over the last decade, TERNA has developed its interpretation and adjustments to Risk Management theory, inspired by international best practices and developed in its financial, insurance and industrial areas, to represent, describe and analyse risk scenarios that could hinder or prevent the achievement of company objectives. One of the Group's top priorities is understanding risk and quantifying it, and above all researching "sustainable" actions able to contain it, in the various forms it may arise within the "critical infrastructure" of national and European interest managed by Terna.

Monitoring and effective management of company risk is implemented through the adoption of general organisational measures, as well as through specific actions which are described below.

From an organisational point of view, the Group has for some time structured itself to guarantee management and supervision of activities and associated risks that is detailed, as well as ensuring that roles and responsibilities are clearly assigned. In this context, it is important to highlight the main players involved:

- **Audit and Risk, Corporate Governance and Sustainability Committee**: consists of independent members of the Board of Directors and supports the Board of Directors in making assessments and decisions relative to the Internal Audit and Risk Management System (IARMS). Periodically, it is called on to assess the adequacy and efficacy of this system with respect to the characteristics of the company and its risk profile;
- **Chief Risk Officer (CRO)**: appointed by the Director responsible for the IARMS, after hearing the Committee's opinion, this individual supports top management in effective handling of the risk-management process for all activities relative to the parent company and its subsidiaries. The CRO has two main objectives: defining company risk analysis, management and control policies and coordinating all entities involved in the IARMS, to maximise efficiency and minimise duplication of work. Finally, the CRO periodically reports to the committee on risk-management results and assists the Chief Executive Officer in defining risk appetite criteria and the risk objectives taken on by Terna.
- **Risk Management**: the organisational area assigned to implement the risk-management policies and guidelines defined by the CRO. It is part of the Security and Services Department, which guarantees effective supervision and coordination of various risk protection aspects, also through

dedicated organisational units. It is concerned with various aspects ranging from workplace health and safety, to physical protection of traditional assets and cyber-physical or smart protection of the ICT ecosystem and its "smart-assets", to operating risks associated with business processes, for all Group companies;

- **Internal Audit Department**: responsible for ensuring that the IARMS is adequate and functional. It also coordinates management of Internal Audit and Risk Management activities carried out by subsidiaries, with the objective of ensuring the maximum level of efficacy and efficiency for these activities. The Manager of the Internal Audit Department is appointed by the Board of Directors based on a proposal by the Director responsible for the IARMS, after approval of the Committee.

Methodology and risk analysis tools

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 company risks. Initially applied only to operating risks, Terna has developed its risk management system with an eye to continuous improvement, aimed at integrated management of the various types of risk that apply to the company.

For this reason, with supervision and coordination provided by Risk Management, a project was completed with the goal of applying ERM methodology to other risk management areas, so as to represent the following types of risk in an integrated manner:

- Operational risks
- Risks relative to Italian Legislative Decree 231/01
- Cyber Risk
- Risks relative to Supplier Qualification
- Health, Safety & Environment Risk
- Physical Security & Emergency Management Risk
- Risks relative to Quality, Environment, Workplace Health and Safety Management Systems, Energy, IT security and Live-Line-Working Multi-Site Testing Laboratory
- Fraud Risk
- Risks relative to Italian law 262/05.

Alongside the adoption and application of an integrated risk management model, Terna has also developed an enterprise Governance, Risk and Compliance (eGRC) IT tool, that it allows it to:

- simplify and classify information to obtain standardised and comparable representation of company risks;
- carry out in-depth research and detailed analysis of the results;
- represent the results using integrated reporting relative to risk levels for every specialist area, to the benefit of top management.

This complex process to structure and standardise risks has made it possible to categorise them based on their characteristics, and represent them based on the following groups or macro-categories: **Governance & Compliance**, **Operations** and **Strategy & Financial**.

For each of the macro-categories, the figure and the table below offer a brief description of the types of risks included, their impact on capital and the measures Terna has established to limit them.

RISK MANAGEMENT IN THE TERNA GROUP

MACRO RISK CATEGORIES

Governance

Description

Processes, principles, policies and rules that define the manner in which an organisation is managed and controlled. In the context of achieving company objectives, identification of the limits for behaviour that is ethical and legal and behaviour that is not.
Methods for the organisation to identify any violation of such behaviour.
Failure by the organisation to establish effective Corporate Governance or to define and implement codes of conduct can:
- facilitate unethical/illegal behaviour by the Board of Directors, top management and employees with consequent impacts on the accuracy of information released externally;
- prevent the spread of a suitable ethical culture, with a high level of responsibility and integrity within the organisation.

Capital affected	Countermeasure
• Infrastructure capital • Natural capital • Human capital • Intellectual capital • Social and relational capital • Financial capital	• Code of Ethics • Organisational and Management Model, pursuant to Italian Legislative Decree 231 of 2001 • Compliance Rules for the Prevention of Crimes and Administrative Offences of Market Abuse • Internal Audit Checks • Audit Model, Italian Law 262/05 • Integrated Management System (Quality, Environment, Workplace Health and Safety, Energy, Anti-corruption, Information Security, Multi-site Testing Laboratory, Live-Line Working, Calibration Centre) • Management System for the Prevention of Serious Accidents (part of the company's Integrated Management System structure) • Information Security Governance Model; Privacy Regulations Model; Anti-Fraud Methodological Model; Memorandums of Understanding

Compliance

Description	
Organisation's need to comply with applicable norms (laws, AEEGSI resolutions/provisions, workplace regulations, etc.), which establish a minimum set of behavioural rules which the organisation must integrate into its internal procedures. These risks may have significant consequences, also relative to the organisation's reputation and stakeholder expectations.	
Capital affected	**Countermeasure**
• Human capital • Intellectual capital • Social and relational capital • Financial capital	• Organisational and Management Model, pursuant to Italian Legislative Decree 231 of 2001 • Compliance Rules for the Prevention of Crimes and Administrative Offences of Market Abuse • Audit Model, Italian Law 262/05 • Integrated Management System (Quality, Environment, Workplace Health and Safety, Energy, Anti-corruption, Information Security, Live-Line Working Multi-site Testing Laboratory, Calibration Centre) • Management System for the Prevention of Serious Accidents (part of the company's Integrated Management System structure) • Information Security Governance Model; Privacy Regulations Model • Risk Observatory to monitor environmental, social and political issues; Fraud Management; Business Qualification System

Operations

Description	
• Processes, principles, policies and rules necessary to supervise and guarantee the continuity of the service provided by Terna; • Activities to manage and protect company assets (physical and non); • Human resource management policies, processes and systems; • Improper implementation and management/maintenance of the technological infrastructure and IT processes that support all business cycles, as well as data confidentiality/integrity/availability; management of cyber security issues, guaranteeing business continuity, etc.; • Management of procurement process, supplier qualification, planning and control over raw materials required to carry out company activities; • Failure of the organisation to effectively supervise legal and regulatory requirements to which it is subject (e.g. inadequate management of disputes or contractual relationships as plaintiff and defendant); • Activities aimed at preventing potential decreases of efficacy and efficiency in company processes and maintaining certification of said systems; • Management strategy for non-regulated activities, marketing and communication; • Management of the innovation process for the products/services provided to customers in the context of non-regulated activities.	
Capital affected	**Countermeasure**
• Infrastructure capital • Natural capital • Human capital • Intellectual capital • Social and relational capital • Financial capital	• Enterprise Risk Management (ERM) Model • Project Risk Assessment and Prototype • Risk Observatory to monitor environmental, social and political issues • Integrated Physical Security System for Terna Substations (PSIS) and VideoBox • Security Operation Center (SOC) • Open Day Terna • Business Qualification System • Fraud Management; Construction site inspections; Training and informational projects; Internal Audit Checks • Information Security Governance Model; Integrated Management System (analysis of results and audit activities)

Strategy & financial

Description	
Research, allocation and usage of financial resources and analysis that supports these decisions, to increase company value while reducing the organisation's financial risk	
Capital affected	**Countermeasure**
• Financial capital	• Financial Key Risk Indicator; Financial Reporting Model and Financial Risk Management Policy

Governance & Compliance

Governance & Compliance Models

Terna – conscious of the need to ensure conditions of correctness and transparency in conducting its affairs and business activities in order to protect its position and image, the expectations of its shareholders and the work of its employees – implements a policy of continuous protection against Governance, Integrity and Compliance risks.

Based on best practices in regard to governance and compliance:

- It has adopted a *Code of Ethics* in which it confirms legality, integrity and responsibility as being its general ethical principles and acknowledges that standards of good business management, respect in the broadest sense of the term, fairness as a basis for loyal, impartial behaviour and transparency in acting and communicating, are particularly important;
- It has implemented an *Organisational and Management Model, as provided for in Italian Legislative Decree 231 of 2001 and subsequent amendments and additions*, with the belief that this Model – beyond the provisions of the Decree, which point to it as an optional, non-compulsory element – can represent an effective tool for raising awareness among all those operating on behalf of Terna. In its structure, the content of the Model is consistent with that laid down in the relevant guidelines drafted by trade associations and with best practices, and represents a further step towards strictness, transparency and a sense of responsibility in internal relations and with the outside world, while at the same time offering shareholders guarantees of efficient and correct management;
- It has approved the "*Compliance rules for the prevention of crimes and administrative offences of market abuse*", aimed at providing users of the Organisation and Management Model foreseen under Italian Legislative Decree 231 with an additional operating tool to assess the appropriateness of their behaviour relative to the classification of crimes and administrative offences of market abuse, and consequently prevent conduct that could potentially lead to corporate liability for the Company;
- It appointed the *Manager in charge of preparing the company's accounting data* as governed by Italian Law 262 of 28 December 2005, as amended, which establishes the financial disclosure audit system, also known as the "*262 Audit Model*", and certifies that accounting documents, records and books correspondence with the deeds and communications disseminated by the Company to the market, as well as with the interim accounting report;
- It adopted an *Integrated Management System* which lays down criteria for the management of Quality, Environment and Workplace Health and Safety, for Energy, Anti-corruption, Information Security, Multi-site Test Lab Security, Live-Line Working and Calibration Centre and is aimed at guaranteeing the efficacy and efficiency of systems, highlighting potential risks in the relative areas and implementing necessary mitigation actions; additionally;
- It adopted, for operating battery sites, a *Management System for the Prevention of Serious Accidents* in accordance with the indications of Italian Legislative Decree 344/99, as amended (Seveso Directive), which is part of the Integrated Management System;
- It developed a *Information Security Governance Model*, with the objective of guiding processes and activities that help to protect the Group's information assets, also establishing a Chief Information Security Officer (CISO), responsible for developing, maintaining and improving the Information Security Governance Model;
- It implemented a revised *Privacy Model* in the Group's companies, to ensure proper implementation of the requirements established in Italian law (Italian Legislative Decree 196/03 Privacy Code and associated Authority provisions) and appointed the *Privacy Supervisor*, responsible for supervising these issues;
- It established a specific Fraud Management structure, accompanied by an *Anti-Fraud Methodological Model*, to guarantee protection of company assets (tangible and intangible assets, direct and upstream benefits) in regards to all those illegal events which could compromise them, through activities aimed at preventing and managing corporate fraud, with the objective of protecting the Company's image and reputation.

ACTIVITIES CARRIED OUT TO PROTECT AGAINST GOVERNANCE AND COMPLIANCE RISKS

Activity	Description
Update Terna Group 231 Organisational Models	In relation to legislative changes introduced by Italian Law 68/2015 (known as the "eco-crimes" law) and Law 69/2015 on environmental crimes and crimes against the public administration, Mafia-type associations and false accounting, certain changes were made to all the Terna Group's 231 Organisational Models. The changes involved: • General part • Special parts: Corporate crimes, Crimes of terrorism and subversion of democratic order, crimes against individuals, environmental crimes.
"Project 231"	The initial phase of the project, which had the aim of redefining and updating the map of at risk areas and the 231 Internal Audit System in reference to the new organisational structure, was completed in July 2016 with the updates made to the Group's 231 Models. Updating of the map of at risk areas line with the corporate structure is under way, which will be followed by the final phase of calculating residual risk.
Training and information measures	In 2016, a new online training campaign began, aimed at almost all employees. It was subsequently extended to new hires and new employees. Additionally, two training sessions were held on 23 November 2016 for the employees of TES, a subsidiary of Tamini.
ISO/IEC 37001:2016 certification	On 1 November 2016, activities were begun to develop and subsequently receive accreditation for Terna S.p.A., Terna Plus and Terna Rete Italia S.p.A. relative to ISO 37001:2016 "Anti-bribery management systems - Requirements with guidance for use". In December 2016, the reviews by the IMQ Certification Body began and were completed successfully. In January 2017, certification was received, making these companies the first in Italy to have certified anti-corruption management systems.
ISO/IEC 17025:2005 accreditation	In December 2016, the process to accredit the activities of the Multi-Site Calibration Centre in Florence by ACCREDIA was successfully completed, in accordance with the ISO/IEC 17025:2005 standard, which is necessary to carry out metrological tests on active electrical energy meters and on electricity measurement systems used to determine energy flows for tax purposes, as foreseen by the Customs Agency. The locations in Turin and Cagliari will be verified in the initial months of 2017.
UNI CEI EN ISO/ IEC50001:2011 certification	Following initial certification in 2015, the necessary activities to maintain certification were carried out in 2016. During the review, it was determined that the Energy Manager, who serves in this role for the entire Group, is that established by FIRE (Italian Federation for Rational Energy Use). Training and actions to increase awareness about the issue of energy savings were also completed. Specifically, all Terna Group employees were offered the online course "Energy Efficiency", and reference people and evaluators (around 70 people) were offered courses on "UNI CEI EN ISO 50001:2011 Energy management Systems - Requirements and Guidelines", "UNI EN ISO 19011:2012 Guidelines for Management System Audits" and "UNI CEI EN 16247 Energy Diagnosis".

Compliance with ISO 9001:2015 ISO 14001:2004 BS OHSAS 18001:2007 ISO 27001:2013	▷	The IMQ Certifying Body confirmed the compliance of business activity with the requirements per the following standards: • UNI EN ISO 9001:2015 (the Quality Management System was adjusted to bring it into line with the 2015 regulatory update) • UNI EN ISO 14001:2004 • BS OHSAS 18001:2007 • ISO 27001:2013
Confindustria INAIL Security Award	▷	On 20 July 2016, Terna was awarded the IV Security Award, presented by Confindustria and INAIL, with the patronage of the President of the Republic. For more details please refer to the section "Sustainability Performance".

Relationships with Institutional Partners

Following an innovative approach to risk reduction policies, Terna identified institutional partners with which to share the risk deriving from its own activities through cooperation with Italian and international regulatory bodies and authorities and the signing of a memoranda of understanding. In particular:

- The *Memorandum of Understanding signed with the Ministry of the Interior* on 30 July 2008, intended to increase the levels of physical protection of electrical substations;
- The *Memorandum of Understanding with Guardia di Finanza* (GdF), renewed on 19 October 2016, with the objective of:
    - preventing criminal infiltration;
    - protecting the legality and transparency of procurement procedures;
    - fighting undeclared employment and unpaid contributions;
    - controlling and monitoring the proper destination and usage of materials in the management of strategic sectors like the electricity market and sources of renewable energy;
- The *Memorandum of Understanding signed with the National Fire Fighter Corps* provides for a collaboration programme to increase physical protection of Terna's substations to prevent outages and strengthen technical assistance;
- The *Memorandum of Understanding with the National Association of Italian Municipalities*;
- The *Memorandum of Understanding with Prefects*, to strengthen the security of assets located throughout the country, through dialogue with the responsible structures;
- *Collaboration agreement between Terna and ISCTI* (Istituto Superiore delle Comunicazioni e delle Tecnologie dell'Informazione - Superior Institute of Information and Communication Technologies) for cooperation with CERT-National;
- *Collaboration agreement between Terna and the Department of Information for Security of the Prime Minister's Office (DIS)*;
- *Agreement between Terna and Anie* (Associazione Nazionale Imprese Elettriche - National Association of Electricity Companies) for the management of environmental safety on job sites.

ACTIVITIES RELATIVE TO RELATIONSHIPS WITH INSTITUTIONAL PARTNERS

Activity		Description
Renewal of the Memorandum of Understanding signed with Guardia di Finanza	▷	On 19 October 2016, the Memorandum of Understanding relative to cooperation between Terna and Guardia di Finanza (GdF) was renewed. Based on this agreement, Terna makes all relevant and qualified information and news available to the GdF to prevent and combat irregularities, fraud and all other economic/financial crime.

Fraud Management

The Group's culture has always emphasised efforts to ensure legality and integrated security to prevent and combat corruption, undeclared work, irregularity in contributions and the risk of criminal infiltration in its economic structure and in contracts and sub-contracts.

In order to identify potential vulnerabilities in its audit system, Terna has, in addition to cooperating with institutional partners, developed a methodological model based on the systematic analysis of preconditions that may generate fraudulent events, identifying "critical areas" and intercepting potential organisational and operational problems, within which these events could arise, and subsequently implementing a series of measures aimed at preventing their occurrence.

This means that the fight against fraudulent events is carried out by continuously monitoring the degree of exposure to fraud risks and risk factors, by gathering and analysing notifications and indications of potential crimes, as well as by examining process and adopting suitable governance and control measures to prevent fraud. To achieve this objective, Terna has provided itself with specialised software and databases able to carry out targeted analysis both relative to aggregate data and statistics and focussing specifically on suppliers, contracts, projects and company departments.

A further aspect of control that has been developed involves the analysis of the stakeholders that Terna works with, aimed at containing risks associated with operations with third parties, and at monitoring "critical" customers, to minimise losses from uncollectable receivables.

FRAUD MANAGEMENT ACTIVITIES

Activity	Description
"Subcontract Management" Portal	The Subcontract Management Portal is a centralised IT tool to manage, analyse and continuously monitor sub-contracts. Operational since 1 February 2015, during 2016 upgrades were implemented based on suggestions received from various users.
"Open & Transparent Site" Portal	In 2016, a series of upgrades were carried out on the portal, which has been online since November 2015. They: • gave the Portal a new visual look and offered access from any electronic device; • provided new functions including the possibility of doing multiple searches by region, construction site, line, building, cable, and substation, drilling down by type and number of contracts and sub-contracts and relative economic values, with video presentations of key figures and graphics structured by area, construction site type, and contract/sub-contractor type that immediately and intuitively demonstrate the existing situation at the various construction sites located throughout Italy.
"Assorel" Prize	In 2016, Terna was recognised with a special mention in the Corporate Communication & Reputation Management Category by the Italian Association of Public Relations Agencies (Assorel) jury for its communication campaign on transparency associated with the launch of "Open & Transparent Sites".
Portal - "Terna GdF Construction Sites: Tenders and Subcontracting"	Implementing the Memorandum, in 2016 the portal "Terna GdF Construction Site: Tenders and Subcontracting" was created. The tool is for exclusive use by Guardia di Finanza, allowing its officers the opportunity to acquire important information relative to investigations carried out throughout the country, for example progress of work in large infrastructure projects, number of companies participating in tenders, method used to award contracts, names of contractors awarded jobs and relative sub-contracts, etc.
"Whistleblowing" Project	In 2016, a "whistleblowing policy" was developed to manage notifications of illegal behaviour, for both internal and external use, fully maintaining confidentiality for the whistle-blower, the content of the notification, identity of the individuals fingered, and protecting the whistle-blower from the risk of retaliation or discrimination at work due to their actions. A web portal that serves as a digitalised management tool was also launched.

Operations

Risk Management for Operating Processes

Terna developed its own Enterprise Risk Management (ERM) methodology for risk analysis, adapting existing best practices to its particular situation, scope of action and requirements as an electricity system operator. Operating risk analysis done with ERM methodology has allowed Terna to obtain a detailed map of the risks associated with all its core processes and the main support processes. For each risk identified, a level of importance is assigned and, for those whose risk level exceeds the selected threshold (risk appetite), possible mitigation actions have been identified and implementation times estimated. The relative action plans have been presented to the relevant managers for implementation. The results are subject to continuous monitoring and periodic auditing to guarantee adequate risk assessment over time and ensure that any new risks are identified.

OPERATING PROCESS RISK MANAGEMENT ACTIVITIES

Activity	Description
Risk Assessment for Operating Processes	In 2016, core risks were updated, relative to the following activities: • settlement (invoicing of economic items), contracts and Grid Code as part of the regulatory affairs process; • systems engineering for the dispatching and conduction process; • IT systems that support the defence of and control over the electricity system. Additionally, completing the scope of ICT, specific risk assessments were done relative to management IT systems and telecommunications. The associated action plans were presented to the appropriate departments for assessment and implementation of the suggested mitigation actions. The effects of these actions are currently being monitored and will continue to be.
"ERM Completion" Project	During 2016, a new project was begun to extend and complete risk analysis through the application of the ERM model to the following areas of company risk: • Risks relative to Italian Legislative Decree 231/01 • Cyber Risk • Risks relative to Supplier Qualification • Health, Safety & Environment Risk • Physical Security & Emergency Management Risk • Risks relative to Quality, Environment, Workplace Health and Safety Management Systems, Energy, IT and Multi-Site Testing Laboratory Security, and Live-Line Working
Environmental Risk Analysis	General evidence of the occurrence of anomalous environmental events led to the study of the effects of climate change on the assets and operation of the electricity system. This study identified the emergence of a new category of risks due to the manifestation of extreme weather events, which can damage infrastructure and negatively affect continuity of electricity service. The results of the study support engineering decisions to strengthen the electricity grids and justify new technical solutions for prevention and mitigation with the aim of increasing the resilience of the electricity system.

Environmental, social and political issues

Terna has established a *Risk Observatory* with the objective of ensuring proper application of the company's Corporate Governance policies and management of information flows toward the CRO, as well as monitoring environmental, social and political problems connected to new planned works and those currently in execution by the Terna Group. It also provides timely reporting to top management, the CRO and the Secretary of the Oversight Committees, pursuant to Italian Legislative Decree 231/01 in reference to events that occur.
The Risk Observatory was set up in order to address "social" trends by monitoring the territory in which projects are localised, acting as a permanent safeguard through the systematic and integrated collection of information, with the preventive goal of intercepting critical situations and highlighting which unforeseen significant "231" events may cause significant delays in the completion of projects (while also delaying the benefit to the group) and result in increased costs.

ACTIVITIES CARRIED OUT TO PROTECT AGAINST ENVIRONMENTAL, SOCIAL AND POLITICAL ISSUES

Activity	Description
"Steering Committee for Environmental, Social and Political Issues"	During 2016, the *"Steering Committee for Environmental, Social and Political Issues"* met a number of times, assessing all identified problems and proposals to resolve them put forward by the Risk Observatory for approval.
Risk Assessment Project	For works considered to be critical, the Risk Observatory began a Risk Assessment Project which, starting with the mapping of operating risks identified through an ERM based risk assessment, can identify real risks and the relative specific criteria for the works during the various stages in their life cycles. This approach is an innovative way of connecting theoretical risk mapping, the result of the application of ERM analysis methods and management of the Terna Group's risks, with specific and prompt project audits aimed at preventing problems arising during initial project stages from continuing over time to subsequent stages, causing delays in the completion of work or, in more extreme cases, compromising satisfactory completion of the initiative. The result of this project was the definition of a prototype form for the Risk Assessment Project, developed to be applicable to any construction project, based on the stage in which it is found.

Physical threats to systems

The complexity and multiplicity of physical threats to Terna sites over the years have necessitated the adoption of various measures to contain risks of corruption, theft and damage to plants and, consequently, to ensure electricity service continuity.
The physical security of substations is provided using devices, systems and divisions operating 24 hours a day, every day. This infrastructure has been further optimised for the surveillance of a subset of substations having been identified as critical based on an index calculated with the assessment of multiple risk elements.
In addition, Terna has developed the surveillance platform PSIS (Integrated Physical Security System for Terna Substations), that allows the dedicated surveillance centre - the Security Operation Center - to continuously monitor any intrusion alarms and video signals coming from 184 structures. To further raise the protection level for Terna's critical assets, in 2016 implementation of a new and more advanced integrated management and security event representation system began, known as SETA. Through an innovative approach to security, the new platform aims to integrate physical and logical security systems into a single central infrastructure, correlating information coming from various sources to more precisely and promptly identify risk situations. At the same time, Terna's VideoBox video surveillance system is used, which is light, flexible, economical and quick to install.

ACTIVITIES CARRIED OUT TO PROTECT AGAINST RISK OF PHYSICAL THREATS TO PLANTS

Attività	Descrizione
Security Assessment for Area Offices	In 2016, an assessment was planned and carried out for the Area Offices that house the staff of the divisions, the Local Operational Areas and the Dispatching Areas. The objective is to focus security actions and provide specific instructions to homogenise the control system for access to these offices.
Meeting with the Ministry of Foreign Affairs (MAE)	In November 2016, a meeting was organised with MAE with the Prefect for the Farnesina Crisis Unit. The Security and Services Director took part, accompanied by the managers of the Physical Safety and Emergency Management Department and the Security and Problem Management Unit. The goal of the meeting was to make a presentation about Terna, outlining its organisational changes and its multiple interests relative to missions and business activities conducted abroad.
Earthquake Emergency in Central Italy	In 2016, Italy was hit by a dramatic series of earthquakes of sizeable magnitude, all concentrated in central Italy, in the area where the regions of Lazio, Abruzzo, Marche and Umbria meet. Terna was a member of the Department of Civil Protection's Operating Committee from the start.
Terna "Open Day" Security	2016 saw an increase in a new type of local communication activity, known as Open Day Terna, implemented by the Institutional Affairs and Authorisations Department. This type of initiative aims to increase access to the population when making decisions about where to locate large projects, in order to gain greater acceptance.
Collaboration with the Carabinieri (Italian Military Police)	In 2016, the technical activities necessary to modernise IT and telecommunications infrastructure were carried out, to support the connection between the Security Operation Center (SOC) and that of the Carabinieri. The privileged relationship that was created by the Memorandum of Understanding between "Cyber SOC" and CNAIPIC (National Anticriminal IT System to Protect Critical Infrastructure) was particularly beneficial and effective, with immediate notification of IT incidents and intrusion attempts relative to Terna's perimeter logical defence equipment handled with top priority.

Information and Cyber Risk

The risks that weigh upon the advanced technologies that make up a company's cyber-environment are ever greater and continuously evolving, especially when these serve to make critical infrastructure functional (like in Terna's case). In addition to traditional threats to every more or less detailed ICT project and those relative to systems (natural or artificial threats), the number, degree of danger and trends associated with cyber-threats are increasing quickly, originating in cyberspace and strengthened by the digitalisation process taking place in every organisation.
With the proliferation of the web of interconnections that is created as computers of all shapes and strengths are connected to new communication technologies, cyber risks now hold a stable position among the most significant risks that impact high-innovation companies.
For some time now, Terna has had an "Information Security Governance" Model, based on a detailed regulatory framework of policies and procedures combined with an operating programme coordinated by Information Risk Management, under the direction and coordination of the Group's Chief Information Security Officer (CISO), which has made it possible to identify the top cyber risks. The programme takes into account all the risk factors to which the ICT system is exposed (organisational, technical and technological, physical/environmental, cyber, etc.), including compliance with laws on data processing and the fight against cyber crime, and its aim is to counteract their impacts (interruptions to grids or IT services critical to electricity system operation and/or with potential damage to the NTG, confidentiality loss, theft or tampering with sensitive, strategic and confidential information relating to the electricity market and/or on third parties held by Terna).
Finally, through the already mentioned Security Operation Center (SOC), a structured process is carried out, aimed at quickly identifying and containing security incidents, minimising information loss and working to restore any involved services. The SOC is also responsible for measuring the risk to which company assets and the information contained in them are exposed.

INFORMATION AND CYBER RISK ACTIVITIES

Activity	Description
Update to Information Security Governance Model 2.0	An update was made to the cyber security policies, in compliance with the Governance Model 2.0 issued in 2016 by the CISO, which aligned specific policies and baseline controls (selected security measures to be implemented in the context of a Security Plan), to eliminate residual cases of overlap or inconsistencies which were discovered during approval.
Fighting cyber risks	2016 was a year of great efforts and improved continuity relative to the fight to contain the main cyber risks: • IT attacks, also through malware, on industrial domain assets (ICS/Scada) • Identification and development of recovery plans for technological vulnerabilities identified in corporate/management domain systems • Analysis and prevention of attempts to hack websites and company work stations (social engineering, ransomware) • Monitoring of downtime for critical services for DSC rooms and to focus improvement actions.
Definition of security standards for former RFI Substation Automation Systems (SAS)	In the tender requirements for the supply of SAS for former RFI substations, the level of cyber security requirements was raised, with technical solutions aimed at: logical segregation of applications, secure access, security protocols for remote access to maintenance and diagnostic functions, interface with Terna's Security Information and Event Management (SIEM) system for remote management of events relative to the system's IT security.
Amendment of the Grid Code - Annexes A.13 and A.26	The attention paid to cyber security issues also had effects on the Grid Code. In the 2016 review of certain technical portions of the Grid Code, in particular Annex A.13 and Annex A.36, a short new chapter on cyber security was added, which provides instructions on certain basic practices which all interconnected operators must follow.
Cyber risks for Industrial Automation and Control Systems (IACS)	During the year, important working groups were established to reduce cyber risks for Industrial Automation and Control Systems (IACS) which support Terna's core business. Among the main initiatives, we note: the project to update logical access rules for the IACS domain to comply with the one-way paradigm; the project to adopt new secure remote access infrastructure, also administrative for the IACS domain; the project to segregate internal networks from the IACS domain.
Identity and Access Management (IAM)	With an eye to streamlining current projects and complying with current regulations, Terna decided to implement a complete Identity and Access Management (IAM) solution, to manage users, profiles and authorisation policies. It offers centralised management of the digital identities of both Terna employees and external personnel, creating suitable profiles that grant access to various applications and information only when appropriate, while simultaneously protecting personal information from unauthorised access.

Supplier risk

Terna makes use of a *Company Qualification System*, established pursuant to the EU Directives (Italian Legislative Decree no. 50 of 18 April 2016, “Public contracts code for labour, services and provisions”), for all the main core areas of supplies, labour and services that Terna itself intends to supervise, established on the basis of the strategic importance, degree of competitiveness and annual volumes supplied. The qualification procedure allows Terna to assess the suitability of each economic operator (supplier/company) by verifying its fulfilment of legal, economic/financial, technical/organisational, training, safety/environmental and social ethics requirements.

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

These activities include continuous screening of information through:

- notifications from *financial providers*, relative to economic/financial performance, as well as changes in the corporate structure (demergers, acquisitions of business units, etc.);
- *vendor rating* forms drafted by technical units which manage the procurement contracts of qualified companies; from other Terna departments;
- news acquired from *publicly available sources.*

The performance of monitored suppliers is constantly analysed which, in the case of situations that no longer comply with qualification requirements, allows for suitable responses such as: letters of notice, temporary suspension from the Register (generally for six months) or in more serious cases, revocation of qualifications (after which the supplier may make a new request for qualification no sooner than one year later).

ACTIVITIES TO PROTECT AGAINST "SUPPLIER" RISK

Activity	Description
Supplier List	In March 2016, a Suppliers List was developed, an integrated informational and screening database system relative to suppliers chosen for departments not subject to qualification processes, aimed at establishing a reference list of businesses for tender procedures in the EU. At present, 11 merchandise groups are on line relative to technical/specialist tasks.
Introduction of a new Information Technology merchandise segment	In October 2016 activities began to establish a qualification process for a new ICT professional services merchandise segment. The project serves the need to have a list of suppliers that have already been analysed and verified to contact for tenders relative to the mentioned services, thereby decreasing tender times, which generally involve a fairly time-consuming prequalification stage.
Developments in the Qualification Portal	A new release of the Qualification Portal was issued in November 2016, which added new functions (improvements to the qualification process for professionals, introduction of vendor ratings for EHSC/CSP and DL, management of new sanction proceedings, reporting) and made improvements to certain existing functions.
"Supply Chain" Project	This project is aimed at reviewing social and environmental aspects of the supply chain, aimed at verifying the degree of coverage offered by the current qualification rules and practices used for suppliers and procurement within the Terna Group, with respect to environmental, social and governance risks. Analysis of the various merchandise segments for which the operating guidelines found in the Multi-year Sustainability Plan will be implemented was begun, which makes ISO 14001 and/or OHSAS 18001 certification a requirement.
"Business Integrity Forum" Project	This initiative works to promote and disseminate tools to increase integrity and fight corruption, with large companies making certain pre-established policies available to small suppliers, in cooperation with Transparency Italia. Use of the policies is not a requirement, but is presented as an ideal extension of the practices already adopted by the larger companies. The PMI Integrity Kit was prepared. This is a combination of documents that suppliers can download and adopt in their own companies, including a Charter of Principles, Notification Systems, and Integrity Pact.

Occupational injuries and environmental impacts

The Terna Group implemented management-related measures, drafting safety and environmental policies and guidelines and ensuring compliance with the legislation in force and the adopted procedures through on the spot inspections carried out on Terna sites and plants.
The Prevention and Protection Services set up for each Production Unit provide ongoing support to employers for implementing all the necessary measures for fulfilment of the obligations pursuant to Italian Legislative Decree 81/08.

ACTIVITIES TO PROTECT AGAINST OCCUPATIONAL INJURY AND ENVIRONMENTAL ACCIDENT RISKS

Attività	Descrizione
On-the-spot site inspections	As part of its site safety monitoring and control activities, the "Integrated Site Safety" project continued in 2016, aiming to ensure comprehensive on-site safety by analysing not only aspects related to safety in the workplace, but also aspects concerning environmental safety – such as pollution, waste management and impact on the surrounding environment – and the correct management of contracts.
Relationships with bodies, entities and associations	In 2016, collaborations continued with external entities and associations in regard to workplace and environmental safety. A new technical forum between Terna and the ANIE Federation (National Federation of Electrotechnical and Electronic Companies) was established to prepare a security management document for construction and maintenance of power lines. It also includes the participation of power line construction companies and cable duct construction companies. In addition to the CONFINDUSTRIA Technical Security Committee, the Terna environmental safety and security structure also participates on the following technical forums: • Security culture • Injury data • Simplification • Tender management In 2016, the activities of the Inter-Company Environmental, Health and Safety Forum continued. This group sees the participation of the main Italian managers of grid structures and infrastructure, with the objective of facilitating communication between the companies, identifying best safety practices, sharing interpretations of regulations and creating a virtuous cycle relative to the health, safety and the environment.
Project: "Near Miss: safety and environment"	In the area of integrated safety and environment matters, and as part of the plan for continuous improvement, the "Near Miss: Safety and Environment" project was implemented with the aim of identifying and analysing all abnormal events, near-accidents and environmental impacts having occurred during work activity which, despite having the potential to do so, did not result in damage to people or the environment. The project is divided into two phases: • The Pilot Project, which began in October 2015 and ended in December 2016, involving operating personnel from one plant unit at each operating area; • Extension of the project to all operating personnel throughout 2017, through specific training to introduce the company procedure.
Training and information measures	In 2016, around 75,000 hours of safety training were provided to all Terna staff, around 52% of total training hours, mainly provided through classroom and outdoor lessons. Over 76% of employees took part in a Safety class during the year. Participation totalled 8,650. Training activities concerned the operation of special vehicles, fire prevention, first aid, management of risks of falling from height and electrical risk, as well as training for all Group personnel and regulated by the Region-State Conference Agreement.

Strategy & Financial

Financial risks

Terna has adopted a dynamic approach to manage various financial risks, including market risks (interest rate, exchange rate and inflation risks), liquidity risks and credit risks. This approach includes constant monitoring of financial markets, in order to carry out planned hedging operations under favourable market conditions, but also to take advantage of possibilities to improve existing hedges, when changes in market conditions or hedged items make previous hedges unsuitable or excessively costly.
From an organisational point of view, Terna has a specific Financial Risk Management structure that is responsible for this type of risk, with the objective of:

- providing support when assessing hedging strategies for financial risks;
- guaranteeing assessment of the financial debt strategy, as well as the tools used for relative hedges, working with the Administration, Finance and Control Department to assess alternative solutions in the case of high risk financial debt;
- monitor the financial strategy and evaluate alternative solutions, in cooperation with the Administration, Finance and Control Department;
- guaranteeing the design of the financial reporting model to assist top management;
- analyse and validate proposals to update risk management policies to be submitted to the Board of Directors for approval, together with the Administration, Finance and Control Department.

This matter is discussed in more depth in paragraph “E. Commitments and risks” of the notes to the Financial Statements of Terna S.p.A. and of the Terna Group.

ACTIVITIES CARRIED OUT TO PROTECT AGAINST FINANCIAL RISKS

Activity	Description
Monitoring Financial Key Risk Indicators	During 2016 monitoring of the Key Risk Indicators continued, specifically: Interest risk, liquidity risk, inflation risk, counterparty risk, and exchange rate risk.

Climate change risk

Numerous stakeholders, including a growing number of investors, are interested in having a full outline of the risks associated with climate change. In fact, these risks are not associated solely with operational risks, but also involve changes in the regulatory and legal frameworks which aim to contain emissions and other situational risks, and therefore also have a strategic aspect.

REGULATORY RISKS	
Reduction of emissions (emission trading/carbon tax)	Terna is not involved in the generation of electricity and therefore is not subject to any obligation to reduce emissions or to any emission-trading schemes. Accordingly, any fiscal or regulatory measures (e.g. carbon tax or emission-reduction targets) do not concern Terna and have no direct consequences on its business and financial performance.
Changes in consumption and generation systems intended to reduce energy consumption	Research into greater efficiency has already reduced the elasticity of energy demand to the growth of GDP. The consequences for Terna are very few: the current regulatory framework significantly limits the risk of repercussions on Terna income from reduced energy demand.

PHYSICAL RISKS ASSOCIATED WITH ENVIRONMENTAL CONDITIONS	
Extreme weather conditions (water shortage, extreme heat, ice)	Analysis of the impact that extreme weather events could have on infrastructure is dealt with in the section on management of operating risks. Extreme weather conditions may also make it difficult for Terna to balance electricity input/withdrawal on the transmission grid. To deal with these risks, Terna constantly takes note of the results of climate research and forecasts potential consequences of medium and extreme climate scenarios, in line with the calculations of the Intergovernmental Panel on Climate Change (IPCC). In particular, Terna is interested in the impacts of temperature increase relative to lower electricity production and changes in consumption, both relative to total amounts and seasonal variations. The overall goal is to increase the reliability of medium/long-term forecasts which influence energy policies for companies in the sector.

OTHER RISKS	
Development of the production of electricity from renewable sources	This poses various operational and technological challenges for Terna in relation to the need to resolve grid congestion problems and for efficient and safe management of non-programmable production. For example, intermittent wind production makes dispatching more difficult.
Reputational	As the probability of critical situations due to extreme weather events increases, that can result in widespread disruption, Terna's exposure to reputation problems increases, both relative to public authorities and the general public.

We also note Terna's participation together with other energy infrastructure managers in a project to identify and analysis methods of governing climate change risks, requested and managed by the ENI Enrico Mattei Foundation, in order to share strategies and procedures and develop synergies between the companies.
Finally, for the details of initiatives aimed at limiting company emissions and monitoring energy consumption, please refer to the information and data found in the "Sustainability Performance" section.

PERFORMANCE

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OPERATING PERFORMANCE

The Terna Group is oriented to continual improvement of its operating performance in all its fields of activities, regulated and non-regulated. In Terna's Regulated Activities, as the operator of reference for the Italian electricity system, it pursues objectives that have not just corporate but systemic importance. For this reason, the first part of this section highlights results related to Terna's operating performance in relation to the objectives indicated in the concession.
The main objectives in the operation of the transmission service by Terna are:

- continuity and security of the service;
- reduction of electricity costs.

A combination of various activities carried out by Terna serve to achieve each objective: grid operation and dispatching, maintenance, and the execution of development projects.
The operating performance related to Non-Regulated and International Activities is dealt with separately.

Regulated Activities

Continuity and security of the electricity service

Each stage of the electricity system – generation, transmission and distribution – contributes to the result of ensuring the availability of electricity for society, guaranteeing adequate quality standards and a number of outages lower than pre-set thresholds.
Terna monitors service continuity through various indices that are defined by the AEEGSI (Resolution 250/04) and the Terna Grid Code. The portions of NTG monitored are those owned by Terna S.p.A. and, since 2012, by the subsidiary Terna Rete Italia S.r.l..

CONTINUITY INDICES USED

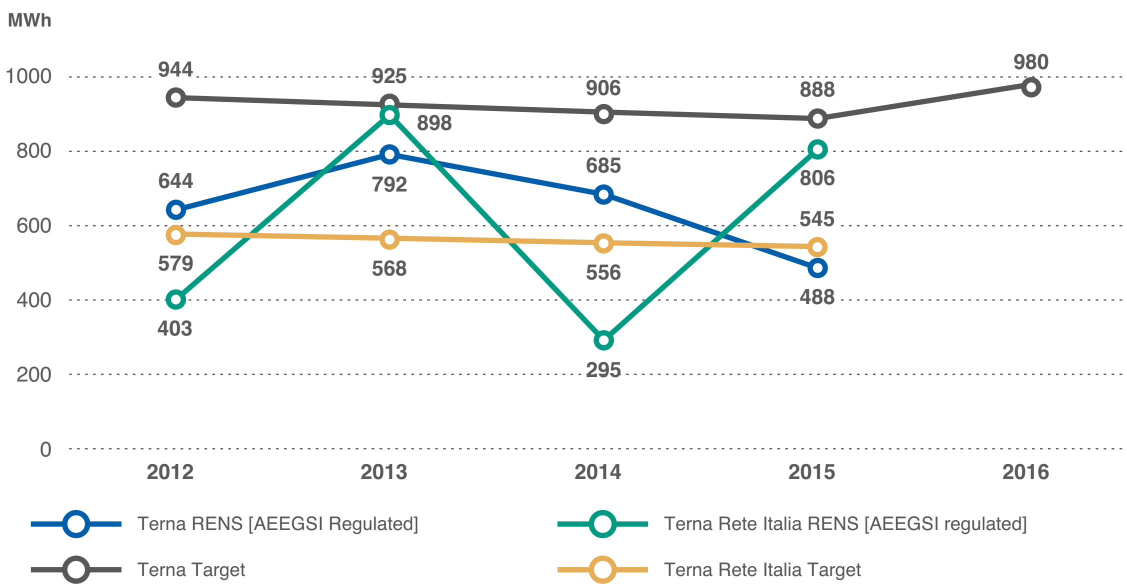
Contents	What it measures	How it is calculated
ENSR* * Regulated Energy Not Supplied (RENS).	Energy not supplied following events that originate from the regulated grid** ** "Regulated grid" means all the High-Voltage and Very-High-Voltage grid.	Sum of the energy not supplied to users connected to the NTG (following events that originate from the relevant grid, pursuant to the AEEGSI regulations on service quality).
ASA*** ***Average Service Availability.	Availability of the NTG service	Calculated taking the ratio between the sum of energy not supplied to users connected to the NTG (ENS) and the energy put into the grid.

These indices are significant for the system because they monitor the frequency and impact of events that have occurred on the electricity grid attributable to faults or to external factors such as meteorological events. For all of them, the period of observation is four years in which there are no significant changes, testifying to the good quality of the service achieved.

We must point out that, at the moment of publication of this report, the figures for the indicators for the year 2016 are not available awaiting release of the totals by the AEEGSI.
It must be stressed, finally, that the relevant index for the purposes of the impact on regulated revenue is the service continuity indicator entitled RENS. In fact, the AEEGSI has regulated the quality of the service provided by Terna using an incentive/penalty scheme set out by Resolution ARG/ELT 197/11. It is applicable to the 2012–2015 regulatory period and relates to the Regulated Energy Not Supplied (RENS) index referring separately to the grid owned by Terna S.p.A. and that owned by the subsidiary Terna Rete Italia S.r.l.. With effect from 2016, the quality of service supplied by Terna is regulated by Resolution 653/15/R/eel, which applies to the 2016–2023 regulatory period. This resolution regulates one index only, the NTG RENS, which includes both the grid owned by Terna S.p.A., as well as the grid of the subsidiary

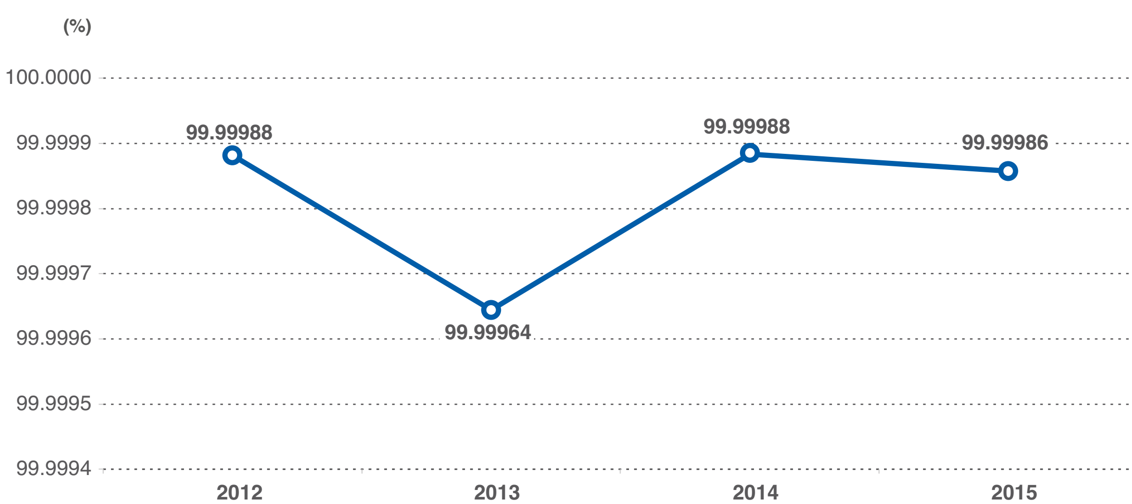
Terna Rete Italia S.r.l. Resolution 38/2016/R/eel recently clarified that the portion of the grid acquired from the FSI Group is excluded from the bonus/penalty scheme for energy not supplied.
Below is the performance for these indexes, starting in 2012.

RENS INDICATOR[17]



The operating results achieved for the index relative to the grid owned by Terna S.p.A., with respect to the reference targets established by the AEEGSI, show improved performance over the years (the higher the index, the worse the performance). Relative to the grid of the subsidiary Terna Rete Italia S.r.l., values greater than the reference targets were seen for years 2013 and 2015. Performance in these years was particularly affected by the significant amounts of energy not supplied following exceptional snowfalls which affected the regions of Veneto (2013), Emilia Romagna and Abruzzo (2015).

ASA INDEX

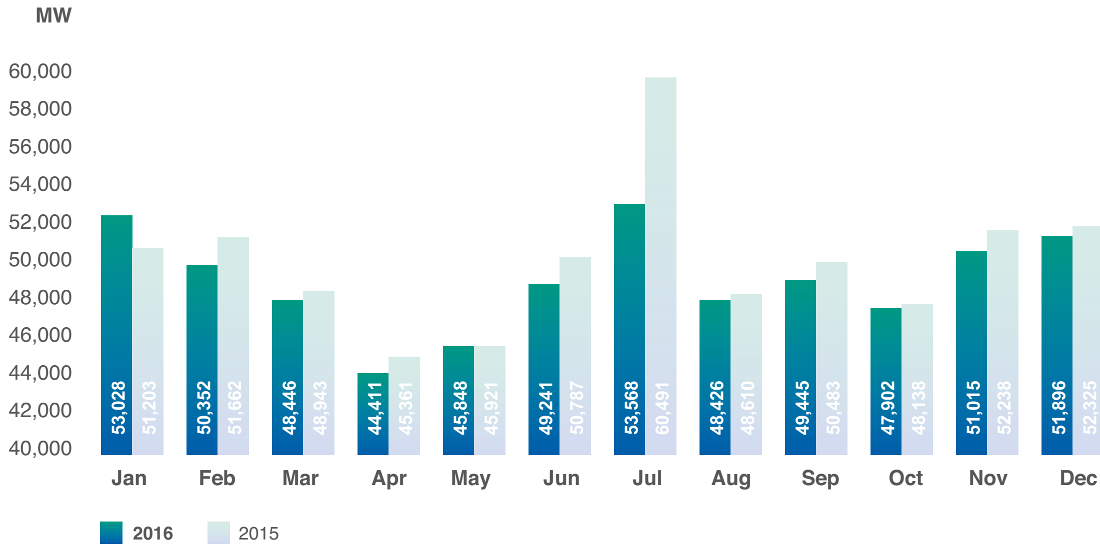


The operating results achieved demonstrate stable performance over the years and very high index values (the higher the value, the better the performance). This index shows that energy not supplied following faults on the grids owned by Terna S.p.A and its subsidiary Terna Rete Italia S.r.l. represent a minimal portion with respect to the total energy supplied to grid users.

(17) For the RENS indicator, the targets for 2012–2015 have been set as an average of the RENS 2008–2011 indicator, referred to in AEEGSI 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 AEEGSI Resolution 653/15/R/eel, with a 3.5% improvement in performance required for each year compared with the previous one. The 2016 figure is provisional.

AVAILABLE, MAXIMUM AND RESERVE POWER

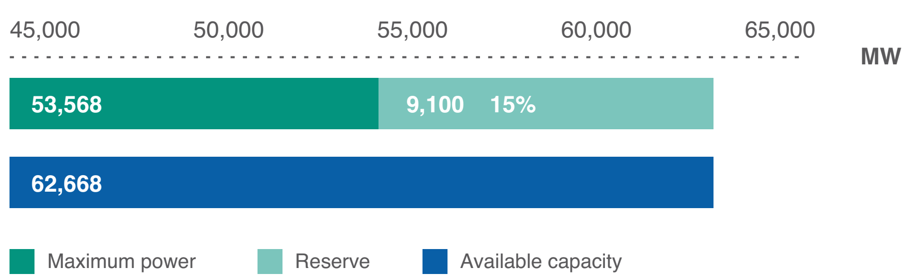
MAXIMUM POWER FIGURES RECORDED IN EACH MONTH OF 2016 AND 2015



In 2016, demand reached a peak of 53,568 MW on 12 July at 17:00, 11.5% below the peak recorded in the same month in 2015.

POWER AVAILABILITY AND RESERVE CORRESPONDING WITH THE PEAK OF 2016

Peak (12 July 2016 at 17:00)



The reserve in question refers to the residual available capacity at that moment in time, net of demand: that potentially usable at the specific time in question (net of systems that are malfunctioning, undergoing maintenance or otherwise unavailable).

Trend in electricity costs

Energy prices and Exchanges with other countries

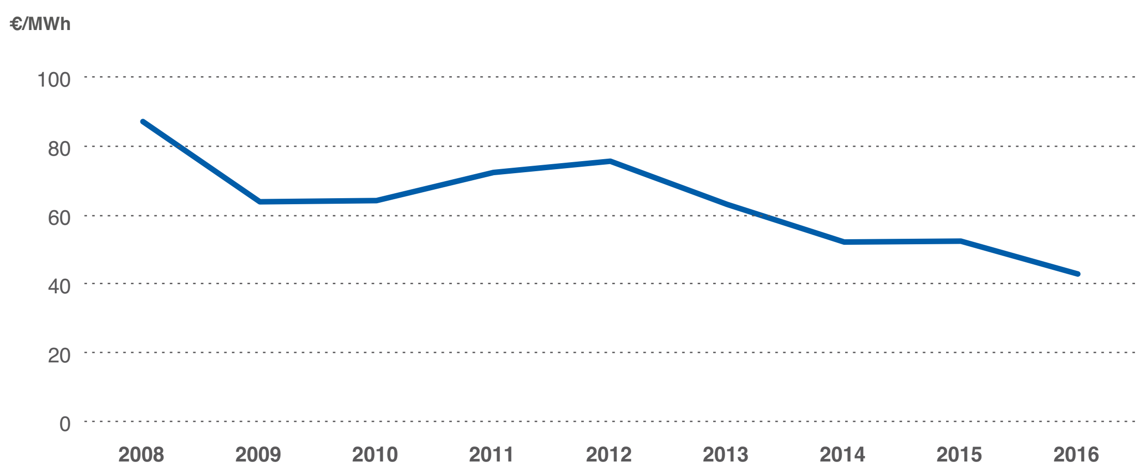
Energy prices

The hourly average price of the Italian power exchange (IPEX[18]/PUN – Single National Price) for financial year 2016 was 43 €/MWh, down compared to 2015, falling to a record low price since the start of the power exchange, in part thanks to development of the electricity grid.

The Day Ahead Market (DAM) where the PUN is formed is structured with a supply/demand mechanism but Italy must also deal with its particular geographical characteristics, with the physical nature of the electricity grid, the widespread location of its plants and consumption locations and all elements which can lead to grid congestion. In fact, there are various "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 grid development.

The chart below shows the Single National Price (PUN) trend from 2008 to 2016, which was constantly downwards (-51%).

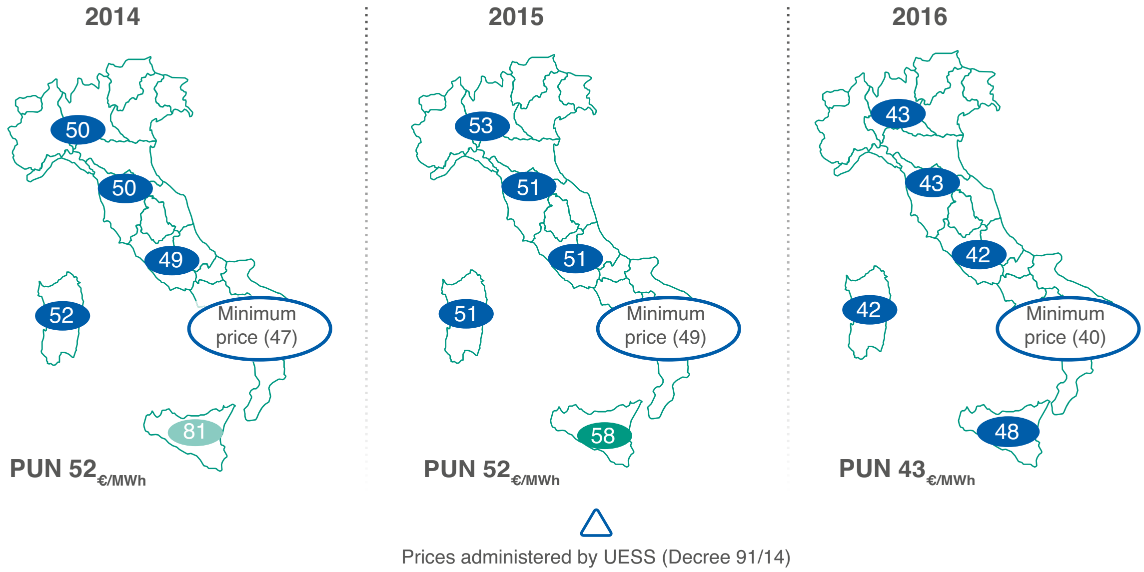
TREND OF THE SINGLE NATIONAL PRICE (PUN) SINCE 2008



In particular, when "Sorgente-Rizziconi" began operating, Terna created the conditions to eliminate the price differential between Sicily and the rest of the country. This new infrastructure represents a strategic project for Italy, as it allows for more efficient use of the production plants in southern Italy, increasing competition and thereby permitting a reduction in energy prices to the benefit of businesses and Italian citizens. Consequently it has already been possible to see some alignment in prices amongst the main zones of the Italian electricity market, and the Single National Price has fallen considerably.

(18) IPEX: Italian Power Exchange.

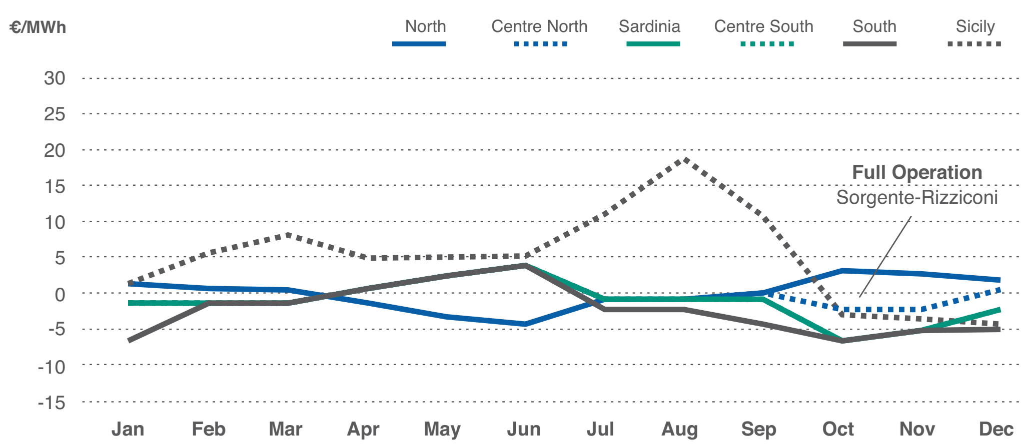
NATIONAL TREND OF THE PUN



Spread between PUN and zonal prices

As shown in the graph above, the annual PUN fell by 18% with respect to the figure in 2015, reaching the historic low of 43 €MWh/year since 2004, the year in which the Italian Power Exchange opened. This was made possible in part by grid development, as well as lower prices from supply provided by thermal plants. Zone prices fell proportionally with respect to the PUN.

The graph below illustrates the trend in the spread between the individual price zone and the PUN.



Exchanges with Foreign Countries

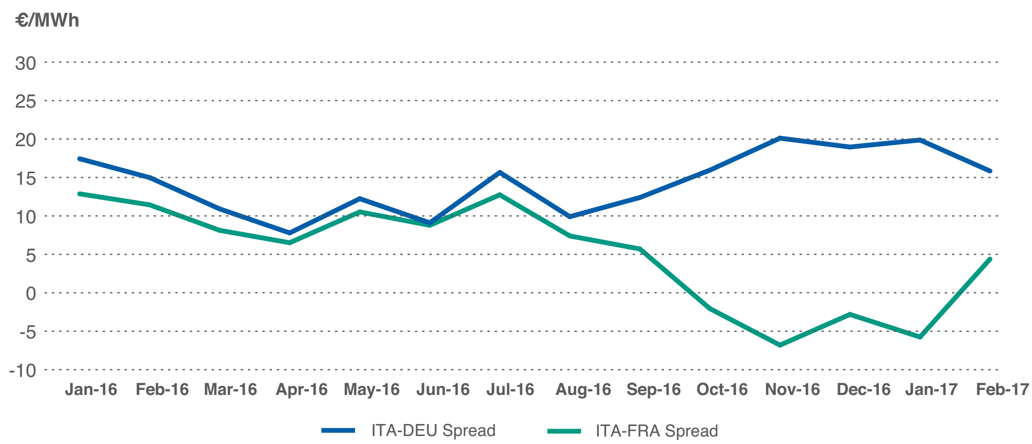
In 2016, foreign trade recorded net imports which fell significantly by around -9.9 TWh with respect to the previous year (-21% YoY). This decrease was due to both the large reductions in imports and the significant increase in exports seen during the final portion of the year, in particular going to Switzerland and France. The export portion can mainly be attributed to extraordinary maintenance on nuclear plants (in France), following the European Union EURATOM directive, as implemented by Autorité de sûreté nucléaire (ASN), issued following the Fukushima accident which makes safety checks more frequent and stricter.
The prices of the French (PNX) and German (EEX/PHELIX) foreign power exchanges, therefore saw diverging

trends. The French price increased notably starting in September, while the Phelix saw performance more in line with previous years.

- The French price (PNX) was 37 €/MWh (stable YoY, as it fell greatly in the first half and then rose significantly in the second half);
- the price on the German power exchange (EEX/PHELIX) was €29/MWh (-8% YoY).

Given that the Italian price decreased significantly (-18%), the spread with both the foreign stock markets fell.

MONTHLY SPREAD FOR ENERGY PRICES COMPARED TO FRANCE (PNX) AND GERMANY (EEX/PHELIX)

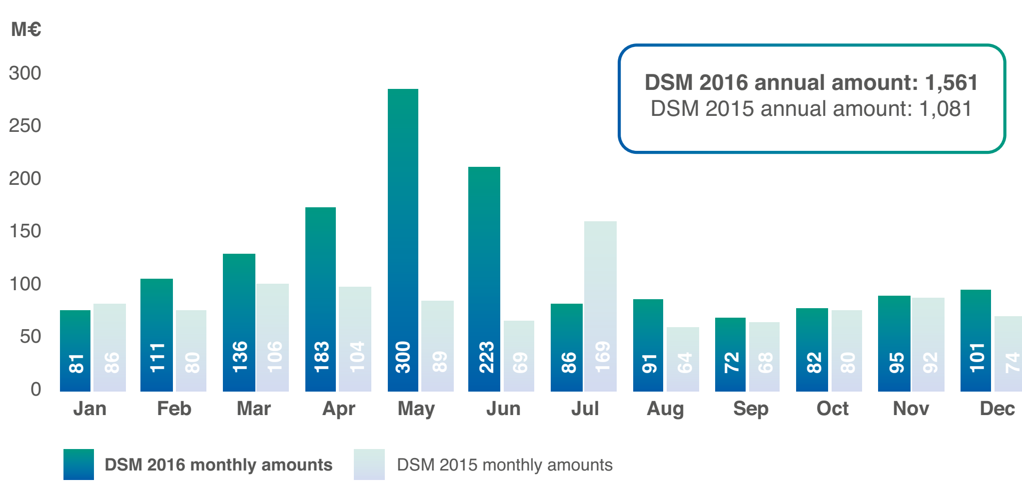


Dispatching Services Market

On the Dispatching Services Market (DSM), Terna procures dispatching resources to guarantee the security and adequacy of the electricity system. In 2016, the net expense on the DSM was € 1,561 million (provisional figure), up compared to the corresponding period of the previous year (€ 1,081 million).

This increase was particularly strong from March to June, to due to technical constraints in certain key grid areas, following lower numbers of plants in service as a result of the energy markets. Partly in consideration of this, the AEEGSI and the Italian Competition Authority began a series of investigatory procedures aimed at determining possible behaviour with negative effects on the performance of energy markets and the dispatching service market, with the further objective of promoting competition and proper functioning of the markets themselves

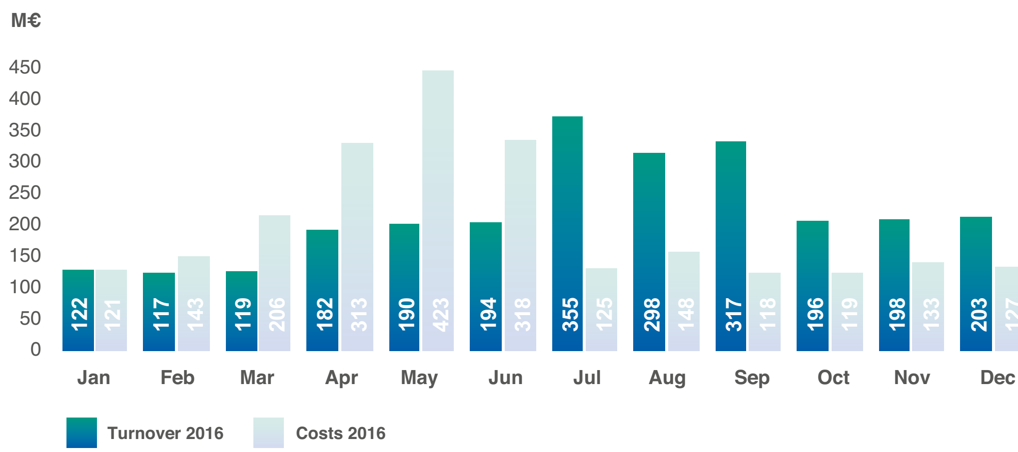
ANNUAL AND MONTHLY AMOUNTS OF DSM EXPENSE



Price for supplying resources on the Dispatching Services Market (uplift)

AEEGSI Resolution 111/06 (TITLE 4) regulates prices for dispatching services and connected guarantees. Dispatching prices include the price for provisioning of resources on the Dispatching Services Market (known as uplift), pursuant to article 44 and subsequent.

The uplift price is the tool used by the system to recover net expenses deriving from energy-related items from the end user, including supplying of services and energy to cover system unbalancing on the DSM, unbalancing prices, congestion income and relative coverage (CCT, CCC, CCP and DCT) and the virtual interconnection service (Interconnector).



This price is invoiced pro-rata to dispatching users based on energy withdrawn, to cover the envisaged accruing monthly cost and prior differences. In 2016, total uplift cost came to € 2,294 million, up with respect to the same period of the previous year, mainly due to the increase in the DSM cost and unbalancing charges (in particular on the consumption-unit side, which is, as mentioned, currently being investigated by the relevant authorities).

Dispatching

Dispatching in 2016 saw a number of important events relative to efficient management of the grid, which are reported below.

MAIN EVENTS IN 2016

Intraday Market Coupling on the border with Slovenia	In June, the Intraday Market Coupling process on the border with Slovenia officially began: the explicit auctions carried out by the JAO (Joint Auction Office) for intraday allocation of the interconnection capacity were replaced by an implicit allocation mechanism that consists of the coupling of the Italian intraday market sessions with the Slovenian market. The mechanism was implemented thanks to the initiative and collaboration of the TSOs and the Energy Exchanges of Italy and Slovenia, with a view to the integration of the markets promoted by the European Commission, and will enable more efficient allocation of the interconnection capacity between Italy and Slovenia, available on an Intraday basis. This allocation model is compatible with continual trading, which is the European target model, and makes it possible to extract the congestion revenue (pricing of the capacity), as required by the EU guidelines on Capacity Allocation and Congestion Management (CACM).
The "D-2 Process"	Again in June, the "D-2 Process" became operational. This incorporates the European Guidelines for Capacity Allocation and Congestion Management (CACM) and involves Terna and the bordering TSOs at the Northern-Italy border (RTE, Swissgrid, APG and ELES) recalculating the NTC (Net Transfer Capacity) on the interconnections every day in a coordinated manner, on the basis of the best forecasting information in their possession. The “D-2 Process” had the effect of strengthening the management of security of exchanges with other countries because it made it possible to identify grid congestions in the operational planning stage and to optimise the NTC thanks to the availability of more accurate forecasting data. The results of the tests, in fact, showed that the process generates additional benefits for the electricity market which makes an average capacity of 200 MW available on the Northern border. This optimisation also made it possible to come closer to the EU objective of 10% in the ratio between installed capacity and interconnection capacity of every member state by 2020.
Anti-blackout re-powering tests	Re-powering tests are necessary to check operating conditions within the electricity system and improve efficiency, to guarantee that service is quickly restored in the case of a blackout. In 2016, three blackout simulations were successfully completed with their associated re-powering operations: in Sardinia, in Sicily and finally in Veneto.

Maintaining Infrastructure

Plant maintenance within the electricity grid is essential to guarantee service quality and continuity. The plant maintenance method adopted by Terna Rete Italia S.p.A. is mainly a predictive one, with the objective of guaranteeing grid reliability within predefined standards. The tools used to support maintenance activities are subject to continuous innovation, as regards the scheduling and execution of operating activities (Workforce Management) and the adoption of modern heliborne inspection techniques for the electricity grid. Terna has participated in international sector benchmark tests for years, with the aim of sharing best maintenance practices, and consistently ranking as one of the best TSOs in terms of fault rates and maintenance costs. In particular, note that in 2016 the programme was begun that will see Terna Rete Italia S.p.A. progressively take over responsibility for maintenance of the electricity assets owned by Rete S.r.l. (deriving from acquisition of the FS lines); in particular the power lines and 61 of the 350 substations acquired have been taken over.

MAINTAINING INFRASTRUCTURES IN 2016

Monitoring and control of plants	22,200 periodic surveillance/technical checks on substations of various voltage levels; visual inspections on 72,800 km of circuits, of which around 31,900 km with helicopter (visual + infra-red) with an average total frequency of around 1.2 inspections per year for each electrical line; beyond infra-red monitoring, around half of the grid – 35,900 km – underwent instrumental controls, both from the ground, using thermal imaging cameras to identify hotspots and ultraviolet cameras (Daycor) to detect the corona effect on isolators and conductors, also using the LLW (live-line working) technique, above all by helicopter, through dedicated LIDAR flights to identify interference, particularly from trees.
Ordinary maintenance	Terna Rete Italia S.p.A. identifies actions to be carried out on the basis of the degradation signals received from the integrated remote management system, from the on-line sensors and from the evidence of the plant monitoring process using MBI (Monitoring and Business Intelligence), the expert system active since 2005 that optimises the maintenance work.
Tree cutting	During 2016, tree cutting regarded approximately 15,400 Km of power lines, to guarantee correct and secure operation of the lines.
Activity with live-line working (LLW)	Approximately 1,800 monitoring checks and 1,000 line maintenance actions with live-line working were carried out. These actions, performed with the line in operation, increase the availability of the plants and contribute to improving service quality and continuity.
Extraordinary maintenance	During 2016, 9 km of overhead lines and 5 km of underground lines were rebuilt and approximately 2,000 km of electricity and guard wires were replaced.

Carrying out development projects

Each year, grid development work involves numerous projects at different stages of the implementation cycle. For details, please refer to the document “Progress on Previous Development Plans - updated to 31/12/2016”, available on the Terna website www.terna.it, pursuant to Resolution of 4 November 2016 627/2016/R/eel, Annex A, art. 7.

Completed work

MAIN WORK COMPLETED MAIN WORK COMPLETED

Villanova-Gissi power line

The 380 kV Villanova-Gissi power line became operational on 31 January 2016. This had been included in the Grid Development Plan and was authorised by the Ministry of Economic Development on 15 January 2013 with Decree No. 239/EL-195/180/2013.

For the electricity system	The work (the initial part of the 380 kV "Foggia-Villanova" power line) was aimed at remedying most of the electrical deficit of Abruzzo resolving its electrical infrastructural shortcomings, eliminating the notable limitations on operations and considerably reducing the risk of blackouts.
For the national community	The benefits for Italy are notable: improved system security and efficiency; economic benefits (savings for households and businesses); and benefits in terms of maintenance of the Adriatic backbone.
For local communities	The project will increase transportation of renewable production by around 700 MW, reducing CO_2 emissions by around 165 thousand tonnes per year.

Sorgente - Rizziconi power line

On 28 May 2016 the 380 kV Sorgente-Rizziconi power line came into service as provided for in the 2016 Development Plan.

For the electricity system	This new infrastructure represents a strategic step forward for Calabria and Sicily and for Italy in general, enabling a more efficient use of the power stations in the south of the country and increasing competition, in turn leading to lower energy prices for Italian businesses and citizens. Over the last 5 years Terna has invested over € 700 million in the project, representing one of the most significant investments in the Group’s history. The project involved 150 technologically advanced and highly skilled companies, including suppliers and construction firms, 90% of which are based in Italy. Over the period, more than 2,000 employees worked on the project.
For the national community	The estimated savings for the system with the new power line will be around € 600 million each year, added to the more than € 7 billion of savings generated since 2005 thanks to the improvements Terna has brought to the Italian Electricity System through investments which have made it possible to reduce grid congestion. Already, just a few weeks after the power line came into operation, an alignment has been seen between prices for Sicily and on the continent.
For local communities	From an environmental standpoint, the new infrastructure will enable Italy to reduce atmospheric emissions of CO_2 by around 700,000 tonnes each year. Thanks to the dismantling of 114 km of overhead power lines and 400 obsolete pylons, 2,500 tonnes of steel, aluminium, glass and concrete can be recycled. In addition, thanks to the use of innovative single-stem pylons for the overhead lines on the Sicily and Calabria sides which require 10 times less surface area than traditional pylons, 228 hectares have been freed up.

2016 also saw the completion of other projects, summarised in the annex “Evolution of the dimensions of the NTG”.
Following the actions to renovate and develop the NTG Terna removed a total of 290 km of obsolete lines, as described in the section on “Sustainability Performance”; please refer to this for more details on the subject.

Progress on construction sites

Regarding the projects detailed below, note that benefits were calculated on the basis of the new Cost Benefit Analysis methodology (CBA 2.0), pursuant to the Italian Regulatory Authority for Electricity, Gas and Water (AEEGSI) Resolution of 4 November 2016 627/2016/R/eel.

MAIN PROGRESS IN 2016

"Udine Ovest-Redipuglia" power line

The project was suspended on 23 July 2015 following ruling 3652/2015, with which the Council of State, holding that the Ministry for Cultural Assets and Heritage had abused its power in the context of the EIA (Environmental Impact Assessment) proceedings, held that protocol 6440 of 24 February 2011 was illegitimate and annulled the EIA provisions, as well as the cited protocol and the single authorisation decree for the work in question. Therefore, Terna had to suspend the construction work which had progressed as follows:

- Udine Sud substation: all the construction work was completed and on-site testing of the equipment installed was finished;
- Udine Ovest and Redipuglia substations: all planned construction work completed and on-site commissioning completed;
- Udine Ovest-Redipuglia power line: 100 out of a total of 115 foundations completed, assembly of 79 pylons out of 115 completed, stringing work begun on conductors, with around 13 km out of 39 total completed;
- the variant to the 380 kV power line "Planais - Udine Ovest" was completed and went into operation and the 220 kV connection Udine Sud - Acciaierie Bertoli Safau S.p.A. was near completion.

On 2 October 2015, a request for redetermination was sent to the Ministry for Economic Development and on 13 November 2015 the MED began the redetermination proceedings with specific protection measures.
On 6 September 2016, a new environmental compatibility decree was issued, followed by the decision of the Services Conference on 18 October 2016 and the Memorandum of Understanding with the Friuli Venezia Giulia region on 12 December 2016.

On 14 February 2017, the Ministry of Economic Development issued a new authorisation decree EL-146-*bis* “Udine Ovest - Redipuglia”, which guarantees the possibility to resume the activities, with completion forecast by the end of 2017.

For the electricity system ▷	This infrastructure represents a strategic project for north and east Italy, able to guarantee that the Friuli electricity system, which is currently not well meshed, will be strengthened. It also offers benefits relative to lower risk of energy not supplied, improves the quality of the electricity service offered to local industrial businesses and households, and improves security in cross-border exchanges with Eastern Europe.
For the national community ▷	Savings for Italy’s system thanks to the new work are estimated at between € 110 and 155 million per year.
For local communities ▷	In terms of the environment, this infrastructure will make it possible to eliminate around 100 km of lines thanks to a rationalisation plan involving 220 kV and 132 kV voltages. Italy will reduce CO_2 emissions by between 750 and 890 thousand tonnes per year.

Authorised work and authorisation procedures in progress

MAIN PROGRESS IN 2016

"Sacca Serenella Cabina Primaria – Cavallino Cabina Primaria" and "Fusina 2 - Sacca Fisola Cabina Primaria Power Lines"

In February 2016, Terna obtained an extension of the authorisation for the project to create the 132 kV "Sacca Serenella Cabina Primaria – Cavallino Cabina Primaria" and "Fusina 2 - Sacca Fisola Cabina Primaria" power lines in cable, included in the Grid Development Plan and approved by the Ministry of Economic Development. The work is necessary to guarantee the widest margins of security and reliability of power supplies to the Venice lagoon.

For the electricity system

This infrastructure will improve operating security and increase reliability of the grid that serves the city of Venice, while also overcoming the current structural antenna that powers the Cavallino main cabin and simultaneously increasing connections with the portion of the grid associated with the 380/132 kV Salgareda substation.

For the national community

Savings for Italy's system thanks to the new work are estimated at between € 9 and 18 million per year.

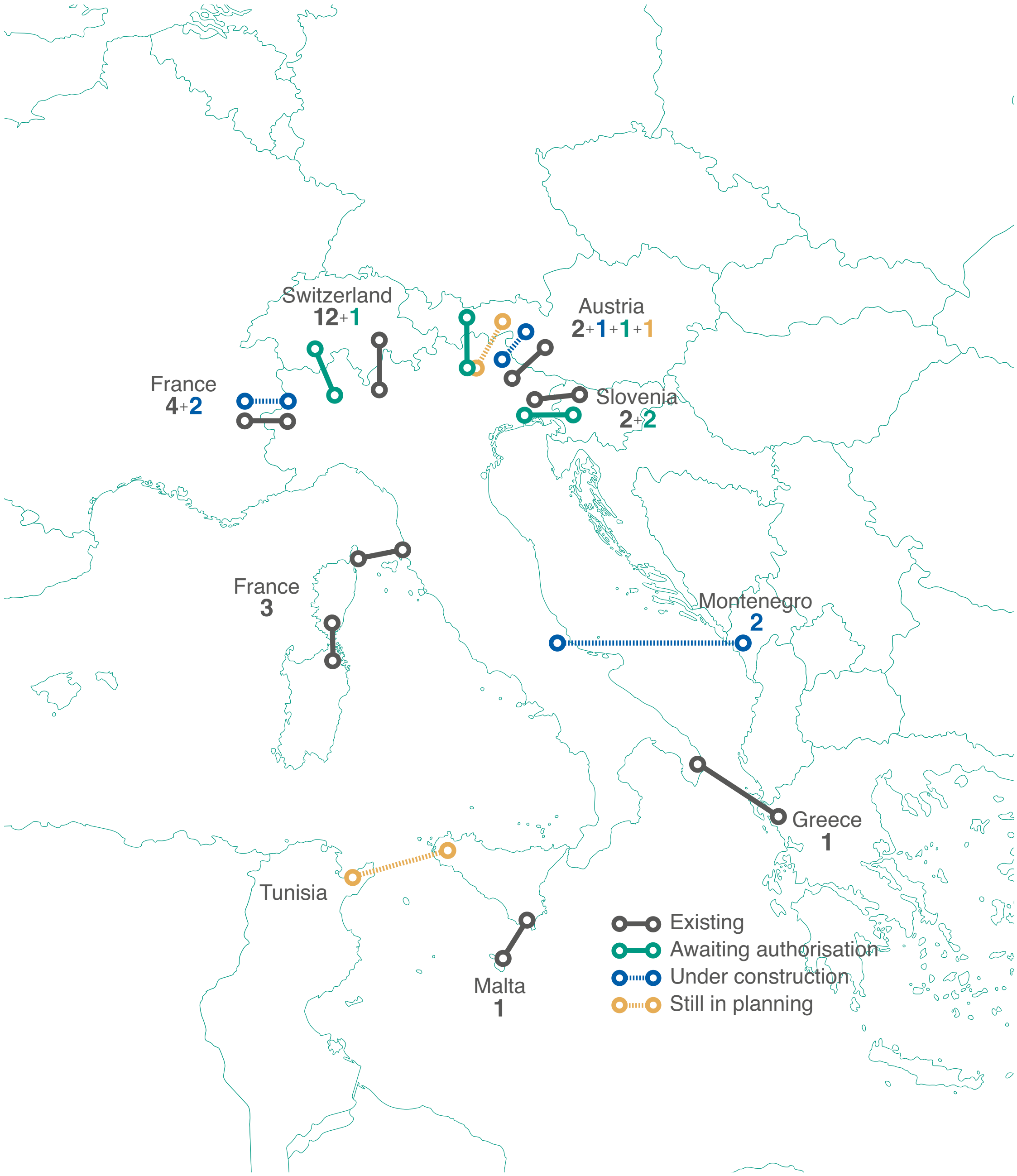
For local communities

In terms of the environment, the infrastructure will allow for removal of around 7 km of 132 kV voltage lines.

WORK AWAITING AUTHORISATION IN 2016

Projects for interconnections with other countries and stage of progress of work

Its geographical position makes Italy a natural hub of the Mediterranean and it can count on an electricity frontier made up of 25 interconnection lines[19] to which must be added 5 new lines under construction.



The development work aimed at increasing the interconnection capacity (Net Transfer Capacity - NTC) on the electrical borders with foreign countries will enable the reduction of the energy procurement costs and the integration of the markets with the possibility of having more resources for operation of the Italian and European electricity system.

(19) Of which 3 merchant lines, i.e. lines not owned by Terna and the Italia-Malta connection owned by Enemalta.

MAIN INTERCONNECTIONS UNDER CONSTRUCTION

"Italy-France" interconnection

The new Italy - France interconnection is a project unique in the world for engineering, technological and environmental solutions used: 190 km of line which will connect, through 25 municipalities of the province of Turin, the substations of Piossasco (Italy) and Grand'Ile (France), created entirely in direct-current underground cable. MED, together with MIT and MATT, issued the authorisation for the local variant on 5 August 2016 relative to the roughly 26 km section of the Italy - France electricity connection between Bussoleno and Salbertrand.

For the electricity system ▷ The creation of the new interconnection will bring benefits for the electricity markets of Italy and France. The increases in energy exchanges will guarantee a reduction in congestion between the two countries and the possibility of more efficient use of renewable sources. This therefore makes the interconnection also a Project of Community Interest (PCI). It is currently a candidate for inclusion on the third PCI list.

For the national community ▷ The infrastructure will increase social and economic welfare at the European level, reducing the price differential between Italy and France. Additionally, based on that demonstrated in the 2016 TYNDP, this interconnection will increase production from renewables in Italy and improve energy efficiency at the European level.

For local communities ▷ The adoption 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 infrastructures, such as the Fréjus safety tunnel, offers another strategic advantage in terms of social/environmental issues.

"Italy-Montenegro" Interconnection

On 4 October 2016 the work to lay the underground cable of the Montenegrin stretch was inaugurated in the presence of the Prime Minister of Montenegro, Milo Dukanović and the Chief Executive Officer of Terna S.p.A., Matteo Del Fante. The interconnection between Italy and Montenegro is a strategic project at the European level that represents the first "electrical bridge" between Italy and the Balkans.

For the electricity system ▷ The work, which when completed at the end of 2019 will offer the possibility to develop interconnection capacity, has been included among the Projects of Common Interest (PCI) by the European Commission, which co-financed the feasibility studies in the framework of the programme to support the Trans-European Network (TEN) priority electrical infrastructures. At present, the project is a candidate for inclusion on the third PCI list.

For the national community ▷ The infrastructure is a fundamental step for the European Energy Union, crucial for integrating the entire Balkan area into Europe, via Italy.

For local communities ▷ The project involves the creation of direct current infrastructure with at least 1000 MW of power, extending a total of 445 km between Villanova (Pescara) and Kotor, with minimal environmental impact, as it involves the use of cables placed 1200 metres below the bottom of the Adriatic sea and buried for the remaining land-based portion.

MAIN INTERCONNECTIONS UNDER CONSTRUCTION, *continued*

Italy - Austria interconnection

The high-voltage interconnection line between Prati di Vizze (IT) - Steinach (AT), planned to go into operation in 2020, will take advantage of the existing Prati di Vizze - Brennero power line. Preparatory activities to create the new 132/110 kV electrical substation in Brennero and relative line connections are currently in progress.

For the electricity system

The line will make it possible to significantly increase the electricity exchange capacity between Italy and Austria, supporting market integration, use of renewable sources and service security.

For the national community

This will provide significant benefits in terms of increasing social economic welfare, contributing to reducing price differentials between Italy and Austria, and ensuring full use of hydroelectric resources, while also improving the security of the electricity supply. The use of existing infrastructure will minimise the environmental impacts of the works.

For local communities

To allow imported power transported along the future Prati di Vizze - Steinach interconnection line to be safely 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 enable optimal use and further development of production capacity from renewable sources defined to serve the relevant portion of the local grid.

INNOVATION

Storage systems

The sharp increase in the production of electricity from non-programmable renewable sources causes significant problems for adjustment of the electricity system and full use of such energy. This has led Terna to begin an innovative investment plan in the field of storage (battery) systems. These systems make it possible to not only recover a part of the renewable energy which is otherwise subject to curtailment due to grid congestion, but also increases the security of the electricity grid thanks to their ultra-fast performance during adjustment.

"Energy intensive" macro project

- *34.8 MW in operation;*
- *a total of € 160.9 mln invested;*
- *€ 2.5 mln invested in 2016*

Introduced in the context of the 2011 DP, this involves the creation of three storage systems in southern Italy, in Ginestra (Benevento), Flumeri (Avellino), and Scampitella (Avellino). The plants include highly innovative technology. The three non-conventional storage systems (NCSS) allow the backbones of the national electricity grid found in these areas to be managed more securely and flexibly. They involve a high concentration of non-programmable renewable sources, and allow for recovery of a portion of the energy produced by the wind plants. 2016 was the first year of experimentation with the project, during which a high level of standardisation in continuous operation of the NCSS was achieved in providing services to the NTG.

“Power intensive” macro project

- *13.5 MW in operation;*
- *a total of € 42.4 mln invested;*
- *€ 5.2 mln invested in 2016*

Approved by the MED in the context of the 2012 Security Plan, this includes an initial phase with the creation of two experimental plants using electrochemical storage systems (in Ciminna in Sicily and in Codrongianos in Sardinia), with the goal of increasing the security of the electricity systems on the larger islands. In 2016, experimentation continued as foreseen in the Storage Lab project with almost the entire system going operational, including the two flow storage systems. The procurement procedures were also begun for the further technologies that will be needed to complete the ambitious experimental programme launched.

Smart island

In 2016, Terna’s commitment to the smart island initiatives continued. These were begun in June 2015, with an agreement to modernise the electricity grid on the island of Giglio. The smart island projects foresee integration of renewable generation, energy storage systems, electrical vehicles and high-tech solutions to manage active demand on the smaller islands.

Pantelleria

In May 2016 a Memorandum of Understanding was signed between Terna Plus, the municipality of Pantelleria and S.Med.E a local company that produces and distributes electricity, with the aim of creating the “Pantelleria Smart Island” project. The aim of the agreement is to increase the spread of clean energy across the island, at the same time reducing use of fossil fuels, for the production of electricity. Thanks to integrated smart grid management, these actions will allow a reduction in pollution, improving environmental conditions and the quality of life of the citizens of Pantelleria. In addition, these aspects will have positive impacts on tourism.

Certosa

In August 2016, Terna Plus also signed an agreement with Vento di Venezia, a company that is working to reclaim the island of Certosa in partnership with the Municipality of Venezia, with the aim of making the island of Certosa a laboratory for smart energy. The three-year project is part of a bigger programme that aims for the environmental and economic recovery, from a social perspective, of 24 hectares of land on the island of Certosa. Thanks to the participation of Terna Plus, the project objectives relative to urban regeneration will be further raised and the island, of notable historical and natural value, will become a "Smart Energy Island", a model of sustainability and innovation at an international level.

Non-Regulated Activities

Below is a summary of the main results achieved in 2016 relative to the Group's non-regulated activities, in the various areas outlined and described in more detail in the "Business and Capital" section. Here is a brief summary:

- Private interconnectors pursuant to Italian Law 99/2009
- Transformers - Tamini Group
- Services for third parties (Engineering, Telecommunications, Operation of third-party plants and BOOT)

Private interconnectors pursuant to Italian Law 99/2009

In 2016, Terna continued the creation of the Italy-France and Italy-Montenegro interconnectors.

INTERCONNECTOR IN CORSO	
Project "Italy-France Interconnector"	On 12 May 2016 the AEEGSI, by means of Resolution 228/2016/I/eel, approved the document "Opinion on the Piemonte Savoia Exemption Application", in preparation for the Ministry of Economic Development issuing an exemption decree for the work for a period of ten years. On 20 July 2016 the Ministry of Economic Development issued the "Decree of exemption for the private line of the interconnection power line" in favour of the subsidiary Piemonte Savoia S.r.l. (PI.SA.). The document was sent to the European Commission for the necessary approval. At present, PI.SA. is waiting to receive notification from MED that the exemption procedure has been completed. Relative to completion of the work, in March 2016 work to lay around 15 km of cable began, for the connection between the Piossasco and Avigliana substations. Relative to the Piossasco substation, geological surveys and basic engineering have been completed and the work to prepare the construction site is done.
Project "Italy-Montenegro Interconnector"	On 2 December 2016, with resolution 701/2016/I/eel, the AEEGSI issued a favourable opinion to the Ministry of Economic Development, supporting an exemption being granted to Monita Interconnector S.r.l. for a ten-year period. Relative to progress in completing the work, on the Italian side the main buildings for the Cepagatti substation have been constructed and production of the main electromechanical structures is complete. On the Montenegro side, completion of the civil works for the Kotor substation are under way. In December 2016, the second cable-laying stage was completed, starting from Kotor: in particular, more than 400 km of cable were laid and therefore in February 2017 the undersea laying was substantially complete.

Transformers - Tamini Group

With a century of experience and high level of know-how, Tamini is a historic industrial company with a reputation for excellence, a national hub of reference in the transformers sector recognised in the electrical sector in Italy and abroad with a Group of approximately 400 specialised employees, with customers located in more than 90 countries worldwide.
Sales of transformers in 2016 was down compared to the previous year (-20%), in particular due to the downturn seen in the power segment.
In particular, with reference to the foreign market in 2016 the first Phase-Shifting Transformer units were delivered; this is a complex and strategic project for Tamini which has managed to enter into this important

sector on a European scale. In addition, again at the Legnano facility, commissioning was carried out successfully on the 500 MVA transformer with transformation ratio 380/220 kV for the Irish operator ESB. This is the largest transformer installed in Ireland, for dimensions and weight.
At the end of August, work began on reclaiming the Melegnano Facility and making it safe. It will remain out of operation until the work is complete.

Services for Third Parties

In Italy, during 2016, Terna continued to perform activities related to services for third parties in the areas of telecommunications (housing telecommunication equipment and maintenance services involving fibre-optic networks), engineering (developing technical solutions and providing innovative services) and operation of third-party plants (operating and maintaining high-voltage and very-high-voltage plants).

SERVICES FOR THIRD PARTIES	
Telecommunications	The purchase of the High-Voltage grid of the Ferrovie dello Stato Group, completed in December 2015, involved the transfer of a contract for the laying and maintenance of the optic fibre owned by Basictel, which in 2016 generated € 5.6 million in revenue, and expires in 2030. In 2016 contracts were signed with the main telecommunications operators for the granting of indefeasible rights of use (IRU) and maintenance services on stretches of optical fibre. In regard to the Italian project on the ultra-broadband network, on 23 June 2016, Terna obtained the pre-qualification to participate in the future tender for the construction of fibre optic backhaul networks.
Engineering	Among the main projects, note the restoration of a 150 kV electrical substation in Sicily, the creation of a cogeneration plant at an industrial site in Tuscany and a connection to a biomass plant in Apulia. Additionally, work continued to create a 132 kV substation for a manufacturing plant in Emilia-Romagna, and the creation of two new substations in Lombardy was begun, as well as connection of a photovoltaic plant in Lazio.
Management of third-party plants	Third Party Plant Management services include the multi-year contract for the maintenance of an undersea cable and contracts for the maintenance of third party user substations, power lines and renewable production substations.

AGREEMENT WITH FERROVIE

On 17 November 2016, Terna S.p.A. and Rete Ferroviaria Italiana S.p.A. signed a Letter of Intent with the aim of working together to identify and carry out initiatives of shared interest relative to renewables in Italy.
In particular, the agreement foresees the development by the two companies of a project to create photovoltaic plants that will power RFI's electricity consumption with clean energy.
Based on the agreement, areas will be identified on which photovoltaic plants can be constructed for up to a maximum of 200 MW. This will guarantee Rete Ferroviaria Italiana clean energy production of up to 300 GWh per year.
The project being examined by Terna and RFI could be the first large operation in the photovoltaic energy sector in Italy to be carried out in a situation of "grid parity", meaning with no government incentives and, in contrast with the past, without additional charges falling to households and businesses.
The initiative falls within a greater context of cooperation between the two companies that begun in 2015 when Terna acquired the high-voltage grid previously owned by the Gruppo Ferrovie dello Stato Italiane S.p.A., which envisages development of numerous activities to take advantage of existing synergies, especially relative to border and interfacing areas and infrastructures.

International Activities

During 2016, activities abroad continued in accordance with the corporate strategy.

INITIATIVES	
Chile	Activities in Chile progressed, with the commissioned plants beginning operations (two substations and a 220 kV power line).
Uruguay	In September 2016 in Uruguay, Terna was awarded a tender by UTE – a vertically integrated, state-owned company which manages the generation, transmission, distribution and sale of electricity – for the construction of three new electricity infrastructures in the country. Specifically, Terna will create three electricity lines: the first at 500 kV will be 213 km long and will start from Melo to reach the locality of Tacuarembo; to this will be added the creation of another two lines connecting to the pre-existing transmission system, for a total length of 10.5 km. Once the tender results are formalised, Terna will have 24 months to construct and commission the three power lines. The total value of the investment is around € 70 million. In December 2016, the contract with the Uruguayan company UTE was signed and the company Difebal was acquired to manage administrative, accounting and corporate activities in preparation for the start of works, planned for the first half of 2017. In particular the BOT (Build Own Transfer) project type entails that, after construction of the assets, Terna will remain the owner of the same, for the entire period of the concession envisaged as 30 years. The O&M activity on the lines will instead remain the responsibility of the concessionaire, which will have the right to purchase ownership of them at the end of the concession.
Brazil	Through its subsidiary Terna Plus, in February 2017 Terna signed an agreement with Planova, a Brazilian company that constructs civil works and infrastructure, aimed at the acquisition of two concessions to operate a total of around 500 km of electricity infrastructure in the South American nation. The two concessions, which will last for thirty years, will involve the construction of 158 km of new lines in the state of Rio Grande do Sul and 350 km in the state of Mato Grosso. The total value of the investment is around € 180 million. The agreement envisages that the Terna Group will have ownership of the concession and operate the lines, while engineering, planning and construction (EPC) will be assigned to Planova, as the “executor” on Terna’s account. Final closing of the contract signed by Terna Plus and Planova is conditional on the following: Planova must obtain all permits and licenses needed for construction and operation of the infrastructure, and the go ahead from the Brazilian anti-trust authorities (Cade - Conselho Administrativo de Defesa Econômica) and the Regulator (Aneel - Agência Nacional de Energia Elétrica).

In addition, technical assistance activities were strengthened and are still in course with local operators and the Authorities in Kenya and Turkey.
A commercial relationship was developed with a number of industrial partners through targeted partnerships and agreements. Of particular note was the Memorandum of Understanding signed with ENI, aimed at developing energy systems with an eye to sustainability and to supporting renewable production sources.
The agreement involves a vast array of potential cooperative projects, including researching electricity systems, in particular those associated with Gas to Power development opportunities, Access to Energy initiatives, the design and creation of renewable plants and their connection to and integration with the electricity grid, Smart Grids, Energy Storage projects, research and development and energy projects with reduced environmental impacts.

ECONOMIC AND FINANCIAL PERFORMANCE

The Terna Group's economic and financial position and performance

The 2016 Annual Financial Report of the Terna Group has been prepared in accordance with the provisions of Art. 154-*ter* of Italian Legislative Decree 58/98 introduced by Italian Legislative Decree no. 195 of 6 November 2007 (the "Transparency Decree"), as amended by Italian Legislative Decree No. 27 of 27 January 2010.
In implementation of the provision of Italian Legislative Decree No. 38 of 28 February 2005 and EEC Regulation No. 1606/2002, the Terna Group prepares the consolidated financial statements as at and for the year ended 31 December 2016 in compliance with the International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board and endorsed by the European Commission (hereinafter "EU IFRSs").
The 2016 Annual Report has been prepared on a historic cost basis, modified where required by law for determining certain items subject to valuation, as well as on a going concern basis.

Consolidation perimeter

The changes in the Terna Group's consolidation perimeter with respect to the situation at 31 December 2015 includes the Uruguayan company "Difebal S.A." acquired by the parent company Terna, on 13 October 2016. In addition, with reference to associates, it is noted that on 28 October 2016, following the entry into the shareholding structure of CORESO S.A. of the Spanish TSO REE, Terna S.p.A. reduced its equity investment to 16.67%, in proportion to the other shareholders.

Basis of presentation

The measurement and recognition criteria applied in this Annual Financial Report are consistent with those adopted in the consolidated financial statements at 31 December 2015. In order to present the performance of the Terna Group and to analyse its financial position, separate reclassified statements have been prepared that differ from those required by the EU-IFRS adopted and contained in the consolidated financial statements. These reclassified tables contain alternative performance indicators with respect to those resulting directly from the tables of the consolidated financial statements, which management considers useful for monitoring Group trends, and representative of the economic and financial results produced by the business. In line with the guidance found in ESMA/2015/1415, the criteria for constructing these indicators are described in the footnotes which reconcile them with the tables contained in the consolidated financial statements, attached to this Integrated Report.
It Is noted that the Income Statement for financial year 2016 includes the contribution of Rete S.r.l. and of TES-Transformer Electro Service (controlled by Tamini S.r.l.), which are also included in the comparative period, since the acquisitions occurred on 23 December and 30 October 2015, respectively. For the purpose of better representation of the effects of the acquisition of the FSI Group grid, some balance sheet items were redetermined under the terms of IFRS 3 and reclassified, without however modifying the net result for financial year 2015 and equity at 31 December 2015.

Group reclassified income statement

The economic results for financial year 2016 for the Terna Group, compared with the previous year, are summarised in the following Operating Income Statement, obtained by reclassifying the figures of the Consolidated Income Statement.

€ million	2016	2015	Δ	Δ %
REVENUE				
- Transmission	1,735.0	1,706.4	28.6	1.7%
- Dispatching	111.3	125.2	(13.9)	(11.1%)
- Other operating revenue	235.7	224.3	11.4	5.1%
of which other revenue from Regulated Activities	*49.1*	*18.1*	*31.0*	*171.3%*
of which revenue from Non-Regulated Activities	*186.6*	*206.2*	*(19.6)*	*(9.5%)*
- IFRIC 12 effects	21.2	26.2	(5.0)	(19.1%)
TOTAL REVENUE	**2,103.2**	**2,082.1**	**21.1**	**1.0%**
OPERATING EXPENSES				
- Personnel	263.6	226.9	36.7	16.2%
- Services, leases and rentals	179.1	145.2	33.9	23.3%
- Materials	66.5	89.9	(23.4)	(26.0%)
- Other expenses	35.9	46.8	(10.9)	(23.3%)
- Quality of Service	(7.8)	7.9	(15.7)	(198.7%)
- IFRIC 12 effects	21.2	26.2	(5.0)	(19.1%)
TOTAL OPERATING EXPENSES	**558.5**	**542.9**	**15.6**	**2.9%**
EBITDA (GROSS OPERATING MARGIN)	**1,544.7**	**1,539.2**	**5.5**	**0.4%**
- Amortisation, depreciation and impairment	508.7	516.8	(8.1)	(1.6%)
EBIT (OPERATING PROFIT)	**1,036.0**	**1,022.4**	**13.6**	**1.3%**
- Net financial income (expense)	(102.8)	(141.1)	38.3	(27.1%)
PROFIT/LOSS BEFORE TAXES	**933.2**	**881.3**	**51.9**	**5.9%**
- Income taxes	305.3	286.0	19.3	6.7%
PROFIT	**627.9**	**595.3**	**32.6**	**5.5%**
- *Minority interests*	*(5.2)*	*(0.2)*	*(5.0)*	-
GROUP NET PROFIT	**633.1**	**595.5**	**37.6**	**6.3%**

In 2016, Terna Group **revenue** was at **€ 2,103.2 million**, an increase of € 21.1 million with respect to the previous year (+1%). This change can be attributed to regulated activities for +€ 45.7 million and to nonregulated activities for -€ 19.6 million, as well as to a decrease of € 5.0 million with respect to the previous financial year referred to the application of IFRIC 12.

REVENUE FROM REGULATED ACTIVITIES

€ million	2016	2015	Δ
Transmission Fee	1,735.0	1,706.4	28.6
Dispatching fee	111.3	125.2	(13.9)
Other operating revenue	49.1	18.1	31.0
of which Quality of Service	*15.4*	*(4.7)*	*20.1*
of which Other	*33.7*	*22.8*	*10.9*
TOTAL	**1,895.4**	**1,849.7**	**45.7**

Revenue from Regulated Activities recorded an increase of € 45.7 million compared to the previous year, mainly due to the following:

- an increase in **transmission revenues** (+€ 28.6 million): for the contribution of the National Transmission Grid acquired at the end of 2015 from the FSI Group (+€ 63.0 million, including the "linearization" under the terms of IFRS 3 of the effects provided for in Resolution 517/2015/R/eel), which offset the overall effects of the new regulatory period 2016–023 (mainly referred to the reduction in revenue relative to the revision of the WACC;
- a decrease in **dispatching revenues** (-€ 13.9 million), which reflects the overall effects of the new regulatory period, mainly due to the reduction in recognised operating expenses;
- a positive impact from **Quality of Service** (+€ 20.1 million), mainly due to the effect of bonuses deriving from the RENS 2015 incentive mechanism set out in Resolution 668/2016/R/eel, for € 12.0 million and the the positive performance seen in 2016 (€ 3.4 million), as a result of estimated total results expected during regulation period 2016–2019 (pursuant to Resolution 653/2015/r/eel);
- an increase in **other revenue** (+€ 10.9 million): of particular importance the higher revenue from sales to third parties, essentially for continuation of the "Copper Plan" (€8.0 million), which provides for the gradual replacement of certain obsolete copper conductors with new aluminium conductors and higher revenue connected with services to connect plants to the NTG (+€1.6 million).

Below we detail the overall economic effects of the premium/penalty mechanisms related to Quality of Service for financial year 2016, compared with 2015.

QUALITY OF SERVICE

€ million	2016	2015	Δ
Revenue			
Premium/(Penalty) RENS	15.4	(4.7)	20.1
	15.4	**(4.7)**	**20.1**
Costs			
Mitigation and sharing mechanisms	3.2	10.8	(7.6)
Contributions to Exceptional Events Fund	3.0	6.1	(3.1)
High-voltage-users compensation mechanisms	0.5	-	0.5
Contingent assets	(14.5)	(9.0)	(5.5)
	(7.8)	**7.9**	**(15.7)**
Net impact of Quality of Service	**23.2**	**(12.6)**	**35.8**

REVENUE FROM NON-REGULATED ACTIVITIES

€ million	2016	2015	Δ
Contribution of the Tamini Group	102.4	121.9	(19.5)
Pampa Norte EPC (Chile)	2.8	14.3	(11.5)
EPC on the NTG	3.3	6.7	(3.4)
New TLC contracts	8.2	1.8	6.4
Provision release	8.7	-	8.7
Services for third parties, other revenues	61.2	61.5	(0.3)
TOTAL	**186.6**	**206.2**	**(19.6)**

Revenue from **Non-Regulated Activities** reported a decrease of € 19.6 million, due to the combined effects of:

- the reduction in revenues from the Tamini Group (-€ 19.5 million), due to the lower 2016 order intake and the 2015 one-off effects related to an insurance indemnity for -€ 4.9 million, as well as the price adjustment of Tamini acquisition (-€ 5.9 million);
- higher revenues recognised in 2015, associated with the Pampa Norte EPC in Chile (-€ 11.5 million);
- reduction in EPC on the NTG (-€ 3.4 million), for one-off activities recognised in 2015;
- revenues from the telecommunications sector (+€ 6.4 million), essentially due to the contract with Basictel (+€ 5.6 million) on Rete S.r.l. power lines, and new concessions for fibreoptic rights;
- the release of a provision for risks recognised on the disposal of the photovoltaic project, as certain contractual obligations (+€ 8.7 million).

OPERATING EXPENSES

Operating expenses during the year, at € 558.5 million, grew with respect to 2015 by **€ 15.6 million**.

The increase is mainly due to the acquisition of Rete S.r.l. (+€ 23.8 million) and the net provision for personnel incentives (+€ 30.0 million), partially compensated for by savings generated by the Group's operating efficiency plan and lower costs related to the Pampa Norte EPC in Chile and to the Tamini Group (-€18.0 million), as well as the impact of quality of service (-€15.7 million).

The breakdown of the Group's operating expenses for the year, with separate evidence for the Tamini Group contribution, is shown in the following table:

€ million	2016	2015	Δ	Δ without Tamini	Δ Tamini
Personnel expenses	263.6	226.9	36.7	32.7	4.0
Services, leases and rentals	179.1	145.2	33.9	32.9	1.0
Materials	66.5	89.9	(23.4)	(11.2)	(12.2)
Other expenses	35.9	46.8	(10.9)	(11.7)	0.8
Quality of Service	(7.8)	7.9	(15.7)	(15.7)	-
IFRIC 12 effects*	21.2	26.2	(5.0)	(5.0)	-
TOTAL	**558.5**	**542.9**	**15.6**	**22.0**	**(6.4)**

* Recognised pursuant to IFRIC 12.

Net of Tamini Group, operating expenses increased by € 22 million compared to the previous year. The increase, net of IFRIC 12 effects for -€ 5.0 million, is due to the following changes:

- **Personnel expenses**: +€ 32.7 million, mainly due to higher net provisions for a new € 30.0 million turnover programme;
- **Services, leases and rentals**: +€ 32.9 million, relating mainly to maintenance costs incurred by the subsidiary Rete S.r.l. (€ 36.0 million) relative to the FSI Group, partially compensated for by reductions in the costs for services recognised by the Group during the year;
- **Materials**: -€ 11.2 million, mainly due to the completion of the EPC for the subsidiary Terna Chile S.p.A., begun in 2015 (-€ 11.6 million);
- **Quality of Service**: -€ 15.7 million, mainly due to provision release relative to the Exceptional Events Fund (-€ 8.7 million, net of accruals relative to the year) and lower provisions for mitigation and sharing mechanisms (-€ 7.5 million) and costs relative to high-voltage user indemnity mechanisms, introduced in 2016 (+€ 0.5 million);
- **Other expenses**: -€ 11.7 million, mainly due to the recognition in 2015 of tax and other additional charges associated with the acquisition of Rete S.r.l. (-€ 13.1 million).

The Gross Operating Margin (EBITDA) of the year was € 1,544.7 million, an increase of € 5.5 million compared to the € 1,539.2 million of 2015, mainly due to the improved result of Regulated Activities. The EBITDA margin was substantially in line with the previous year: it moved from 73.9% in 2015 to 73.4% in 2016; net of the effect of the new turnover plan it would be 75.0%.
Amortisation, depreciation and impairment amounted at € 508.7 million, a reduction of € 8.1 million with respect to 2015, mainly due to lower depreciation and amortisation after a review of the useful life of electricity lines (increased from 40 to 45 years), partially compensated for by the entry into operation of new plants, by depreciation and amortisation related to the subsidiary Rete S.r.l. (+€ 24.8 million) as well as for greater impairment in 2015 of certain plants owned by the Parent Company and the subsidiary Terna Plus S.r.l. (-€ 22.9 million).

EBIT (operating profit) was at **€ 1,036.0 million**, compared to € 1,022.4 million in 2015 (+1.3%).
Net financial expense for the year, at € 102.8 million, mainly relative to the parent company (€ 101.5 million), fell by € 38.3 million with respect to the € 141.1 million reported in 2015, mainly due to the general decrease in interest rates in 2016 and one-off effects associated with the liability management operation completed on 20 July 2015 (€ 32.3 million), partially offset by lower capitalisation (€ 12.7 million).
After deducting net financial expense, **profit before taxes** reached at **€ 933.2 million**, up by € 51.9 million compared with the previous year (+5.9%).

Income taxes for the year amounted to € 305.3 million, an increase of € 19.3 million (+6.7%) over the previous year, mainly due the effects of greater pre-tax profit.
The tax rate for the year was 32.7%, substantially in line with the 32.5% applied in 2015.

Net profit for the year reached **€ 627.9 million**, an increase of € 32.6 million (+5.5%) with respect to the € 595.3 million of 2015.

Group net profit (therefore excluding minority interests) stood at **€ 633.1 million**, an increase of € 37.6 million (+6.3%) compared to € 595.5 million in 2015.

Economic results by business segment

The breakdown of the Terna Group's results by business segment, in relation to financial years 2016 and 2015, is detailed in the table below[20].

€ million	2016	2015	Δ	Δ %
Total revenue from Regulated Activities	**1,895.4**	**1,849.7**	**45.7**	**2.5%**
Transmission Fee	1,735.0	1,706.4	28.6	1.7%
Dispatching revenues	111.3	125.2	(13.9)	(11.1%)
Quality of Service	15.4	(4.7)	20.1	(427.7%)
Other core revenue	33.7	22.8	10.9	47.8%
Total revenue of Non-Regulated Activities	**186.6**	**206.2**	**(19.6)**	**(9.5%)**
Tamini Group revenue	102.4	116.0	(13.6)	(11.7%)
Other non-regulated revenue	84.2	90.2	(6.0)	(6.7%)
IFRIC 12 effects	21.2	26.2	(5.0)	(19.1%)
Total revenue	**2,103.2**	**2,082.1**	**21.1**	**1.0%**
Total costs of Regulated Activities	**399.9**	**363.8**	**36.1**	**9.9%**
Personnel	226.6	194.9	31.7	16.3%
External resources	153.7	123.4	30.3	24.6%
Quality of Service	(7.8)	7.9	(15.7)	(198.7%)
Other expenses	27.4	37.6	(10.2)	(27.1%)
Total costs of Non-Regulated Activities	**137.4**	**152.9**	**(15.5)**	**(10.1%)**
Tamini Group costs	109.2	115.6	(6.4)	(5.5%)
Other non-regulated costs	28.2	37.3	(9.1)	(24.4%)
IFRIC 12 effects	21.2	26.2	(5.0)	(19.1%)
Total operating expenses	**558.5**	**542.9**	**15.6**	**2.9%**
EBITDA	**1,544.7**	**1,539.2**	**5.5**	**0.4%**
EBITDA Regulated Activities	**1,495.5**	**1,485.9**	**9.6**	**0.6%**
EBITDA Non-Regulated Activities	**49.2**	**53.3**	**(4.1)**	**(7.7%)**

Regulated Activities

The **EBITDA of Regulated Activities** amounted to € 1,495.5 million, up € 9.6 million compared to the figure for the previous year. This increase was due to the positive effects of Quality of Service (+€ 35.8 million), the contribution by Rete S.r.l. (+€ 26.4 million), higher other revenues (+€ 10.9 million), mainly relative to the "Copper Plan", the positive effect on operating expenses of saving actions (+€4.2 million) and the recognition in 2015 of tax for the acquisition of Rete S.r.l. (+€ 13.1 million), in part compensated for by non-recurring costs in 2016 for the new turnover plan incentives (-€ 32.3 million), the reduction in the transmission fee (-€ 34.4 million), and for dispatching activities (-€13.9 million) which essentially reflect the effects of the new 2016–023 regulatory period.

Non-Regulated Activities

EBITDA of Non-Regulated Activities for 2016, equal to € 49.2 million, reported a reduction of € 4.1 million, mainly deriving from the Tamini Group (-€ 7.2 million), for lower contributions from EPC on the NTG (-€ 3.4 million), partially compensated for by the contract with Basictel (+€ 5.3 million to the change in the Rete S.r.l. perimeter). Also noteworthy are the one-off effects associated with the release of the provision for risks allocated for the disposal of the photovoltaic project, as certain contractual obligations expired (+€ 8.7 million) and the adjustment to the price paid to acquire Tamini (-€ 5.9 million), as registered in 2015.

(20) The Terna Group's business segments are defined within the internal management control system adopted by the Parent Company, in line with the 2017-2021 Strategic Plan.

Investments

Resolution 654/15/R/eel confirmed the effects of incentive regulations from prior regulatory periods for all investments that came into operation by 31 December 2015.
Below is the classification of the Group's investments in 2016, according to the remuneration categories identified within the new regulatory framework (V Period).

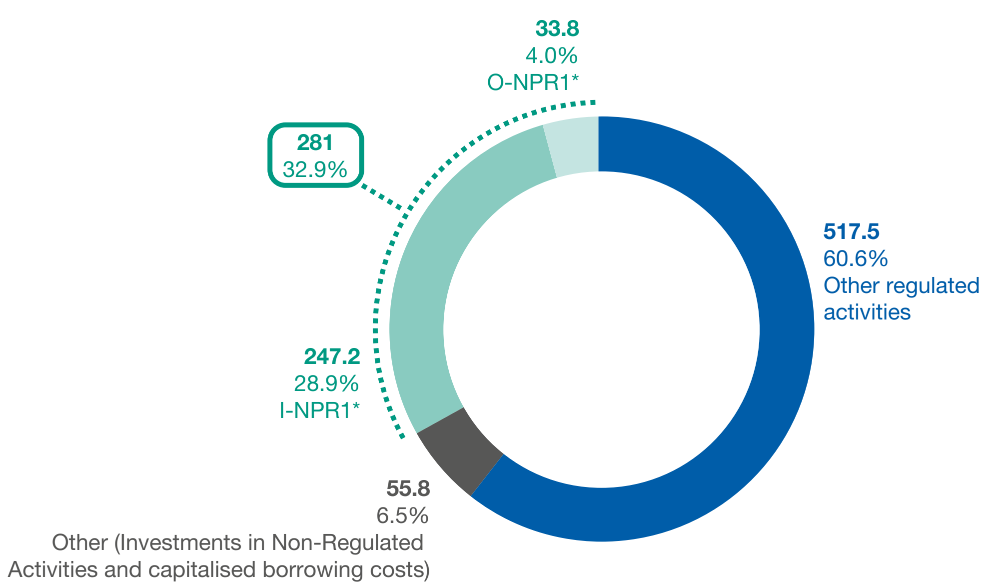
€ million	2016	2015	Δ	Δ %
I-NPR1	247.2	213.5	33.7	15.8%
O-NPR1	33.8	21.0	12.8	61.0%
Investments with incentives*	**281.0**	**234.5**	**46.5**	**19.8%**
Other regulated activities	517.5	800.5	(283.0)	(35.4%)
Investments in Regulated Activities	**798.5**	**1,035.0**	**(236.5)**	**(22.9%)**
Other**	55.8	68.1	(12.3)	(18.1%)
Total investments	**854.3**	**1,103.1**	**(248.8)**	**(22.6%)**

* Investments classified in accordance with Art. 20 of Resolution 654/15/R/eel and pending approval by the AEEGSI, described below.
** These include "investments in Non-Regulated Activities" and "capitalised borrowing costs".

Total investments in 2016 amounted to € 854.3 million, compared with the € 1,103.1 million of the previous year. Of these, **investments with incentives** (I-NRP1 and O-NRP1 categories) amounted to **€ 281.0 million**, an increase of € 46.5 million with respect to the previous year (+19.8%).

The item "Other" includes investments in Non-Regulated Activities (€ 39.8 million), mainly related to investments made by the subsidiary Piemonte Savoia S.r.l., and capitalised borrowing costs (€ 16.0 million).

INVESTMENTS BY REMUNERATION CATEGORY



* Investment classification in accordance with art. 20 Res. 654/15 and pending approval by the AEEGSI.

The Group's reclassified statement of financial position

The reclassified consolidated statements of financial position of the Terna Group at 31 December 2016 and 31 December 2015 are presented below, obtained by reclassifying the data found in the Consolidated Statement of Financial Position.

€ million	at 31.12.2016	at 31.12.2015	Δ
Net non-current assets			
- Intangible assets and goodwill	516.0	529.5	(13.5)
- Property, plant and equipment	12,386.1	12,078.7	307.4
- Financial assets	89.1	89.5	(0.4)
Total	**12,991.2**	**12,697.7**	**293.5**
Net working capital			
- Trade receivables	466.9	568.3	(101.4)
- Inventories	10.2	12.4	(2.2)
- Other assets	20.4	13.8	6.6
- Trade payables	(758.4)	(720.9)	(37.5)
- Net energy-related pass-through payables	(545.9)	(617.9)	72.0
- Net tax assets	52.0	132.5	(80.5)
- Other liabilities	(337.7)	(363.9)	26.2
Total	**(1,092.5)**	**(975.7)**	**(116.8)**
Gross invested capital	**11,898.7**	**11,722.0**	**176.7**
Provisions	(384.6)	(373.5)	(11.1)
NET INVESTED CAPITAL	**11,514.1**	**11,348.5**	**165.6**
Equity	**3,535.4**	**3,320.8**	**214.6**
Minorities	**19.8**	**25.0**	**(5.2)**
Net financial debt	**7,958.9**	**8,002.7**	**(43.8)**
TOTAL	**11,514.1**	**11,348.5**	**165.6**

The increase in net non-current assets of € 293.5 million, compared with the figure at 31 December 2015, is mainly attributable to the item **Property, plant and equipment** (+€ 307.4 million) owing to the combined effects of:

- investments of € 812.8 million during the year;
- amortisation and depreciation for the year of € 449.2 million;
- other changes during the year of € 53.1 million, mainly relative to plant grants, in particular those received for projects financed by MED/EU; disposals and impairment (€ 3.1 million).

Intangible assets and goodwill recorded a decrease of € 13.5 million compared to previous year, attributable to the combined effects of:

- investments during the year of € 41.5 million (of which € 21.3 million in dispatching infrastructure[21]) and depreciation and amortisation during the year (€ 51.4 million, of which, in particular, € 27.5 million relative to depreciation and amortisation of dispatching infrastructure and € 5.6 million relative to amortisation of the concession).
- impairment of goodwill recognised in 2015 at the time TES merged with the Tamini Group, for € 3.6 million.

Total investments made by the Group in 2016 amounted to € 854.3 million, in line with the Strategic Plan, compared with € 1,103.1 million in 2015 (up by -22.6%).

(21) Recognised pursuant to IFRIC 12.

In particular, we note strategic investments relative to activities under way for the HVDC "Italy - Montenegro" (€ 201.9 million) and "Italy - France" (€ 22.5 million) interconnections, the "Villanova-Gissi" (€ 25.5 million) and "Sorgente-Rizziconi" (€ 73.4 million) power lines, which began operating in January and May 2016, respectively. Other significant investments in 2016 were the 380 kV substations in Bari Nord and Melilli (respectively, € 14.3 million and € 12.1 million), as well as the restructuring of the metropolitan area of Palermo (€ 11.5 million) and the creation of the Capri-Continent interconnection (€ 10.9 million) for which, in particular, laying and protection of the undersea cable was completed.

Net working capital amounted to -€ 1,092.5 million and during the year generated cash for € 116.8 million with respect to 2015, due to the joint effects of:

Cash generated

- Reduction in **trade receivables** of -€ 101.4 million, in particular due to the decrease in grid transmission fee receivables (-€ 76.0 million), mainly attributable to the effects of the regulatory review and the receipt from the Fund for Energy and Environmental Services (Cassa per i Servizi Energetici e Ambientali - CSEA) for additional Terna S.p.A. TF revenues for the years 2014 and 2015 (€ 63.3 million). Also of note was the reduction in receivables from Non-Regulated Activities (in particular with reference to the trend of Tamini Group);
- Increase in **trade payables** of € 37.5 million, mostly attributable to the higher investment activities reported in the last period of the year;
- Decrease in **net tax assets** of € 80.5 million due to the reduction in the Group's credit position for VAT (-€79.0 million, in contrast to the credit of €113.9 million held at 31 December 2015).

Cash absorbed

- reduction in **net energy-related pass-through payables** of -€ 72.0 million (€ 545.9 million at 31 December 2016), relating to the electricity settling activities performed by the Parent Company, due to the combined effects of:
  - uplift fee (+€ 167 million), up with respect to the same period in 2015, to take into account both higher costs for the Dispatching Services Market (DSM) and for unbalancing (including the effects of Resolution 333/2016/R/eel);
  - increases in net receivables for interruptibility service (+€ 19 million);
  - increase in net payables associated with essential units for electricity system security - UESS (approx. € 61 million);
  - higher net payables relative to the capacity payment (approx. € 72 million), for higher payments ordered by the AEEGSI in previous year.
- decrease in **other liabilities** (-€ 26.2 million) mainly relative to lower payables to employees (-€ 21.6 million, mainly for amounts disbursed following the generational turnover programme), payables existing at 31 December 2015 for Pampa Norte EPC contract in Chile (-€ 9.4 million), changes in grants received (-€ 11.0 million), net of the recognition of the interconnector guarantee provision[22] established by the 2016 Stability Law (+€ 19.7 million) to support interconnection works pursuant to article 32 of Italian Law 99/09.

(22) We can note that on 30 September 2016 the relative implementing Decree was issued by the MED, as commented on in the "External Context" paragraph within the "Company and the External Context" section, to which the reader is referred.

Gross invested capital, therefore, amounted to € 11,898.7 million, recording an increase compared with the previous financial year of € 176.7 million.

Provisions showed an increase of € 11.1 million, owing mainly to:

- provisions for risks and charges of +€ 39.8 million, mainly for provisions for plants being commissioned (€ 32.9 million, in particular for urban and environmental restoration projects and the provisions relative to Sorgente-Rizziconi and Villanova-Gissi), the net change in the provision for early retirement incentives (€ 17.8 million), the release of the provision for risks associated with the disposal of the photovoltaic project (-€ 8.7 million);
- provision for deferred tax liabilities (-€ 27.3 million), mainly due to tax effects on depreciation and amortisation and changes in the provisions for risks and charges described previously.

Net invested capital amounted to € 11,514.1 million, an increase of € 165.6 million compared with 31 December 2015 and is financed by equity for € 3,535.4 million (compared with € 3,320.8 million at 31 December 2015), by minority-interest equity for € 19.8 million (€ 25.0 million at 31 December 2015) and by net financial debt of € 7,958.9 million (-€ 43.8 million compared with the € 8,002.7 million of 31 December 2015).

Table reconciling profit for the period and Shareholders' Equity of the Group with the same values recorded by the Parent Company

A reconciliation of consolidated equity and profit with the amounts reported by the Parent is provided below.

euro milioni	Net profit 2016	Equity at 31.12.2016
Financial Statements of the Parent Company	**535.5**	**3,024.8**
Results and equity contributed by the Group Companies:		
- Group Companies - Regulated Activities	97.0	424.0
- Group Companies - Non-Regulated Activities	(6.0)	78.9
Equity-accounted investees	1.4	27.5
Consolidated financial statements total	**627.9**	**3,555.2**
Minority interests – Non-Regulated Activities	(5.2)	19.8
Terna Group Consolidated Financial Statements	**633.1**	**3,535.4**

Cash flows

Net financial debt

The Group's net financial debt at 31 December 2016 closed at €7,958.9 million.

€ million	31.12.2016	31.12.2015	Δ
Net financial debt (by duration)			
A. Medium- and long-term debt			
- Bonds	6,420.5	6,406.1	14.4
- Floating-rate loans	1,983.9	2,110.4	(126.5)
- Derivative financial instruments	(312.9)	(680.9)	368.0
- Other non-current financial assets (Interconnector guarantee provision)	(17.4)	-	(17.4)
Total	**8,074.1**	**7,835.6**	**238.5**
B. Short-term debt			
- Bonds (current portion)	769.9	-	769.9
- Floating-rate loans (current portions)	134.6	122.9	11.7
- Short-term loans	20.1	416.6	(396.5)
- Other net current financial liabilities	95.9	59.2	36.7
- Cash and cash equivalents	(1,135.7)	(431.6)	(704.1)
Total	**(115.2)**	**167.1**	**(282.3)**
Total net financial debt	**7,958.9**	**8,002.7**	**(43.8)**
Net financial debt (per type of instrument)			
- Bonds	7,190.4	6,406.1	784.3
- Floating-rate loans	2,118.5	2,233.3	(114.8)
- Derivative financial instruments	(312.9)	(680.9)	368.0
- Short-term loans and other financial liabilities	116.0	475.8	(359.8)
- Cash and cash equivalents and other financial assets	(1,153.1)	(431.6)	(721.5)
Total net financial debt	**7,958.9**	**8,002.7**	**(43.8)**

TheGroup's net financial debt decreased by € 43.8 million in 2016 due to the following changes:

- increase in bonds (+€ 784.3 million), as a result of the bond issues on 03 March 2016 for € 80.0 million and on 11 October 2016 for € 750.0 million, net of the fair value adjustment of the same financial instruments (-€ 45.2 million, including amortised cost) as a result of the change in forward rates as of 31 December 2016;
- decrease in floating-rate loans (-€ 114.8 million), mainly for instalments paid from outstanding loans;
- change in the mark to market for derivative financial instruments (+€ 368.0 million) as a result of the derivative portfolio simplification during the second quarter of 2016, partially compensated for by the fair value change in instruments existing at 31 December 2016;
- a decrease in short-term loans and other financial liabilities (-€ 359.8 million) mainly as a result of repayment made by the parent company of the credit lines outstanding at 31 December 2015;
- an increase in cash and cash equivalents and other financial assets (-€ 721.5 million). Available liquidity at 31 December 2016 amounted to € 1,135.7 million, of which € 258.8 million invested in time deposits and € 876.9 million deposited in current bank accounts, while other non-current financial assets include the Interconnector Guarantee Provision established pursuant to article 32 of Italian Law 99/09, equal to € 17.4 million at 31 December 2016.

Cash flow

The cash flows for FYs 2016 and 2015 are shown in the table below.

€ million	2016 Cash flow	2015 Cash flow
- Net profit	627.9	595.3
- Amortisation, depreciation and impairment	508.7	516.8
- Net change in provisions	11.1	(67.4)
- Net Losses (Gains) on asset disposals	(9.8)	(1.7)
Operating Cash Flow	**1,137.9**	**1,043.0**
- Change in net working capital*	112.8	151.2
- Other changes in non-current assets	63.0	(786.9)
- of which tangible and intangible non-current assets acquired with the FSI Group	*-*	*(757.0)*
- Changes in equity investments	2.9	1.3
Cash Flow from Operating Activities	**1,316.6**	**408.6**
net of the change in non-current assets acquired with the FSI Group	*1,316.6*	*1,165.6*
- Total investments	(854.3)	(1,103.1)
Free Cash Flow	**462.3**	**(694.5)**
net of the change in non-current assets acquired with the FSI Group	*462.3*	*62.5*
- Dividends	(406.2)	(402.0)
- Cash flow hedge reserve net of the tax effect and other changes in equity	(12.3)	34.4
- Other changes in equity attributable to non- controlling interests	-	25.2
Change in net financial debt	**43.8**	**(1,036.9)**
net of the change in non-current assets acquired with the FSI Group	*43.8*	*(279.9)*

* Does not take into account impairments regarding current assets (€ 4.0 million in 2016 and € 3.7 million in 2015).

Cash Flow from Operating Activities in 2016 came out at € 1,316.6 million compared to the € 408.6 million in the previous year. This result can mainly be attributed to Operating Cash Flow (+€ 1,137.9 million, compared to +€ 1,043.0 million in 2015) and cash generated from net working capital (+€ 112.8 million, compared to +€ 151.2 million the previous year) and other changes in non-current assets (+€ 63.0 million, in particular due to plant grants received, compared to -€ 786.9 million in 2015, essentially due to absorption associated with the acquisition of Rete S.r.l.).

The change in net working capital, of +€ 112.8 million, is mainly due to the reduction in trade and tax receivables.

The Group's **total investments** amounted to € 854.3 million.

Therefore, **Free Cash Flow** was equal to € 462.3 million, compared to -€ 694.5 million of 2015 (net of effects relative to the acquisition of Rete S.r.l., cash flows from operations in 2015 balance for € 62.5 million).

Taking into account remuneration of shareholders (disbursement of the 2015 dividend balance for € 261.3 million and the 2016 interim dividend for € 144.9 million) and considering other changes in equity (in particular the change in the cash flow hedging reserve), net financial debt fell by € 43.8 million to € 7,958.9 million, compared to the increase of € 1,036.9 million seen in 2015 (net of the operation with the FSI Group the change in debt was € 279.9 million).

Terna S.p.A. economic and financial position and performance

The 2016 Annual Financial Report of Terna S.p.A. has been prepared in accordance with the provisions of Art. 154-*ter* of Italian Legislative Decree 58/98 introduced by Italian Legislative Decree no. 195 of 6 November 2007 (the “Transparency Decree”) as amended by Italian Legislative Decree No. 27 of 27 January 2010.

In implementation of the provision of Italian Legislative Decree No. 38 of 28 February 2005 and EEC Regulation No. 1606/2002, Terna S.p.A. prepares the financial statements at and for the year ended 31 December 2016 in compliance with the International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board and endorsed by the European Commission (hereinafter “EU IFRSs”).

The 2016 Annual Report has been prepared on a historic cost basis, modified where required by law for determining certain items subject to valuation, as well as on a going concern basis.

In compliance with the provisions of Art. 2364 of the Italian Civil Code and Art. 9.2 of the company’s Bylaws, the Board of Directors has resolved to call the shareholders to meet within one hundred and eighty days of the financial year end, insofar as Terna S.p.A. is a company required to prepare the consolidated financial statements.

Basis of presentation

The measurement and recognition criteria applied in this Annual Financial Report are consistent with those adopted in the financial statements for the year ended 31 December 2015.

In order to present the performance of Terna S.p.A. and to analyse its financial position, separate reclassified statements have been prepared that differ from those required by the EU-IFRS adopted by the Company and contained in the financial statements for the year.

These reclassified tables contain alternative performance indicators with respect to those resulting directly from the tables of the separate financial statements, which management considers useful for monitoring Company trends, and representative of the economic and financial results generated by the business.
In line with the guidance found in ESMA/2015/1415, the criteria for constructing these indicators are described in the footnotes which reconcile them with the tables contained in the separate financial statements, attached to this Integrated Report.

For the purposes of better comparison some balance sheet balances have been reclassified, but without altering the value of equity at 31 December 2015.

Reclassified income statement of Terna S.p.A.

The reclassified Income Statement of Terna S.p.A. for 2016 and 2015 is shown below.

€ million	2016	2015	Δ	Δ %
REVENUE				
- Transmission	1,497.4	1,519.7	(22.3)	(1.5%)
- Dispatching	111.3	125.2	(13.9)	(11.1%)
- Other operating revenue	149.7	129.8	19.9	15.3%
- IFRIC 12 effects	21.2	26.2	(5.0)	(19.1%)
TOTAL REVENUE	**1,779.6**	**1,800.9**	**(21.3)**	**(1.2%)**
OPERATING EXPENSES				
- Personnel expenses	82.0	44.5	37.5	84.3%
- Services, leases and rentals	322.4	319.7	2.7	0.8%
- Materials	3.1	4.3	(1.2)	(27.9%)
- Other expenses	25.3	24.4	0.9	3.7%
- Quality of Service	(7.8)	7.9	(15.7)	(198.7%)
- IFRIC 12 effects	21.2	26.2	(5.0)	(19.1%)
TOTAL OPERATING EXPENSES	**446.2**	**427.0**	**19.2**	**4.5%**
EBITDA (GROSS OPERATING MARGIN)	**1,333.4**	**1,373.9**	**(40.5)**	**(2.9%)**
- Amortisation, depreciation and impairment	432.7	456.5	(23.8)	(5.2%)
EBIT (OPERATING PROFIT)	**900.7**	**917.4**	**(16.7)**	**(1.8%)**
- Net financial income (expense)	(102.0)	(135.0)	33.0	(24.4%)
PROFIT/LOSS BEFORE TAXES	**798.7**	**782.4**	**16.3**	**2.1%**
- Income taxes	263.2	255.3	7.9	3.1%
PROFIT	**535.5**	**527.1**	**8.4**	**1.6%**

In the year 2016, Terna S.p.A achieved **revenue** of € 1,779.6 million, with a decrease of 1.2% (-€ 21.3 million) compared to 2015, mainly due to the following factors:

- decrease in the **transmission fee** (-€ 22.3 million), deriving from the overall effects of the new 2016-2023 regulatory period (which involves a reduction in revenue relative to the revision of WACC, partially compensated for by the reduction in time-lag);
- a decrease in the **fee for dispatching activity** (-€ 13.9 million), which reflects the overall effects of the new regulatory period, mainly due to a reduction in operating expenses recognised;
- change in "**other operating revenue**" (+€ 19.9 million), deriving in particular from the positive impact provided by Quality of Service (+€ 20.1 million), substantially due to the effect of bonuses from the RENS 2015 incentive mechanism, defined in Resolution 668/2016/R/eel, for € 12.0 million, with respect to the estimated penalties of € 6.5 million recognised the previous year. The balance also reflects the positive performance seen during the year (€ 3.4 million), taking into account the estimated total results expected during regulation period 2016-2019 (pursuant to Resolution 653/2015/r/eel);

Of note also are revenues from assets in concession[23], of € 21.2 million, which showed a decrease compared to the same period of the previous year of € 5.0 million.

Operating expenses amounted to € 446.2 million, up by € 19.2 million with respect to the balance of the previous year (+4.5%), mainly due to the effects of the following phenomena:

- "**Personnel expenses**": the increase of € 37.5 million, mainly due to the higher net provisions for a new turnover plan for € 30.4 million;

(23) This item includes the recognition of revenue provided by "IFRIC 12 Service Concession Arrangements", with the same amount in operating expenses.

- "**Services, leases and rentals**": the € 2.7 million increase is mainly due to:
  - the impact of the overall positive performance for the quality of transmission service. In particular, in 2016 Terna assigned Terna Rete Italia a bonus of € 10.0 million[24], in contrast to the penalty of € 10.0 million recorded in 2015, with an overall effect of +€ 20.0 million;
  - lower costs for technical maintenance and operation services performed by Terna Rete Italia (-€ 13.6 million, mainly due to the change in the business perimeter);
  - lower costs for remote transmission and IT services (-€ 4.0 million) essentially due to the change in the attribution of the relative activities within the Group, starting in July 2015;
- **Quality of Service**: -€ 15.7 million, mainly due to provision release relative to the Exceptional Events Fund (-€ 8.7 million, net of accruals relative to the year). There was also a decrease in provisions made relative to the mitigation and sharing mechanisms (-€ 7.5 million) and costs relative to high-voltage user indemnity mechanisms, introduced in 2016 (+€ 0.5 million).

EBITDA (gross operating margin) amounted to € 1,333.4 million, equal to 74.9% of revenues (in contrast to 76.3% in 2015), down by € 40.5 million compared to the 2015 figure (-2.9%), due to the combined effects of lower revenues and higher operating expenses.

The item **amortisation, depreciation and impairment** came to € 432.7 million for the year, falling by € 23.8 million with respect to 2015 (-5.2%), mainly due to lower depreciation and amortisation after a review of the useful life of electricity lines (increased from 40 to 45 years), greater allowances for 2015 impairment for certain plants (-€ 15.9 million), partially compensated for by new plants going operational.

EBIT (operating profit) therefore amounted to € 900.7 million, down by € 16.7 million (-1.8%) compared to 2015.

Net financial expense for the year, at € 102.0 million, shows a decrease of € 33.0 million compared to the € 135.0 million reported in 2015, mainly due to the general decrease in interest rates in 2016 and one-off effects associated with the liability management operation completed on 20 July 2015 (€ 32.3 million), partially compensated for by lower capitalisation (-€ 12.7 million) and by the allowance for impairment accounts on the equity investment in the associate CGES (€ 4.3 million).
After deducting net financial expense, **profit before taxes** reached at € 798.7 million, up by € 16.3 million compared with the previous year (+2.1%).
Income taxes for the year came to € 263.2 million, up by € 7.9 million (+3.1%) with respect to the previous year. This increase is mainly due to greater profits before taxes, taking into account also the larger non-deductible items of 2015 and the effects of the 2016 Stability Law (Italian Law 208/2015).

The **tax rate** for the year was 33.0%, substantially in line with the 32.6% rate recorded in 2015.

Consequently, **profit** came out at € 535.5 million, up by € 8.4 million compared with the net profit for the year in 2015 (+1.6%).

(24) In this regard, it is noted that on the basis of Art. 9.3 of the services contract with the subsidiary, Terna undertakes to pay annually to Terna Rete Italia S.p.A. a premium or a penalty of an amount corresponding to the net total value of the premiums/penalties linked to the electrical service quality mechanisms recognised for a maximum total value of € 10.0 million for each year of reference.

Reclassified statement of financial position of Terna S.p.A.

The reclassified statement of financial position of Terna S.p.A. at 31 December 2016 and 2015 is summarised below. The table is obtained by reclassifying the data stated in the Statement of financial position.

€ million	at 31.12.2016	at 31.12.2015	Δ
Net non-current assets			
- Intangible assets and goodwill	328.9	336.3	(7.4)
- Property, plant and equipment	10,368.3	10,141.8	226.5
- Financial assets	1,497.6	1,473.8	23.8
Total	**12,194.8**	**11,951.9**	**242.9**
Net working capital			
- Trade receivables	396.8	480.7	(83.9)
- Inventories	0.1	-	0.1
- Other assets	49.9	5.7	44.2
- Trade payables	(409.6)	(511.4)	101.8
- Net energy-related pass-through payables	(576.4)	(641.4)	65.0
- Net tax assets	28.6	109.2	(80.6)
- Other liabilities	(315.1)	(303.3)	(11.8)
Total	**(825.7)**	**(860.5)**	**34.8**
Gross invested capital	**11,369.1**	**11,091.4**	**277.7**
Provisions	(243.3)	(216.2)	(27.1)
NET INVESTED CAPITAL	**11,125.8**	**10,875.2**	**250.6**
Equity	**3,024.8**	**2,908.1**	**116.7**
Net financial debt	**8,101.0**	**7,967.1**	**133.9**
TOTAL	**11,125.8**	**10,875.2**	**250.6**

The increase in **net non-current assets** of € 242.9 million, compared with the figure of 31 December 2015, is mainly attributable to the item **property, plant and equipment** which saw an increase of € 226.5 million, mainly attributable to:

- investments of € 667.1 million during the year;
- amortisation and depreciation for the year of € 383.1 million;
- other changes during the year of € 55.5 million, specifically plant grants, mainly for projects financed by MED/EU; disposals and impairment (-€ 2.0 million).

With reference to investments during the year, in particular we note strategic investments relative to activities under way for the HVDC Italy - Montenegro (€ 201.9 million) and Italy - France (€ 22.5 million) interconnections, the Villanova-Gissi (€ 25.5 million) and Sorgente-Rizziconi (€ 73.4 million) power lines, which began operating in January and May 2016, respectively. Other significant investments in 2016 were made to create the 380 kV substations in Bari Nord and Melilli (respectively, € 14.3 million and € 12.1 million), as well as the restructuring of the metropolitan area of Palermo (€ 11.5 million) and the creation of the Capri-Continent interconnection (€ 10.9 million) for which, in particular, laying and protection of the undersea cable was completed.

Intangible assets and goodwill recorded a reduction of € 7.4 million compared to 2015, attributable to ordinary period changes, in particular:

- period investments of € 39.3 million (of which € 21.3 million in dispatch infrastructures[25]);
- portion of amortisation/depreciation accruing (€ 46.7 million of which, in particular, € 27.5 million relating to the amortisation of the dispatching infrastructures and € 5.6 million relating to amortisation of the concession).

Financial assets also increased by € 23.8 million, essentially due to the capital increase subscribed for the subsidiary Terna Crna Gora d.o.o. (€ 28.0 million), partially offset by the impairment of the equity investment in the associate CGES (€ 4.3 million).

Net working capital stands at -€ 825.7 million and absorbed € 34.8 million of cash during the year essentially deriving from the following:

Cash absorbed, for a total of € 211.1 million, relating to:

- a reduction in **net energy-related pass-through payables** of -€ 65.0 million (€ 576.4 million at 31 December 2016), relating to electricity settlement activity by the Company, mainly due to the combined effects of:
  - calculation of the net credit at the end of 2016 relative to the uplift fee (+€ 167 million), up with respect to the same period in 2015, to take into account both greater final costs determined by the Dispatching Services Market (DSM) and greater costs deriving from unbalancing (including the effects of Resolution 333/2016/R/eel);
  - increases in net receivables covering interruptibility service (+€ 19 million);
  - increase in net payables associated with essential units for electricity system security - UESS (approx. € 61 million) following an increase in funding against payment substantially in line at the end of the period;
  - greater net payables relative to the capacity payment (approx. € 72 million), for lower payments ordered by the AEEGSI in 2016 relative to the previous year;
- decrease in **trade payables** for € 101.8 million mainly for lower payables due to Terna Rete Italia S.p.A. subsidiaries (-€ 68.6 million) in particular for the change in business perimeter and the schedule for liquidation of the relative payable items with respect to the previous year, as well as the effect of lower investment during the last period of the year and the adjustment in the annual fee for technical maintenance and operation services. These effects were partially compensated for by the payables due to the subsidiary associated with Quality of Service, commented on above (+€ 10.0 million). Also of note was the reduction in payables due to the subsidiary Terna Storage S.r.l. (-€ 26.5 million), owing to the lower investment activities recorded in the year;
- increase in **other assets** for € 44.2 million (€ 49.9 million at 31 December 2016, € 5.7 million at 31 December 2015), mainly attributable to:
  - receivables from the subsidiaries Terna Rete Italia S.r.l. and Terna Rete Italia S.p.A. for IRES payments on account paid by the Company for tax consolidation (respectively € 35 million and € 1.2 million);
  - recognition of payments on account and prepayments relative to the optic fibre housing contract signed with Clouditalia during the last quarter of the year to acquire optic fibre that will be finalised in 2017 (€ 4.8 million and € 2.7 million, respectively).

(25) Recognised pursuant to IFRIC 12.

Cash generated for a total of € 176.3 million, relating to:

- **trade receivables**: -€ 83.9 million, in particular due to the decrease in grid transmission fee receivables (-€ 76.0 million), mainly attributable to the amount received from the Fund for Energy and Environmental Services (Cassa per i Servizi Energetici e Ambientali - CSEA), for additional Terna S.p.A. TF revenues for the years 2014 and 2015 (€ 63.3 million), as well as the receivable existing at 31 December 2015 from the subsidiary Terna Rete Italia S.p.A. for Quality of Service (-€ 10.0 million);
- **net tax assets**: -€ 80.6 million attributable to the reduction in the Company's creditor position relative to the tax authorities for VAT (-€ 79.7 million, in consideration of the credit of € 102.3 million at 31 December 2015);
- **other liabilities** (-€ 11.8 million) mainly relative to the recognition of the interconnector guarantee provision[26] established for Terna S.p.A. by the 2016 Stability Law (+€ 19.7 million) for the execution of interconnection works pursuant to article 32 of Italian Law 99/09, partially compensated for by the release of portions of plant grants (-€ 5.6 million).

Gross invested capital therefore amounted to € 11,369.1 million, with an increase of € 277.7 million compared to 31 December 2015.

Provisions came to € 243.3 million, up by € 27.1 million, essentially due to the combined effect of the following changes:

- net increase in provisions for risks and charges for € 54.2 million, mainly for provisions for plants going into operation (€ 32.9 million, in particular for urban and environmental restoration projects and the provisions relative largely to the Sorgente-Rizziconi), the net change in the provision for early retirement incentives (€ 17.8 million), as well as the provision made for IMU (council tax) (€ 4.0 million);
- utilisation of previous allocations made to the provision for net deferred tax liabilities (€ 29.7 million), mainly due to the tax effect on additional amortisation with respect to the economic/technical portions, partially compensated for by the tax effect on amortisation and changes in the provisions for risks and charges previously described.

Net invested capital stands at € 11,125.8 million and is financed through **equity** for € 3,024.8 million (as compared with € 2,908.1 million at 31 December 2015) and by **net financial debt** for € 8,101.0 million (+€ 133.9 million compared with 31 December 2015).

(26) We can note that on 30 September 2016 the relative implementing Decree was issued by the MED, as commented on in the "External Context" paragraph within the "Company and the External Context" section, to which the reader is referred.

Cash flows

Net financial debt

The Company's net financial debt at 31 December 2016 closed at €8,101.0 million:

€ million	31.12.2016	31.12.2015	Δ
Net financial debt (by duration)			
A. Medium- and long-term debt			
- Bond	6,420.5	6,406.1	14.4
- Floating-rate loans	1,979.5	2,103.8	(124.3)
- Derivative financial instruments	(313.0)	(681.8)	368.8
- Other non-current financial assets (*Interconnector guarantee provision*)	(17.4)	-	(17.4)
Total	**8,069.6**	**7,828.1**	**241.5**
B. Short-term debt:			
- Bond (current portion)	769.9	-	769.9
- Short-term loans	-	398.2	(398.2)
- Floating-rate loans (current portions)	132.4	120.7	11.7
- Short-term loan to Terna Interconnector S.r.l.	(39.0)	(3.7)	(35.3)
- Other net current financial liabilities	95.9	59.2	36.7
- Net intercompany treasury current account position	163.2	(25.4)	188.6
- Cash and cash equivalents	(1,091.0)	(410.0)	(681.0)
Total	**31.4**	**139.0**	**(107.6)**
Total net financial debt	**8,101.0**	**7,967.1**	**133.9**
Net financial debt (per type of instrument)			
- Bonds	7,190.4	6,406.1	784.3
- Floating-rate loans	2,111.9	2,224.5	(112.6)
- Derivative financial instruments	(313.0)	(681.8)	368.8
- Short-term loans and other financial liabilities	56.9	453.7	(396.8)
- Cash and cash equivalents (including the net balance of the intercompany current a/c)	(927.8)	(435.4)	(492.4)
- *Interconnector Guarantee Provision*	(17.4)	-	(17.4)
Total net financial debt	**8,101.0**	**7,967.1**	**133.9**

The net financial debt, which increased overall by € 133.9 million in 2016, due to the following changes:

- increase in bonds (+€ 784.3 million), as a result of the bond issues on 3 March 2016 for € 80.0 million and on 11 October 2016 for € 750.0 million, as well as the fair value adjustment of the same financial instruments (-€ 45.2 million, including amortised cost) as a result of the change in forward rates as of 31 December 2016;
- decrease in floating-rate loans (-€ 112.6 million), mainly for instalments paid from outstanding loans;
- change in the mark to market of derivative financial instruments (€ +368.8 million), resulting from the derivative portfolio simplification carried out during the second quarter of 2016 partially offset by the net effects on the fair value of these derivatives owing to the update of the reference interest rate curve with respect to the curve of December 2015;
- a decrease in short-term loans and other financial liabilities (€ 396.8 million) mainly as a result of repayment made by the Company of the credit lines outstanding at 31 December 2015;
- an increase in cash and cash equivalents (€ 492.4 million). Cash and cash equivalents at 31 December 2016 amounted to € 927.8 million, of which € 258.8 million invested in time deposits and € 669.0 million deposited in bank current accounts.
- the Interconnector Guarantee Provision, established pursuant to article 32 of Italian Law 99/09 (equal to € 17.4 million at 31 December 2016).

Cash flow

€ million	2016 Cash flow	2015 Cash flow
- Net profit	535.5	527.1
- Amortisation, depreciation and impairment	432.7	456.5
- Net change in provisions	27.1	(41.8)
- Net Losses (Gains) on asset disposals	(7.7)	(1.6)
Operating Cash Flow	**987.6**	**940.2**
- Change in net working capital*	(37.2)	60.1
- Changes in equity investments	(23.8)	(789.8)
of which the purchase of the holding in Rete S.r.l.	*-*	*(770.1)*
- Other changes in non-current assets	64.7	13.9
Cash Flow from Operating Activities	**991.3**	**224.4**
net of the purchase of the holding in Rete S.r.l.	*991.3*	*994.5*
- Total investments	(706.4)	(1,021.6)
Free Cash Flow	**284.9**	**(797.2)**
net of the purchase of the holding in Rete S.r.l.	*284.9*	*(27.1)*
- Dividends	(406.2)	(402.0)
- Cash flow hedge reserve net of the tax effect and other changes in equity	(12.6)	26.3
Change in net financial debt	**(133.9)**	**(1,172.9)**
net of the purchase of the holding in Rete S.r.l.	*(133.9)*	*(402.8)*

* Does not take into account impairment of trade receivables of the year (€ 2.4 million in 2016 and € 3.0 million in 2015).

The **Cash Flow from Operating Activities** in 2016 came out at € 991.3 million compared to the € 224.4 million in the previous year. This result is mainly attributable to Operating Cash Flow (+€ 987.6 million, compared to +940.2 million in 2015), cash absorbed by net working capital (-€ 37.2 million, compared to +€ 60.1 million generated the previous year), the change in equity investments (-€ 23.8 million, compared to -€ 789.8 million in 2015, which essentially suffered from absorption deriving from the acquisition of Rete S.r.l. for -€ 770.1 million) and other changes in non-current assets (+€ 64.7 million, in particular for plant grants).

The change in **net working capital**, of -€ 37.2 million, is mainly due to the reduction in trade and tax receivables.

The Group's **total investments** amounted to € 706.4 million.

Therefore, **Free Cash Flow** was equal to € 284.9 million, compared to -€ 797.2 million of 2015 (net of effects relative to the acquisition of Rete S.r.l., cash flows from operations in 2015 generated cash for € 27.1 million.

Taking into account remuneration of shareholders (disbursement of the 2015 dividend for € 261.3 million and the 2016 interim dividend for € 144.9 million) and considering other changes in equity (in particular the change in the cash flow hedge reserve), net financial debt increased by € 133.9 million compared to the +€ 1,172.9 million seen in 2015 (net of the operation with the FSI Group the change in debt was € 402.8 million).

STOCK PERFORMANCE

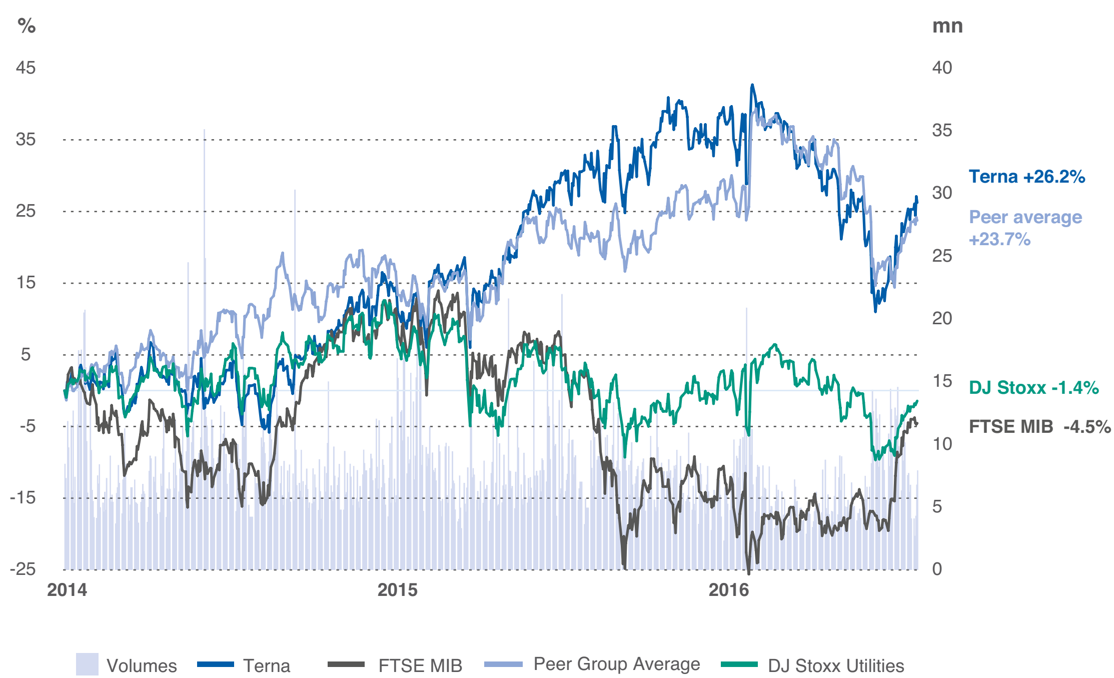
Terna S.p.A. has been listed on the Borsa Italiana electronic market since 23 June 2004 and is one of the leading Italian companies in terms of stock market capitalisation (sixteenth on the FTSE MIB index). From the listing date until the end of 2016, the value of the stock had almost tripled (+156%) and the total return for the shareholder (TSR[27]) was 429%, outperforming both the Italian reference index (TSR FTSE MIB +9%) and the European sector index (TSR DJ Stoxx Utilities +120%).

The main European stock exchanges ended 2016 with contrasting performance. Milan saw a drop of 10.2%, London and Madrid finished at +14.4% and -2.0%, respectively, Frankfurt finished up 3.7% and Paris closed at +4.9%. While stock prices continue to benefit from the decision of the European Central Bank to strengthen expansive measures relative to monetary policy, the markets have been influenced by continuing volatility and an international situation of macroeconomic and political instability.

In 2016, Terna stock recorded a drop of 8.5%, in line with the European benchmark sector index (DJ Stoxx Utilities -8.9%) and outperforming the FTSE MIB index (-10.2%). The stock also recorded an average daily volume traded of approximately 7.3 million shares daily, down compared to 2015 (8.4 million shares).

From June 2014 to the end of 2016 Terna recorded a Total Shareholder Return (TSR) of 26%, while the return of the companies in the FTSE MIB was negative, at -5%. The reference European index (DJ Stoxx Utilities) recorded a negative TSR of -1%. In the same period the peer group average[28] recorded +24%. The daily average of volumes traded was approximately 8 million units.

TERNA STOCK - TSR (FROM JUNE 2014 TO THE END OF 2016)



Source: Bloomberg

(27) Total Shareholder Return (or TSR): total return on an equity investment, calculated as the sum of:
i) stock performance;
ii) dividends reinvested: the ratio between the dividends per share distributed in the reference period and the price of the stock at the beginning of the said period. The dividends are considered reinvested in the stock.

(28) The "peer group average" relates to: Snam, Red Electrica de España (REE), Enagas, National Grid, United Utilities and Severn Trent.

MAIN SHARE INDICATORS

	2016	2015	2014	2013	2012
No. shares (millions)	2,010	2,010	2,010	2,010	2,010
Price at end of year (€/share)	4.35	4.76	3.76	3.63	3.02
Market capitalisation* (millions of Euro)	9,367	8,482	7,718	6,713	5,688
Average price during the year (€/share)	4.66	4.22	3.84	3.34	2.83
Earnings per share (€)	0.315	0.296	0.271	0.256	0.231
Dividend per share (€)	0.21	0.20	0.20	0.20	0.20
Payout ratio	77.32%	76.30%	89.30%	88.40%	86.80%
Dividend yield**	4.7%	4.2%	5.3%	5.5%	6.6%
Total Shareholder Return***	(4.3%)	32.5%	8.9%	27.6%	24.9%

* Calculated on the basis of the annual average price.
** Calculated as the ratio between the unit dividend for the year and the end-of-year price.
*** Shareholder return negative in 2016, after the +32.5% recorded in 2015 and due to the sensitivity of regulated stock to the decrease in interest rates (10-year BTP yield from 1.6% to 1.8%, during 2016).

PROPORTION OF TERNA SHARES	2016	2015
> in the FTSE MIB index	2.06%	2.10%

Source: Borsa Italiana.

RATINGS

	Short Term	M/L term	Outlook
Terna S.p.A.*			
Standard & Poor's	A-2	BBB	Stable
Moody's	Prime-2	Baa1	Negative
Fitch	F2	BBB+	Stable
Italian Republic*			
Standard & Poor's	A-3	BBB-	Stable
Moody's	Prime-2	Baa2	Negative
Fitch	F2	BBB+	Negative

* Data at 31 December 2016.

More information on the stock trend and dividend distribution policy is available on Terna S.p.A.'s website (www.terna.it – under "*Investor Relations*").

Presence in the stock exchange sustainability indexes

Terna's constant commitment to improving its ESG (Environmental, Social and Governance) performance is demonstrated by its sustainability ratings, issued by specialised companies, its inclusion in the main international quoted sustainability indices and the appreciation of socially responsible investors. In 2016, Terna was confirmed in all the main international stock market indexes. Additionally, in January 2017, RobecoSAM, the ratings agency that carries out the annual assessments to determine the composition of the Dow Jones Sustainability Index, published its Sustainability Yearbook 2017, classifying Terna as Silver Class, for its score which was close to that of the leading company in the electric utilities sector.

TERNA'S PRESENCE IN SUSTAINABILITY INDEXES

INDEX	INDEX FEATURES
DOW JONES SUSTAINABILITY INDEX	Included in the DJSI World since 2009.
ECPI	Included in the ECPI since 2007.
ETHIBEL SUSTAINABILITY INDEX (ESI)	Included in the ESI since 2009.
EURONEXT VIGEO	Since 2012, present in the World 120, Eurozone 120 and Europe 120 baskets.
FTSE ECPI	Included in the FTSE ECPI since 2010.
FTSE4Good	Present in the index (Global and Europe baskets) since 2005.
MSCI	Stably included in the index since 2007.
STOXX® ESG	Included in the index since 2011.
STOXX® LOW CARBON	Included in the index since February 2016, when this index was launched.
UNITED NATIONS GLOBAL COMPACT ("GC100")	Present in the index since 2013.

Terna is also selected in certain "Investment registers" prepared with selective sustainability criteria, which, particularly when public, are a reference for investors focused on ESG performance such as Ethibel, ASN Bank, TRIODOS Bank and Storebrand.

SUSTAINABILITY PERFORMANCE

The improvement in Terna's environmental and social performance is based on a constant commitment to progress in all sustainability areas. The objectives are outlined in the Sustainability Plan, which accompanies the Strategic Plan in a multi-year horizon, aiming to ensure the availability of intangible assets functional to the business model, above all relational capital – i.e. good relationships with stakeholders. The expectations of stakeholders are fundamental in developing the Sustainability Plan. By acknowledging these expectations, they help to serve as a foundation, accompanying the generation of positive and lasting economic results. Limiting the Group's environmental footprint, which is also of significance relative to risk reduction, including reputational risk, is also part of Terna's qualification as an excellent operator, going beyond the technical field and developing the capacity to work in a manner that respects the environment.

One of the Sustainability Plan objectives for 2016 was revising the materiality matrix, the tool that ranks significant issues – relative to reporting and initiatives that support the Strategic Plan – combining both the company and stakeholders' points of view. The priority of the issues that emerges from the new materiality matrix – the development of which is described in an Annex – is reflected in the information provided in the complete Integrated Report. Below we list the most significant issues, with an indication of where they are discussed in the Integrated Report or other official Terna documents.

The most significant objectives for Terna and its stakeholders are:

- the alignment of Corporate Governance with best practices, discussed in the Corporate Governance Report,
- careful risk management, respect for economic/financial objectives and operating performance (continuity, quality, cost of the transmission service), all discussed in this Report in dedicated chapters or paragraphs,
- good stakeholder management, in particular local stakeholders, discussed in the chapter of the Integrated Report dedicated to social/relational capital,
- integrity in conducting business,
- environmental issues such as visual and landscape impact, greenhouse gas emissions, biodiversity and waste management,
- issues relative to human resources such as the development of personnel (discussed in the chapter on human capital), worker health and safety and equal opportunities.

The data regarding sustainability performance refer to the Terna Group, excluding the Tamini Group, covering a total of 95.1% of Group revenue.

The complete report of Terna's social and environmental indicators, in accordance with the GRI (Global Reporting Initiative) G4 standard, is available in the Sustainability Report and in the "Sustainability" section of the institutional website www.terna.it.

Integrity in conducting business

Integrity, transparency and legality are values that permeate the Terna business culture, which recognises all three as fundamental principles in its Code of Ethics. The importance of these aspects is also in line with Terna's role as the licensee of a service of general interest, which implies ethical responsibilities relative to the community as a whole and relative to the supervisory authorities. Significant activities in 2016 relative to integrity in conducting business include the new agreement with Guardia di Finanza for "Security in the network", ISO 37001 Anti-bribery certification and the "Open & Transparent Sites" website, already referenced in the chapter "Risk Management".

Compliance with norms

Respect for norms is the foundation on which any voluntary improvement initiative must be based. The management policies and systems that Terna uses to ensure compliance with norms and rules are described in this Report with reference to the various issues in question. In this paragraph, we focus on relevant indicators, represented by administrative or judicial sanction or significant penalty proceedings to which Terna has been subjected. Also taking into account the indicators contained in the GRI-G4 guidelines, Terna's compliance with norms is illustrated by the following points:

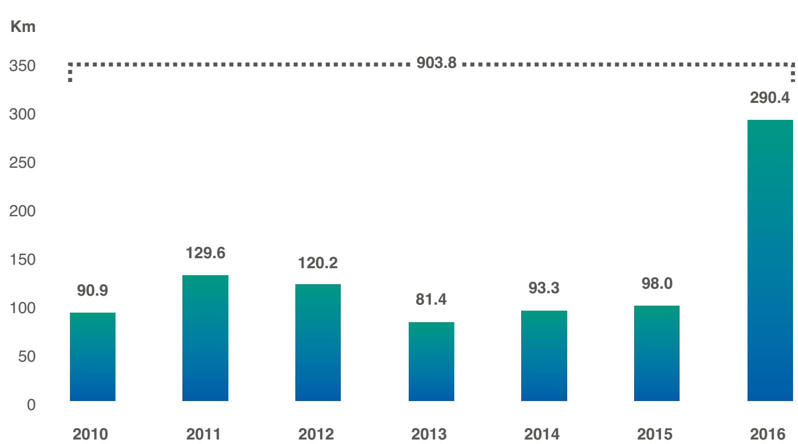
- No significant definitive administrative or judicial proceedings were recorded in 2016 or in the two years prior that imposed on Terna fines or obligations to "do/not do" (e.g. prohibitions), or that criminally convicted its employees.
- In particular, the accounting records show that no fines exceeding € 10,000 regarding the environment were received in 2016.
- There are no pending judicial proceedings against Terna related to bribery, anti-trust, monopolistic practices, nor were there any sentences condemning Terna in relation to the same issues in 2016 or the previous two years.
- There are no pending criminal proceedings for injuries caused to third parties by Terna's assets.
- No injuries were suffered by employees of contractors during work entrusted by Terna to the latter, which gave rise to definitive judicial proceedings, sentencing Terna to compensate for damages, or resulting in criminal convictions of Terna's employees.
- No fines relative to cases of harassment or occupational injuries for employees or former employees were applied in 2016 or the previous two years for which definitive responsibility was assigned to Terna.

Environment

Visual/landscape impact and land use

Among the most significant environmental issues are the visual and landscape effects of electricity infrastructure. On the other hand, the physical removal of power lines, made obsolete through grid development investments, constitutes one of the most important positive contribution of Terna's business has on the environment, both in visual and landscape terms and in terms of use of terrain.
In 2016, 290 km of lines were demolished. Demolitions are defined as overhead lines removed (or replaced by cable lines) and do not include declassified or enhanced lines. This was an exceptional amount, due to the removal of over 200 km of obsolete power lines in Valtellina. Net of this, demolition involved around 80 km, in line with the trend in previous years (around 100 km/year).
In the 2010-2016 period, 903.8 km of lines were demolished.

KM OF POWER LINES DEMOLISHED



Another contribution to the reduction of visual and landscape impacts derives from the use of a new type of pylons that allow them to blend in better. The use of these innovative pylons is possible only when the technical characteristics of the project (land, slope and grade of the section) are suitable. 468 single-stem pylons and 15 "Germoglio" and "Foster" pylons were in fact installed as of 2016.

Greenhouse gas emissions

Terna's business is electricity transmission and it has no production activities, which in the electricity industry – and among all businesses in general – are those most responsible for greenhouse gas emissions. Greenhouse gas emissions are therefore not a significant indicator of the Group's sustainability performance. However, given the commitment that Terna has voluntarily made to limit emissions, data on the Group's direct emissions is given below.

TOTAL DIRECT AND INDIRECT EMISSIONS OF GREENHOUSE GASES – CO_2 EQUIVALENT TONNES*

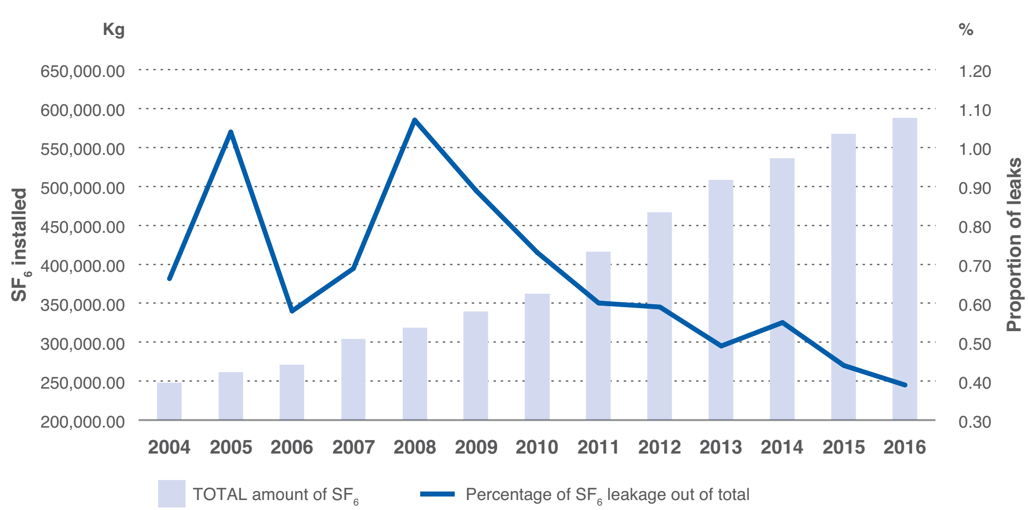
	2016	2015	Δ%
Direct emissions	61,991.7	66,799.4	(7.2)
of which SF_6 leakage	54,101.9	58,478.3	(7.5)
Indirect emissions *(Electricity)*	74,715.5	70,325.6	6.2

* The conversion of direct energy consumption and SF_6 (sulphur hexafluoride) and refrigerant gas leaks to equivalent CO_2 emissions is calculated this year using the parameters indicated in the IPCC Fifth Assessment Report (AR5) and Greenhouse Gas Protocol (GHG) Initiative. This led to a change in the equivalent tonnes of SF_6 and refrigerant gas and total direct emissions compared to that which was previously published. For indirect consumption of electricity, conversion is done taking into account the weight of thermoelectric production relative to the total of Italian electricity production for 2016. The reference for the breakdown of the productive mix is the "Monthly report on the electricity system", December 2016 final figures, available at www.terna.it.

Direct greenhouse gas emissions associated with Terna's business mainly derive from leaks of gas SF_6 (87% of total direct emissions in 2016), which has decreased by 7.5%, contributing to a 7.2% decline in total direct emissions. Indirect emissions have, instead, increased by 6.2% coming from a new conversion factor relative to previous years, more than an actual increase in consumption. We note that, for technical reasons, the energy consumed by Terna cannot be traced to a supply contract. This makes it impossible for Terna to reduce indirect emissions by selecting supplies from renewable sources, and the need to use a conversion factor based on the average for Italian electricity production.

The gas SF_6 (sulphur hexafluoride), thanks to its chemical and physical properties, is used as insulation in certain electrical equipment, including switches, current transformers and armoured systems. Part of the gas found in the equipment is released into the atmosphere due to seal defects, malfunctions and, sometimes, during operations to restore pressure. The gas SF_6 is a significant greenhouse gas, 23,500 times more powerful than CO_2.

In 2016, thanks to programmes to contain the amount of SF_6 leakage and in the absence of significant incidents, leakage decreased with respect to the previous year, not only in terms of percentages, but also as an absolute value. The impact of leakage on total installed amounts in 2016 was 0.39%, the lowest figure since measurement began (0.44% in 2015, 0.55% in 2014). This figure can be compared with the figure of 0.70%, which represents the weighted average of the main European TSOs, calculated as the ratio between the sum of leakages and the sum of total amounts.



Energy efficiency

The second source of Terna's direct emissions is fuel for company vehicles. 2016 saw a reduction in emissions deriving from the combustion of petrol and diesel for vehicles and jet kerosene for helicopters, a drop of 3.5%. This was above all thanks to lower consumption by company vehicles, partially due to modernisation of the auto fleet, which occurred in 2016, and involved a switch to more efficient engines.

Energy efficiency is also strived for in Terna's buildings and substations, with the potential to decrease electricity consumption, affecting indirect emissions. Among the initiatives launched in 2016 we note the switch to LED bulbs in the Pero offices (Milan) and the installation of innovative light towers (with LED technology) in the Basiliano electrical substation (Udine). The benefits for these projects in terms of carbon-dioxide reduction will be quantified at the end of 2017.

The remodelling and entirely new construction carried out at the Terna offices should also be noted. Part of a multi-year programme, these projects will raise the energy class of the buildings owned by the Group, accompanying the civil work with an improvement in energy performance. During 2016, the construction of the new Turin headquarters and the remodelling of the Palermo offices contributed to improving the energy class of Terna's main buildings, in line with the objective to bring these buildings to 70% (expressed as a % of total cubage in the offices considered) in classes A, B or C by 2020, compared to 45% in 2015.

Other environmental impacts

Biodiversity

The presence of lines may cause potentially negative effects for birdlife. While the risk of electrocution affects low- and medium-voltage lines, and therefore does not affect Terna plants, high-voltage lines are associated with the risk of collision. To minimise this risk, for stretches of line where birds frequently cross, special devices known as "dissuaders" have been installed. Due to their high visibility and the noise they make when the wind hits them, they make electricity lines more easily perceptible to birds in flight.

Over the years Terna has initiated research and scientific studies to investigate this issue and identify increasingly effective solutions. The first Italian study dedicated to the issue of collisions[29] , and based on the results of the Terna-LIPU agreement, shows a low risk of collision.

In January 2016, experimentation began involving a section of the Villanova-Gissi power line and using AVIMON, a device that detects impacts of birdlife with power-line guard wires. During the two highest periods of bird traffic (pre-reproduction and post-reproduction), no collisions were detected, confirming the results of previous on-site monitoring.

DETERRENTS FOR BIRDLIFE ON THE NTG

	Units	2016	2015	Δ%
Affected lines	no.	57	53	7.5
Length of affected lines	km	212	205	3.4
Total dissuaders installed	no.	14,472	13,866	4.4

Waste management

Most of Terna's waste is recovered to be sent for production recycling. Only some residues are sent to the waste-disposal sites and therefore have an environmental impact.
93% of waste was recovered in 2016 (92% in 2015, 81% in 2014).
Such waste derives mainly from maintenance and modernisation works to the electricity infrastructure, activities which depend on technical considerations regarding the security and efficiency of the system, which therefore may change significantly from year to year.

(29) Costantini et al., "Estimates of avian collision with power lines and carcass disappearance across differing environments", Animal conservation, 2016.

Actual recycling depends on materials. Some materials can easily be separated and consequently reused (for example the iron parts of pylons); however, in some cases, it is impossible or too costly to separate the parts, especially for equipment purchased some years ago.
For these reasons, the annual changes in the percentage of waste recycled must not be interpreted as representing a trend.

Costs for the environment

In 2016, Terna incurred total costs for the environment consisting of € 29.8 million for investments and € 19.1 million for operating costs.
As a general guideline, costs for the environment refers to the cost of steps taken by an organisation, or on its behalf by others, to prevent, reduce or repair damage to the environment which results from its operating activities (European Commission Recommendation 2001/453/EC). For more details on the methodology adopted to account for environmental costs please see the "Sustainability Report".

COSTS FOR THE ENVIRONMENT - INVESTMENT AND OPERATING COSTS € MILLION

Investments	2016	2015	Δ%
Environmental offsets(1)	14.7	1.2	1,085
Environmental-impact studies(2)	2.4	5.0	(52)
Environmental activities – new plants (3)	4.3	5.8	(26)
Environmental activities – existing plants (4)	7.5	7.1	6
Demolitions	0,9 (5)	1.2	(27)
Total investments	**29.8**	**20.3**	**47**
Costs			
Costs for environmental activities (6)	19.1	19.4	(1.5)
Total operating expenses	**19.1**	**19.4**	**(1.5)**

(1) **Environmental offsets**: these are amounts for offsetting the works set out in the Grid Development Plan, as determined by special agreements entered into with local institutions. The 2015 figure was lower with respect to the previous year, as certain works did not begin operating until 2016.
(2) **Environmental impact studies**: these relate to plants provided for in the Grid Development Plan that are at the construction stage or in the process of being authorised by the relevant administrations.
(3) **Environmental activities - new plants**: the amount shown is based on an estimate. On the basis of an analysis of several large investment projects, at least 1% of the total project expense related to environmental items, usually determined by obligations (for example, camouflaging with trees, barriers against noise, installation of dissuaders for birdlife, environmental monitoring, and analysis of excavated earth and rock). Therefore, a value of 1% of investment costs for projects with similar features was considered.
(4) **Environmental activities - existing plants**: the expenses for upgrading existing plants in accordance with environmental provisions and new regulations (for example noise and visual/landscape aspects).
(5) **Demolitions**: the costs for the definitive dismantling of lines as part of rationalisation projects. In 2016, we also note two demolition projects involving 176 km on the Grossotto-Lovero (Sondrio) and Milano Stazzona (Como) power lines. The activity, performed directly by the engineering unit from the Milan operating area, is not added to the item in the table as the methodology determined in 2010 does not include projects carried out directly by the operating areas, which are normally of little significance. This project cost around € 700,000. In 2017, the possibility of amending the methodology to insert other similar cases in the future will be evaluated.
(6) **Costs for environmental activities**: cutting trees, cutting grass, waste management and demolitions/dismantling for small amounts not included in investments. These cost items, which can be determined directly from the industrial accounting, do not exhaust the year's total environmental costs, but represent the majority of them.

Human resources

In the paragraph "Human capital" a description is provided of the numbers, composition and evolution of the Group's personnel, and the development and training initiatives, together with information on equal opportunities, occupational health and safety.

Occupational injuries

As in previous years, in 2016 there were no fatal or grave occupational injuries suffered by the Group's employees. Also with reference to fatal or grave injuries in years prior to the reporting period, there were no cases in which company liability was definitively determined. The total number of injuries was 28.
The injury and lost-day rates shown below are calculated both on the basis of definitions adopted by GRI and the International Labour Organisation (ILO) and on the basis of another widely-used definition.

OCCUPATIONAL INJURIES – TERNA EMPLOYEES, GRI-ILO DEFINITIONS (*)

	2016	2015	Δ
Number of injuries	28	24	4
- of which serious	-	-	-
- of which fatal	-	-	-

INJURY RATE AND SEVERITY INDEXES

(GRI-ILO definition*)	2016	2015	Δ
Injury Rate:			
number of injuries with at least one day's abstention from year and multiplied by 200,000**	1.00	0.84	0.16
Lost day rate: days not worked per injury x 200,000 / hours worked***	31.28	36.13	(4.85)

* As required by the GRI protocols, the definitions adopted are those provided for by the International Labour Organisation (ILO). To facilitate comparison with other sources, the following notes show the figures of the same indicators calculated with alternative formulae.

** Using a multiplication factor of 1,000,000 rather than 200,000, the injury rate index was 5.0 in 2016 and 4.2 in 2015.

*** Using a multiplication factor of 1,000 rather than 200,000, the injury severity index was 0.2 in 2016 and 0.2 in 2015.

The overall picture that is revealed by this data – which always shows low figures and report the absence of fatal injuries – testifies to the effectiveness of the policies and practices implemented to ensure employee health and safety.
More specifically, the intense training and information delivered on the matter, together with the constant supervision are what lies behind the management system that has obtained, and maintained (since 2007), OHSAS 18001. The activities are managed by an organisational structure assigned to safety, structured into a central supervisory office and managers throughout the territory.

Other initiatives and recognition

NEXT ENERGY project

Terna has created NEXT ENERGY in partnership with the Fondazione Cariplo, an initiative that aims to promote the development of young talent and support innovative projects for the development of the electricity system. The initiative is divided into two distinct pathways. The first is reserved for 15 engineering graduates, and the second for 10 teams of young researchers who have a business idea to be developed. The new graduates were offered a six-month paid internship from October 2016-March 2017 in the Terna departments responsible for innovative business, while the Cariplo Foundation managed the incubation and acceleration of the 10 selected teams through its technical partner PoliHub, part of the Politecnico di Milan and focused on accelerating start-ups. This also had a duration of six months. Terna guaranteed the connection with its technical departments, to create an open innovation initiative. The selection of participants took place through two calls, which could be accessed for around two months on the dedicated website www.nextenergyprogram.it. At the end of September 2016, the jury, composed of equal numbers of Terna, Cariplo Foundation and PoliHub representatives, chose the 10 best innovative projects to begin the business empowerment process. For the innovator pathway, the NEXT ENERGY call includes a second assessment, by the end of April 2017, conducted by the Panel in order to award the best 3 candidates with vouchers to be spent in the go-to-market, totalling € 50,000, € 30,000 and € 20,000 respectively.

Companies Safety Prize

Terna has won the 4th edition of the "Companies Safety Prize" awarded by Confindustria and INAIL with patronage of the President of the Republic and the technical collaboration of APQI (Associazione Premio Qualità Italia - Italy Quality Prize Association) and Accredia (the Italian Accreditation Body) for supporting and sharing a business culture based of health and safety. A recognition of Terna's leadership in the use of increasingly innovative solutions to protect the health and safety of workers.

ANNEXES

142 Annexes related to "The Materiality Analysis"

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Annexes related to “The Materiality Analysis”

In preparing the 2016 Integrated Report Terna took into account the basic principles of the Integrated Reporting Framework finalised by the IIRC-International Integrated Reporting Council. Among these principles is materiality, which calls upon companies to consider, in choosing matters to be dealt with and the KPIs connected with them, their effective importance in terms of their relationship to value creation.

In 2013, Terna conducted a materiality analysis in line with the GRI-G4 standard, resulting in the matrix that offers a compact assessment of significant from the point of view of Group management and stakeholders. This matrix was updated in 2014 and maintained in 2015.
Based on changes to the company, new tools activated by Terna to manage stakeholders and growing external emphasis on the issue (e.g. amendments made to the requirements for certain ISO certifications), in 2016 Terna decided it was appropriate to fully revise the analysis.

The revision process began with updating the thematic tree, completed through the analysis of internal and external sources of data, making it possible to identify and detail significant issues at the current time. In addition to a comprehensive review of the terminological description of the issues, one of the most important changes was the addition of “Strategic approach to stakeholder management” as a transversal aspect, which arose following the growing attention paid to this concept, on both a national and international scale.
After the thematic tree was updated, 22 interviews were carried out with management from all company departments to discuss relationships with stakeholders in general, and more specifically the relative significance of the issues to be placed on the materiality matrix.

To update the aspect of “significance for Terna”, the interviews focused on the importance attributed to various issues by management, considering the way it was reflected in internal rules, procedures, policies and guidelines, in targets and resources allocated, and in concrete activities and projects. This significance expresses, de facto, the level of commitment that the Group has already proven and structured in relation to each issue.

To update the aspect of “significance for stakeholders”, the starting point was the information already held by the departments relative to stakeholder requests and opinions, information that may come from a plurality of sources:

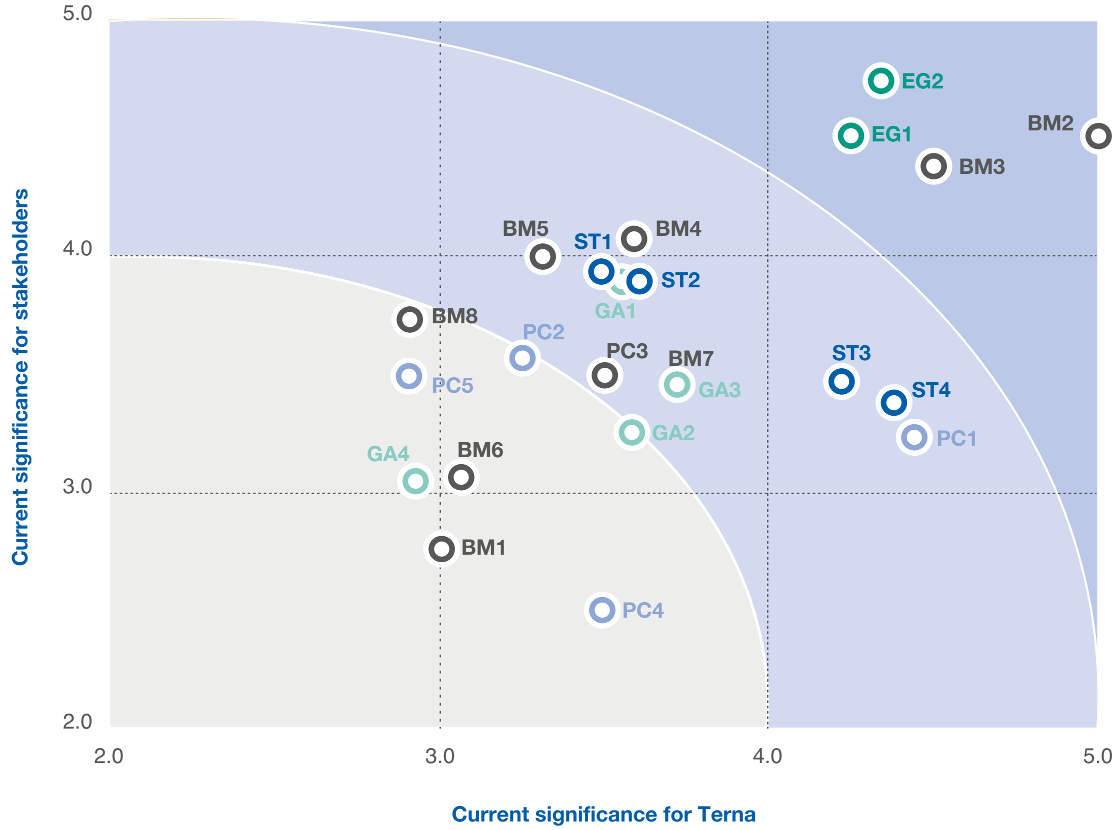
- direct, targeted and structured engagement initiatives (e.g. climate surveys, customer satisfaction, focus groups, etc.);
- opinions expressed by stakeholders in the context of relations with Terna (e.g. email correspondence, meeting minutes, alignment meetings, etc.);
- opinions independently expressed by stakeholders and passively received by Terna (e.g. press and online clippings, position papers, press releases, etc.);
- assessments resulting from opinions developed over time through relations with stakeholders.

The Materiality Matrix summarises the company’s point of view and that of the stakeholders, making it possible to:

- identify “material” issues, that is those which are of the greatest import to Matrix and of the greatest interest to stakeholders;
- verify the degree of alignment or misalignment between stakeholder perspectives and that of Terna relative to each issue.

On the matrix, issues of greater importance are farther away from the origin, on both axes.

THE TERNA GROUP'S MATERIALITY MATRIX



ETHICS AND GOVERNANCE MODEL
EG1 Alignment to best practices on the subject of governance
EG2 Integrity in conducting business

TRANSMISSION SERVICE
ST1 Sustainable planning of NTG development
ST2 Integrating the electricity markets
ST3 Quality, security and continuity of the electricity service
ST4 Reducing electricity service costs

MANAGING ENVIRONMENTAL IMPACTS
GA1 Mitigating the visual, landscape and acoustic impact
GA2 Safeguarding biodiversity
GA3 Managing and monitoring electromagnetic fields
GA4 Reducing the Group's environmental footprint

BUSINESS MANAGEMENT
BM1 Strategic approach to stakeholder management
BM2 Observing the economic and financial targets
BM3 Careful risk management
BM4 Selectivity of investments and observance of the plans
BM5 Optimal management of relations with local stakeholders
BM6 Developing and diversifying the business
BM7 Environmental and social oversight of the supply chain
BM8 Innovation and Research

PEOPLE AND SOCIETY
PC1 Health and safety of workers and correct working practices
PC2 Developing human resources
PC3 Promoting wellbeing in the company
PC4 Promoting diversity and equal opportunities
PC5 Social commitment and positive impact on the country

Annexes related to "The Company and the External Context"

Regulatory framework and other information

Summary of the main provisions in 2016

The main legislation of the year includes the 2016 Stability Law and the 2017 Budget Law which contain changes on the subject of taxation, the decree of the Ministry of Economic Development of 30 September 2016 on the interconnector fund, the reform of the Service Conference and the reform of the Contracts Code.

MAIN PROVISIONS IN 2016

Standard	Content
Changes on the subject of taxation	**Italian Law no. 208 of 28 December 2015** provides for the reduction of IRES from the 2017 tax period and introduced super-depreciation, which enables the deductibility for amounts increased by 40% of new instrumental goods. The measure was extended for 2017 by Italian Law no. 244 of 11 December 2016 (2017 Budget Law), which also provides for a higher increase for more innovative goods (hyper-depreciation).
Interconnector Pursuant to Law 99/09	The **2016 Stability Law** (Law No. 208 of 30 December 2015) intervenes on the regulation of the Interconnectors envisaging an extension to 31 December 2021 of the virtual import regime pursuant to paragraph 6 of art. 32 of Law 99/09. It also establishes a guarantee fund with Terna into which flow the amounts, determined as € 1/MWh per year, that the awarded subjects (i.e. the assignees of power assigned who have made the commitment with Terna for financing) are required to pay. A decree of the Ministry of Economic Development of 30 September 2016 approved the related implementing regulation.
Reform of the Services Conference	**Italian Legislative Decree no. 127 of 30 June 2016**, implementing the delegation contained in Italian Law no. 124 of 7 August 2015 (Reform of the PA) laid down new rules for the Services Conference, an instrument with which the authorisation proceedings for projects for new works on the national transmission grid are performed.
Reform of the Contracts Code	**Italian Legislative Decree no. 50 of 18 April 2016**, implementing Enabling Law no. 11 of 28 January 2016, transposed Directives 2014/23/EU, 2014/24/EU and 2014/25/EU on the subject of contracts and concessions. Italian Legislative Decree 50/16 replaces Italian Legislative Decree 163/06 and reforms the rules on the subject of public contracts also for the special sectors.

Below is a brief description of the other regulatory measures of interest for the Parent Company issued during 2016 and, subsequently, up to the date of preparation of the present Annual Financial Report.

LAWS AND MEASURES ISSUED IN 2015 WITH EFFECT FROM 2016

Italian Law no. 208 of 28 December 2015, commented on above among the main 2016 measures.

Italian Law Decree No. 210 of 30 December 2015 on "Extension of the terms envisaged by legislative measures" published in Italian Official Journal No. 302 of 30 December 2015, converted with Italian Law No. 21 of 25 February 2015, published in Italian Official Journal No. 47 of 26 February 2016.

Italian Law No. 221 of 28 December 2015, "Environmental provisions to promote green economy measures and to reduce excessive use of natural resources", published in the Italian Official Gazette No. 13 of 2 February 2016.

LAWS AND DECREES ISSUED IN 2016

On taxes	**Italian Law no. 232 of 11 December 2016**, Forecast Government Budget for Financial Year 2017 and Multi-year Budget for 2017-2019.
On energy	**Decree of the Ministry of Economic Development of 30 September 2016**. The MED issued the decree which, implementing Article 1, paragraph 831 of the 2016 Stability Law (Italian Law no. 208 of 28 December 2015) contains the regulation of the Guarantee Fund for the creation of the Interconnectors pursuant to Art. 32 of Italian Law 99/09.
	Italian Decree Law of 30 December 2016, no. 244, "Extension and definition of terms".
On employment	**Decree of the Minister of Labour and Social Policies, 25 March 2016**
	Decree implementing the rules of the Stability Law 2016 (Law 208/15) providing for the application of a substitute tax of 10% on bonuses of up to € 2,000 for employees with annual employment income up to € 50,000.
	Italian Legislative Decree no. 159 of 1 August 2016 regarding "Implementation of Directive 2013/35/EU on minimum health and safety rules related to the exposure of workers to risks deriving from physical agents (electromagnetic fields) and that abrogates Directive 2004/40/EC", published in Official Journal no. 192 of 18 August 2016.
On company law	**Italian Legislative Decree no. 25 of 15 February 2016**, "Implementation of Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and prospectus be published for the public offer or admission to trading of financial instruments", published in the Official Journal, No. 52 of 3 March 2016.
	Italian Legislative Decree no. 135 of 17 July 2016, entitled "Implementation of Directive 2014/56/EU that amends Directive 2006/43/EC concerning statutory audits of annual accounts and consolidated accounts", published in Official Journal no. 169 of 21 July 2016.
	Italian Legislative Decree no. 254 of 30 December 2016, Implementation of Directive 2014/95/EU of the European Parliament and Council of 22 October 2014, containing an amendment to Directive 2013/34/EU on the communication of non-financial information and diversity information from certain companies and certain large groups

Besides Italian Legislative Decree no. 50 of 18 April 2016 commented on above among the main measures in 2016, the following measures were issued:

On contracts and infrastructure

- **Italian Law no. 11 of 28 January 2016**, "Delegation to the Government for the implementation of Directives 2014/23/EU, 2014/24/EU and 2014/25/EU of the European Parliament and of the Council of 26 February 2014, on the award of concession contracts, on public procurement and procurement procedures by entities operating in the water, energy, transport and postal service sectors, as well as to revise the current regulations on public contracts for works, services and supplies", published in the Official Journal no. 23 of 29 January 2016.
- **Italian Legislative Decree no. 33 of 15 February 2016**, "Implementation of Directive 2014/61/EU of the European Parliament and of the Council of 15 May 2014 setting out measures to reduce the installation costs of high-speed electronic communication networks", published in the Official Gazette no. 57 of 9 March 2016.
- **Decree of the Ministry of Economy and Finance of 3 August 2016** entitled "Concession of the State guarantee on financial operations of investment platforms eligible for the European Fund for Strategic Investments (EFSI)".

On industry research

- **Decree of the Italian Ministry of Economic Development of 21 April 2016** "Approval of the 2015–2017 three-year national electricity system research Plan and the division of resources for 2015," published in the Italian Official Journal no. 145 of 23 June 2016.

Beyond Italian Legislative no. 127 of 30 June 2016, previously mentioned amongst the main provisions for 2016, in implementation of the delegated powers defined in Law no. 124 of 07 August 2015 on the reorganisation of public administrations, the following legislative decrees were adopted:

On public administrations and public equity investments

- **Italian Legislative Decree no. 174 of 26 August 2016**, entitled "Consolidated Law on companies with public equity investments", published in Italian Official Journal no. 210 of 8 September 2016.
- **Italian Legislative Decree no. 97 of 25 May 2016**, "Revision and simplification of the provisions on the prevention of corruption, on openness and transparency, amending Italian Law no. 190 of 6 November 2012 and Italian Legislative Decree no. 33 of 14 March 2013 pursuant to Article 7 of Law no. 124 of 7 August 2015, concerning the reorganisation of the public administrations", published in Official Journal no. 132 of 8 June 2016.

Further information

Further information required by specific legal or sector regulations is presented below.

Treasury shares

The Parent Company does not hold any treasury shares or shares of Cassa Depositi e Prestiti S.p.A. or CDP Reti S.p.A., nor has it acquired or sold any during the year, either directly or indirectly.

Related-party transactions

Related-party transactions carried out by the Terna Group in 2016 consisted largely of services under the scope of ordinary business and regulated by market conditions, as is described in greater detail in the Consolidated and Separate Financial Statements at 31 December 2016[30].

(30) Transactions with members of the Board of Statutory Auditors of the Parent Company, and in particular their fees, are detailed in the comments on the "Services" item in the Notes to the Consolidated and Separate Financial Statements at 31 December 2016, to which reference should be made. In addition, implementing CONSOB Resolution No. 18049 of 23 December 2011, the disclosure on fees paid to "*members of the administrative and auditing bodies, general managers*", as well as on equity interests held by the same, and by other subjects as provided for by the Article mentioned, is included in the Annual Remuneration Report published in accordance with the law.

The Parent Company's Corporate Governance[31] rules ensure that these transactions are carried out in compliance with the criteria of procedural and substantial correctness, with the same terms that would apply to independent counterparties and in accordance with the rules on the transparency of disclosures to the market.
We can note that no transactions of major importance[32] were carried out in 2016, nor were operations subject to disclosure obligations because they fall within the cases of exclusion provided for in the said Regulations[33].

Information on ownership structures

Information required under Art. 123-*bis*, "Information on ownership structure" of the "Consolidated Law on Financial Intermediation" (Italian Legislative Decree No. 58 of 24 February 1998), is presented in a separate report ("Report on Corporate Governance and Ownership Structures"), approved by Terna's Board of Directors for 2016, which is available on the website of Terna S.p.A. (www.terna.it - in the section "Investor Relations").

Certifications in accordance with Article 2.6.2, paragraphs 8 and 9, of the Italian Stock Exchange Regulation organized and managed by Borsa Italiana S.p.A. with regard to the conditions pursuant to Articles 36 and 37 of the CONSOB Market Regulation (no. 16191/2007)

With regard to the provisions of Article 36 of Regulation no. 16191/2007 as subsequently amended (CONSOB Markets Regulation), implementing rules of Legislative Decree no. 58 of 24 February 1998 on the subject of markets, Terna S.p.A. does not hold any significant controlling interests under the terms of the aforementioned regulations in companies incorporated in and regulated by the laws of non-EU countries.
With regard to the provisions of Article 37 of the same CONSOB Markets Regulation, Terna S.p.A. is subject to the de facto control of Cassa Depositi e Prestiti S.p.A., currently held through CDP Reti S.p.A. (joint-stock company controlled by Cassa Depositi e Prestiti S.p.A.) which holds an equity interest amounting to 29.851% in the share capital. The verification, from which the existence of such control emerged, was carried out by Cassa Depositi e Prestiti and disclosed to the Company and the CONSOB since 19 April 2007 and, subsequently, with letters of 30 October 2014 and 2 December 2014. At present, no management or coordination has been formalised or exercised; Terna S.p.A. goes about its business directly or through its subsidiaries with independent management and trading.

Participation in the legislative simplification process pursuant to CONSOB Resolution 18079 of 20 January 2012

Pursuant to Art. 3 of CONSOB Resolution no. 18079 of 20 January 2012, Terna decided to adopt the simplified system envisaged by Arts. 70, paragraph 8, and 71, paragraph 1-*bis*, of the CONSOB Regulation no. 11971 of 14 May 1999 and subsequent amendments (CONSOB Issuer Regulations), thereby availing itself of the right to be exempt from the requirement to publish disclosure documents provided for in occasion of significant mergers, de-mergers, share capital increases by contribution of non-cash assets, acquisitions and sales.

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(31) On 15 December 2016, the Board of Directors of the parent company, Terna S.p.A. amended the "Procedure for Related-Party Transactions" adopted within the Terna Group.
(32) That is, related-party transactions identified in accordance with the provisions of Annex 3 of the "Regulations on Related-Party Transactions" (adopted with CONSOB Resolution no. 17221 dated 12 March 2010, subsequently amended with CONSOB Resolution no. 17389 of 23 June 2010).
(33) As they are "*transactions coming under the scope of the ordinary business of the Company's continuing operations or those of its subsidiaries or associates or financial activities related thereto, provided that they were concluded at conditions equivalent to market or standard terms*".

Annexes related to “Business and Capital”

Evolution of the dimensions of the NTG

Below are the details of the changes in the amounts of plants with respect to the situation at 31 December 2015.

DETAILS OF THE ELECTRICAL SUBSTATIONS OWNED BY THE TERNA GROUP[34]

(at 31/12)	Unit of measurement	2016	2015	Δ	Δ %
380 kV					
Substations	No.	161	159	2	1.26
Power transformed	MVA	110,708	109,508	1,200	1.10
220 kV					
Substations	No.	150	150	-	-
Power transformed	MVA	30,837	30,692	145	0.47
Lower voltages (≤150 kV)					
Substations	No.	544	541	3	0.55
Power transformed	MVA	3,911	3,815	96	2.52
Total					
Substations	No.	855	850	5	0.59
Power transformed	MVA	145,456	144,015	1,441	1.00

DETAILS OF POWER LINES OWNED BY THE TERNA GROUP[35]

(at 31/12)	Unit of measurement	2016	2015	Δ	Δ %
380 kV					
Circuit length	km	12,314	12,118	197	1.62
Line length	km	11,238	11,105	133	1.20
220 kV					
Circuit length	km	11,698	11,721	(23)	(0.20)
Line length	km	9,363	9,482	(118)	(1.25)
Lower voltages (≤150 kV)					
Circuit length	km	48,832	48,760	72	0.15
Line length	km	45,765	45,685	80	0.18
Total					
Circuit length	km	72,844	72,599	245	0.34
aerial	km	69,618	69,515	103	0.15
underground cable	km	1,804	1,736	69	3.95
undersea cable	km	1,422	1,348	74	5.50
Line length	km	66,366	66,272	94	0.14
aerial	km	63,140	63,188	(48)	(0.08)
underground cable	km	1,804	1,736	69	3.95
undersea cable	km	1,422	1,348	74	5.50
Proportion of direct-current connections (200–380–500 kV)					
Circuits	km	2,066	2,066		
% of total	%	2.84	2.85		
Lines	km	1,746	1,746		
% of total	%	2.63	2.63		

(34) MVA calculated to three decimal places and rounded to the unit. Percentages calculated to five decimal places and rounded to two decimal places.
(35) Km calculated to three decimal places and rounded to the unit. Percentages calculated to five decimal places.

MAIN CHANGES IN NUMBERS OF PLANTS OWNED BY THE TERNA GROUP

SUBSTATIONS

New plants:
We note the following **new activations**:
- transformer substation in Villafranca Tirrena [ME] (7 x 380 kV bays and 3 x 150 kV bays);
- switching substation and photovoltaic production connection in Lanuvio [RM] (5 150 kV bays);
- switching substation in Butera [ME] (4 150 kV bays);
- switching substation and photovoltaic production connection in Brindisi Cerrito [BR] (2 150 kV bays);

The **start of operations** for the transformer substation in Tuscania [VT] is also noted.

Existing plants:
- activation of 22 new bays in the substations of Melfi and Rizziconi (2 bays at 380 kV), Rotonda 150 (2 bays at 150 kV), Bisaccia 380 kV, Brindisi Sud, Castelnuovo and Deliceto (1 bay at 150 kV each), Cedegolo Sud (3 bays at 132 kV), Chiari and Musocco (2 bays at 132 kV each), Avenza, Marginone, Martignone, Parma Vigheffio and San Rocco (1 bay at 132 kV each);
- activation of 17 new machine and/or power factor correction bays in the substations of Chiari and Pian Camuno (1 bay at 380 kV and 1 bay at 132 kV each), Casanova, Erchie and Roma Sud (1 bay at 380 kV each), Sulcis (2 bays at 220 kV), Casellina, Patria and Taio (1 bay at 220 kV each), Rotonda 150 and Rumianca (1 bay at 150 kV each), Bolzano, Casellina and Marginone (1 bay at 132 kV each);
- activation of 6 new machine and/or power factor bays in the substations of Melfi (1 bay at 380 kV and 1 bay at 150 kV), Rizziconi (1 bay at 380 kV), Chiari (2 bays at 132 kV), Suvereto (1 bay at 132 kV);
- deactivation and/or demolition of 11 bays in the substations of Cislago (1 bay at 380 kV and 1 bay at 132 kV), Fratta (2 bays at 220 kV), Misterbianco, Paternò and Rotonda (1 bay at 150 kV each), Cedegolo, Marginone, Parma Vigheffio and San Rocco (1 bay at 132 kV each).

TRANSFORMERS

We note the following **new activations**:
- 2 new 380/150 kV auto-transformers of 250 MVA for commissioning of the Villafranca Tirrena substation;
- 2 new 380/132 kV auto-transformers of 250 MVA in the substations of Chiari and Pian Camuno;
- 1 new 220/15 kV transformer of 230 MVA for commissioning of the Partinico synchronous condenser;
- 1 new 150/20 kV transformer of 25 MVA with commissioning of the Brindisi Cerrito substation;
- 1 new 150/20 kV transformer of 25 MVA in the Rotonda 150 substation;
- replacement of one 380/132 kV transformer of 250 MVA with a similar one of the same power in the Sandrigo substation;

We also note the **replacements** of 2 transformers one 220/15 kV of 40 MVA with a similar one of 63 MVA at the substation in Colorno and one 220/15 kV of 40 MVA with one of the same power at the Ottana substation.

POWER LINES

- entry into service of 16 new lines for a total of 246.9 km of circuits: Villanova - Gissi 380 kV (69.6 km overhead), Scilla - Villafranca Tirrena 1 and 2 380 kV (total 85.2 km in cable), Sorgente - Villafranca Tirrena 1 and 2 380 kV (total 40.5 km overhead and double circuits), Castelnuovo di Conza - Goleto 150 kV (18.4 km overhead), Tommaso Natale - Pallavicino 150 kV (5.7 km in cable), Benevento II - Benevento Nord 2 150 kV (3.8 km in cable), Misterbianco - Paternò 150 kV (3.0 km overhead), Brindisi Cerrito - Brindisi Sud 150 kV (0.2 kV in cable), Monte Crocetta - Vicenza Viale Pace 2 132 kV (7.9 km in cable), cl Forno - cp Cedegolo Sud 132 kV (5.4 km in cable), Avenza - Massa Zona Industriale 132 kV (3.7 km mixed), Vicenza Monteviale - Monte Crocetta 132 kV (2.3 km in cable), Cedegolo Sud - S.Fiorano 132 kV (1.3 km in cable), se Cuneo San Rocco - cp Cuneo San Rocco 132 kV (0.1 km overhead);
- **activation** of 2 short links (totalling 0.1 km) at 132 kV between adjacent installations;
- **construction** of 6 in-out derivations on the same number of operating lines with an overall increase of the same number of circuits and 38.3 km of circuit, of which: + 1 line + 3.9 km at 380 kV, + 1 line at 220 kV + 2 lines + 33.2 km at 150 kV, + 2 lines + 1.3 km at 132 kV;
- **construction of variants, rigid derivations and/or changes in the line and/or grid distribution** with a total reduction of 22.0 km of circuits, of which: + 4.4 km at 220 kV, + 1.3 km at 150 kV, - 28.4 km at 132 kV, + 0.3 km at 60 kV;

With reference to the subsidiary **Terna Rete Italia S.r.l.**, we note the start of operations for 2 new lines, totalling 12.2 km of circuits: Albano - Lanuvio 150 kV (8.3 km mixed) and Caserta Sud - Saint Gobain 150 kV (3.9 km in cable). Relative to the subsidiary **Rete S.r.l.**, we note the acquisition from RFI S.p.A. of 3 in-out derivations on the same number of 150 kV operating lines with an increase of the same number of circuits and 9.4 km of circuit:

Criteria for Preparing and Approval Process of the Development Plan

Terna manages the National Transmission Grid (NTG) based on criteria of security and cost-effectiveness of the electricity system. The requirement of guaranteeing a balance between the supply and demand for electricity necessitates that the transmission grid is adequate in relation to changes in the extent and location of power withdrawals and injections; in this regard, Terna prepares on an annual basis the NTG Development Plan (DP), which contains the transmission grid development investments scheduled over the short and long term and the progress status of the development works planned in previous years.
The 2017 DP is concerned with NTG development investments for 2017-2026. The document describes the reference framework, the objectives and the criteria that the Transmission Grid planning process is based on, the new development needs which emerged during 2016, the action priorities and the expected results deriving from implementing the DP. The Plan is accompanied by a closer examination of analyses carried out on the economic sustainability of the main development plans. The Document can be found at Terna's website[36] and is sent to the Ministry of Economic Development and the relative Authorities on 31 January of every year for approval.
The data and information used in the NTG planning process refer to three basic aspects in the functioning of the electricity system: the status of the electricity system and its evolution, the development and distribution of consumption and the production of electricity. This planning process is graphically represented in summary below.

CRITERIA FOR PREPARING THE DEVELOPMENT PLAN

Objectives	Analysis of medium- and long-term scenarios	Development needs	Definition of actions to develop the NTG	Contents of Development Plan
Security, continuity, service and coverage of demand	Analysis of regulatory framework and strategic guidelines	Strengthening of critical sections	New power lines/substations	List of actions
Quality of Service	Analysis of current grid and market scenarios	Removal of limited hubs	Upgrading of existing grid	Cost/Benefit analysis
Reduction of congestion, cost-effectiveness of the service	Development of demand	Removal of constraints for renewable energy sources	Improvements with devices for integrating renewables	Schedules and costs of works
Reduction of constraints for renewable energy sources	Development of new power plants	Increased exchange with other countries	NTG Connections	Expected results
Guarantee of connection	Analysis of import development and Merchant lines	Improvement in voltage profiles and Quality of Service	PST and smart systems	
Compliance with landscape and environmental constraints	Opportunities for expanding NTG		Reorganisation/rationalisation of grid	

The 2017 DP has a large number of new elements with respect to previous editions, in line with changes in the energy context, characterised on one hand by new climate objectives deriving from the signing of the Paris Accords (COP21) and, on the other, by the revised regulatory structure developed by the Authority for Electricity, Gas and Water (AEEGSI), which changed the regulatory logic and is now based on an output-based system that aims to measure the benefits of development projects and identify solutions that are more efficient globally, at lower costs and with less impact on the environment.

(36) At http://www.terna.it/it-it/sistemaelettrico/pianodisviluppodellarete/pianidisviluppo.aspx

As already mentioned in the energy context section, the Energy Union package, together with the signing of the Paris Accords, have the aim of guaranteeing energy to Europe and its citizens that is secure, sustainable and at accessible prices. There are specific measures relative to three key sectors: decarbonization, market efficiency and security of supply.
In this context, Terna, as the operator of the transmission grid, is also called upon to contribute to decarbonization, through the implementation of a plan which will require making developments to the grid to allow the achievement of even more challenging objectives. These challenges require significant efforts from the company, aimed at developing the transmission grid in a situation that is constantly evolving, while simultaneously guaranteeing satisfactory standards of adequacy, quality and security, with the latter also meaning the ability of the electricity system to be resilient and able to deal with critical events that are external to the system.
The cited guidelines and relative initiatives are also reflected in the 2017 Development Plan which implements, among other things, the provisions found in the recent Resolution 627/2016/R/eel of 4 November 2016, "Provisions for consultation of the ten-year National Transmission Grid Development Plan and approval of the minimum requirements of the Plan, for assessments for which the Authority is responsible", with which AEEGSI outlined the requirements of the Grid Development Plan and, in particular, made explicit the criteria for the new Cost Benefit Analysis (CBA 2.0). This new Cost Benefit Analysis involves significant alignment with the criteria and methods applied in ENTSO-E, introducing the development of analysis of three-year periods and with five reference scenarios as well as, for the first time, environmental and social benefit indexes. In line with these guidelines, medium and long-term development scenarios have been prepared.
The DP follows a detailed approval process, which is set out briefly below.

APPROVAL PROCESS FOR THE TERNA DP
Terna's preparation of the ten-year Development Plan.
Assessment by the Grid User Consultation Committee (based on the Terna Grid Code, Chapter 13).
Public consultation by the AEEGSI, with the results made public (Italian Legislative Decree 93/2011 - Art. 36, paragraph 13).
Process submitted to the Strategic Environmental Assessment (SEA)* by the Ministry of the Environment and Protection of Land and Sea, in conjunction with the Ministry for Cultural Heritage and Tourism. (Italian Legislative Decree 152/2006 as subsequently amended and supplemented).
Assessment and approval by the Ministry of Economic Development, once the opinion of the Regions that are affected by the planned interventions has been obtained and taking into consideration the assessment made by the AEEGSI (Italian Legislative Decree 93/2011 - Art. 36, paragraph 12).

* It is also potentially subject to screening to check whether it should undergo SEA pursuant to Italian Legislative Decree No. 1 of 24 January 2012. The SEA is a procedure instituted specifically, by Community Directive 2001/42/EC, for the strategic environmental assessment of plans or programs that could have significant effects on the environment. This Directive was implemented in Italy through Legislative Decree 152/2006, taking effect on 31 July 2007.

In 2016, consultations relative to the 2015 and 2016 DPs were completed by AEEGSI. Observations received from stakeholders on the DP, based on a request by AEEGSI, were commented on by Terna and published on the AEEGSI website.
On 4 November 2016, with Opinion 2016/I/EEL, the AEEGSI published the results of the consultations relative to the cited DPs and issued the clearance for approval of the same by the Ministry of Economic Development.

Annexes related to "Economic and financial performance"

Alternative Performance Measures

In line with the ESMA/2015/1415 guidelines, the Alternative Performance Measures used in the present Integrated Report - Integrated Report are illustrated below.

Measure	Description
Economic results	
Gross Operating Margin - EBITDA	this is a measure of operating performance and it is calculated by combining the **Operating Profit (EBIT)** with **Amortisation**, **depreciation and impairment**.
Operating Profit - EBIT	this is a measure of operating performance and it is calculated by combining the **Profit before taxes** with **Net financial expenses/income**.
EBITDA MARGIN	this is a measure of operating performance and it derives from the ratio between the **Gross Operating Margin (EBITDA)** and **Revenue**.
TAX RATE	this expresses the proportion of tax with respect to the result and derives from the ratio between **Taxes on the profit** and the **Profit before taxes**.
Equity results	
Net working capital	this is an equity measure which expresses the company's liquidity situation and it is determined by the difference between **current assets** and **current liabilities** of a non-financial nature represented on the balance sheet.
Gross Invested Capital	this is an equity measure which expresses the total of the Group's non-current assets and derives from the sum of **Net non-current assets** and **Net Working Capital**.
Net Invested Capital	this is an equity measure which expresses the investments made by the Group net of the contribution of external capital and it is determined by the **Gross Invested Capital** net of **Sundry provisions**.
Cash flows	
Net financial debt	this is a measure of the Group's financial structure and it is determined as the sum of the **short- and long-term financial payables** and the related **derivative instruments**, net of **cash and cash equivalents** and of **financial assets**.
Free Cash Flow	this is the cash flow and it is given by the difference between the **cash flow from operating activities** and the **cash flow for investments**.

Reconciliation tables

In line with the ESMA/2015/1415 guidelines, the reconciliation of the financial schedules for the Income Statement, Statement of Financial Position, Net Financial Debt and Cash Flow of the Terna Group and Terna S.p.A. are presented below with the relative Income Statement and Statement of Financial Position.

Reconciliation with reclassified Income Statement schedules, Statement of Financial Position and Net Financial Debt of the Terna Group

The Group's reclassified income statement	€ million	Consolidated income statement
Transmission Fee	1,735.0	"Revenue from sales and services"
Dispatching fee	111.3	
Revenue from construction of assets in concession	21.2	
Other operating revenue - Regulated Activities	49.1	"Revenue from sales and services" for € 165.1 million and "Other revenue and income"
Other operating revenue - non-Regulated Activities	186.6	
Personnel expenses	263.6	"Personnel expenses" net of the costs from construction of assets in concession pursuant to IFRIC 12 (€ 4.4 million)
Services, leases and rentals	179.1	"Services" net of the costs from construction of assets in concession pursuant to IFRIC 12 (€ 12.3 million)
Materials	66.5	"Raw materials and consumables" net of the costs from construction of assets in concession pursuant to IFRIC 12 (€ 4.5 million)
Other expenses	35.9	Other operating expenses
Quality of Service	(7.8)	
Costs from construction of assets in concession	4.4	"Personnel expenses"
	12.3	"Services"
	4.5	"Raw materials and consumables"
Net financial income (expense)	(102.8)	Points 1, 2 and 3 of letter C - "Financial income/ expense"
Income taxes for the year	305.3	"Taxes for the year"

The Group's reclassified statement of financial position	€ million	Consolidated statement of financial position
Financial assets	89.1	"Equity-accounted investees", "Other non-current assets" and "Non-current financial assets" for the carrying amount of the other investments (€ 0.1 million);
Trade receivables	466.9	"Trade receivables" net of energy-related pass-through revenue receivables (€ 976.4 million)
Other assets	20.4	"Other current assets" net of other tax assets (€ 47.1 million)
Net tax assets	52.0	"Income tax assets", "Other current assets" for the amount of the other tax assets (€ 47.1 million), "Other current liabilities" for the amount of other tax liabilities (€ 6.7 million) and "Tax liabilities"
Trade payables	(758.4)	"Trade payables" net of the energy-related pass-through costs payable (€ 1,522.3 million)
Net energy-related pass-through payables	(545.9)	"Trade receivables" for energy-related pass-through revenue receivables (€ 976.4 million) and "Trade payables" for energy-related pass-through costs payable (€ 1,522.3 million)
Other liabilities	(337.7)	"Other non-current liabilities" and "Other current liabilities" net of other tax liabilities (€ 199.6 million)
Sundry provisions	(384.6)	"Employee benefits", "Provisions for risks and charges" and "Deferred tax liabilities"
Net financial debt	7,958.9	"Long-term loans", "Current portion of long-term loans", "Non-current financial liabilities", "Short-term loans", "Cash and cash equivalents", "Non-current financial assets", net of other investments (€ 0.1 million), "Current financial assets" and "Current financial liabilities"

Net financial debt statement	€ million	Consolidated statement of financial position
"Bond" and "Floating-rate loans"	8,404.4	Corresponds to "Long-term loans"
"Derivative financial instruments" - medium and long-term	(312.9)	Corresponds to "Non-current financial liabilities" and "Non-current financial assets" for the value of FVH derivatives (€ 325.7 million)
Other non-current financial assets	(17.4)	included under "Non-current financial assets"
"Bonds (current portions)" and "Floating-rate loans (current portions)"	904.5	Corresponds to "Current portion of long-term loans"
Other net current financial liabilities	95.9	Corresponds to "Current financial assets", "Current financial liabilities" and "Non-current financial assets" for the value of deferrals on Revolving Credit Facility commissions (€ 4.3 million).

Reconciliation of the Terna Group's Cash Flow

€ million	Cash flow 31.12.2016	Financial Statements Reconciliation	Cash flow 31.12.2015	Financial Statements Reconciliation
- Net profit for the year	627.9		595.3	
- Amortisation, depreciation and impairment	508.7		516.8	
- Net change in provisions	11.1		(67.4)	
Employee benefits		(1.4)		(40.8)
Provisions for risks and charges		39.8		(10.7)
Deferred tax liabilities		(27.3)		(15.9)
- Net Losses (Gains) on asset disposals (1)	(9.8)		(1.7)	
Operating Cash Flow	**1,137.9**		**1,043.0**	
- Change in net working capital:	112.8		151.2	
*Inventories**		1.6		9.2
*Trade receivables***		(73.3)		200.7
Income tax assets		14.3		(8.1)
Other current assets		67.6		(89.1)
Trade payables		136.8		40.1
Tax liabilities		(7.3)		14.2
Other liabilities		(26.9)		(15.8)
- Other changes in non-current assets	65.9		(785.6)	
Goodwill		-		(43.5)
Intangible assets (2)		-		(44.3)
of which intangible assets acquired with the transaction with the FSI Group		-		(38.0)
Property, plant and equipment (3)		65.5		(697.6)
of which tangible assets acquired with the transaction with the FSI Group		-		(719.0)
Non-current financial assets		(0.1)		0.3
OTHER NON-CURRENT ASSETS		(2.5)		(1.5)
Equity-accounted investees		3.0		1.0
Cash Flow from Operating Activities	**1,316.6**		**408.6**	
net of the change in non-current assets acquired with the FSI Group	1,316.6		1,165.6	
Investments				
- Total investments	(854.3)		(1,103.1)	
Property, plant and equipment (3)		(812.8)		(1,058.6)
Intangible assets (2)		(41.5)		(44.5)
Total cash flows provided by/(used in) investing activities	**(854.3)**		**(1,103.1)**	
Free Cash Flow	**462.3**		**(694.5)**	
net of the change in non-current assets acquired with the FSI Group	462.3		62.5	
- Equity reserve cash flow hedges net of the tax effect and other changes in equity attributable to the owners of the Parent(4)	(12.3)		34.4	
- Other changes in equity attributable to non-controlling interests(4)	-		25.2	
- Dividends paid to the owners of the Parent	(406.2)		(402.0)	
Change in net financial debt	**43.8**		**(1,036.9)**	
net of the change in non-current assets acquired with the FSI Group	43.8		(279.9)	
- Change in loans	**660.3**		**251.2**	
Non-current financial assets		344.4		95.0
Current financial assets		38.1		(0.9)
Non-current financial liabilities		5.5		(22.6)
Long-term loans		(112.1)		431.3
Short-term loans		(396.5)		416.6
Current portion of long-term loans		781.6		(641.2)
Current financial liabilities		(0.7)		(27.0)
- Change in cash and cash equivalents	**704.1**		**(785.7)**	

* Does not take into account impairment of inventories (€ 0.6 million in 2016).

** Does not take into account impairments of trade receivables of the year (€ 3.4 million in 2016 and € 3.7 million in 2015).

(1) Included in the balances of "Other revenue and income" and "Other operating expenses" of the consolidated financial statements

(2) See note 15 to the financial statements.

(3) See note 13 to the financial statements.

(4) See the Statement of changes in consolidated equity.

Reconciliation with the reclassified schedules of the Income Statement, Statement of Financial Position and Net Financial Debt of Terna S.p.A.

Terna reclassified income statement	€ million	Income Statement
Transmission Fee	1,497.4	"Revenue from sales and services"
Dispatching fee	111.3	"Revenue from sales and services"
Revenue from construction of assets in concession	21.2	"Revenue from sales and services"
Other operating revenue	149.7	"Revenue from sales and services" for € 61.2 million and "Other revenue and income"
Personnel expenses	82.0	"Personnel expenses" net of the costs from construction of assets in concession pursuant to IFRIC 12 (€ 0.2 million)
Services, leases and rentals	322.4	"Services" net of the costs from construction of assets in concession pursuant to IFRIC 12 (€ 19.6 million)
Materials	3.1	"Raw materials and consumables" net of the costs from construction of assets in concession pursuant to IFRIC 12 (€ 1.4 million)
Other expenses	25.3	Other operating expenses
Quality of Service	(7.8)	
Costs from construction of assets in concession	0.2	"Personnel expenses"
	19.6	"Services"
	1.4	"Raw materials and consumables"
Net financial income (expense)	(102.0)	Points 1 and 2 of letter C - "Financial income/ expense"
Income taxes for the year	263.2	"Taxes for the year"

Reclassified statement of financial position of Terna	€ million	Statement of financial position
Financial assets	1,497.6	"Non-current financial assets" for the value of the equity investments in subsidiaries and associates (€ 1,494.0 million) and "Other non-current assets"
Trade receivables	396.8	"Trade receivables" net of energy-related pass-through revenue receivables (€ 976.4 million)
Other assets	49.9	"Other current assets" net of other tax assets (€ 27.1 million)
Net tax assets	28.6	"Income tax assets", "Other current assets" for the amount of the other tax assets (€ 27.1 million), "Other current liabilities" for the amount of other tax liabilities (€ 1.3 million) and "Tax liabilities"
Trade payables	(409.6)	"Trade payables" net of the energy-related pass-through costs payable (€ 1,552.8 million)
Net energy-related pass-through payables	(576.4)	"Trade receivables" for energy-related pass-through revenue receivables (€ 976.4 million) and "Trade payables" for energy-related pass-through costs payable (€ 1,552.8 million)
Other liabilities	(315.1)	"Other non-current liabilities" and "Other current liabilities" net of other tax liabilities (€ 145.5 million)
Sundry provisions	(243.3)	"Employee benefits", "Provisions for risks and charges" and "Deferred tax liabilities"
Net financial debt	8,101.0	"Long-term loans", "Current portion of long-term loans", "Non-current financial liabilities", "Short-term loans", "Cash and cash equivalents", "Non-current financial assets", net of the value of equity investments (€ 1,494.0 million), "Current financial assets" and "Current financial liabilities"

Terna net financial debt statement	€ million	Statement of financial position
"Bond" and "Floating-rate loans"	8,400.0	Corresponds to "Long-term loans"
"Derivative financial instruments" - medium and long-term	(313.0)	Corresponds to "Non-current financial liabilities" and "Non-current financial assets" for the value of FVH derivatives (€ 325.7 million)
"Bonds (current portions)" and "Floating-rate loans (current portions)"	902.3	Corresponds to "Current portion of long-term loans"
Other non-current financial assets	(17.4)	included under "Non-current financial assets"
Short-term loan to Terna Interconnector	(39.0)	included under "Current financial assets"
"Net intercompany treasury current account position" and "Cash and cash equivalents"	(927.8)	Corresponds to "Cash and cash equivalents"
Other net current financial liabilities	95.9	Corresponds to "Current financial assets" net of the short-term loan to Terna Interconnector (€ 39.0 million), "Current financial liabilities" and "Non-current financial assets" for the value of deferrals on Revolving Credit Facility commissions (€ 4.3 million).

Reconciliation of Terna S.p.A. Cash Flow

€ million	Cash flow 31.12.2016	Financial Statements Reconciliation	Cash flow 31.12.2015	Financial Statements Reconciliation
- Net profit for the year	535.5		527.1	
- Amortisation, depreciation and impairment	432.7		456.5	
- Net change in provisions	27.1		(41.8)	
Employee benefits		2.6		(6.9)
Provisions for risks and charges		54.2		(13.7)
Deferred tax liabilities		(29.7)		(21.2)
- Net Losses (Gains) on asset disposals(1)	(7.7)		(1.6)	
Operating Cash Flow	**987.6**		**940.2**	
- Change in net working capital*	(37.2)		60.1	
Inventories		(0.1)		0.7
*Trade receivables**		(89.8)		246.7
Income tax assets		11.6		(1.2)
Other current assets		35.9		(96.9)
Trade payables		4.5		(46.5)
Tax liabilities		(10.9)		17.6
Other liabilities		11.6		(60.3)
- Other changes in non-current assets	40.9		(775.9)	
Property, plant and equipment		64.7		14.7
Non-current financial assets		(23.8)		(789.8)
of which the purchase of the holding in Rete S.r.l.		-		(770.1)
Other non-current assets		-		(0.8)
Cash Flow from Operating Activities	**991.3**		**224.4**	
net of the purchase of the holding in Rete S.r.l.	991.3		994.5	
Investments				
- Total investments	(706.4)		(1,021.6)	
Property, plant and equipment (2)		(667.1)		(977.4)
Intangible assets (3)		(39.3)		(44.2)
Total cash flows provided by/(used in) investing activities	**(706.4)**		**(1,021.6)**	
net of the purchase of the holding in Rete S.r.l.	284.9		(27.1)	
Free Cash Flow	**284.9**		**(797.2)**	
- Dividends (4)	(406.2)		(402.0)	
- Equity reserve cash flow hedges net of the tax effect and other changes in equity	(12.6)		26.3	
Change in net financial debt	**(133.9)**		**(1,172.9)**	
net of the purchase of the holding in Rete S.r.l.	(133.9)		(402.8)	
- Change in loans	**626.3**		**228.3**	
Current financial assets		2.8		(4.6)
Non-current financial assets		344.4		95.0
Non-current financial liabilities		6.3		(23.5)
Long-term loans		(109.9)		431.9
Short-term loans		(398.2)		398.2
Current portion of long-term loans		781.6		(641.7)
Current financial liabilities		(0.7)		(27.0)
- Change in cash and cash equivalents	**492.4**		**(944.6)**	

* Does not take into account impairment of trade receivables of the year (€ 2.4 million in 2016 and € 3 million in 2015).
(1) Included in the "Other revenue" and "Other operating costs" items of the financial statements.
(2) See note 11 to the financial statements.
(3) See note 13 to the financial statements.
(4) See the Statement of changes in equity.

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Consolidated financial statements

Consolidated income statement

€ million	Notes	2016	2015
A - REVENUE			
1. Revenue from sales and services	1	2,032.6	2,011.9
of which: related parties		*1,521.7*	*1,559.7*
2. Other revenue and income	2	70.6	70.2
Total revenue		**2,103.2**	**2,082.1**
B - OPERATING EXPENSES			
1. Raw materials and consumables	3	71.0	95.7
2. Services	4	191.4	160.7
of which: related parties		*43.0*	*11.3*
3. Personnel expenses	5	*268.0*	*231.8*
- gross personnel expenses		*325.1*	*301.2*
- capitalised personnel expenses		*(57.1)*	*(69.4)*
of which: related parties		*2.4*	*2.5*
4. Amortisation, depreciation and impairment	6	508.7	516.8
5. Other operating expenses	7	28.1	54.7
of which: related parties		*0.1*	*-*
Total expenses		**1,067.2**	**1,059.7**
A-B OPERATING PROFIT		**1,036.0**	**1,022.4**
C - FINANCIAL INCOME/EXPENSE			
1. Financial income	8	4.5	13.1
2. Financial income	8	(105.5)	(154.2)
of which: related parties		*(4.4)*	*(5.2)*
3. Share of profit/(losses) from equity-accounted investees	9	(1.8)	-
D - PROFIT BEFORE TAXES		**933.2**	**881.3**
E - INCOME TAXES OF THE YEAR	**10**	**305.3**	**293.3**
F - NET PROFIT FOR THE YEAR FROM CONTINUING OPERATIONS		**627.9**	**588.0**
G - NET PROFIT FOR THE YEAR FROM DISCONTINUED OPERATIONS	**11**	**-**	**7.3**
H - NET PROFIT FOR THE YEAR		**627.9**	**595.3**
Profit for the year attributable to owners of the Parent		***633.1***	***595.5***
Profit for the year attributable to Non-Controlling Interests		***(5.2)***	***(0.2)***
Earnings per share			
Basic earnings per share	12	0.315	0.296
Diluted earnings per share		0.315	0.296
Earnings per share from continuing operations			
Basic earnings per share	12	0.315	0.293
Diluted earnings per share		0.315	0.293

Consolidated statement of comprehensive income

€ million	Notes	2016	2015
NET PROFIT FOR THE YEAR		**627.9**	**595.3**
Other comprehensive income for the year which will subsequently be released to the income statement			
- Cash flow hedges net of tax effect	23	(12.9)	20.7
Other comprehensive income for the year which will not subsequently be released to the income statement			
- Actuarial gains (losses) on employee benefits net of tax effect	23	0.8	13.2
NET COMPREHENSIVE INCOME FOR THE YEAR		**615.8**	**629.2**
NET COMPREHENSIVE INCOME FOR THE YEAR ATTRIBUTABLE TO:			
Owners of the Parent		621.0	629.4

Consolidated statement of financial position

€ million	Notes	at 31.12.2016	at 31.12.2015
A - NON-CURRENT ASSETS			
1. Property, plant and equipment	13	12,386.1	12,078.7
of which: related parties		*35.8*	*33.6*
2. Goodwill	14	230.1	233.7
3. Intangible assets	15	285.9	295.8
4. Equity-accounted investees	16	75.2	78.2
5. Non-current financial assets	17	347.5	691.8
of which: related parties		*0.5*	*-*
6. Other non-current assets	18	13.8	11.3
Total non-current assets		**13,338.6**	**13,389.5**
B – CURRENT ASSETS			
1. Inventories	19	10.2	12.4
2. Trade receivables	20	1,443.3	1,373.4
of which: related parties		*291.7*	*335.2*
3. Current financial assets	17	26.2	64.3
of which: related parties		*-*	*0.2*
4. Cash and cash equivalents	21	1,135.7	431.6
5. Income tax assets	22	19.7	34.0
6. Other current assets	18	67.5	135.1
Total current assets		**2,702.6**	**2,050.8**
TOTAL ASSETS		**16,041.2**	**15,440.3**

Consolidated statement of financial position

€ million	Notes	at 31.12.2016	at 31.12.2015
C - EQUITY ATTRIBUTABLE TO OWNERS OF THE PARENT			
1. Share capital		442.2	442.2
2. Other reserves		815.3	827.4
3. Retained earnings and losses		1,789.7	1,596.4
4. Interim dividend		(144.9)	(140.7)
5. Net profit for the year		633.1	595.5
Total equity attributable to owners of the Parent	**23**	**3,535.4**	**3,320.8**
D - EQUITY ATTRIBUTABLE TO NON-CONTROLLING INTERESTS	**23**	**19.8**	**25.0**
Total equity - owners of the Parent and non-controlling interests		**3,555.2**	**3,345.8**
E – NON-CURRENT LIABILITIES			
1. Long-term loans	24	8,404.4	8,516.5
of which: related parties		*500.0*	*500.0*
2. Employee benefits	25	104.1	105.5
3. Provisions for risks and charges	26	238.6	198.8
4. Deferred tax liabilities	27	41.9	69.2
5. Non-current financial liabilities	24	12.8	7.3
6. Other non-current liabilities	28	138.1	124.1
Total non-current liabilities		**8,939.9**	**9,021.4**
F - CURRENT LIABILITIES			
1. Short-term loans	24	20.1	416.6
2. Current portion of long-term loans	24	904.5	122.9
3. Trade payables	29	2,280.7	2,143.9
of which: related parties		*69.8*	*41.7*
4. Tax liabilities	29	8.1	15.4
5. Current financial liabilities	24	126.4	127.1
of which: related parties		*0.6*	*0.8*
6. Other current liabilities	29	206.3	247.2
of which: related parties		*4.6*	*44.4*
Total current liabilities		**3,546.1**	**3,073.1**
TOTAL LIABILITIES AND EQUITY		**16,041.2**	**15,440.3**

Statement of changes in consolidated equity

31 DECEMBER 2015–31 DECEMBER 2016

	CONSOLIDATED SHARE CAPITAL AND RESERVES		
€ million	Share capital	Legal reserve	Share premium reserve
EQUITY AT 31 DECEMBER 2015	442.2	88.4	20.0
NET PROFIT FOR THE YEAR			
OTHER COMPREHENSIVE INCOME:			
Change in fair value of cash flow hedging derivativesnet of tax effect			
Actuarial gains (losses) on employee benefitsnet of tax effect			
Total other comprehensive income	-	-	-
NET COMPREHENSIVE INCOME	-	-	-
TRANSACTIONS WITH EQUITY OWNERS:			
Allocation of 2015 profit			
- *Retained earnings*			
- *Dividends*			
Interim dividend 2016			
Total transactions with equity owners	-	-	-
Other changes			
EQUITY AT 31 DECEMBER 2016	442.2	88.4	20.0

31 DECEMBER 2014–31 DECEMBER 2015

	CONSOLIDATED SHARE CAPITAL AND RESERVES		
€ million	Share capital	Legal reserve	Share premium reserve
EQUITY AT 31 DECEMBER 2014	442.2	88.4	20.0
NET PROFIT FOR THE YEAR			
OTHER COMPREHENSIVE INCOME:			
Change in fair value of cash flow hedging derivativesnet of tax effect			
Actuarial gains (losses) on employee benefitsnet of tax effect			
Total other comprehensive income	-	-	-
NET COMPREHENSIVE INCOME	-	-	-
TRANSACTIONS WITH EQUITY OWNERS:			
Allocation of 2014 profit			
- *Retained earnings*			
- *Dividends*			
Interim dividend 2015			
Total transactions with equity owners	-	-	-
Other changes			
EQUITY AT 31 DECEMBER 2015	442.2	88.4	20.0

Cash flow hedge reserve	Other reserves	Retained earnings and losses	Interim dividend	Net profit for the year	Equity attributable to the owners of the Parent	Equity attributable to non-controlling interests	Equity - owners of the Parent and Non-Controlling Interests
(5.3)	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)		(12.9)
	0.8				0.8		0.8
(12.9)	0.8	-	-	-	(12.1)	-	(12.1)
(12.9)	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)
(18.2)	725.1	1,789.7	(144.9)	633.1	3,535.4	19.8	3,555.2

Cash flow hedge reserve	Other reserves	Retained earnings and losses	Interim dividend	Net profit for the year	Equity attributable to the owners of the Parent	Equity attributable to non-controlling interests	Equity - owners of the Parent and Non-Controlling Interests
(26.0)	711.1	1,453.4	(140.7)	544.5	3,092.9	-	3,092.9
				595.5	595.5	(0.2)	595.3
20.7					20.7		20.7
	13.2				13.2		13.2
20.7	13.2	-	-	-	33.9	-	33.9
20.7	13.2	-	-	595.5	629.4	(0.2)	629.2
		142.5		(142.5)	-		-
			140.7	(402.0)	(261.3)		(261.3)
			(140.7)		(140.7)		(140.7)
-	-	142.5	-	(544.5)	(402.0)	-	(402.0)
		0.5			0.5	25.2	25.7
(5.3)	724.3	1,596.4	(140.7)	595.5	3,320.8	25.0	3,345.8

Consolidated statement of cash flows

€ million	2016	2015
NET PROFIT FOR THE YEAR	**627.9**	**595.3**
ADJUSTMENTS FOR:		
Amortisation, depreciation, impairment losses/(reversals of impairment losses) on property, plant and equipment and intangible assets*	495.3	500.4
Accruals to provisions (including employee-related provisions) and impairment losses	60.6	45.7
(Gains)/Losses on disposals of property, plant and equipment	(9.8)	(1.7)
Financial (income)/expense	100.7	142.8
Income taxes	305.3	293.3
CASH FLOWS GENERATED BY OPERATING ACTIVITIES, BEFORE CHANGES IN NET WORKING CAPITAL	**1,580.0**	**1,575.8**
Increase/(Decrease) in provisions (including employee-related and tax provisions)	(17.6)	(62.4)
(Increase)/decrease in inventories	1.6	9.2
(Increase)/decrease in trade receivables and other current assets	(2.0)	102.1
Increase/(decrease) in trade payables and other current liabilities	99.0	35.6
Increase/(decrease) in other non-current liabilities	0.2	1.5
(Increase)/decrease in other non-current assets	(20.6)	(3.1)
Interest income and other financial income received	479.1	134.7
Interest expense and other financial expense paid	(235.6)	(318.7)
Income taxes paid	(324.1)	(321.5)
CASH FLOWS GENERATED BY OPERATING ACTIVITIES [A]	**1,560.0**	**1,153.2**
- of which: related parties	*31.3*	*(46.2)*
Investments in non-current property, plant and equipment, net of grants received	(756.3)	(1,032.1)
Recognition of newly-acquired Property, plant and equipment	-	(727.5)
Revenue from sale of property, plant and equipment and intangible assets and other changes	12.4	3.4
Capitalised financial expenses	16.0	28.7
Investment in non-current intangible assets, net of grants received	(41.5)	(44.5)
Recognition of intangible assets, new acquisitions	-	(44.3)
(Increase)/decrease in equity interests in associates	3.0	1.0
(Increase)/decrease in other investments	(0.1)	0.3
Recognition of Goodwill from new acquisitions	-	(43.5)
CASH FLOWS USED IN INVESTING ACTIVITIES [B]	**(766.5)**	**(1,858.5)**
- of which: related parties	*(2.2)*	*(16.5)*
Increase/(decrease) in Reserves and retained earnings and losses	-	0.5
Dividends paid	(406.2)	(402.0)
Change in short- and medium/long-term financial payables (including short-term portions)**	316.8	295.9
Recognition of equity attributable to non-controlling interests	-	25.2
CASH FLOWS GENERATED BY FINANCING ACTIVITIES [C]	**(89.4)**	**(80.4)**
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS [A+B+C]	**704.1**	**(785.7)**
Cash and cash equivalents at start of the year	431.6	1,217.3
Cash and cash equivalents at end of the year	1,135.7	431.6

* Net of set-up grants taken to income statement for the year.
** Net of derivatives and of impacts on adjustment to fair value.

Notes to the Consolidated Financial Statements

A. Accounting policies and measurement criteria

Introduction

Terna S.p.A. has registered offices in Viale Egidio Galbani 70, Rome, Italy. The Consolidated Financial Statements at and for 2016 include the separate financial statements and those of the subsidiaries (the "Group"). The subsidiaries included within the scope of consolidation are listed below.
These Consolidated Financial Statements were authorised for publication by the Directors on 15 March 2017.
The Consolidated Financial Statements at and for the year ended 31 December 2016 are available upon request at the Terna S.p.A. registered offices at Viale Egidio Galbani 70, Rome, or on the company's website www.terna.it.
The Board of Directors has also authorised the Chairwoman and Chief Executive Officer to make any formal alterations to the Consolidated Financial Statements and any additions and adjustments to the chapters concerning significant subsequent events.

The Terna Group owns 99.6% of the Italian National Transmission Grid.
It is the largest independent transmission system operator in Europe and among the leaders in the world in terms of kilometres of lines managed (more than 72 thousand km).
It is responsible for the transmission and management of power flows on the High-Voltage and Very-High-Voltage Grid throughout the national territory, in order to maintain the balance between demand and supply of energy (dispatching). It is also responsible for the planning, construction and maintenance of the grid.
It acts as the Italian TSO (Transmission System Operator) with a monopoly under government licence in accordance with the regulations of the Italian Regulatory Authority for Electricity, Gas and Water (AEEGSI) and the guidelines of the Ministry of Economic Development. It ensures the security, quality and cost efficiency of the national electricity system and pursues the development of the grid and its integration with the European grid. It ensures equal conditions of access for all Grid users.

Compliance with IAS/IFRS

The consolidated financial statements at 31 December 2016 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), endorsed by the European Commission ("IFRS-EU").
This document has also been prepared taking into account the provisions of Legislative Decree no. 38 of 28 February 2005, of the Italian Civil Code and CONSOB Resolutions nos. 15519 ("Provisions governing financial statements in implementation of Art. 9, paragraph 3, of Legislative Decree no. 38/2005") and 15520 ("Amendments to the implementing rules for Legislative Decree no. 58/1998"), as well as CONSOB Communication no. 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 are composed 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 from the close 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 (Income Statement) presents the components of profit or loss for the year; while the second (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 and the Group, which as from financial year 2008 has been prepared as a single document, exercising the option granted by Italian Legislative Decree no. 32 of 2 February 2007, which amended Art. 40 (Integrated Report on Operations) of Italian Legislative Decree no. 127 of 09 April 1991.
These Consolidated Financial Statements are presented in millions of euro, and all figures are shown in millions of euro, unless otherwise indicated.
We can specify that, for the purpose of better representation of the effects of acquisition of the FSI grid, a number of comparative equity balances (particularly with reference to the items goodwill, other liabilities and deferred tax liabilities) were redetermined under the terms of IFRS 3, without however modifying the economic result for financial year 2015 and equity at 31 December 2015.
We must also specify that some balances of the financial statements at 31 December 2015, provided for comparison, have been restated, without, however, altering the equity figures at 31 December 2015 and those of the Income Statement for 2015.

Use of estimates

Preparation of the Consolidated Financial Statements requires the use by the Group of estimates and assumptions that affect the carrying amounts of assets and liabilities and related disclosures, in addition to contingent assets and liabilities at the reporting date. The estimates and associated assumptions are based on previous experience and various factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about 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 related future years.
The assets and liabilities subject to key estimates and assumptions used by the Group in applying the IFRSs endorsed by the European Commission that could have significant effects on the Consolidated Financial Statements or that could give rise to risks that would entail significant adjustments to the carrying amount 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 an indication 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 assessment 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 (hereinafter "CGU") to which it belongs.
An impairment loss is recognised in the Income Statement when the asset's book value, or the net invested capital of the CGU to which it belongs, is greater than its recoverable amount.
Impairment losses of CGUs are first taken as a reduction in the carrying amount of any allocated goodwill and then as a reduction in other assets of the CGU on a pro rata basis. Except for goodwill, impairment losses may be reversed up to the recoverable amount if there is an indication that the impairment loss no longer exists or when there is a change in the methods used to measure recoverable amount.

Allowance for doubtful accounts

Trade receivables are initially recognised at fair value net of any impairment losses relating to sums considered non-recoverable, which are taken to the specific Allowance for doubtful accounts. Impairment losses 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, in the presence of an obligation in course (legal or implicit), as a result of a past event, it is probable that the disbursement of resources will be necessary to fulfil the obligation, the amount of which can be reliably estimated. 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 values of money and the specific risks connected with the liability). After initial recognition, the value of the risk provision is updated to reflect the passing of time and any changes in the estimate following alterations to the amounts envisaged, 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 expense".
Liabilities that can be associated with legal and tax disputes and liabilities associated with town planning and environmental requalification projects are estimated by the Group. The measurement of provisions for legal disputes is based on the probability of incurring an expense, including the use of external lawyers supporting the Group companies; the estimate of provisions to be set aside for urban planning and environmental requalification projects, the "offsets" aimed at offsetting the environmental impact of the development of plants, is based on an analysis of the agreements signed with the local authorities involved and the progress of activities on the development of the new plants.

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 deferred compensation benefits) were made on the basis of the "vested benefits" method by means of the "Projected Unit Credit" (PUC) criterion. These valuations are based on economic and demographic assumptions: discount rate (used to determine the current value of the obligation, determined considering the return of high quality bond securities in line with the duration of the group of workers measured), inflation rate, rate at which future salary levels increase, increase rate of average health reimbursement, increase rate of electrical consumer goods prices and demographic techniques, such as, for example, mortality and invalidity, retirement, resignation, advances and family members.

Subsidiaries and the scope of consolidation

The scope of consolidation includes the Parent Company Terna S.p.A. and the companies over which the Parent Company has the power to exercise directly or indirectly, control understood as power, or the ability to guide significant activities (which have a substantial impact on the Parent Company's results), and the exposure, or the right, to the variable returns deriving from the relationship with the subsidiaries, and finally the ability to exercise its power over the subsidiaries in order to influence these returns. The financial statements of subsidiaries are included in the consolidated financial statements 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:

Company Name	Registered office	Currency	Share capital	% held	Consolidation method
COMPANIES CONTROLLED DIRECTLY BY TERNA S.P.A.					
Terna Rete Italia S.p.A.	Rome	€	120,000	100%	Line-by-line
Business	Design, construction, management, development, operation and maintenance of grid structures and lines and of other infrastructures connected to the said grids, of plants and equipment functional to the said business in the sectors of electricity dispatch and transmission and in similar, related or connected segments.				
Terna Rete Italia S.r.l.	Rome	€	243,577,554	100%	Line-by-line
Business	Design, construction, management, development, operation and maintenance of high-voltage power lines.				
Terna Storage S.r.l.	Rome	€	10,000	100%	Line-by-line
Business	Design, construction, management, development and maintenance of diffused energy storage systems (including batteries), pumping and/or storage systems, as well as plants, equipment and infrastructure, including grids.				
Terna Crna Gora d.o.o.	Podgorica (Montenegro)	€	56,000,000	100%	Line-by-line
Business	Authorisation, construction, and management of transmission infrastructures comprising the Italy-Montenegro electrical interconnection in Montenegro territory.				
Terna Plus S.r.l.	Rome	€	16,050,000	100%	Line-by-line
Business	Design, construction, management, development, operation and maintenance of plants, equipment and infrastructures including grids and systems, including diffused energy accumulation, pumping and/or storage. Execution of Non-Regulated Activities.				
Terna Interconnector S.r.l.	Rome	€	10,000	65%*	Line-by-line
Business	Design, construction, management, development, operation and maintenance, also on behalf of third parties, of lines and network structures and other related infrastructures, plants and equipment functional to the said activities in the sector of electricity transmission or in analogous, related or connected sectors.				
Monita Interconnector S.r.l.	Rome	€	10,000	95%**	Line-by-line
Business	Design, construction, management, development, operation and maintenance, also on behalf of third parties, of lines and network structures and other related infrastructures, plants and equipment functional to the said activities in the sector of electricity transmission or in analogous, related or connected sectors.				
Rete S.r.l.	Rome	€	387,267,082	100%	Line-by-line
Business	Design, construction, management, development, operation and maintenance of high-voltage power lines.				
Difebal S.A.	Montevideo (Uruguay)	Uruguayan pesos	140,000	100%	Line-by-line
Business	Design, construction and maintenance of electricity infrastructure in Uruguay.				

* 5% held by Terna Rete Italia S.p.A. and 30% held by Transenergia S.r.l..
** 5% held by Terna Rete Italia S.p.A..

Company Name	Registered office	Currency	Share capital	% held	Consolidation method
COMPANIES CONTROLLED THROUGH TERNA PLUS S.R.L.					
Tamini Trasformatori S.r.l.	Melegnano (Milan)	€	3,000,000	70%*	Line-by-line
Business	Construction, repair and sales of electrical machinery.				
Terna Chile S.p.A.	Santiago del Cile (Chile)	CLP	1,000,000	100%	Line-by-line
Business	Design, construction, administration, development, operation and maintenance of any type of structure, plant, equipment and electrical infrastructure, including those of interconnection; production of all kinds of products and services, constructions, electrical and civil engineering works; research, consulting and assistance on questions related to the core business; carrying out any other activity that can improve the use and development of plants, resources and skills.				
COMPANIES CONTROLLED THROUGH TAMINI TRASFORMATORI S.R.L.					
V.T.D. Trasformatori S.r.l.	Valdagno (Vicenza)	€	774,000	100%	Line-by-line
Business	Production, repair and sales in any form allowed by current laws of electrical and electro-mechanical instruments and machinery.				
Tamini Transformers USA LLC	Oakbrook (Chicago - Illinois)	USD	42,904	100%	Line-by-line
Business	Sales of industrial and power electrical transformers.				
Transformer Electro Service S.r.l.	Ospitaletto (Brescia)	€	1,134,000	100%	Line-by-line
Business	Production of electricity transformers for industrial use and for the sector of electricity production and transmission. It is noted that the company holds 100% of the share capital of the Indian manufacturing company known as “Tes Transformer Electro Service Asia Private Limited” (share capital equal to 100,000.00 Indian rupees).				
COMPANIES CONTROLLED THROUGH TERNA INTERCONNECTOR S.R.L.					
Piemonte Savoia S.r.l.	Rome	€	10,000	100%	Line-by-line
Business	Design, construction, management, development, operation and maintenance, also on behalf of third parties, of lines and network structures and other related infrastructures, plants and equipment functional to the said activities in the sector of electricity transmission or in analogous, related or connected sectors.				

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

The change in the Terna Group’s scope of consolidation with respect to the situation at 31 December 2015 involves, within Non-Regulated Activities, the acquisition of the Uruguayan company Difebal S.A. by the parent company Terna, on 13 October 2016.

Associates

Investments in associates are those in which the Terna Group exercises significant influence, understood as the ability to participate in the determination of financial and management policies in the investee, without having control or joint control. In assessing whether or not Terna has a significant influence, potential voting rights that are presently exercisable or convertible are also considered.

These investments are initially recognised at acquisition 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 are indications that the investment has suffered lasting losses, the Group determines the amount of impairment as the difference between the recoverable value and the carrying amount of the investment in question. In the event that the loss pertaining to the Group exceeds the book value 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 jointly-controlled entities, 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. Specifically, joint control is given by the sharing, on a contractual basis, of control over an agreement, which exists only when decisions relating to the relevant activities require the unanimous consent of all parties that share control.

The associates and joint ventures included are listed below:

Company Name	Registered office	Currency	Share capital	% held	Consolidation method	Carrying amount at 31.12.2016 *(€ million)*
ASSOCIATES						
Cesi S.p.A.	Milan	€	8,550,000	42.698%	Equity Method	44.9
Activity	Experimental electro-technical research.					
Coreso S.A.	Brussels (Belgium)	€	1,000,000	16.67%*	Equity Method	0.3
Activity	Technical centre owned by various electricity transmission companies which implements joint TSO technical coordination activities in order to improve and strengthen security and coordination of the electricity system in central/western Europe.					
CGES A.D.	Podgorica (Montenegro)	€	155,108,283	22.0889%	Equity Method	30.0
Activity	Electricity dispatch and transmission operator in Montenegro.					
COMPANY SUBJECT TO JOINT CONTROL						
ELMED Etudes Sarl	Tunis (Tunisia)	Tunisian Dinar	2,700,000	50%	Equity Method	-
Activity	Study activity concerning the connection of the Italian and Tunisian electricity grids.					

* Falling from 20% to 16.67% during October 2016.

Note that on 28 October 2016, following the entry into the shareholding structure of CORESO S.A. of the Spanish TSO REE, Terna S.p.A. reduced its equity investment to 16.67%, in proportion to the other shareholders, by selling some of the shares it held. However, the company retained its classification as an associate.

Consolidation policies

All separate financial statements of subsidiaries used to prepare the Consolidated Financial Statements were drafted as of 31 December 2016 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 with associates and joint ventures are eliminated in proportion to the Group's holding therein. In both cases, unrealised losses are eliminated, unless they represent 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 exchange rate differences are taken to the Income Statement.
Non-monetary assets and liabilities in foreign currency stated at historic 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 are recognised at historical cost, including costs directly attributable to putting the asset in the condition necessary for it to be capable of operating in the manner for which it was acquired. In the event of legal or constructive obligations, cost also includes the present value of the estimated cost of disposal or removal of the asset. The corresponding liability is recognised in provisions for risks and charges. Borrowing costs directly attributable to the acquisition, 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 recognised in the Income Statement when 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 are 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. The depreciation of assets begins when the assets become available for use.
Liabilities associated with items of property, plant and equipment are taken to a specific provision as a balancing entry to the related asset. The amount is taken to the Income Statement through the depreciation of the asset.
Property, plant and equipment are written off either at the time of disposal or when no future economic benefit is expected from their utilisation or disposal. Any profit or loss, recognised in the Income Statement, is determined as the difference between the net fee deriving from disposal and the net carrying amount of the assets eliminated.

The main depreciation rates calculated on the basis of the related asset's useful life are as follows.

DEPRECIATION RATES	
Civil and industrial buildings	2.50%
Transmission lines	2.22%
Transformer stations:	
- 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 plants	5.00%
- Electronic calculation equipment	10.00%

Note that with reference to the transmission lines owned by the parent company Terna S.p.A. and by Terna Rete Italia S.r.l., the estimate of useful life was reviewed to take empirical evidence into account mainly related to physical deterioration and technical obsolescence. This indicated that for transmission lines it was reasonable to adjust expected technical economic life to 45 years (up from the 40 years assumed in previous years). The AEEGSI, on the basis of similar considerations, reviewed the useful life of lines for regulatory purposes (with Resolution 654/2015/R/eel). The review of the useful life of transmission lines did not involve assets owned by Rete S.r.l, for which the useful life was specifically defined under AEEGSI Resolution 517/2015/R/eel.

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

Property, plant and equipment acquired under finance leases - and through which the Group has substantially acquired all the risks and rewards of ownership - are recognised as Group assets at the lower of fair value and the present value of minimum lease payments due, including any amounts to be paid to exercise the purchasing option. The corresponding liability to the lessor is recognised under financial payables. 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 taken in full to profits or losses over the term of the lease.

Intangible assets

Intangible assets, which all have finite useful lives, are 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 business, obtained by the parent company Terna S.p.A. on 1 November 2005, with acquisition of the TSO Business unit. As established in the Decree issued by the Ministry of Productive Activities on 20 April 2005, this concession runs for twenty-five years, renewable for another twenty-five years, from the date of effective transfer of the activities, functions, assets and legal arrangements of the concession from GSE (formerly GRTN) to Terna S.p.A.. This intangible asset was initially recognised at cost, which reflected fair value.

Other non-current intangible assets essentially refer to software developments and updates.

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; the asset can be used and it is possible to demonstrate that it will generate probable future economic benefits.

Financial expense directly attributable to the acquisition, construction or production of a non-current asset which justifies capitalisation pursuant to IAS 23 are capitalised as part of the cost of the asset.
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

These include the property, plant and equipment and intangible assets employed in the dispatching activity, carried out under concession, which fall within the scope of application of IFRIC 12, since the relevant criteria apply: the services provided are regulated and control exists over the residual interest. More specifically, in view of the fee structure for dispatching activities, the Intangible Asset model has been applied, as provided for in the Interpretation.
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, fee revenue continues to be recognised in accordance with IAS 18 and financial expense continues 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 related legislation envisage that the NTG will return to public grantor, either via the payment of an indemnity or otherwise.

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. It 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.
In adopting the IFRSs endorsed by the European Commission, the Group decided to restate only those business combinations that occurred after the transition date (1 January 2004). Goodwill arising on acquisitions before that date corresponds to the amount recognised using the previous accounting policies.

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 the accrued ancillary expenses. Net estimated realisable value means the estimated price of sale 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 proportionally to the ratio of costs for the works carried out up to the reporting date and total cost of the contract (cost-to-cost method). Differences

between the value of completed contracts and payments on account received are recognised under the Statement of Financial Position assets or liabilities, considering any impairment losses on the work carried out so as to take into account the risks of customers' refusal to recognise the work performed. Expected contract losses are immediately taken to the Income Statement.
Contract costs include all costs that relate directly to the specific contract, as well as fixed and variable costs incurred by the Group as part of normal operations.

Financial instruments

Financial assets

Any financial assets other than derivative financial instruments that the 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 estimated future cash flows. Financial assets are derecognised when, following their transfer or settlement, the Group companies are no longer involved in their management and no longer hold 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 impairment losses due to sums considered non-recoverable, which are taken to the specific allowance for impairment. Impairment losses are measured on the basis of the present value of estimated future cash flows.
Receivables with due dates that fall under normal commercial terms are not discounted.

Cash and cash equivalents

Cash and cash equivalents are recognised at the 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 irrelevant risk of value changes.

Trade payables

Trade payables are initially recognised at fair value and subsequently stated at amortised cost. If their due date falls under 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 part of changes in the fair value qualifying as effective is initially recognised in Other comprehensive income (accumulated in equity) and subsequently in the Income Statement, in line with the economic effects produced by the hedged transaction. The portion of the fair value of the hedging instrument that does not qualify as effective is taken to 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 the Income Statement. 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 IFRSs are recognised in the Income Statement.
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 of interest rates at the reporting date, and by converting amounts in currencies other than the euro at the year-end exchange rate.
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 liabilities in respect of employee benefits payable upon or after termination of employment relate to defined benefit plans (deferred compensation benefits, additional month's pay, indemnity for lack of notice, energy discount, ASEM health benefits and other benefits) or other long-term employee benefits (loyalty bonus) and is recognised net of any plan assets. It is measured separately for each plan on the basis of actuarial calculations that estimate the amount of future benefits that employees have accrued at the reporting date. The liability is recognised on an accruals basis over the vesting period. It 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 towards others as a 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 obligation. Where the effect of the time value of money is material, provisions are measured by discounting estimated future cash flows using a discount rate that reflects current market assessment of the time value of money and the specific risk applicable to the liability, if present. Where discounting is used, the increase in the provisions due to the passage of time is recognised in the Income Statement as financial expense. If the liability relates to property, plant and equipment (site disposal and restoration, for example), the provision is recognised as a balancing 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 estimate are recognised within the Income Statement for the year in which the change occurs, except for costs expected for dismantling, removal and reclamation, which come as a result of changes in the timing and use of the economic resources necessary to extinguish the obligation or attributable to a material change in the discount rate, which are recognised as an increase or reduction of the related assets and recognised in the Income Statement through depreciation.

Grants

Public 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, for plants already operating as of 31 December 2002, among other liabilities and taken to the Income Statement in relation to the depreciation period of the assets in question. As of financial year 2003, for new plants beginning operation, the related grants are recognised as a direct reduction in the non-current assets themselves.
Grants for operating expenses are expensed in full when the recognition requirements are satisfied.

Revenue

Revenue is recognised when it is probable that the economic benefits deriving from the operation will be used by the enterprise. 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 transaction. 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 non-Terna grid owners, as well as revenue recognised for managing activities related to the balancing of the national electrical system, which do not increase equity, are reported net of the related costs (pass-through energy 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 items – pass-through revenue/costs*).

Financial income and expense

Financial expense directly attributable to the acquisition, construction or production of an asset that qualifies 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 before being ready for use. The directly attributable financial expense is that which would not have been incurred if the expenditure for the asset had not been incurred.
Where funds are borrowed specifically, costs eligible for capitalisation are the actual costs incurred less any income earned on the temporary investment of such borrowings. Where funds are raised through general borrowing, the eligible amount is determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate will be the weighted average of the financial expense applicable to the general pool, excluding any specifically borrowed funds. The amount of capitalised borrowing costs during a year shall in any case not exceed the amount of financial expense incurred during that year.

Capitalisation commences as from the date all the following conditions have been met: (a) expenditures have been incurred for the asset; (b) financial expense have been incurred; and (c) activities to prepare the asset for its intended use or sale are in progress.
Capitalisation ceases when the activities necessary to prepare the asset for its intended use or sale are substantially complete.
The capitalisation rate used for 2016 amounts to 1.38% and that for 2015 amounts to 2.05%.
Financial income and expense 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 investee companies 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 Shareholders' Meeting and the Board of Directors, respectively.

Earnings per share

Basic earnings per share are calculated by dividing the profit or loss for the year attributable to holders of ordinary shares by the weighted average of outstanding ordinary shares during the year.

Income taxes

Current income taxes are recognised as "Tax liabilities", net of advances paid, or "Income 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 the 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 each year end.
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 standards

International accounting standards taking effect from 1 January 2016

A number of new amendments to the accounting standards already applicable came into force as from 1 January 2016, but these had no impact on the Company. Specifically, we note:

Amendment to IAS 19 – Defined Benefit Plans: Employee Contributions

On 17 December 2014 the European Commission endorsed the amendment to IAS 19 which enables recognition of contributions paid by employees to reduce the service costs of a defined benefit plan for employees.

Improvements to IFRSs (2010–2012 Cycle)

Endorsed by the European Commission on 17 December 2014, the Annual Improvement related to the 2010–2012 cycle was approved, incorporating changes to the standards IFRS 2, IFRS 3, IFRS 8, IAS 16, IAS 24, IAS 37, IAS 38 and IAS 39.

Amendments to IFRS 11 – Accounting for Acquisitions of Interests in Joint Operations

On 24 November 2015 the European Commission endorsed the amendment to IFRS 11 that clarifies the accounting treatment in the event of acquisitions of interests in a joint operation the activities of which represent a business under the terms of IFRS 3, making reference to the recognition criteria in the standard itself.

Amendments to IAS 16 and IAS 38 – Clarification of Acceptable Methods of Depreciation and Amortisation

An amendment to IAS 16 and IAS 38 was endorsed on 2 December 2015 by the European Commission. This defines as the only acceptable method of depreciation and amortisation the one that reflects the expected ways of consuming the future economic benefits generated by an asset, excluding revenue-based amortisation methods, that is those based on revenue generated by an asset.

Improvements to IFRSs (2012–2014 Cycle)

The Annual Improvement related to the 2012–2014 cycle was endorsed on 15 December 2015. This contained minor amendments to a number of standards: IFRS 5, IFRS 7, IAS 19, IAS 34.

Amendments to IAS 27 – Equity Method in Separate Financial Statements

On 18 December 2015 an amendment to IAS 27 was endorsed; this extends to the separate financial statements, starting from financial year 2016, the option to apply the equity method in accounting for equity investments in subsidiaries, joint ventures and associates.

Amendments to IAS 1 – Disclosure Initiative

On 18 December 2015 an amendment to IAS 1 was endorsed; this provides some clarifications on the disclosure obligation provided for in the amended standard. In the short term, the project provides for limited changes to aspects regarding materiality, disaggregation of accounting items, structure of the Notes to the Financial Statements and disclosure on debt, the Income Statement (other comprehensive income) and accounting policies. In the medium term the Board’s intention is to arrive at a new IFRS to replace IAS 1 (Presentation of Financial Statements), IAS 7 (Statement of Cash Flows) and IAS 8 (Accounting Policies, Changes in Accounting Estimates and Errors).

International financial reporting standards endorsed but not yet in force

As of the date these financial statements were prepared, the European Commission has endorsed some new accounting standards and amendments to existing accounting standards. The possible impact of their application on the financial statements of the Terna Group is being evaluated. These accounting standards are listed below.

IFRS 15 – Revenue from Contracts with Customers

On 29 October 2016, the European Commission approved the new IFRS 15 on revenue recognition, which replaces 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". The new IFRS 15 is valid for all transactions in all sectors and is based on a five-step model: identify the contract with the customer, identify the performance obligations provided for in the contract, determine the transaction price, allocate the transaction price and finally recognise revenue when the performance obligations are satisfied. Performance occurs when control over goods or services underlying the performance obligation is passed 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 new standard takes effect on 1 January 2018 and can be applied in advance and retrospectively.

IFRS 9 - Financial Instruments:

On 22 November 2016, the European Commission approved the final version of standard IFRS 9 - Financial Instruments, in its definitive version of 24 July 2014, which starts a complex and detailed process of replacing IAS 39, divided into the following phases: classification and assessment, derecognition, impairment and hedge accounting. The new standards take effect on 1 January 2018. Early application is allowed. The main innovations of 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 management model adopted by the company to manage financial assets with reference to the collection of cash flows and on the characteristics of the contractual cash flows of the said 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, was superseded, as it was considered a weak point. The new IFRS 9 provides for a model characterised by 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 for recognition of losses on receivables. The new standard completed, in addition, the stage of the Hedge Accounting project, except for the rules on macro hedge accounting which will be published later and provides, among the other changes, substantial revision of hedge accounting so as to better reflect risk management activities in the financial statements.

International financial reporting standards not yet endorsed

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 its financial statements, taking account of the date on which they take effect. In particular, we note the following:

IFRS 16 - Leases

On 13 January 2016, the IASB published the new standard IFRS 16 which governs the accounting for leasing contracts, replacing the previous IAS 17. Among the changes the new standard, overcoming the distinction between operating and financial leasing, bases the accounting presentation on the “right of use” approach, which for the lessee makes the accounting uniform for any type of leasing. 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 two asset items with opposite signs: the right to use the asset among the assets, and the payable for the leasing among the liabilities. IFRS 16 will take effect on 1 January 2019, but early application is permitted for companies that adopt IFRS 15 (Revenue from contracts with customers).

Amendment to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses

On 19 January 2016, the IASB published an amendment to IAS 12 that intends to clarify the recognition of deferred tax assets for losses not recognised in the income statement on financial instruments carried at fair value.

Amendment to IAS 7: Disclosure Initiative

As part of the “Disclosure Initiative” project, on 29 January 2016 an amendment to IAS 7 was published, providing a number of clarifications on the disclosure obligations provided for in preparing the Statement of Cash Flows.

Clarifications to IFRS 15 Revenue from Contracts with Customers

On 12 April 2016, the IASB published a document clarifying certain aspects deriving from the TRG (Transition Resource Group for Revenue Recognition) discussions, providing guidance for the new IFRS 15: identifying performance obligations, principal versus agent considerations, and an application guide for licenses.

Amendment to IAS 2: Classification and Measurement of Share-based Payment Transactions

Published by IASB on 20 June 2016, this is an amendment to IAS 2 that clarifies classification and measurement of share-based payments.

Amendment to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

An amendment published on 12 September 2016 by the IASB, which clarifies doubts about application that may arise based on the different initial application for the new IFRS 9 in relation to the date on which the new insurance contracts standard IFRS 4 takes effect, which has not yet been published.

Improvements to IFRSs (2014–2016 Cycle)

Published by the IASB on 8 December 2016, the annual Improvements related to the 2014–2016 cycle contain minor amendments to IFRS 1, IFRS 12 and IAS 28.

IFRIC 22: Foreign Currency Transactions and Advance Consideration

On 8 December 2016, the IASB published the interpretation for IAS 21 to provide guidance in the selection of an exchange rate to be used when recording a transaction in a foreign currency, in the case that the consideration in the foreign currency was received or paid in advance of the recognition of the related assets.

Amendment to IAS 40: Transfers of Investment Property

Published by the IASB on 8 December 2016, this amendment to IAS 40 has the aim of providing guidance related to the transfer of real estate investments when there is evidence of a change in use.

B. Notes to the consolidated income statement

Revenue

1. Revenue from sales and services – € 2,032.6 million

€ million	2016	2015	Δ
Grid transmission fees	1,733.0	1,706.6	26.4
Adjustments for prior year grid transmission fees	2.0	(0.2)	2.2
Other energy revenue	132.5	151.4	(18.9)
Quality of Service premiums/(penalties)	15.4	(4.7)	20.1
Other revenue from sales and services	149.7	158.8	(9.1)
TOTAL	**2,032.6**	**2,011.9**	**20.7**

Grid transmission fee

The grid transmission fee refers to remuneration related to the Parent Company (€ 1,498.5 million), Terna Rete Italia S.r.l. (€ 173.3 million) and Rete S.r.l. (€ 63.2 million, including "linearization" pursuant to IFRS 3 of the effects envisaged in Resolution 517/2015/R/eel).
The increase in revenues for the transmission service (+€ 28.6 million) reflects the following phenomena:

- contribution of the inclusion during 2016 of the National Transmission Grid acquired at the end of 2015 from the FSI Group (+€ 63.0 million);
- overall effects of the new regulatory period 2016–2023 (which involves a reduction in revenues related to the review of the WACC, partially compensated for by a reduction in time-lag).

Other energy revenue

This essentially refers to the fee received for the dispatching service (DIS component, € 111.3 million) and revenue from the construction and development of dispatching infrastructures recognised following application of IFRIC 12 (€ 21.2 million).
The decrease in other energy revenue, down by € 18.9 million with respect to the previous year, is due to the reduction in the fee for dispatching services (-€ 13.9 million), which reflects the overall effects of the new regulatory period, mainly due to a decrease in operating expenses recognised and lower investment in dispatching infrastructure (-€ 5 million).

Quality of Service premiums/(penalties)

This item, amounting to € 15.4 million in 2016, includes:

- contingencies recognised during the year relatived to 2015 performance, as defined in Resolution 668/2016/R/eel, for € 12.0 million;
- measurement of the RENS incentive mechanism envisaged in Resolution 653/2015/r/eel, calculated on a pro-rata basis taking into account the estimate of overall expected results during regulatory period 2016–2019, for € 3.4 million.

Compared to the previous year, the item increased by € 20.1 million, due to the cited contingency, compared to the penalties estimated in the previous year (+€ 6.5 million), the 2016 performance results (+€ 3.4 million) and integration of the 2014 bonus recognised in the previous year (-€ 1.8 million).

Other revenue from sales and services

The item "Other revenue from sales and services" amounted to € 149.7 million and for the most part refers to revenue from:

- contracts and other assets in the context of non-regulated activities related to the Tamini Group (€ 102.9 million) and Terna Plus S.r.l. (€ 7.4 million);
- a contract to lay optic fibre owned by Basictel (€ 5.6 million) on power lines owned by the subsidiary Rete S.r.l. and for new contracts to grant usage rights on the Group's optic fibre (€ 2.3 million);
- non-regulated specialised activities in the field of High-Voltage and Very-High-Voltage provided by Terna S.p.A. and the subsidiary Terna Rete Italia S.p.A. to third-party customers, including maintenance (€ 24.9 million);
- NTG connection services (€ 2.4 million);
- activities to design international interconnection lines (€ 1.6 million).

The change in the item (-€ 9.1 million) is mainly due to greater revenue achieved by the subsidiary Terna Chile S.p.A. in the previous year (-€ 12.1 million) for the work order that was substantially completed in 2016, the reduction in revenue for designing of interconnection projects with other countries (-€ 3.0 million), the decrease in work orders to sell transformers related to the Tamini Group (-€ 2.7 million), compensated for by revenue provided by the aforementioned new telecommunications contracts (+€ 6.4 million), as well as greater revenue for services to connect plants to the NTG (+€ 1.6 million).

Pass-through revenue/costs

This item includes the revenue and costs "passed-through" (whose net balance is therefore nil), which relate entirely to the Parent. These flows arise with operators active in the electricity market, and involve the daily purchase and sale of energy. To this end, the measurements at each point of input and withdrawal are taken and the differences from the energy market schedules are calculated. These differences (called imbalances) are measured using algorithms established by the regulatory framework. The net charge resulting from the measurement of these imbalances and of the buying and selling transactions executed by the Parent Company Terna on the Dispatching Services Market are billed on a pro rata basis to each consumer with the Uplift fee. The item also includes the grid transmission fee which the Parent Company pays to other owners of the grid, not included in the scope of consolidation.

The components of these transactions are detailed below.

€ million	2016	2015	Δ
Revenue - Power Exchange:			
- foreign market - exports	2.6	1.7	0.9
- Sale of energy on the Market for Dispatching Services and others	335.7	358.0	(22.3)
- imbalances and other minor items	461.9	795.5	(333.6)
- resources procurement for the Market for Dispatching Services (uplift)	2,393.4	1,400.6	992.8
- Congestion revenue - and related financial hedges	440.7	511.2	(70.5)
- other items - Power Exchange	212.8	57.1	155.7
- Interconnector/Shipper	73.7	72.9	0.8
- Market coupling	86.8	137.3	(50.5)
Total revenue - Power Exchange	**4,007.6**	**3,334.3**	**673.3**
Fee to cover remuneration of essential units	685.3	726.7	(41.4)
Fee to remunerate electricity capacity availability	255.5	280.1	(24.6)
Fee to cover interruptibility service and other components	606.3	605.8	0.5
Other items	37.0	97.4	(60.4)
Revenue from grid transmission fees to be recognised to	6.8	14.8	(8.0)
Total revenue Non-Power Exchange	**1,590.9**	**1,724.8**	**(133.9)**
TOTAL PASS-THROUGH ENERGY REVENUE	**5,598.5**	**5,059.1**	**539.4**
Energy purchases:			
- to provide the dispatching service	2,172.5	1,614.0	558.5
- for unbalancing	1,129.8	928.1	201.7
- foreign market - imports	1.1	1.4	(0.3)
- congestion revenue and related financial hedges	285.7	356.0	(70.3)
- other items - Power Exchange	49.8	45.6	4.2
- Interconnector/Shipper	364.0	379.1	(15.1)
- Market coupling	4.7	10.1	(5.4)
Total costs - Power Exchange	**4,007.6**	**3,334.3**	**673.3**
Costs for remuneration of units essential to system security	685.3	726.7	(41.4)
Costs for remuneration of electricity capacity availability	255.5	280.1	(24.6)
Costs for interruptibility service and other components	606.3	605.8	0.5
Other items	37.0	97.4	(60.4)
Fees for the remuneration of NTGs of other owners	6.8	14.8	(8.0)
Total services and fees	**1,590.9**	**1,724.8**	**(133.9)**
TOTAL PASS-THROUGH ENERGY COSTS	**5,598.5**	**5,059.1**	**539.4**

In 2016, total Uplift cost came to € 2,393.4 million, up with respect to the same period the previous year when it was € 992.8 million, mainly due to the increase in the DSM cost and unbalancing charges (in particular on the consumption unit side, which is currently being investigated by the relevant authorities).

2. Other revenue and income – € 70.6 million

€ million	2016	2015	Δ
Rental income	22.6	22.8	(0.2)
Net contingent assets	12.4	10.7	1.7
Sales to third parties	11.6	6.7	4.9
Gains on the disposal of plant components	10.5	1.9	8.6
Sundry grants	9.4	12.7	(3.3)
Settlements for losses	3.0	8.4	(5.4)
Other revenue	1.1	7.0	(5.9)
TOTAL	**70.6**	**70.2**	**0.4**

The significant items in "Other revenue and income" refer mainly to rental income (€ 22.6 million) associated particularly with the housing of the optic fibre of the Wind Group on the proprietary grids, to sundry grants (€ 9.4 million), net contingent assets (€ 12.4 million), gains on the disposal of plant components (€ 10.5 million) and sales to third parties (€ 11.6 million).
This item, essentially in line with the previous year (+€ 0.4 million), particularly reflects the following phenomena:

- reduction in grants for variants requested by third parties (€ 3.4 million), for one-off activities recognised in 2015;
- lower revenue from insurance settlements (€ 5.4 million), a change essentially due to the coverage of the cost to reconstruct a transformer recognised in the previous year;
- greater net contingent assets (€ 1.7 million), which includes reversal of a provision for risks recognised for a transaction to dispose of a photovoltaic project, as certain contractual obligations were found not to exist (+€ 8.7 million), partially compensated for by the change in contingencies related to the Tamini Group (-€ 7.0 million);
- increase in sales to third parties and capital gains from disposal of plant parts (totalling +€ 13.5 million), above all from revenue achieved from the sale of recovered copper in implementation of the so-called "Copper Plan" (€ 8.0 million) and sales of certain assets to update the company vehicle fleet (€ 4.0 million);
- recognition in 2015 of the adjustment of the purchase price of the subsidiary Tamini Trasformatori S.r.l. (€ 5.9 million) resulting from the additional agreement signed by the parties.

Operating expenses

3. Raw materials and consumables - € 71.0 million

This item includes the value of consumption of materials and miscellaneous equipment and materials used in the ordinary work of operating and maintaining plants of the Group and of third parties, and consumption of materials for fulfilling the Tamini Group's and the Chilean subsidiary's orders.
The € 24.7 million decrease over the previous year (€ 95.7 million in 2015) derives in particular from lower costs finalised by the Tamini Group due to lower business (-€ 12.2 million) and the substantial completion of a work order by the subsidiary Terna Chile S.p.A., which was begun in 2015 (-€ 11.6 million). It also recognises the lower costs recorded with the application of IFRIC 12 for the construction and development of dispatching infrastructure (-€ 1.3 million).

4. Services - € 191.4 million

€ million	2016	2015	Δ	Δ without Tamini	Δ Tamini
Maintenance and sundry services	84.0	82.1	1.9	(2.2)	4.1
Tenders on plants	54.8	24.6	30.2	32.6	(2.4)
IT services	17.0	18.0	(1.0)	(1.2)	0.2
Leases and rentals	13.8	13.2	0.6	(0.9)	1.5
Remote transmission and telephone	12.0	12.1	(0.1)	1.1	(1.2)
Insurance	9.8	10.7	(0.9)	0.3	(1.2)
TOTAL	191.4	160.7	30.7	29.7	1.0

This item is affected by the expenses of the Tamini Group for services related to orders for the creation of transformers. Net of the contribution from the Tamini Group, costs of services increased compared to the previous year by € 32.9 million, if the lower costs recognised in application of IFRIC 12 (-€ 3.2 million) are not taken into consideration.

€ million	Δ without Tamini	Δ IFRIC 12	Δ without Tamini/IFRIC 12
Maintenance and sundry services	(2.2)	(2.1)	(0.1)
Tenders on plants	32.6	(0.4)	33.0
IT services	(1.2)	(0.6)	(0.6)
Leases and rentals	(0.9)	-	(0.9)
Remote transmission and telephone	1.1	(0.1)	1.2
Insurance	0.3	-	0.3
TOTAL	29.7	(3.2)	32.9

This increase is mostly attributable to the maintenance costs incurred by the subsidiary Rete S.r.l. (€ 36.0 million) related to the FSI Group, partially compensated for by reductions in the costs for services recognised by the Group during the year.

5. Personnel expenses – € 268.0 million

€ million	2016	2015	Δ
Wages, salaries and other short-term employee benefits	273.3	279.2	(5.9)
Directors' fees	2.9	2.6	0.3
Deferred compensation benefits, energy discount and other employee benefits	16.8	17.3	(0.5)
Early retirement incentives	32.1	2.1	30.0
Gross personnel expenses	***325.1***	***301.2***	***23.9***
Capitalised personnel expenses	(57.1)	(69.4)	12.3
TOTAL	268.0	231.8	36.2

This item includes the cost of personnel employed by the Tamini Group companies for € 25.0 million, an increase of € 4.0 million compared to the figure for 2015, substantially due to the addition of the subsidiary TES in the Tamini Group.

€ million	2016	2015	Δ	Δ Tamini	Δ IFRIC 12	Δ without Tamini/IFRIC 12
Gross personnel expenses	325.1	301.2	23.9	3.8	-	20.1
Capitalised personnel expenses	(57.1)	(69.4)	12.3	0.2	(0.5)	12.6
TOTAL	268.0	231.8	36.2	4.0	(0.5)	32.7

Personnel expense, net of Tamini's contribution and the cost recognised in application of IFRIC 12, saw an increase of € 32.7 million compared to the previous year, mainly due to greater net provisions for the redundancy plan, of € 30.0 million. The figure is substantially in line with that of 2015 considering the savings generated by the generational turnover plan established in 2015, while taking into account assumptions deriving from management requirements in the area of Rete S.r.l. assets and the impacts of lower capitalisation during the year.
The following table shows the number of Group employees by category at year-end and the average number for the financial year.

	Average number		Final number	
	2016	2015	31.12.2016	31.12.2015
Senior Managers	77	74	76	76
Middle managers	560	545	567	514
Office staff	1,952	2,010	1,978	1,971
Blue-collar workers	1,212	1,172	1,248	1,206
TOTAL	**3,801**	**3,801**	**3,869**	**3,767**

The average number of Group employees did not change with respect to financial year 2015. The increase in the final number in 2016 is due in particular to the hiring programme that the Terna Group established following the acquisition of Rete S.r.l. and the related electricity assets from FSI S.p.A. More specifically, the need for new personnel is connected to the increase in the amount of assets for which Terna Rete Italia S.p.A. must provide services to Rete S.r.l., which will vary on the basis of the amount of these taken on (initially entrusted to RFI S.p.A., a company of the FSI Group), until activities to integrate these assets into the NTG are completed.

	Terna S.p.A.	Terna Rete Italia S.p.A.	Terna Storage S.r.l.	Terna Crna Gora d.o.o.	Terna Plus S.r.l.	Tamini Group
Units	465	2,986	-	5*	17	396

* Local employees.

6. Amortisation, depreciation and impairment – € 508.7 million

€ million	2016	2015	Δ
Amortisation of intangible assets	51.4	55.3	(3.9)
- of which: infrastructure rights	*27.5*	*34.6*	*(7.1)*
Depreciation of property, plant and equipment	449.2	434.9	14.3
Impairment of property, plant and equipment	0.5	22.9	(22.4)
Impairment of goodwill	3.6	-	3.6
Impairment of current assets	4.0	3.7	0.3
TOTAL	**508.7**	**516.8**	**(8.1)**

The € 8.1 million reduction in the item compared to 2015 is mainly due to lower depreciation after a review of the useful life of electricity lines (increased from 40 to 45 years, to take empirical evidence into account mainly in terms of physical deterioration and technical obsolescence), partially offset by the entry into operation of new plants, by depreciation and amortisation related to the subsidiary Rete S.r.l. (+€ 24.8 million) as well as by greater impairment during the previous year of certain plants owned by the Parent Company and the subsidiary Terna Plus S.r.l. (-€ 22.9 million).

7. Other operating expenses - € 28.1 million

€ million	2016	2015	Δ
Net electricity service quality expenses	(7.8)	7.9	(15.7)
of which estimated costs of Mitigation and Sharing	*(5.3)*	*2.2*	*(7.5)*
of which contributions to the Exceptional Events Fund	*(3.0)*	*5.7*	*(8.7)*
of which high-voltage users compensation mechanisms	*0.5*	*-*	*0.5*
Allocations made to provisions for disputes	5.5	2.5	3.0
Indirect and local taxes and duties	15.3	29.4	(14.1)
Net contingent liabilities	2.2	2.0	0.2
Losses on disposal/decommissioning of plant	0.7	0.2	0.5
Other operating expenses	12.2	12.7	(0.5)
TOTAL	**28.1**	**54.7**	**(26.6)**

The Group's other operating expenses, of € 28.1 million, are mainly attributable to the Parent Company (€ 17.5 million) and to the Tamini Group (€ 5.8 million).
The component "Indirect and local taxes and duties" mainly includes IMU (*Imposta Municipale Unica*-single council tax) for € 10.2 million and taxes for TOSAP (*Tassa per l'Occupazione del Suolo Pubblico*, tax on the occupation of public spaces and areas), and TARES (*Tassa Rifiuti e Servizi*, the tax on waste and municipal services) (€ 4.2 million).
The € 26.6 million decrease in the item derives mostly from:

- measurement of net charges deriving from the Quality of Service adjustment mechanisms which decreased by € 15.7 million, mainly due to contingencies related to the Exceptional Events Provision (-€ 8.7 million, net of accruals during the year) and to lower provisions for the Mitigation and Sharing mechanisms (-€ 7.5 million). Also of note were costs related to the high-voltage user indemnity mechanisms, introduced in 2016 (+€ 0.5 million);
- lower costs for "indirect and local taxes and duties", essentially due to the recognition in 2015 of the registration tax and other accessory charges associated with the acquisition of Rete S.r.l. (-€ 13.1 million) and also for lower costs for IMU recognised during the year (-€ 0.8 million).

8. Net financial income/(expense) - € (101.0) million

€ million	2016	2015	Δ
FINANCIAL EXPENSE			
Financial expense from Cassa Depositi e Prestiti	(4.5)	(5.2)	0.7
Interest expense on medium/long-term loans and related hedges	(101.0)	(174.6)	73.6
Debt adjustment (Bonds) and related hedges	(13.2)	-	(13.2)
Discounting of deferred compensation benefits and other personnel-related provisions and provisions for risks and charges	(2.0)	(1.9)	(0.1)
Capitalised financial expenses	16.0	28.7	(12.7)
Exchange losses	(0.3)	-	(0.3)
Other financial expense	(0.5)	(1.2)	0.7
Total expense	**(105.5)**	**(154.2)**	**48.7**
FINANCIAL INCOME			
Interest income and other financial income	4.5	10.4	(5.9)
Debt adjustment (Bonds) and related hedges	-	1.0	(1.0)
Exchange gains	-	1.7	(1.7)
Total income	**4.5**	**13.1**	**(8.6)**
TOTAL	**(101.0)**	**(141.1)**	**40.1**

Net financial expense amounted to € 101.0 million, essentially attributable to the Parent Company (€ 99.7 million), € 105.5 million of financial expense and € 4.5 million of financial income. The € 40.1 million decrease in financial expense with respect to the previous financial year is mainly the result of the following factors:

- decrease in financial expense related to medium- and long-term debt and the related hedging (+€ 73.6 million) attributable mainly to the general decrease in market rates during 2016 and to one-off effects connected with the Liability Management operation carried out on 20 July 2015 (€ 32.3 million);
- fair value adjustment of bonds and the related hedges (-€ 14.2 million);
- lower capitalised borrowing costs (-€ 12.7 million) due to the lower cost of net debt in 2016 compared with that recognised in 2015 and lower investments during the year;
- lower interest income and other financial income (-€ 5.9 million) attributable to lower liquidity invested during the year and the general decrease in market rates.

9. Share of profit/(losses) from equity-accounted investees - € (1.8) million

The item of € 1.8 million (the 2015 figure was zero), indicates the impairment of the equity investment in the associate CGES (€ 5.0 million), net of the positive effects of the adjustment to the portion of equity of the equity investment in the associates of the CESI Group at the end of the year (€ 3.2 million).

10. Income taxes of the year - € 305.3 million

€ million	2016	2015	Δ
Income taxes of the year			
Current taxes:			
- IRES (corporate income tax)	283.8	285.9	(2.1)
- IRAP (regional tax on productive activities)	55.2	57.0	(1.8)
Total current taxes	**339.0**	**342.9**	**(3.9)**
New temporary differences:			
- deferred tax assets	(22.9)	(21.8)	(1.1)
- deferred tax liabilities	0.6	-	0.6
Reversal of temporary differences:			
- deferred tax assets	25.3	22.8	2.5
- deferred tax liabilities	(29.7)	(36.3)	6.6
IRES tax rate adjustment	1.4	(8.2)	9.6
Total change in deferred tax assets and liabilities	**(25.3)**	**(43.5)**	**18.2**
Adjustment of prior-year taxes	(8.4)	(6.1)	(2.3)
TOTAL	**305.3**	**293.3**	**12.0**

Current taxes, at € 339.0 million, fell by € 3.9 million with respect to the previous year, essentially due to the recognition of the Tamini Group's tax loss, which applied the tax consolidation mechanism in 2016.
Deferred tax assets and liabilities, equal to -€ 25.3 million, changed by +€ 18.2 million, mainly due to the positive impact on the adjustment in net deferred tax liabilities[37] recognised in the 2015 financial statements (-€ 9.6 million). Also of note was the tax effect on depreciation and amortisation and the change in provisions for risks and charges.
Adjustment of prior-year taxes, of -€ 8.4 million, are related to the higher current taxes paid in previous years. The change with respect to the financial year (-€ 2.3 million) is mainly related to the parent company.
The effective proportion of income taxes (€ 305.3 million) to the profit before taxes was 32.7% compared with 33.3% in 2015.
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.

€ million	2016	2015
Profit/(loss) before taxes	933.2	881.3
THEORETICAL TAX	**256.6**	**242.4**
IRAP	55.2	57.0
Permanent differences	0.4	8.4
TAX (net of adjustments of prior-year taxes and one-off variations)	**312.3**	**307.8**
RATE	**33.5%**	**34.9%**
Adjustment of prior-year taxes	(8.4)	(6.3)
Tax rate adjustment	1.4	(8.2)
INCOME TAXES OF THE YEAR	**305.3**	**293.3**
ACTUAL TAX RATE	**32.7%**	**33.3%**

(37) In 2015, the Stability Law (Italian Law no. 208 of 28 December 2015) introduced a reduction in the IRES rate (art. 1 paragraphs 61-64), starting from 2017, from 27.5% to 24% for entities not classified as credit or financial institutions.

11. Net profit for the year from discontinued operations – € 0.0 million

The item was zero in 2016. In the previous year, it included the effects of the reversal of provisions set aside for probable expenses related to tax obligations deriving from the sale of Terna Participações by the Parent Company (for € 7.3 million), which are considered extinguished owing to expiry of the period of collection by the Brazilian local authority.

12. Earnings per share

Basic earnings per share, which corresponds to diluted earnings per share, amounts to € 0.315 (numerator of € 633.1 million, corresponding to the net profit for the year related to the Parent Company, and denominator of 2,009,992.0 thousand shares).

C. Operating segments

Consistent with the 2017–2021 Strategic Plan, and in line with IFRS 8, the following are the operating segments identified within the Terna Group:

- **Regulated Activities**
- **Non-Regulated Activities**

Regulated Activities include the development, operation and maintenance of the National Transmission Grid in addition to dispatching and measuring and activities related to the creation of storage systems. These activities are represented in a single operating segment, as activities regulated by the AEEGSI with similar characteristics in terms of the remuneration model and the tariff determination methods.
The operating segment of non-regulated activities instead includes specialised services provided to third parties mainly relating to systems engineering services, the operation and maintenance of high-voltage and very-high-voltage plants and the housing of telecommunications equipment and optical fibre network maintenance services. These activities are provided in a free market context by means of specific commercial initiatives.
We must specify that the operating segment of Non-Regulated Activities includes also the operating result of the Tamini Group, referable essentially to the construction and sale of electrical machinery, in particular power transformers, and the results of the companies set up to develop interconnection projects with other countries in an "interconnector" arrangement, that is Terna Interconnector S.r.l., Piemonte Savoia S.r.l. and Monita Interconnector S.r.l., and the company Terna Chile S.p.A. set up to develop initiatives in the South American market.
Below are the results of the operating segments of the Terna Group in the year 2016 and 2015, in line with the evidence of the Group management control system and the reconciliation with the Group's profit before taxes.

€ million	2016	2015	Δ	Δ %
TOTAL REVENUE FROM REGULATED ACTIVITIES	**1,895.4**	**1,849.7**	**45.7**	**2.5%**
TOTAL REVENUE FROM NON-REGULATED ACTIVITIES	**186.6**	**206.2**	**(19.6)**	**(9.5%)**
Revenue from construction of assets in concession (pursuant to IFRIC 12)	21.2	26.2	(5.0)	(19.1%)
TOTAL REVENUE	**2,103.2**	**2,082.1**	**21.1**	**1.0%**
EBITDA*	**1,544.7**	**1,539.2**	**5.5**	**0.4%**
*of which EBITDA from Regulated Activities***	*1,495.5*	*1,485.9*	*9.6*	*0.6%*
of which EBITDA from Non-Regulated Activities	*49.2*	*53.3*	*(4.1)*	*(7.7%)*
EBITDA margin	***73.4%***	***73.9%***		
*EBITDA margin on Regulated Activities***	78.9%	80.3%		
EBITDA margin on Non-Regulated Activities	26.4%	25.8%		
Reconciliation of segment result with pre-tax company result				
EBITDA	**1,544.7**	**1,539.2**		
Amortisation, depreciation and impairment	508.7	516.8		
EBIT	**1,036.0**	**1,022.4**		
Financial income/(expense)	(101.0)	(141.1)		
Share of profit/(loss) of equity-accounted investees	(1.8)	-		
Profit/(loss) before taxes	**933.2**	**881.3**		

* The Gross Operating Margin - EBITDA is an indicator of operating performance and is calculated by combining the Operating Profit (EBIT) with Amortisation, Depreciation and Impairment.
** EBITDA including indirect costs.

The Group's revenue for financial year 2016 amounted to € 2,103.2 million recording growth of € 21.1 million (+1.0%) with respect to financial year 2015.
Gross Operating Margin (EBITDA) came out at € 1,544.7 million, increasing by € 5.5 million (+0.4%) compared with € 1,539.2 million of 2015.

The increase in **Gross Operating Margin** (**EBITDA**) **from Regulated Activities**, up by € 9.6 million over the previous year, was mainly due to the positive effects of Quality of Service (+€ 35.8 million), the change in the Rete S.r.l. perimeter (+€ 26.4 million), greater other revenues (+€ 10.9 million), mainly related to the "Copper Plan", the positive effect on operating expenses of containment actions begun in 2015 (+€ 4.2 million) and the recognition in 2015 of registration tax sustained for the acquisition of Rete S.r.l. (+€ 13.1 million), partially offset by non-recurring costs in 2016 for early retirement incentives (-€ 32.3 million), the reduction in the "transmission fee" for the parent company and Terna Rete Italia S.r.l. (-€ 34.4 million), and for dispatching activities (-€ 13.9 million) which essentially reflect the effects of the new 2016–2023 regulatory period.

The decrease in **Gross Operating Margin** (**EBITDA**) **from Non-Regulated Activities**, which fell by € 4.1 million with respect to the previous year, was mainly attributable to the Tamini Group (-€ 7.2 million), lower contributions from variants requested by third parties (-€ 3.4 million), partially offset by the contract to lay fibre owned by Basictel (+€ 5.3 million to the change in the Rete S.r.l. perimeter). Of note also were one-off effects associated with the release of the provision for risks allocated for the disposal of a photovoltaic project, as certain contractual obligations were found to no longer exist (+€ 8.7 million) and the adjustment to the price paid to acquire Tamini (-€ 5.9 million), as registered in 2015.
The Group's **EBITDA margin** was substantially in line with the previous year and went from 73.9% in 2015 to 73.4% in 2016.

The information regularly reported to Senior Management does not make direct reference to segment activities but rather to the measurement and presentation of gross invested capital, given the non-material contribution of Non-Regulated Activities. The following table reports that indicator at 31 December 2016 and 31 December 2015.

	Italy	
€ million	**31.12.2016**	**31.12.2015**
Net non-current assets*	12,991.2	12,697.7
of which Investments in associates and joint controlled entities	*75.2*	*78.2*
Net working capital (NWC)**	(1,092.5)	(975.7)
Gross invested capital***	11,898.7	11,722.0

* Net non-current assets include the value of the items "Property, plant and equipment", "Goodwill", "Intangible assets", "Equity-accounted investees", "Other non-current assets" and "Non-current financial assets" for the value of the other equity investments (€ 0.1 million).

** NWC (Net Working Capital) is equal to the difference between total current assets, net of cash and cash equivalents and of the item "Current financial assets" and total current liabilities net of the short-term portion of long-term financing and net of the items "Short-term loans" and "Current financial liabilities", and the item "Other non-current liabilities".

*** The gross invested capital is equal to the sum of net non-current assets and the NWC (Net Working Capital).

As regards the dependence of the Terna Group companies on external customers, in 2016 transactions that generated revenue from individual customers or companies under common control equal to more than 10% of consolidated revenue were represented by transactions with related parties in respect of regulated activities.

D. Notes to the consolidated statement of financial position

Assets

13. Property, plant and equipment – € 12,386.1 million

€ million	Land	Buildings	Plant and equipment	Industrial and commercial equipment	Other assets	Assets under construction and payments on account	TOTAL
COST AT 01.01.2016	**185.2**	**1,546.8**	**15,322.8**	**94.6**	**140.2**	**1,950.2**	**19,239.8**
Investments	0.4	0.3	0.4	2.2	15.9	793.6	812.8
Entry into use	5.1	229.3	1,049.9	0.2	3.0	(1,287.5)	-
Disposals and impairment	-	(0.1)	(41.6)	-	(21.2)	(0.6)	(63.5)
Other changes	(1.3)	(4.4)	(55.8)	-	-	8.4	(53.1)
COST AT 31.12.2016	**189.4**	**1,771.9**	**16,275.7**	**97.0**	**137.9**	**1,464.1**	**19,936.0**
ACCUMULATED DEPRECIATION AND IMPAIRMENT AT 01.01.2016	**-**	**(441.4)**	**(6,540.8)**	**(71.9)**	**(107.0)**	**-**	**(7,161.1)**
Depreciation for the year	-	(40.7)	(391.4)	(4.8)	(12.3)	-	(449.2)
Disposals	-	-	39.3	-	21.1	-	60.4
Reclassifications	-	(0.1)	0.1	-	-	-	-
ACCUMULATED DEPRECIATION AND IMPAIRMENT AT 31.12.2016	**-**	**(482.2)**	**(6,892.8)**	**(76.7)**	**(98.2)**	**-**	**(7,549.9)**
Carrying amount							
At 31.12.2016	**189.4**	**1,289.7**	**9,382.9**	**20.3**	**39.7**	**1,464.1**	**12,386.1**
At 31.12.2015	**185.2**	**1,105.4**	**8,782.0**	**22.7**	**33.2**	**1,950.2**	**12,078.7**
Δ	**4.2**	**184.3**	**600.9**	**(2.4)**	**6.5**	**(486.1)**	**307.4**

"Plant and equipment", at 31 December 2016 includes, in particular, the energy transportation network as well as the transformation stations in Italy.
The item "Property, plant and equipment" recorded an increase compared to the previous year, of € 307.4 million, due to:

- investments during the year of +€ 812.8 million, of which € 774.0 million within the context of the Group's Regulated Activities. Investments of € 38.8 million were made in the area of Non-Regulated Activities, mainly for the creation of the private Italy-France interconnection line (€ 29.0 million), as well as for variants carried out for third parties;
- depreciation for the year of -€ 449.2 million;
- other changes during the year of -€ 53.1 million, mainly related to plant grants, in particular those received for projects financed by MED/EU; disposals and impairment (-€ 3.1 million).

A summary of changes in property, plant and equipment during the year is provided in the table below.

€ million	
Investments	
- Transmission lines	508.0
- Transformer stations	245.7
- Storage systems	7.7
- Other	51.4
Total investments in property, plant and equipment	**812.8**
Depreciation for the year	(449.2)
Other changes	(53.1)
Disposals and impairment	(3.1)
TOTAL	**307.4**

With reference to investments during the year in **Regulated Activities** (€ 774.0 million), in particular we note those of the Parent Company, related mainly to activities underway to create the "Italy - Montenegro" (€ 201.9 million) and "Italy - France" (€ 22.5 million) HVDC interconnections, the "Villanova-Gissi" (€ 25.5 million) and "Sorgente-Rizziconi" (€ 73.4 million) power lines, which began operating in January and May 2016, respectively, to create the 380 kV substations in Bari Nord and Melilli (respectively, € 14.3 million and € 12.1 million), the restructuring of the metropolitan area of Palermo (€ 11.5 million) and the creation of the Capri-Continent interconnection (€ 10.9 million) for which, in particular, laying and protection of the undersea cable was completed.
The investments also include the actions to purchase and/or renovate offices (€ 11.3 million).

14. Goodwill – € 230.1 million

Goodwill refers to the acquisition of Terna Rete Italia S.r.l, recognised in the balance sheet for an amount of € 101.6 million, the acquisition of RTL, recognised in the balance sheet for € 88.6 million, the acquisition of Rete S.r.l. for € 26.3 million and the acquisition of TES-Transformer Electro Services within the Tamini Group for € 13.6 million.
Goodwill decreased with respect to the previous year by € 3.6 million, due to impairment of the goodwill generated at the time TES was merged into the Tamini Group in 2015.

Impairment testing

For impairment purposes, goodwill was allocated to two Cash Generating Units (CGU): the first related to the perimeter of the Group's Regulated Activities and the second related to the perimeter of Non-Regulated Activities - transformer manufacturing and sales.

Cash Generating Unit – Perimeter of the Group's transmission activities

In order to determine the recoverable amount, "the fair value less cost of disposal" configuration was used. More specifically, the fair value less cost of disposal was determined taking into consideration the listing for the Terna stock at 31 December 2016, net of the fair value of financial liabilities and the estimated fair value of the segment for Non-Regulated Activities (transformer manufacturing and sales).
The result obtained is significantly higher than the value recorded in the balance sheet including goodwill.

Cash Generating Unit – perimeter of transformer production and sales

The impairment test was performed to determine the value in use (VIU) of the CGU, on the basis of cash flows foreseen in the Tamini Group's Industrial Plan and the terminal value of the same, normalised in line with the applicable accounting standards, applying a 2% growth rate and an 8.1% discount rate.
The result obtained, determined based on the above parameters, came to € 63.2 million, and considering that the Terna Group's stake is equal to 70% of Tamini Trasformatori S.r.l. share capital, impairment amounted to € 3.6 million.

15. Intangible assets – € 285.9 million

€ million	Infrastructure rights	Concessions	Other assets	Assets under development and payments on account	TOTAL
Cost	371.2	135.9	232.1	33.2	772.4
Accumulated amortisation	(255.9)	(57.4)	(163.3)	-	(476.6)
BALANCE AT 31.12.2015	**115.3**	**78.5**	**68.8**	**33.2**	**295.8**
Investments	-	0.2	0.8	40.5	41.5
Entry into use	16.0	-	19.0	(35.0)	-
Amortisation for the year	(27.5)	(5.6)	(18.3)	-	(51.4)
BALANCE AT 31.12.2016	**103.8**	**73.1**	**70.3**	**38.7**	**285.9**
Cost	387.2	136.1	251.9	38.7	813.9
Accumulated amortisation	(283.4)	(63.0)	(181.6)	-	(528.0)
BALANCE AT 31.12.2016	**103.8**	**73.1**	**70.3**	**38.7**	**285.9**
Δ	**(11.5)**	**(5.4)**	**1.5**	**5.5**	**(9.9)**

Intangible assets amounted to € 285.9 million (€ 295.8 million at 31 December 2015). This item, in particular, includes:

- the infrastructures used for the dispatching services, carried out under concession and booked as set out by “IFRIC 12 - Service Concession Arrangements”, for a net book value at 31 December 2016 of € 103.8 million for infrastructures which came into operation and € 22.9 million for infrastructures under construction included in the category “Assets under development and payments on account” (€ 115.3 million and € 17.6 million respectively at 31 December 2015);
- the concession for the provision of electricity transmission and dispatching services in Italy (with net carrying amount of € 73.1 million at 31 December 2016), with a term of twenty-five years, recognised initially during 2005 at fair value and subsequently measured at cost.

Other intangible assets manly comprise application software developed internally or purchased when implementing systems development projects. The investments related to them, referred mainly to the Parent Company (€ 18.0 million), were made essentially through internal development.
The difference with respect to the previous financial year (-€ 9.9 million) is due to the net effect of amortisation (€ 51.4 million, of which € 27.5 million relating to dispatching infrastructures and € 5.6 million relating to the concession) and investments (€ 41.5 million, of which € 21.3 million for infrastructure rights).
Investments for the year in intangible assets (€ 41.5 million, of which in Regulated Activities € 40.6 million referred mainly to the Parent Company), we note in particular those for the development and evolution of software for the Remote Management System for Dispatching (€ 9.6 million), for the Power Exchange (€ 4.3 million) and for the protection of the Electricity System (€ 1.1 million), as well as software applications and general use licenses (€ 16.3 million).

16. Equity-accounted investee – € 75.2 million

This item amounts to € 75.2 million and relates to the equity investments of the Parent Company Terna S.p.A. in the associate CESI S.p.A. (€ 44.9 million), in the associate CORESO S.A. (€ 0.3 million) and in the associate CGES – CrnoGorski Elektroprenosni Sistem AD (€ 30.0 million).
The value of the equity investment in CESI increased by € 2.1 million compared to the previous year, as a result of the equity investment adjustment to the equity at the end of the year referable to the stake held by the Group in the same company (€ 3.2 million), taking into account the dividend received during the year (-€ 1.1 million).
The value of the equity investment in CGES fell by € 5.0 million with respect to the previous year, due to impairment of the investment value recognised for the purposes of the consolidated financial statements, essentially due to the tariff revision which is applicable to the 2017–2019 period.

17. Financial assets

€ million	31.12.2016	31.12.2015	Δ
FVH derivatives	325.7	688.2	(362.5)
Revolving Credit Facility Commissions	4.3	3.6	0.7
Other Investments	0.1	-	0.1
Interconnector Guarantee Fund	17.4	-	17.4
NON-CURRENT FINANCIAL ASSETS	**347.5**	**691.8**	**(344.3)**
Deferred assets on FVH derivative contracts	26.1	61.5	(35.4)
Other current financial assets	0.1	2.8	(2.7)
CURRENT FINANCIAL ASSETS	**26.2**	**64.3**	**(38.1)**

The fair value of the FVH derivatives hedging the Parent Company's bonds, equal to € 325.7 million, is calculated by discounting expected cash flow with the market interest rate curve at the reporting date. The decrease in the fair value of derivatives (-€ 362.5 million) compared to 31 December 2015 is mainly attributable to the cancellation of FVH derivatives for a notional amount of € 1.8 billion (€ 0.6 billion expiring in 2019, € 0.7 billion expiring in 2021 and € 0.5 billion expiring in 2023) with a view to simplifying the derivatives portfolio followed during the second quarter of 2016, partially offset by the increase in the value of the residual portfolio following a decrease in the reference interest rate curve compared to December 2015.
The item also includes the deposit for the Interconnector Guarantee Fund (€ 17.4 million) established for the creation of interconnection works pursuant to article 32 of Italian Law 99/09.

The item "Current financial assets" showed a balance of € 26.2 million (€ 64.3 million at 31 December 2015) and a decrease compared to the previous year of € 38.1 million due essentially to the reduction in net financial income accrued on the related financial instruments, but not yet paid (-€ 35.4 million).

18. Other assets

€ million	31.12.2016	31.12.2015	Δ
Loans and advances to employees	9.0	9.1	(0.1)
Deposits with third parties	4.8	2.2	2.6
OTHER NON-CURRENT ASSETS	**13.8**	**11.3**	**2.5**
Other tax assets	47.1	121.3	(74.2)
Contractual advances to suppliers	7.7	5.7	2.0
Prepayments of operating expenses and accrued income	6.6	3.1	3.5
Other current assets - Interconnector Guarantee Fund	2.0	-	2.0
Receivables due from others:	4.1	5.0	(0.9)
OTHER CURRENT ASSETS	**67.5**	**135.1**	**(67.6)**

"Other non-current assets" (€ 13.8 million) shows a +€ 2.5 million change related to the previous year, mainly due to the increase in contractual security deposits paid by the subsidiary Terna Rete Italia S.p.A. to public entities and administrations (+€ 2.6 million, mainly connected to the subsidiary's business).
The item "Other current assets", equal to € 67.5 million, showed a decrease of € 67.6 million compared to the balance at 31 December 2015 mainly owing to:

- other tax assets (-€ 74.2 million), substantially attributable to the decrease in the Group's receivables from tax authorities for VAT (-€ 79.0 million, with respect to the credit of € 113.9 million existing at 31 December 2015), mainly owing to the decrease in energy-related payables, partially offset by the recognition of the subsidiary Terna Rete Italia S.p.A. receivable from the financial administration for IRAP (€ 6.0 million), for which reimbursement was requested when 2015 taxes were liquidated;

- portions of costs already paid but accruing after 31 December 2016 (+€ 3.5 million), mainly related to the recognition of prepayments related to the optic fibre housing contract signed in the last quarter of the year with Clouditalia for the purchase of optic fibre, which will be finalised in 2017 (€ 2.7 million).

19. Inventories – € 10.2 million

Inventories under current assets, of € 10.2 million, consist mainly of materials and equipment destined for the work of operating, maintaining and building plants.
The item showed a decrease of -€ 2.2 million compared to the figure for the previous year, mainly for the reduction in the balance of the inventories of Tamini Trasformatori S.r.l. and of its subsidiaries.

20. Trade receivables – € 1,443.3 million

€ million	31.12.2016	31.12.2015	Δ
Energy-related receivables	997.8	826.0	171.8
Grid transmission fee receivables	324.0	400.0	(76.0)
Other trade receivables	121.5	147.4	(25.9)
TOTAL	1,443.3	1,373.4	69.9

Trade receivables at 31 December 2016 amounted to € 1,443.3 million and are recognised net of impairment losses, referred to items considered non-collectable, recognised in allowances for doubtful accounts (€ 25.6 million for energy items and € 13.4 million for other items in 2016, compared with € 25.5 million for energy items and € 10.8 million for other items in 2015); the carrying amount shown approximates substantially the fair value.

Energy-related/adjusted receivables – € 997.8 million

The item includes receivables for "pass-through items" related to business performed by the Parent Company under Resolution 111/06 (€ 976.4 million) and receivables due from NTG operators for margin fees (€ 18.0 million). It also includes the receivable due from Fund for Energy and Environmental Services (*Cassa per i Servizi Energetici e Ambientali* - CSEA) related to the measurement of RENS performance recognised in 2016 (€ 3.4 million).
The balance as a whole increased by € 171.8 million with respect to the previous year due to pass-through energy-related receivables (+€ 171.3 million), mostly owing to the increase in the net receivable (€ 181.1 million) related to the uplift fee for supplying resources on the Dispatching Services Market (DSM) and energy-related items associated with the same, mainly for the greater final cost in the DSM and greater charges for unbalancing (including the effects of Resolution 333/2016/R/eel).

Grid transmission fee receivables – € 324.0 million

Grid transmission fee receivables, of € 324.0 million, is related to the remuneration awarded for the use of the National Transmission Grid by electricity distributors. The above receivables show a decrease of € 76.0 million compared to the previous year, attributable mainly to the payment made by *Cassa per i Servizi Energetici e Ambientali* (CSEA) for the supplement to the GTF revenues of Terna S.p.A. for the years 2014 and 2015 (€ 63.3 million) and the recognition of the GTF accruing in the last two months of the year on the basis of the new tariffs established for 2016, the first year of the new 2016-2023 regulatory period.

Other trade receivables – € 121.5 million

Other trade receivables refer mainly to receivables from non-regulated business customers, for specialised services provided to third parties mainly in the context of systems engineering services, the operation and maintenance of High-Voltage and Very-High-Voltage plants and the housing of telecommunications equipment and optical fibre grid maintenance services.
The item showed a decrease of € 25.9 million compared to the previous year, substantially deriving from the lower receivables for contract work in progress (-€ 18.0 million) for the Group, commented on below, and from other receivables, more specifically associated with the Chile work order that is nearing completion.
Below is the table of receivables for contract work in progress (€ 29.3 million) related to works of multi-year duration which the Group is carrying out with third party customers:

€ million	Payments on account	Contract value	Balance at 31.12.2016	Payments on account	Contract value	Balance at 31.12.2015
Receivables for contract work in progress	(32.1)	61.4	**29.3**	(25.6)	72.9	**47.3**

The Group's contract work in progress showed a decrease compared to the previous year of € 18 million, due substantially to the change in the Tamini Group's orders (-€ 13.7 million) and to the order of the subsidiary Terna Chile S.p.A. (-€ 3.4 million).

The amount of the guarantees issued to third parties by the Parent Company at 31 December 2016 came to € 52.0 million, of which € 26.0 million for sureties issued to secure the contractual obligations arising under the scope of operations and € 26.0 million as follows: € 14.3 million in the interest of the subsidiary Terna Rete Italia S.p.A., € 6.3 million in the interest of the subsidiary Terna Plus S.r.l., € 4.8 million in the interest of the subsidiary Difebal S.A., € 0.6 million for guarantees issued in the interest of the subsidiary Terna Rete Italia S.r.l.; all issued on the credit lines of Terna S.p.A..

21. Cash and cash equivalents – € 1,135.7 million

Cash and cash equivalents at 31 December 2016 amounted to € 1,135.7 million, of which € 258.8 million liquid funds related to the simplification of the derivatives portfolio carried out in 2016 and € 876.9 million of positive net liquidity in bank current accounts.

22. Income tax assets - € 19.7 million

Income tax assets amounted to € 19.7 million and recorded a decrease of € 14.3 million compared to the previous year due mainly to the use of the parent company's IRAP credit recognised in 2015 when the 2014 tax return was filed (-€ 9.8 million) and the use of the IRES credit (-€ 5.1 million).

Liabilities

23. Equity attributable to owners of the Parent – € 3,535.4 million

Share capital – € 442.2 million

The share capital of the Parent Company is represented by 2,009,992,000 ordinary shares, par value € 0.22 each.

Legal reserve – € 88.4 million

The legal reserve amounts to 20% of the share capital of the Parent Company.

Other reserves – € 726.9 million

Other reserves decreased by € 12.1 million compared to the previous year, due substantially to Other Comprehensive Income, in particular:

- for adjustment to fair value of derivative instruments hedging the Parent Company's floating-rate loans - cash-flow hedges (-€ 12.9 million, considering the related tax effect of € 3.8 million);
- for recognition of the actuarial gains and losses on employee benefits (+€ 0.8 million, considering the related tax effect of € 0.5 million).

Retained earnings and losses – € 1,789.7 million

The increase in the year of the item "Retained earnings and losses" of € 193.3 million mainly refers to allocation of the residual profit achieved by the Group in 2015 compared to the distribution of the 2015 dividend on the part of the Parent Company (a total of € 402.0 million).

Interim dividend 2016

After receiving the report of the Independent Auditors required by Art. 2433-*bis* of the Italian Civil Code, on 04 November 2016 the Parent Company's Board of Directors approved the distribution of an interim dividend amounting to € 144.9 million, equal to € 0.0721 per share, which is payable from 23 November 2016, with an ex-dividend date (coupon 25) of 21 November 2016.

Equity attributable to non-controlling interests

Equity attributable to non-controlling interests, related to the Tamini Group, came to € 19.8 million, down by € 5.2 million over the value at 31 December 2015, which was € 25.0 million, due to losses recognised by the Group during the year.

24. Loans and financial liabilities

€ million	31.12.2016	31.12.2015	
Bonds	6,420.5	6,406.1	14.4
Bank loans	1,983.9	2,110.4	(126.5)
LONG-TERM LOANS	**8,404.4**	**8,516.5**	**(112.1)**
CFH derivatives	12.8	7.3	5.5
NON-CURRENT FINANCIAL LIABILITIES	**12.8**	**7.3**	**5.5**
Short-term loans	20.1	416.6	(396.5)
SHORT-TERM LOANS	**20.1**	**416.6**	**(396.5)**
Bonds	769.9	-	769.9
Current portion of long-term loans	134.6	122.9	11.7
CURRENT PORTION OF LONG-TERM LOANS	**904.5**	**122.9**	**781.6**
TOTAL	**9,341.8**	**9,063.3**	**278.5**

Gross debt for the year, equal to € 9,341.8 million, increased by € 278.5 million with respect to the previous year .

The increase in the value of bonds (+€ 784.3 million) is attributable for € 750.0 million to the bond issue of 11 October 2016, for € 80.0 million to bond issue on 3 March 2016, and for -€ 45.2 million to the changes in fair value of the hedged risk net the amortised cost effect.
The last official prices at 31.12.2016 for the bonds listed on the Luxembourg Stock Exchange are detailed below:

- bond maturity 2024: 2016 price € 130.48 and 2015 price € 127.94;
- bond maturity 2023: 2016 price* € 131.96 and 2015 price € 124.45;
- bond maturity 2019: 2016 price € 113.07 and 2015 price € 115.86;
- bond maturity 2026: 2016 price € 103.09;
- bond maturity 2021: 2016 price € 118.33 and 2015 price € 119.08;
- bond maturity 2017: 2016 price € 100.86 and 2015 price € 104.32;
- bond maturity 2018: 2016 price € 103.20 and 2015 price € 105.35;
- bond maturity 2022: 2016 price € 101.61 and 2015 price € 98.15;
- bond maturity 2028: 2016 price € 94.60.

* Source BNP Paribas, in the absence of up-to-date prices sources Reuters and Bloomberg.

The debt which was originally floating rate, shows a decrease of € 114.8 million compared to the previous year, due to:

- drawdown of a new EIB loan for € 8.0 million;
- decrease in mortgages and loans, for € 122.8 million, due to the reimbursement of the due instalments of the existing loans.

Long-term loans

€ million	Maturity	31.12.2015	31.12.2016	Portion with maturity within 12 months	Portion with maturity beyond 12 months	2018	2019	2020	2021	2022	After	Average interest rate as of 31.12.2016	Average interest rate net of hedging as of 31.12.2016
Bonds	2024	1,050.1	1,054.2	-	1,054.2	-	-	-	-	-	1,054.2	4.90%	0.25%
Bonds IL	2023	712.8	710.2	-	710.2	-	-	-	-	-	710.2	2.73%	0.87%
Bonds PP	2019	677.2	660.4	-	660.4	-	660.4	-	-	-	-	4.88%	3.17%
Bonds PP	2026	-	78.7	-	78.7	-	-	-	-	-	78.7	1.60%	1.60%
Bonds 1250	2021	1,453.3	1,432.5	-	1,432.5	-	-	-	1,432.5	-	-	4.75%	2.15%
Bonds 1250	2017	769.2	769.9	769.9	-	-	-	-	-	-	-	4.13%	4.13%
Bonds 1000	2022	995.3	996.1	-	996.1	-	-	-	-	996.0	-	0.88%	0.88%
Bonds 750	2018	748.2	749.1	-	749.1	749.1	-	-	-	-	-	2.88%	2.88%
Bonds 750	2028	-	739.3	-	739.3	-	-	-	-	-	739.3	1.00%	1.00%
Total fixed rate		**6,406.1**	**7,190.4**	**769.9**	**6,420.5**	**749.1**	**660.4**	**-**	**1,432.5**	**996.0**	**2,582.4**		
EIB	2015-2030	1,724.5	1,611.9	132.4	1,479.5	132.4	111.3	116.1	112.1	112.1	895.5	0.37%	0.63%
CDP	2019	500.0	500.0	-	500.0	-	500.0	-	-	-	-	0.79%	0.91%
Leasing	2019-2021-2022	8.8	6.6	2.2	4.4	2.0	1.9	0.3	0.1	0.1	(0.8)	0.89%	0.89%
Total floating rate		**2,233.3**	**2,118.5**	**134.6**	**1,983.9**	**134.4**	**613.2**	**116.4**	**112.2**	**112.2**	**894.7**		
TOTAL		**8,639.4**	**9,308.9**	**904.5**	**8,404.4**	**883.5**	**1,273.6**	**116.4**	**1,544.7**	**1,108.2**	**3,477.1**		

The total amount of the Terna Group's loans at 31 December 2016 was € 9,308.9 million (€ 904.5 million due within 12 months and € 8,404.4 million due after more than 12 months), of which € 3,477.1 million is due after more than five years.
The following table shows changes in long-term debt for the year, with an indication of the notional debt:

	31.12.2015							31.12.2016		
€ million	Notional debt	Carrying amount	Market value	Repay. and capitalis.	Draw-downs	Δ Fair Value 31.12.2015 31.12.2016	Δ carrying amount	Notional debt	Carrying amount	Market value
2024 Bond	800.0	1,050.1	1,023.5	-	-	4.1	4.1	800.0	1,054.2	1,043.8
IL bond	565.9	712.8	704.3	(0.5)	-	(2.1)	(2.6)	565.4	710.2	746.1
Private Placement 2019	600.0	677.2	695.1	-	-	(16.8)	(16.8)	600.0	660.4	678.4
Private Placement 2026	-	-	-	-	80.0	(1.3)	78.7	80.0	78.7	82.5
2021 Bond	1,250.0	1,453.3	1,488.5	-	-	(20.8)	(20.8)	1,250.0	1,432.5	1,479.2
2017 Bond	770.0	769.2	803.2	-	-	0.7	0.7	770.0	769.9	776.6
2022 Bond	1,000.0	995.3	981.5	-	-	0.8	0.8	1,000.0	996.1	774.0
2018 Bond	750.0	748.2	790.2	-	-	0.9	0.9	750.0	749.1	1,016.1
2028 Bond	-	-	-	-	750.0	(10.7)	739.3	750.0	739.3	709.5
Total bonds	**5,735.9**	**6,406.1**	**6,486.3**	**(0.5)**	**830.0**	**(45.2)**	**784.3**	**6,565.4**	**7,190.4**	**7,306.2**
Bank loans	2,233.3	2,233.3	2,233.3	(122.8)	8.0	-	(114.8)	2,118.7	2,118.5	2,118.7
Total bank loans	**2,233.3**	**2,233.3**	**2,233.3**	**(122.8)**	**8.0**	**-**	**(114.8)**	**2,118.7**	**2,118.5**	**2,118.7**
Total Financial debt	**7,969.2**	**8,639.4**	**8,719.6**	**(123.3)**	**838.0**	**(45.2)**	**669.5**	**8,684.1**	**9,308.9**	**9,424.9**

Compared to 31 December 2015, long-term debt shows overall an increase of € 669.5 million, mainly due for € 830.0 million to the issue of two new Bonds, for € 122.8 million to repayment of the instalment of EIB loans, for -€ 45.2 million to the reduction in the fair value of the bonds, also considering the amortised cost of all loans and for € 8 million to the drawdown of a new EIB loan.
At 31 December 2016, the Group had an additional debt capacity of € 2,050.0 million represented by three revolving credit facilities entered into in December 2014, December 2015 and July 2016, to which must be added the additional capacity of approximately € 962.0 represented by uncommitted bank lines.
In addition, as provided for in IFRS 7, the table shows the fair value of financial payables which for bond loans is their market value on the basis of the prices at the reporting date, while for floating-rate loans it was assumed to be substantially equal to the notional amount of repayment.

Non-current financial liabilities

€ million	31.12.2016	31.12.2015	Δ
CFH DERIVATIVES	12.8	7.3	5.5
TOTAL	**12.8**	**7.3**	**5.5**

The item "Non-current financial liabilities", of € 12.8 million at 31 December 2016, includes the fair value measurement of cash-flow hedging derivatives.
Fair value was measured by discounting the expected cash flows using the market yield curve at the reporting date. The change in the interest rate curve compared with 31 December 2015 resulted in a change amounting to +€ 5.5 million.

Short-term loans – € 20.1 million

The item "short-term loans", at € 20.1 million, is due to the balance of short-term loans disbursed to the Tamini Group, and fell by € 396.5 million compared to the previous year, mainly due to repayments made by the parent company of credit lines existing at 31 December 2015.

Current financial liabilities

Current financial liabilities include at 31 December 2016 the value of net financial expenses accrued on financial instruments and not yet paid. This item shows a decrease, compared with the previous year, of -€ 0.7 million.

€ million	31.12.2016	31.12.2015	Δ
DEFERRED LIABILITIES ON:			
Hedging derivatives	0.7	3.1	(2.4)
Bond	123.5	120.6	2.9
Loans	2.2	3.4	(1.2)
TOTAL	**126.4**	**127.1**	**(0.7)**

Net financial position

Pursuant to CONSOB Communication of 28 July 2006 and in compliance with Recommendation ESMA/2011/81 of 23 March 2011, we can disclose that the net financial position of the Group is as follows:

€ million		31.12.2016
A.	Cash	876.9
B.	Short-term deposits	258.8
C.	**Liquidity (A) + (B)**	**1,135.7**
D.	Current portion of long-term payables	904.5
E.	Short-term loans	20.1
F.	Other net financial liabilities	95.9
	of which related parties	*0.1*
G.	**Current financial debt (D) + (E) + (F)**	**1,020.5**
H.	**Net current financial debt (G) – (C)**	**(115.2)**
I.	Non-current bank payables	1,983.9
	of which to related parties	*500.0*
J.	Bonds issued	6,420.5
K.	Derivative financial instruments in portfolio	(312.9)
L.	Other non-current financial assets (Interconnector guarantee fund)	(17.4)
M.	**Net non-current financial debt (I) + (J) + (K) + (L)**	**8,074.1**
N.	**Net financial debt (H) + (M)**	**7,958.9**

Default risk and debt covenants

This risk is associated with the possibility that the loan contracts or bond rules 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 S.p.A. contain covenants that are typical of international practice. The principal covenants relate to:

- the Company's bond debt, which consists of an € 800.0 million issue in 2004 and eight issues in the context of its EMTN Programme "(€ 8,000,000,000 Medium Term Notes Programme)";
- bank debt, 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 debt");
- a series of loans to the Company from the European Investment Bank (EIB) for a total amount of € 1,611.9 million.

The main covenants related to the bond issues and the EMTN Programme consist in clauses regarding i) "negative pledges", on the basis of which the Issuer or the Relevant Subsidiaries cannot create or continue mortgages, pledges or other constraints on their assets or revenue, to guarantee listed bonds (with the exception of certain "consented guarantees") ii) "pari passu", on the basis of which the securities constitute a direct obligation, unconditional and not guaranteed by the Issuer, without preference among them and with at least the same level of seniority as other present and future non-guaranteed and non-subordinated loans of the Issuers iii) "event of default", on the basis of which if certain predetermined events occur (e.g., lack of payment, liquidation of the Issuer, breach of contractual obligations, cross-default, etc.) a situation of breach is established and the loan in question is immediately collectable.
The main covenants related to bank debt consist in clauses related to i) negative pledges, on the basis of which the Issuer or the Relevant Subsidiaries cannot create or continue mortgages, pledges or other constraints on their assets or revenue, to guarantee listed bonds, with the exception of "consented guarantees", ii) on the basis of which the Borrower's payment obligations in relation to the loan contracts in question are not subordinated to any obligation related to other non-guaranteed 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. lack of payment, grave imprecisions in documents and/or

declarations, insolvency, ceasing of business, substantially prejudicial effects, breach of contractual obligations including equality of conditions among lenders, cross-default, etc.) a situation of breach is established and the loan in question is immediately collectable, iv) obligatory early repayment in the case of below investment grade ratings (BBB-) for the majority of ratings agencies or in the case the Company ceases to be monitored by at least one agency.
The main covenants related to the EIB loans consist in clauses related to i) negative pledges, on the basis of which the Company cannot create constraints with the exception of constraints granted in relation to debt lower than given amounts and under contractually specified circumstances; ii) granting to the Bank, upon request of the same, new guarantees in the case of ratings of lower than BBB+/Baa1 for two ratings agencies out of three, or in the case in which the rating ceases to be published by all of the agencies, iii) "pari passu", on the basis of which the Company ensures that payment obligations are classified at the same level as those related to all other unsecured non-subordinated creditors, iv) cases of contract termination/application of the acceleration cause/withdrawal (e.g. lack of payment, grave imprecisions in documents and/or declarations, insolvency, events that create negative consequences on financial commitments made by the Company, special administration, liquidation, substantial prejudicial change, breach of contractual commitments, etc.) v) obligatory early repayment following the occurrence of given events (e.g. change in control over the Company, loss of the concession, extraordinary corporate events, etc.).
None of the covenants have been infringed to date.

25. Employee benefits – € 104.1 million

The Group provides benefits to its employees during their period of employment (loyalty bonus), at the termination of their employment (deferred compensation benefits, additional month's pay and allowance in lieu of notice), and in the period after the termination of employment (electricity discount and the ASEM health plan).
The loyalty bonus is awarded to employees and managers of the Group when they reach certain seniority levels (25 and 35 years of service).
The benefits granted at the termination of employment are recognised for all employees (termination indemnities), managers hired or appointed before 28 February 1999 (Indemnity for Lack of Notice), and employees (blue-collar workers, white-collar workers and junior executives) hired before 24 July 2001 (Additional Month's Pay Indemnity).
Post-employment benefits consist of the following:

- discount on electricity consumed for domestic use. This benefit is offered to all employees hired before 30 June 1996 (energy discount);
- a healthcare plan complementing the national health service, as agreed under the terms of the national contract for industrial managers (the ASEM health plan).

The composition of deferred compensation benefits and other employee-related provisions at 31 December 2016 is detailed below along with changes in the period.

€ million	31.12.2015	Provision	Interest cost	Utilisations and other changes	Actuarial gains/ (losses)	31.12.2016
Benefits payable to employees						
Loyalty bonus	4.2	0.6	-	(0.3)	-	4.5
Total	**4.2**	**0.6**	**-**	**(0.3)**	**-**	**4.5**
Benefits payable upon termination of employment						
Deferred compensation benefits	51.8	0.3	1.0	(1.6)	2.4	53.9
Additional month's pay indemnity	7.3	0.2	0.1	(0.8)	0.1	6.9
Indemnities for lack of notice and similar	0.8	-	-	(0.2)	-	0.6
Total	**59.9**	**0.5**	**1.1**	**(2.6)**	**2.5**	**61.4**
Post-employment benefits						
Energy discount	33.7	0.5	0.7	(0.9)	(5.2)	28.8
ASEM	7.7	0.2	0.2	(0.1)	1.4	9.4
Total	**41.4**	**0.7**	**0.9**	**(1.0)**	**(3.8)**	**38.2**
TOTAL	**105.5**	**1.8**	**2.0**	**(3.9)**	**(1.3)**	**104.1**

The item, of € 104.1 million at 31 December 2016, showed a reduction compared to the previous year of € 1.4 million, attributable to net utilisations and other changes for the year (-€ 2.1 million, also based on participation of personnel in the cited voluntary redundancy programme in 2015), and to actuarial gains and losses (-€ 1.3 million), offset by the recognition of discounting expense for the year (+€ 2.0 million).

Details of the pension cost relating to current employment and interest income and expense are shown below.

€ million	Loyalty bonus	Deferred compen-sation benefits	Additional month's pay in-demnity	Indemnities for lack of notice and similar	Energy di-scount	ASEM	TOTAL
Net impact recognised in profit or loss							
- cost relating to current work performed	0.6	0.3	0.2	-	0.5	0.2	**1.8**
- interest income and expense	-	1.0	0.1	-	0.7	0.2	**2.0**
- curtailment (revenue)	-	-	(0.5)	(0.2)	-	(0.1)	**(0.8)**
TOTAL RECOGNISED IN INCOME STATEMENT	**0.6**	**1.3**	**(0.2)**	**(0.2)**	**1.2**	**0.3**	**3.0**

Revaluation of the net liability for employee benefits is illustrated in the table below, where the types of actuarial gains and losses, recognised among Other Comprehensive Income, are detailed.

€ million	Deferred compen-sation benefits	Additional month's pay indemnity	Energy discount	ASEM	TOTAL
Actuarial gains/(losses)					
- based on past experience	(1.3)	(0.1)	(0.8)	(0.2)	**(2.4)**
- due to changes in demographical assumptions	-	-	1.1	0.1	**1.2**
- due to changes in other economic assumptions	1.0	-	(8.2)	0.4	**(6.8)**
- due to changes in discount rate	2.7	0.2	2.7	1.1	**6.7**
TOTAL OCI IMPACTS	**2.4**	**0.1**	**(5.2)**	**1.4**	**(1.3)**

Finally, the statements below show the main actuarial assumptions used, a sensitivity analysis on the movements in these assumptions and the payment schedule envisaged in the plan. It should be noted that the interest rate used to determine the current value of the obligation was calculated, in line with 2015, considering the yield of the Iboxx Eurozone Corporates AA index at 31 December 2016 in line with the duration of the group of workers measured.

	Loyalty bonus	Deferred compensation benefits	Additional month's pay indemnity	Indemnities for lack of notice and similar	Energy discount	ASEM
Discount rate	1.31%	0.88%	0.47%	0.13%	1.31%	1.31%
Inflation rate	1.50%	1.50%	-	1.50%	1.50%	3.00%
Duration (in years)	10.3–12.7	10–11	7.0–8	3–4.5	14.5–20	15.3–20

€ million	Loyalty bonus	Deferred compensation benefits	Additional month's pay indemnity	Indemnities for lack of notice and similar	Energy discount	ASEM	TOTAL
Discount rate +0.25%	4.6	50.5	6.6	0.6	27.9	9.0	**99.2**
Discount rate -0.25%	4.5	52.9	6.8	0.6	30.2	9.8	**104.8**
Inflation rate +0.25%	4.5	52.5	n/a	n/a	30.2	n/a	**87.2**
Inflation rate -0.25%	4.6	50.9	n/a	n/a	27.8	n/a	**83.3**
Annual rate of increase in healthcare +3%	n/a	n/a	n/a	n/a	n/a	16.5	**16.5**
Annual rate of increase in healthcare -3%	n/a	n/a	n/a	n/a	n/a	5.8	**5.8**
Conversion value of KW/h +5%	n/a	n/a	n/a	n/a	30.5	n/a	**30.5**
Conversion value of KW/h -5%	n/a	n/a	n/a	n/a	27.6	n/a	**27.6**

€ million	Loyalty bonus	Deferred compensation benefits	Additional month's pay indemnity	Indemnities for lack of notice and similar	Energy discount	ASEM	TOTAL
By the end of 2017	0.7	2.6	1.2	-	0.8	0.3	**5.6**
By the end of 2018	0.2	2.9	0.5	0.1	0.8	0.3	**4.8**
By the end of 2019	0.3	1.9	0.4	0.1	0.8	0.3	**3.8**
By the end of 2020	0.4	3.0	0.5	-	0.8	0.4	**5.1**
By the end of 2021	0.8	3.4	0.6	0.2	0.8	0.4	**6.2**

26 - Provisions for risks and charges – € 238.6 million

€ million	Provision for disputes and litigation	Provisions for sundry risks and charges	Provision for early retirement	Total
Balance at 31.12.2015	**12.8**	**147.2**	**38.8**	198.8
Provisions	5.5	60.7	32.3	98.4
Utilisations and other changes	(3.7)	(40.5)	(14.5)	(58.6)
Balance at 31.12.2016	**14.6**	**167.4**	**56.6**	238.6

Provision for disputes and litigation – € 14.6 million

The provisions are set aside to cover the liabilities at year-end that may arise from lawsuits and out-of-court disputes relating to the Group companies' activities. The amount set aside takes into account the opinions both of internal and external legal counsel and recorded an increase of € 1.8 million with respect to the previous year, due to net provisions made during the financial year.

Provisions for sundry risks and charges – € 167.4 million

The provisions recorded a net increase of € 20.2 million, compared to the previous year, referable in particular to:

- net provisions for charges following plants beginning operations (for € 32.9 million, particularly related to urban and environmental restoration projects and the provision related to the Sorgente-Rizziconi and Villanova-Gissi works);
- reversal of the provision for risks allocated in previous years, associated with the disposal of a photovoltaic project (-€ 8.7 million);
- net utilisations related to the Incentive Plan for senior managers (-€ 3.7 million).

Provision for early retirement incentives – € 56.6 million

This provision reflects the estimated extraordinary charges adjusted based on the redundancy plan established for the year, connected to the voluntary early termination of the working relationship of employees of the Group who are eligible for retirement. The item shows a net increase of € 17.8 million, due to the provision recognised against the redundancy plan of € 32.3 million, offset by disbursements made during the year (€ 14.5 million).

27. Deferred tax liabilities – € 41.9 million

€ million	31.12.2015	Provisions	Utilisa-tions and other changes	Impact recognised in statement of comprehensive income	31.12.2016
DEFERRED TAX LIABILITIES					
Property, plant and equipment	176.8	0.6	(27.5)	-	149.9
Employee benefits and financial instruments	3.1	-	-	-	3.1
Total deferred tax liabilities	**179.9**	**0.6**	**(27.5)**	**-**	**153.0**
DEFERRED TAX ASSETS					
Provisions for risks and charges	(39.5)	(12.4)	14.7	-	(37.2)
Allowance for doubtful accounts	(3.2)	-	-	-	(3.2)
Employee benefits	(23.2)	(7.6)	8.6	0.5	(21.7)
CFH derivatives	(2.0)	-	-	(3.8)	(5.8)
Release of goodwill	(39.9)	-	2.9	-	(37.0)
Other	(2.9)	(2.9)	(0.4)	-	(6.2)
Total deferred tax assets	**(110.7)**	**(22.9)**	**25.8**	**(3.3)**	**(111.1)**
NET DEFERRED TAX LIABILITIES	**69.2**	**(22.3)**	**(1.7)**	**(3.3)**	**41.9**

This balance, equal to € 41.9 million, reflects the net movements in the Group's deferred tax assets and liabilities.
Deferred tax liabilities (€ 153.0 million) showed a decrease of € 26,9 million, essentially attributable to the Parent Company Terna and to the subsidiary Terna Rete Italia S.r.l. (-€ 25.3 million and -€ 4.8 million, respectively), for utilisation of prior-period provisions for additional depreciation and amortisation with respect to the economic/technical portions, as well as net changes related to the Rete S.r.l. business combination performed by the Group in 2015 (+€ 3.5 million).

Deferred tax assets (€ 111.1 million) were substantially in line with the balance at 31 December 2015 (€ 110.7 million), but saw the following changes during the year:

- net utilisations recognised on provisions for risks and charges (€ 2.3 million), mainly due to the tax effects of the reversal of the provision for the photovoltaic project, referenced above (€ 2.1 million);
- net utilisations for employee benefits (€ 1.0 million);

- net provisions that did not affect the Income Statement for € 3.3 million, attributable to the tax effect of changes in cash flow hedge financial instruments and employee benefits;
- utilisation of the relevant proportion of deferred tax assets allocated for the release of goodwill recorded following the incorporation of RTL by the Parent Company (€ 2.9 million);
- provisions recognised by the subsidiary Rete S.r.l. related to the non-deductible portion of statutory depreciation and amortisation recognised by the Company (€ 3.6 million).

28. Other non-current liabilities – € 138,1 million

This item, amounting to € 138.1 million at 31 December 2016 encompasses the deferred positions of set-up grants of the Parent Company (€ 101.2 million) and of Terna Rete Italia S.r.l. (€ 17.2 million) as well as the Interconnector Guarantee Fund established under Terna S.p.A. by the 2016 Italian Stability Law (€ 19.7 million) for the creation of interconnection works pursuant to article 32 of Italian Law 99/09.
The increase in this item with respect to the previous financial year, of € 14,0 million, essentially derives from the recognition of the Interconnector Guarantee Fund mentioned above, partially offset by the reversal of the portion of grants related to depreciation of plants in the period for which they were recognised, net of new grants received by Terna Rete Italia S.r.l. (€ 5.7 million).

29. Current liabilities

€ million	31.12.2016	31.12.2015	Δ
Short-term loans*	20.1	416.6	(396.5)
Current portion of long-term loans*	904.5	122.9	781.6
Trade payables	2,280.7	2,143.9	136.8
Tax liabilities	8.1	15.4	(7.3)
Current financial liabilities*	126.4	127.1	(0.7)
Other current liabilities	206.3	247.2	(40.9)
TOTAL	**3,546.1**	**3,073.1**	**473.0**

* For these items see the comments in Note 24. Loans and financial liabilities.

Trade payables – € 2,280.7 million

€ million	31.12.2016	31.12.2015	Δ
Suppliers:			
- Energy-related payables	1,525.8	1,435.7	90.1
- Non-energy-related payables	735.7	687.9	47.8
Payables due to associates	10.1	9.9	0.2
Payables for contract work in progress	9.1	10.4	(1.3)
TOTAL	**2,280.7**	**2,143.9**	**136.8**

Suppliers

Energy-related/adjusted payables – € 1,525.8 million

The increase in the item of € 90.1 million compared to the previous year is essentially attributable to:

- payables for pass-through energy items: up by € 99.3 million due mainly to the following items:
  - payables associated with capacity payments (+€ 69.1 million), substantially due to lower payments approved by the Authority in favour of production unit users;
  - payables associated with remuneration of essential units - UESS (+€ 23.2 million), substantially due to greater amounts associated with collection against payments, which were substantially aligned at the end of the period;
  - payables of amounts deriving from electricity market transactions (+€ 18.5 million) mainly associated with the Dispatching Services Market (DSM);
- payables due to the Cassa per i Servizi Energetici e Ambientali (CSEA): this fell by € 9.7 million, essentially due to the recognition of lower charges deriving from bonus/penalty mechanisms connected with transmission service quality. In particular, the balance at the end of 2015 included the negative performance estimate for RENS (€ 6.5 million against the bonus recognised in 2016), and greater grants to the Exceptional Events Provision with CSEA (€ 6.1 million in 2015 against € 3.0 million recognised in 2016).

Non-energy-related payables

Amounts due to suppliers refer to invoices both already received and yet to be received for tenders, services and the purchase of materials and equipment.
The balance at 31 December 2016 (€ 735.7 million) increased by € 47.8 million with respect to the figure of the previous year (€ 687.9 million), for the most part due to greater investment activities during the final part of the year. The change in payables related to the Tamini Group was -€ 9.6 million.

Payables to associates

This item, of € 10.1 million, and basically in line with the previous year, shows payables to the associate CESI S.p.A. for services received principally from the Parent Company (€ 1.6 million) and the subsidiary Terna Rete Italia S.p.A. (€ 8.4 million), related to studies and experimental research in the electro-technical sector.

Payables for contract work in progress

Payables for contract work in progress, of € 9.1 million at 31 December 2016, show a € 1.3 million decrease compared with the figure recorded at 31 December 2015 (€ 10.4 million), essentially due to the effect of the reduction of balances related to orders of the Tamini Group (-€ 3.5 million) partially offset by recognition of advances related to the order in Chile (+€ 1.6 million). The item is structured as shown below.

€ million	Paymen-ts on account	Contract value	Balance at 31.12.2016	Paymen-ts on account	Contract value	Balance at 31.12.2015
Payables for contract work in progress	(28.0)	18.9	**(9.1)**	(23.7)	13.3	**(10.4)**

The carrying amount of trade payables is substantially equal to the fair value.
The commitments taken on by the Group towards suppliers equal € 2,701.4 million and regard purchases associated with the normal “operating cycle” forecast for 2017-2021.

Tax liabilities – € 8.1 million

The item represents the amount of the Group's tax payables net of related payments on account and represents IRES payables for € 10.0 million and net IRAP credits of € 1.9 million.
The Group's tax liabilities recorded a net decrease, compared to the previous year, of € 7.3 million, attributable substantially to lower IRES payments on account in the previous year. We note also the greater IRAP value seen in previous years, due to greater non-deductible personnel expense items, which became deductible the previous year.

Other current liabilities – € 206.3 million

€ million	31.12.2016	31.12.2015	Δ
Payments on account	53.6	59.0	(5.4)
Other tax liabilities	6.7	7.4	(0.7)
Payables to social security institutions	23.6	24.7	(1.1)
Payables to employees	34.3	55.9	(21.6)
Other payables to third parties	88.1	100.2	(12.1)
TOTAL	**206.3**	**247.2**	**(40.9)**

Payments on account

This item (€ 53.6 million) recognises set-up grants related to plants received by the Group (€ 46.6 million for the Parent Company, € 4.1 million for Terna Rete Italia S.r.l. and € 3.4 million for Terna Plus S.r.l.) for assets still under construction at 31 December 2016.
With respect to the balance at 31 December 2015 (€ 59.0 million), the item decreased by € 5.4 million, mainly due to the net effect of new payments on account received from third parties (€ 51.1 million, including plant grants received for projects financed by MED/EU) and grants made directly to reduce the carrying amount of assets for € 56.5 million.

Other tax liabilities

Other tax liabilities, at € 6.7 million, saw a decrease of € 0.7 million compared to the previous year, mainly due to the effect of recording greater IRPEF withholdings for employee wages and deferred compensation benefits in 2015, (-€ 0.8 million).

Payables to social security institutions

Payables to social security institutions, essentially relating to payables of the Parent Company and the subsidiary Terna Rete Italia S.p.A due to INPS, amount to € 23.6 million and were lower than in the previous year (€ 24.7 million), substantially due to lower grants recognised for staff incentives (-€ 0.5 million). The item also includes the payable related to the *Fondo Previdenziale Elettrici* - F.P.E. (Pension Fund for Electricians) of € 3.7 million (€ 4.4 million at 31 December 2015).

Payables to employees

Payables to employees, of € 34.3 million, pertain essentially to the Parent Company and to the subsidiary Terna Rete Italia S.p.A. and mainly regard:

- amounts relating to staff incentives to be paid the following year (€ 21.5 million);
- payables due to employees for unused holiday time and abolished public holidays (€ 10.5 million).

The item shows a decrease of € 21.6 million, attributable mainly to higher payables recognised in 2015 for amounts to be paid following employees' acceptance of the generational turnover plan launched by the Company in 2014 (-€ 9.7 million), to the reduction in payables for deferred compensation benefits (-€ 9.4 million) and also for incentives for personnel (-€ 2.7 million).

Other payables to third parties

Other payables to third parties, equal to € 88.1 million, mainly regard security deposits (€ 66.7 million) received from electricity market operators securing their contractual obligations against dispatching and virtual interconnection contracts and also deferred income (€ 7.7 million, mainly related to the Group's Non-Regulated business).
The item showed a total increase of € 12.1 million, attributable essentially to lower security deposits (+€ 10.0 million).

E. Commitments and risks

Risk management

Market and financial risks of the Group

During the financial year, in going about its business, the Terna Group is exposed to various different financial risks: market risk (namely exchange rate risk, interest rate risk and inflation 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 measure them, with further quantitative disclosures concerning the 2016 separate financial statements.
The Group's risk management policies seek to identify and analyse the risks the companies are exposed to, establishing appropriate limits and controls and monitoring 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 operations of the companies.
The exposure of the Terna Group 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 in managing them.

	31.12.2016			31.12.2015		
€ million	Receivables at amortised cost	Hedging derivatives	TOTAL	Receivables at amortised cost	Hedging derivatives	TOTAL
Assets						
Derivative financial instruments	-	325.7	**325.7**	-	688.2	**688.2**
Cash on hand and deposits	1,153.1	-	**1,153.1**	431.6	-	**431.6**
Trade receivables	1,443.3	-	**1,443.3**	1,373.4	-	**1,373.4**
TOTAL	**2,596.4**	**325.7**	**2,922.1**	**1.805,0**	**688.2**	**2.493,2**

	31.12.2016				31.12.2015			
€ million	Payables at amortised cost	Loans at fair value	Hedging derivatives	TOTAL	Payables at amortised cost	Loans at fair value	Hedging derivatives	Total
LIABILITIES								
Long term debt	2,118.5	7,190.4	-	**9,308.9**	2,233.3	6,406.1	-	**8,639.4**
Derivative financial instruments	-	-	12.8	**12.8**	-	-	7.3	**7.3**
Trade payables	2,280.7	-	-	**2,280.7**	2,143.9	-	-	**2,143.9**
TOTAL	**4,399.2**	**7,190.4**	**12.8**	**11,602.4**	**2,233.3**	**6,406.1**	**7.3**	**10,790.6**

Market risks

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 risks include three types of risks: 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 corporate Risk Management Policy. Speculative

activity is not envisaged in the corporate mission.
The Terna Group seeks to adopt a dynamic approach to financial risk management. This approach is characterised by risk aversion, aiming at minimising risk through continuous monitoring of financial markets in order to plan hedging transactions in favourable market conditions.
The fair value of 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 conducting its operations, Terna is exposed to the risk of fluctuations in interest rates. Its main source of interest rate risk is associated with items of net financial debt and the related hedging positions in derivative instruments that generate financial expense. Terna's borrowing strategy focuses on long-term loans, whose term reflects the useful life of company assets. It pursues an interest rate risk hedging policy that aims at guaranteeing at least a percentage of fixed-rate debt of 40% as provided for in the corporate policies. Taking into account the low level of interest rates and the new regulatory review, this percentage was taken at 31.12.2016 to more than 80%. Accordingly, the hedging instruments used, at various maturity dates, include both derivatives that transform fixed rates into floating rates and derivatives that transform floating rates into fixed rates.
The financial assets and liabilities in respect of derivative instruments in place during the year can be classified as:

- cash flow hedging derivatives, related to hedging the risk of changes in cash flows associated with long-term floating-rate loans;
- fair value hedging derivatives, related to 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 subscribed by the Terna Group:

	31.12.2016		31.12.2015		Δ	
€ million	Notional amount	Fair value	Notional amount	Fair value	Notional amount	Fair value
FVH derivatives	1,350.0	325.7	3,150.0	688.2	(1,800.0)	(362.5)
CFH derivatives	2,974.1	(12.8)	3,050.2	(7.3)	(76.1)	(5.5)

Sensitivity to interest-rate risk

As regards interest rate risk management, Terna has, on the one hand, entered into fixed-to-floating interest rate swaps (FVHs) to hedge the fair value of fixed-rate risk bonds and, on the other hand, floating-to-fixed interest rate swaps (CFHs) to hedge the expected cash flows in respect of all other floating-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 the perfect temporal matching 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 the income statement at the same time. Accordingly, for FVH derivatives, any changes in the fair value of the hedged item attributable to the risk being hedged must be booked in the income statement, thereby offsetting the changes in the fair value of the derivative booked in the income statement. For CFH derivatives, the changes in the fair value of the derivative must be booked in "Other comprehensive income" (in Shareholders' Equity, recognising any ineffective portion of the hedge directly

in the income statement) and then reversed through the income statement in the same period in which the cash flows of the hedged instrument materialise. The characteristics of the CFH derivatives mirror those of the underlying hedged asset so the related cash flows will materialise at the same maturities as the interest on the debt, with no impact of the changes in fair value on the income statement.
The following table reports the amounts booked in the income statement and in "Other comprehensive income" for positions that are sensitive to changes in interest rates, the theoretical value of the positions following a positive or negative shift in the yield curve and the differential impact of such changes recognised in the income statement and in "Other Comprehensive Income". A hypothetical 10% variation in interest rates with respect to market interest rates at the reporting date was assumed:

	Profit or loss			Equity		
€ million	Current rates +10%	Current amounts	Current rates -10%	Current rates +10%	Current amount	Current rates -10%
31.12.2016						
Positions sensitive to interest rate variations (FVH, bonds, CFH)	(11.1)	**(11.2)**	(11.3)	(12.3)	**(12.8)**	(13.3)
Hypothetical change	0.1	-	(0.1)	0.5	-	(0.5)
31.12.2015						
Positions sensitive to interest rate variations (FVH, bonds, CFH)	1.1	**1.1**	1.1	(4.9)	**(6.4)**	(7.5)
Hypothetical change	-	-	-	1.5	-	(1.2)

Inflation risk

As regards inflation rate risk, the rates established by Regulators to remunerate Terna S.p.A.'s activities are determined so as to allow coverage of the sector's recognised costs. Such cost components are updated on an annual basis to consider the accrued impact of inflation. Having used an inflation-linked bond issue in 2007 the Company 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 expense.

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 of 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 2016, the component of financial instruments associated with exchange rate risk is residual and attributable to the Tamini Group.

Liquidity risk

The liquidity risk is the risk Terna might encounter difficulty in discharging its obligations in respect of its financial liabilities and operational cycle. Liquidity risk management seeks to ensure adequate coverage of financial needs by obtaining adequate lines of credit and appropriate management of any surplus liquidity. At 31 December 2016, Terna had available short-term credit lines for approximately € 962 million and revolving credit lines for € 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 trade receivables and the financial investments of the Group.
The credit risk originated by open positions on transactions in financial derivatives is considered to be marginal since the counterparties, in compliance with financial risk management policies, are leading international credit institutions with high ratings, while in the measurement we take into account the CVA.
Terna provides its services essentially to counterparties considered solvent by the market, and therefore with a high credit standing, and does not have highly concentrated credit risk.
Credit risk management is guided by the provisions of AEEGSI Resolution no. 111/06, which, in Art. 49, introduced instruments for the limitation of risks related to the insolvency of dispatching customers, both on a preventive basis and in the event of 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 defined by the Authority.
The following table summarises the exposure to such risk as at the reporting date.

€ million	31.12.2016	31.12.2015	Δ
FVH derivatives	325.7	688.2	(362.5)
Cash and cash equivalents and other financial assets	1,153.1	431.6	721.5
Trade receivables	1,443.3	1,373.4	69.9
TOTAL	**2,922.1**	**2,493.2**	**428.9**

The total value of the exposure to credit rate risk at 31 December 2016 is represented by the carrying amount of financial assets, 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.

€ million	31.12.2016	31.12.2015
Italy	1,398.7	1,256.5
Euro-area countries	27.1	80.7
Other countries	17.5	36.2
TOTAL	**1,443.3**	**1,373.4**

€ million	31.12.2016	31.12.2015
Distributors	322.9	335.6
CSEA	73.8	82.9
Input dispatching contractors	190.4	189.5
Withdrawal dispatching contractors (non distributors)	718.3	598.3
Parties which have signed virtual import contracts and virtual import services (interconnectors and shippers)	13.0	18.2
Sundry receivables	124.9	148.9
TOTAL	**1,443.3**	**1,373.4**

The following table breaks down customer receivables by due date, reporting any potential impairment.

	31.12.2016		31.12.2015	
€ million	Impairment	Gross	Impairment	Gross
Not yet past due	-	1,337.2	-	1,282.8
0-30 days past due	-	55.2	-	10.5
31-120 days past due	-	16.5	-	18.5
More than 120 days past due	(39.0)	73.4	(36.3)	97.9
TOTAL	**(39.0)**	**1,482.3**	**(36.3)**	**1,409.7**

Changes in the allowance for doubtful accounts in the course of the year were as follows.

€ million	31.12.2016	31.12.2015
Balance at 1 January	(36.3)	(33.6)
Reversal of provision	1.1	0.8
Impairment for the year	(3.8)	(3.5)
TOTAL	**(39.0)**	**(36.3)**

The value of guarantees received from eligible electricity market operators is illustrated below.

€ million	31.12.2016	31.12.2015
Input dispatching activity	215.4	243.2
Withdrawal dispatching activity	1,015.4	1,019.2
Grid transmission fees - distributors	287.3	257.8
Virtual importing	93.8	71.7
TOTAL	**1,611.9**	**1,591.9**

In addition, Non-Regulated Activities are exposed to “counterparty risk”, in particular with subjects with which contracts involving income are signed, in consideration of the credibility and solvency of the parties in question and the impact that their possible insolvency could have on the financial balance of the business. Counterparty risk is mitigated by implementing special procedures to assess counterparties, which measure economic, financial and reputational aspects of the subjects in question.

Default risk and debt covenants

This risk is associated with the possibility that the loan contracts or bond rules to which the Parent is a party may contain provisions authorising counterparties to call in such loans immediately upon the occurrence of certain events, thereby generating liquidity risk. For more information on the contractual provisions of outstanding loans at 31 December 2016, please see the section “Loans and financial liabilities” in the notes of the Terna Group.

Legal disputes

The main unrecognised commitments and risks of the Parent Company Terna and the subsidiaries Terna Rete Italia S.r.l., Terna Rete Italia S.p.A. and the Tamini Group companies at 31 December 2016 are illustrated below. The other subsidiaries had no significant commitments and contingencies at that date.

Litigation concerning licensed activities

Given that it has been the licensee for transmission and dispatching activities since 1 November 2005, the Parent has been involved as a party in a number of cases appealing AEEGSI, MED and/or Terna measures relating to activities operated under the license. Only in cases in which the plaintiffs not only claim defects in the measures, but also allege that Terna violated the rules established by such authorities, or in cases in which the measure had an impact on Terna, the Company appeared before court. Within the scope of this litigation, although a number of cases have seen the AEEGSI Resolutions struck down in the first and/or second instance, together with, where applicable, the consequent measures adopted by Terna, it is felt that there is little risk of adverse outcomes for Terna, since the matters generally regard pass-through items. This position is supported by the information provided by the external legal counsel representing the Company in the cases involved. As the licensee for transmission and dispatching activities, the measures taken by the Parent Company Terna when applying the Resolutions adopted by the Authority are sometimes the subject of challenges. In appropriate circumstances, the costs of such challenges may be borne by the Authority.

Legal disputes concerning supply contracts

The legal dispute in question concerns supply contracts signed by the Tamini Group companies and their customers for the supply of transformers and components relating to them.
The said legal dispute regards mostly lawsuits initiated by the Tamini Group companies in order to recover the receivables deriving from the abovementioned contracts, but regards also certain actions for compensation brought against the companies in question, for alleged damages caused by the machinery and/or components supplied by the same.
In relation to the said lawsuits, as of today unfavourable outcomes cannot be excluded.

The Revenue Agency

On 27 March 2012, the Parent Company Terna, as jointly and severally responsible with Enel Distribuzione S.p.A. ("Enel Distribution"), received a notice for the payment of greater taxes due as a result of the sale transaction of the holding owned by Enel Distribuzione in Elat S.r.l. (later Telat S.r.l., today Terna Rete Italia S.r.l.) to Terna S.p.A. (for the amount of approximately € 38 million, including interest). The appeal lodged by Terna against the notice of liquidation was accepted by the Provincial Tax Commission of Rome, with a ruling than confirmed in appeal by the Regional Tax Commission of Rome. The Revenue Agency did not lodge an appeal with the Supreme Court. The favourable ruling, therefore, became definitive; consequently, there is no longer any risk of future financial outlays for the Company.

F. Business combinations

There were no business combinations during FY 2016.

G. Related-party transactions

Terna's transactions with related parties during the year, taking account of the de facto control exercised by Cassa Depositi e Prestiti S.p.A. ascertained in 2007, regarded relations with the associate companies (Cesi S.p.A., CGES A.D. and Coreso S.A.) the employee pension funds (Fondenel and Fopen), and with Cassa Depositi e Prestiti, with CDP Reti S.p.A. and with companies directly or indirectly controlled by the Ministry of Economy and Finance.
Given that the companies of the Terna Group and the aforementioned subsidiaries directly or indirectly controlled by the Ministry of Economy and Finance fall within the definition of "Government-related entities" as per IAS 24 - "Related party disclosures", the Group adopts the partial exemption provided by the same standard, which dispenses with the required disclosures of relationships with other companies controlled, connected or under joint control of the same government body; in particular, the qualitative and quantitative indications of relationships with Government-related entities which have a significant impact on the Group's results are reported below in this section; no amounts relating to "pass-through items" are given here.
Related party transactions in the financial year 2016 are mainly services that are part of core business and regulated by market conditions.
Below is an explanation of the nature of the transactions implemented by the Terna Group with related parties and the respective receivables and payables totalled during the year, in addition to the respective receivables and payables in place as of 31 December 2016.

Related party	Revenue transactions	Cost transactions
Cassa Depositi e Prestiti S.p.A.		Credit line.
Cesi S.p.A.	Leasing of laboratories and other similar structures for specific purposes, dividends.	Studies and technical consultancy services, research, design and experimentation
CORESO S.A.		Technical TSO coordination services.
GSE Group	MIS component, dispatching fee.	Leasing of spaces and workstations.
Enel Group	TF fee and aggregation of measures, dispatching fee, leasing and rentals, line maintenance, works to move/vary lines, optical fibre housing and maintenance of power line communication on company-owned power lines.	Return of electricity discount, building services, supply of MV power to new stations, specialised services for connection to Terna control and protection systems.
Ferrovie Group	Dispatching fee, line moving work.	Right-of-way fees.
ENI Group	Dispatching fee.	Contributions for NTG connections, sundry services.
Poste Italiane		Sundry services.
CONI Servizi S.p.A.		Sundry services.
ANAS S.p.A.	Work on line moving/variants.	Right-of-way fees.
Fondenel and Fopen		Pension contributions borne by the Terna Group.
SNAM Group		Contribution for NTG connections
Fincantieri S.p.A.	HV Line maintenance.	
Ansaldo Energia S.p.A.	Maintenance on plants.	

ECONOMIC TRANSACTIONS

€ million	Income items: Grid transmission fees and other energy-related items	Income items: Non energy-related items	Negative income components: Non energy-related items
De facto parent company			
Cassa Depositi e Prestiti S.p.A.	-	-	4.7
Total de facto parent company	**-**	**-**	**4.7**
Associates:			
Cesi S.p.A.	-	-	2.3
CORESO S.A.	-	-	1.6
Total associates	**-**	**-**	**3.9**
Other related companies:			
GSE Group	22.9	-	0.6
Enel Group	1,485.3	2.6	2.9
Eni Group	4.5	-	0.1
Ferrovie Group	2.3	-	34.3
Anas S.p.A.	-	-	0.9
CONI Servizi S.p.A.	-	-	0.1
Poste Italiane Group	-	-	0.1
Ansaldo Energia S.p.A.	-	4.1	-
Total other related companies	**1,515.0**	**6.7**	**39.0**
Pension funds:			
Fondenel	-	-	0.4
Fopen	-	-	1.9
Total pension funds	**-**	**-**	**2.3**
TOTAL	**1,515.0**	**6.7**	**49.9**

EQUITY TRANSACTIONS

€ million	Property, plant and equipment: Capitalised costs	Receivables and other assets: Other	Receivables and other assets: Financial	Payables and other liabilities: Other	Payables and other liabilities: Financial	Guarantees*
De facto parent company						
Cassa Depositi e Prestiti S.p.A.	-	-	0.5	0.1	500.6	-
Total de facto parent company	**-**	**-**	**0.5**	**0.1**	**500.6**	**-**
Associates:						
Cesi S.p.A.	16.6	0.1	-	10.3	-	1.2
Total associates	**16.6**	**0.1**	**-**	**10.3**	**-**	**1.2**
Other related companies:						
GSE Group	0.2	4.1	-	0.1	-	-
Enel Group	7.8	283.4	-	31.9	-	509.9
Eni Group	-	2.1	-	0.9	-	19.9
Ferrovie Group	11.2	1.2	-	29.2	-	24.2
Anas S.p.A.	-	0.5	-	-	-	-
SNAM Group	-	-	-	0.3	-	-
CONI Servizi S.p.A.	-	0.1	-	0.1	-	-
Fincantieri S.p.A.	-	0.2	-	-	-	-
Total other related companies	**19.2**	**291.6**	**-**	**62.5**	**-**	**554.0**
Pension funds:						
Fopen	-	-	-	1.5	-	-
Total pension funds	**-**	**-**	**-**	**1.5**	**-**	**-**
TOTAL	**35.8**	**291.7**	**0.5**	**74.4**	**500.6**	**555.2**

* The guarantees refer to the bank guarantees received on contracts.

H. Significant non-recurring events and transactions, and atypical or unusual transactions

No significant, non-recurring, atypical or unusual transactions - with the exception of those described above - were carried out during 2016, either with third parties or with related parties.

I. Notes to the statement of cash flows

The cash flow generated from **continuing operations** in the year amounted to around € 1,560.0 million, which reflects around € 1,580.0 million in cash from operating activities (self-financing) and around € 20.0 million in financial resources generated by the management of net working capital.

Investing activities used net financial resources of around € 766.5 million, and included specifically € 756.3 million of investment in property, plant and equipment (€ 812.8 million net of plant grants totalling € 56.5 million) and € 41.5 million of investment in intangible assets and capitalised borrowing costs for € 16.0 million.

The net change in **loan flows** in relation to shareholders' equity drops by € 406.2 million due to the disbursement of the 2015 dividend balance (€ 261.3 million) and the 2016 interim dividend (€ 144.9 million).

Consequently, the financial resources used in investing activities and the remuneration of equity during the year, led to total financial requirements of € 1,172.7 million, covered totally by the cash flows generated by operating activities (€ 1,560.0 million). The net financial debt therefore decreased during the year.

L. Subsequent events

Agreement for the acquisition of two concessions for the construction and operation of grids in Brazil

On **2 February 2017**, through its subsidiary Terna Plus, Terna signed an agreement with Planova, a Brazilian company that constructs civil works and infrastructure, aimed at acquiring two concessions to create a total of around 500 km of electricity infrastructure in the South American nation. The operation comes within the scope of Terna's strategy for development of electricity grids and infrastructures abroad, thanks to the know-how gained in the core business of electricity transmission.
The two concessions, which will last for thirty years, will involve the construction of 158 km of new lines in the State of Mato Grosso and 350 km in the State of Rio Grande do Sul. The total value of the contract is around $ 180 million. The agreement envisages that the Terna Group will have ownership of the lines concession and operation, while engineering, planning and construction (EPC) will be assigned to Planova, as the "executor" on Terna's account. The deal will enable Terna to make use of its industrial role through a project of dimensions and characteristics compliant with the corporate strategy, in support of long-term growth and value creation. Final closing of the contract signed by Terna Plus and Planova is conditional on the following: Planova must obtain all permits and licenses needed for construction and operation of the infrastructure, and the go ahead from the Brazilian anti-trust authorities (Cade - Conselho Administrativo de Defesa Econômica) and the Regulator (Aneel - Agência Nacional de Energia Elétrica).

"Udine Ovest-Redipuglia" power line: the authorisation decree relaunches work on the project

On **14 February 2017**, the Ministry of Economic Development issued the authorisation decree for the "Udine Ovest-Redipuglia" power line and associated rationalization, no. 239/EL-146*bis*/245/2017 of 14 February 2017. Terna greets with satisfaction the new authorisation decree, which closes the procedure opened at the end of 2015 and will make it possible to reopen the construction site and to finish a project necessary for electrical security of Friuli Venezia Giulia, already 80% complete.
On 12 November 2015 Terna had received approval, from the Ministry of Economic Development, for the launch of the redetermination procedure. The new procedural process also entailed an Environmental Impact Assessment (EIA) proceeding, which ended with a positive decree (9 September), the Services Conference at the Ministry of Economic Development (on 18 October) and the positive opinion on the State-Region Understanding of the FVG executive committee (9 December).
The 40 km of new line, built thanks to an investment of approximately € 110 million, will make secure the electricity grid in the Region which is based on infrastructures created at the beginning of the 1980s, and will make it possible to demolish 110 km of old lines and around 400 pylons in 30 Municipalities of lower Friuli. 680 building located today at 100 metres from the lines to be demolished will benefit from this decommissioning and 367 hectares of land will be freed from power line easements.

Disclosure pursuant to art. 149-*duodecies* of the CONSOB issuer regulations

The following table, prepared in accordance with Art. 149-duodecies of the CONSOB Issuer Regulations, presents the fees for 2016 for the audit and non-audit services provided to the Terna Group by the auditing companies.

In €	Entity providing service	Fees due for the year
Statutory audit	PwC	577,495
Attestation services	PwC	171,000
TOTAL		**748,495**

Certification of the consolidated financial statements pursuant to Art. 81 ter of Consob Regulation no. 11971 dated 14 May 1999 and subsequent amendments and additions

"Consolidated Financial Statements"

1. The undersigned Matteo Del Fante, as CEO, and Tiziano Ceccarani, as Executive officer responsible for the preparation of the financial report for TERNA S.p.A., also considering that established by art. 154 bis, paragraphs 3 and 4 of Italian Legislative Decree no. 58 of 24 February 1998, certify:
   - the suitability in relation to the business characteristics; and
   - the effective application of the administrative and accounting procedures for the preparation of the consolidated financial statements during financial year 2015.
2. The assessment of the suitability of the administrative and accounting procedures for the preparation of the consolidated financial statements as at 31/12/2016, is based on a set of standards and methodologies defined by Terna S.p.A. in line with the Internal Control – Integrated Framework model issued by the Committee of Sponsoring Organizations of the Treadway Commission, which represents a set of reference standards for the internal control and risk management system, generally accepted worldwide.
3. It is also specified that:

   3.1. the consolidated financial statements at 31 December 2016:

   a. are prepared in compliance with the applicable international accounting standards recognised in the European Community in accordance with Regulation (EC) no. 1606/2002 of the European Parliament and Council of 19 July 2002 and the provisions issued in implementation of art. 9 of Italian Legislative Decree no. 38/2005;

   b. correspond to the entries in the books and accounting records;

   c. are suitable to providing a true and fair view of the economic and financial position of the issuer and of all the companies included in the scope of consolidation;

   3.2. the report on operations includes a reliable analysis of the trend and operating result, in addition to the position of the issuer and all the companies included in the scope of consolidation and a description of the main risks and uncertainties to which they are exposed.

Rome, 15 March 2017

Chief Executive Officer
(Matteo Del Fante)

Executive officer responsible for the preparation of the Company's financial report
(Tiziano Ceccarani)

This certification is an English translation of the original certification, which was issued in Italian. This certification has been prepared solely for the convenience of international readers.

Executive officer responsible for preparation of the Company's financial report

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DEPENDENT AUDITORS REPORT IN ACCORDANCE WITH ARTICLES 14 AND 16 OF LEGISLATIVE DECREE 39 OF 27 JANUARY 2010

To the shareholders of
Terna SpA

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Terna group, which comprise the statement of financial position as of 31 December 2016, 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, a summary of significant accounting policies and other explanatory notes.

Directors responsibility for the consolidated financial statements

The directors are 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, as well as with the regulations issued to implement article 9 of Legislative Decree 38/2005.

Auditors responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (ISA Italia) drawn up pursuant to article 11 of Legislative Decree 39/10. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatements.

An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The audit procedures selected depend on the auditor professional judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the group preparation of consolidated financial statements that give a true and fair view, to plan and perform 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. An audit also includes evaluating the appropriateness of accounting policies used and

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the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of Terna group as of 31 December 2016 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, as well as with the regulations issued to implement article 9 of Legislative Decree 38/2005.

Report on compliance with other laws and regulations

Opinion on the consistency of the report on operations and of certain information set out in the report on corporate governance and ownership structure with the consolidated financial statements

We have performed the procedures required under auditing standard (SA Italia) 720B to express an opinion, as required by law, on the consistency of the report on operations and of the information set out in the report on corporate governance and ownership structure referred to in article 123-bis, paragraph 4, of Legislative Decree 58/98, which are the responsibility of the directors of Terna SpA, with the consolidated financial statements of Terna group as of and for the year ended 31 December 2016. In our opinion, the report on operations and the information in the report on corporate governance and ownership structure mentioned above are consistent with the consolidated financial statements of Terna group as of and for the year ended 31 December 2016.

Rome, 5 April 2017

PricewaterhouseCoopers SpA

Signed by

Paolo Caccini
(Partner)

This report has been translated into English from the Italian original solely for the convenience of international readers

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Financial statements

Income Statement of Terna S.p.A.

€	Notes	2016	2015
A REVENUE			
1 Revenue from sales and services	1	1,691,038,762	1,717,471,308
of which: related parties		*1,543,904,897*	*1,589,651,701*
2 Other revenue and income	2	88,519,126	83,468,488
of which: related parties		*35,383,989*	*46,896,202*
Total revenue		**1,779,557,888**	**1,800,939,796**
B OPERATING EXPENSES			
1 Raw materials and consumables	3	4,517,526	8,223,687
of which: related parties		*-*	*2,904*
2 Services	4	342,031,738	341,657,963
of which: related parties		*281,119,665*	*303,151,141*
3 Personnel expenses	5	82,158,300	44,818,105
- gross personnel expenses		*85,208,740*	*47,078,064*
- capitalised personnel expenses		*(3,050,440)*	*(2,259,959)*
of which: related parties		*569,335*	*622,843*
4 Amortisation, depreciation and impairment	6	432,751,165	456,500,108
5 Other operating expenses	7	17,427,522	32,308,997
of which: related parties		*66,338*	*17,869*
Total expenses		**878,886,251**	**883,508,860**
A-B OPERATING PROFIT		**900,671,637**	**917,430,936**
C FINANCIAL INCOME/EXPENSE			
1 Financial income	8	6,441,206	19,062,715
of which: related parties		*2,162,151*	*5,295,096*
2 Financial expense	8	(108,458,669)	(154,119,655)
of which: related parties		*(4,504,903)*	*(6,178,821)*
D PROFIT BEFORE TAXES		**798,654,174**	**782,373,996**
E INCOME TAXES OF THE YEAR	9	**263,170,441**	**262,543,430**
F NET PROFIT FOR THE YEAR FROM CONTINUING OPERATIONS		**535,483,733**	**519,830,566**
G NET PROFIT FOR THE YEAR FROM DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE	10	**-**	**7,282,532**
H NET PROFIT FOR THE YEAR		**535,483,733**	**527,113,098**

Statement of Comprehensive Income of Terna S.p.A.

€	Notes	2016	2015
NET PROFIT FOR THE YEAR		**535,483,733**	**527,113,098**
Other comprehensive income for the year which will subsequently be released to the income statement			
- Cash flow hedges net of tax effect	20	(13,383,782)	21,321,951
Other comprehensive income for the year which will not subsequently be released to the income statement			
- Actuarial gains (losses) on employee benefits net of tax effect	20	812,532	4,922,820
NET COMPREHENSIVE INCOME FOR THE YEAR		**522,912,483**	**553,357,869**

Statement of Financial Position of Terna S.p.A.

€	Notes	at 31.12.2016	at 31.12.2015
A - NON-CURRENT ASSETS			
1 Property, plant and equipment	11	10,368,322,003	10,141,855,027
of which: related parties		*58,617,887*	*73,784,527*
2 Goodwill	12	88,577,142	88,577,142
3 Intangible assets	13	240,306,485	247,658,618
4 Non-current financial assets	14	1,841,416,160	2,162,055,434
of which: related parties		*514,650*	*-*
5 Other non-current assets	15	3,555,717	3,582,801
Total non-current assets		**12,542,177,507**	**12,643,729,022**
B - CURRENT ASSETS			
1 Inventories	16	126,030	-
2 Trade receivables	17	1,373,234,200	1,285,832,679
of which: related parties		*305,205,581*	*362,804,641*
3 Current financial assets	14	65,252,321	68,061,270
of which: related parties		*39,001,896*	*3,859,436*
4 Cash and cash equivalents	18	927,739,262	435,316,242
of which: related parties		*(163,223,536)*	*25,351,672*
5 Income Tax assets	19	10,359,010	21,975,400
6 Other current assets	15	77,027,375	112,926,569
of which: related parties		*36,161,857*	*-*
Total current assets		**2,453,738,198**	**1,924,112,160**
TOTAL ASSETS		**14,995,915,705**	**14,567,841,182**

Statement of Financial Position of Terna S.p.A.

€	Notes	at 31.12.2016	at 31.12.2015
C - EQUITY			
1 Share capital		442,198,240	442,198,240
2 Other reserves		819,759,437	832,330,687
3 Retained earnings and losses		1,372,258,416	1,247,143,719
4 Interim dividend		(144,920,423)	(140,699,440)
5 Net profit for the year		535,483,733	527,113,098
Total Equity	**20**	**3,024,779,403**	**2,908,086,304**
D - NON-CURRENT LIABILITIES			
1 Long-term loans	21	8,400,030,058	8,509,914,842
of which: related parties		*500,000,000*	*500,000,000*
2 Employee benefits	22	29,717,025	27,083,425
3 Provisions for risks and charges	23	211,996,586	157,815,063
4 Deferred tax liabilities	24	1,558,803	31,319,661
5 Non-current financial liabilities	21	12,679,798	6,382,372
6 Other non-current liabilities	25	169,630,570	156,750,635
of which: related parties		*48,684,175*	*49,936,449*
Total non-current liabilities		**8,825,612,840**	**8,889,265,998**
E - CURRENT LIABILITIES			
1 Short-term loans	21	-	398,250,000
2 Current portion of long-term loans	21	902,300,551	120,674,482
3 Trade payables	26	1,962,379,672	1,957,911,162
of which: related parties		*352,519,640*	*443,549,752*
4 Tax liabilities	26	7,600,975	18,497,883
of which: related parties		*2,313,508*	*(3,919,049)*
5 Current financial liabilities	21	126,406,395	127,086,272
of which: related parties		*603,958*	*802,569*
6 Other current liabilities	26	146,835,869	148,069,081
of which: related parties		*1,829,562*	*43,036,066*
Total current liabilities		**3,145,523,462**	**2,770,488,880**
TOTAL LIABILITIES AND EQUITY		**14,995,915,705**	**14,567,841,182**

Statement of changes in equity

31 DECEMBER 2015–31 DECEMBER 2016

	SHARE CAPITAL AND RESERVES OF TERNA S.p.A.	
€ million	Share capital	Legal reserve
EQUITY AT 31 DECEMBER 2015	442.2	88.4
NET PROFIT FOR THE YEAR		
OTHER COMPREHENSIVE INCOME:		
Change in fair value of cash flow hedging derivativesnet of tax effect		
Actuarial gains (losses) on employee benefitsnet of tax effect		
Total other comprehensive income	-	-
NET COMPREHENSIVE INCOME	-	-
TRANSACTIONS WITH EQUITY OWNERS:		
Allocation of 2015 profit		
- Retained earnings		
- Dividends		
Interim dividend 2016		
Total transactions with equity owners and other transactions	-	-
EQUITY AT 31 December 2016	442.2	88.4

31 DECEMBER 2014–31 DECEMBER 2015

	SHARE CAPITAL AND RESERVES OF TERNA S.p.A.	
€ million	Share capital	Legal reserve
EQUITY AT 31 December 2014	442.2	88.4
NET PROFIT FOR THE YEAR		
OTHER COMPREHENSIVE INCOME:		
Change in fair value of cash flow hedging derivativesnet of tax effect		
Actuarial gains (losses) on employee benefitsnet of tax effect		
Total other comprehensive income	-	-
NET COMPREHENSIVE INCOME	-	-
TRANSACTIONS WITH EQUITY OWNERS:		
Allocation of 2014 profit		
- Retained earnings		
- Dividends		
Interim dividend 2015		
Total transactions with equity owners and other transactions	-	-
EQUITY AT 31 DECEMBER 2015	442.2	88.4

Share premium reserve	Cash flow hedge reserve	Other reserves	Retained earnings and losses	Interim dividend	Net profit for the year	Equity
20.0	(4.7)	728.7	1,247.1	(140.7)	527.1	2,908.1
					535.5	535.5
	(13.4)					(13.4)
		0.8				0.8
-	(13.4)	0.8	-	-	-	(12.6)
-	(13.4)	0.8	-	-	535.5	522.9
						-
			125.1	140.7	(527.1)	(261.3)
					-	-
				(144.9)		(144.9)
-	-	-	125.1	(4.2)	(527.1)	(406.2)
20.0	(18.1)	729.5	1,372.2	(144.9)	535.5	3,024.8

Share premium reserve	Cash flow hedge reserve	Other reserves	Retained earnings and losses	Interim dividend	Net profit for the year	Equity
20.0	(26.0)	723.7	1,198.7	(140.7)	450.4	2,756.7
					527.1	527.1
	21.3					21.3
		5.0				5.0
-	21.3	5.0	-	-	-	26.3
-	21.3	5.0	-	-	527.1	553.4
			48.4		(48.4)	-
				140.7	(402.0)	(261.3)
				(140.7)		(140.7)
-	-	-	48.4	-	(450.4)	(402.0)
20.0	(4.7)	728.7	1,247.1	(140.7)	527.1	2,908.1

Statement of cash flows

€ million	2016	2015
NET PROFIT FOR THE YEAR	**535.5**	**527.1**
ADJUSTMENTS FOR:		
Amortisation, depreciation, impairment losses/(reversals of impairment losses) on property, plant and equipment and intangible assets*	421.6	441.7
Provisions (including employee-related provisions) and impairment losses	53.4	39.4
(Gains)/Losses on disposals of property, plant and equipment	(7.7)	(1.6)
Financial (income)/expense	102.0	137.4
Income taxes	263.2	262.6
CASH FLOWS GENERATED BY OPERATING ACTIVITIES, BEFORE CHANGES IN NET WORKING CAPITAL	**1,368.0**	**1,406.6**
Increase/(Decrease) in provisions (including employee-related and tax provisions)	5.5	(51.2)
(Increase)/decrease in inventories	(0.1)	0.7
(Increase)/decrease in trade receivables and other current assets	(21.2)	149.2
Increase/(decrease) in trade payables and other current liabilities	6.3	(76.2)
Increase/(decrease) in other non-current assets	(18.1)	(18.8)
Increase/(decrease) in other non-current liabilities	(1.3)	(2.4)
Interest income and other financial income received	479.1	138.8
Dividend received	1.1	1.1
Interest expense and other financial expense paid	(235.7)	(319.7)
Income taxes paid	(317.2)	(276.4)
CASH FLOWS GENERATED BY OPERATING ACTIVITIES [A]	**1,266.4**	**951.7**
- of which: related parties	*(141.7)*	*(147.6)*
Investments in non-current property, plant and equipment, net of grants received	(611.6)	(948.8)
Revenue from sale of non-current property, plant and equipment	9.2	3.4
Investments in intangible assets - non-current	(39.3)	(44.2)
Capitalised financial expenses	15.6	28.3
Intra-group transactions	-	(17.1)
(Increase)/decrease in equity interests	(23.8)	(789.8)
CASH FLOWS USED IN INVESTING ACTIVITIES [B]	**(649.9)**	**(1,768.2)**
- of which: related parties	*15.2*	*(2.9)*
Dividends paid	(406.2)	(402.0)
Change in short- and medium/long-term financial payables (including short-term portions)**	317.4	277.6
Change in receivable short-term loans	(35.3)	(3.7)
CASH FLOWS GENERATED BY FINANCING ACTIVITIES [C]	**(124.1)**	**(128.1)**
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS [A+B+C]	**492.4**	**(944.6)**
Cash and cash equivalents at start of year	435.4	1,380.0
Cash and cash equivalents at end of year	927.8	435.4

* Net of set-up grants taken to income statement for the year.
** Net of derivatives and of impacts on adjustment to fair value.

Notes to the Financial Statements

A. Accounting policies and measurement criteria

Introduction

Terna S.p.A., which operates in the electrical energy transmission and dispatching sector, is a joint-stock company with headquarters at Viale Egidio Galbani 70, Rome, Italy.
These Separate financial statements were authorised for publication by the Directors on 15 March 2017.
The Separate Financial Statements at and for the year ended 31 December 2016 are available upon request at the Terna S.p.A. registered offices in Viale Egidio Galbani 70, Rome, or on the company's website www.terna.it.
The Board of Directors has authorised the Chairwoman and Chief Executive Officer to make any formal alterations to the Separate Financial Statements and any additions and adjustments to the chapters concerning significant events subsequent to the reporting date.

Compliance with IAS/IFRS

The Separate Financial Statements have been prepared in accordance with the 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), endorsed by the European Commission ("IFRS-EU").
This document has also been prepared taking into account the provisions of Legislative Decree no. 38 of 28 February 2005, the Italian Civil Code and CONSOB Resolutions nos. 15519 ("*Provisions governing financial statements in implementation of Art. 9, paragraph 3, of Legislative Decree no. 38/2005*") and 15520 ("*Amendments to the implementing rules for Legislative Decree no. 58/1998*"), both of 27 July 2006, as well as CONSOB Communication no. DEM/6064293 of 28 July 2006 ("*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, modified where necessary for certain financial instruments, as well as 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 to the Statements.
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 from the reporting date.
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 (Income Statement) presents the components of profit or loss for the year; while the second (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 the company and Group, which as from the financial year 2008 has been prepared as a single document, exercising the option granted under Italian Legislative Decree no. 32 of 2 February 2007, which amended Art. 40 (Integrated Report on Operations) of Italian Legislative Decree no. 127 of 9 April 1991.
The Separate Financial Statements have been prepared in euro, while the figures in the notes are given in millions of euro, unless otherwise specified.
The Separate Financial Statements have been prepared using the historical cost method, with the exception of items that are recognised at fair value in accordance with the IFRSs-EU, as indicated in the accounting policies for each item.
We specify that, for the purpose of a better representation of the effects of the acquisition of the FSI grid, some comparative equity balances (particularly with reference to the items other assets and trade payables) were reclassified, without however modifying equity at 31 December 2015.
We must also specify that some balances of the financial statements at 31 December 2015, provided for comparison, have been restated, without, however, altering the equity figures at 31 December 2015 and those of the Income Statement for 2015.

Use of estimates

Preparation of the statement of financial position and Income Statement in accordance with the IFRSs-EU requires the use of estimates and assumptions that affect the carrying amounts of assets and liabilities and related disclosures, in addition to contingent assets and liabilities at the reporting date. The estimates and associated assumptions are based on previous experience and various factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other objective sources. Actual results may, therefore, differ from these estimates. The estimates and underlying assumptions are reviewed periodically and the effects of any changes are recognised in the Income Statement, 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 related future years.
The assets and liabilities subject to key estimates and assumptions used by the Company in applying the IFRSs endorsed by the European Commission that could have significant effects on the separate financial statements or that could give rise to risks that would entail significant adjustments to the carrying amount 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 an indication 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 assessment 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 (hereinafter "CGU") to which it belongs.
An impairment loss is recognised in the Income Statement when the asset's book value, or the net invested

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

Allowance for doubtful accounts

Trade receivables are initially recognised at fair value net of any impairment losses relating to sums considered non-recoverable, which are taken to the specific Allowance for doubtful accounts. Impairment losses 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, in the presence of an obligation in course (legal or implicit), as a result of a past event, it is probable that the disbursement of resources will be necessary to fulfil the obligation, the amount of which can be reliably estimated. Liabilities that can be associated with legal and tax disputes and liabilities associated with town planning and environmental requalification projects are estimated by the Company. The measurement of provisions for legal disputes is based on the probability of incurring an expense, including the use of external lawyers supporting the Company; the estimate of provisions to be set aside for town planning and environmental requalification projects, the “offsets” aimed at offsetting the environmental impact of the development of plants, is based on an analysis of the agreements signed with local entities involved and the progress of activities on the development of the new plants. Where the time value of money is significant, provisions are discounted, using a rate that the Company believes to be appropriate (a pre-tax rate is used, so as to reflect current market values of money and the specific risks connected with the liability). After initial recognition, the value of the risk provision is updated to reflect the passing of time and any changes in the estimate following alterations to the amounts envisaged, 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 expense”.

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 deferred compensation benefits), were made on the basis of the “vested benefits” method by means of the “Projected Unit Credit” (PUC) criterion. These valuations are based on economic and demographic assumptions: discount rate (used to determine the current value of the obligation, determined considering the return of high quality bond securities in line with the duration of the group of workers measured), inflation rate, rate at which future salary levels increase, increase rate of average health reimbursement, increase rate of electrical consumer goods prices and demographic techniques, such as, for example, mortality and invalidity, retirement, resignation, advances and family members.

Investments in subsidiaries and associates

Investments in subsidiaries are those in entities over which Terna has the power to directly or indirectly govern financial and operating policies so as to obtain benefits from their activities. Investments in associates are those in entities over which Terna has significant influence.
In assessing the existence of a situation of control or significant influence, meaning the ability to participate in the determination of the financial and management policies of the investee without holding control or joint control, potential voting rights that could be used or converted are also taken into account.
Investments in subsidiaries and associates are measured at cost, reduced to reflect impairment losses. If the reasons for the impairment losses no longer exist, the carrying amount of the investment is reinstated within the limits of the impairment losses, and the reversal is taken to the Income Statement.
In the event that an investee's loss attributable to the shareholders of the Parent Company exceeds that investments' carrying amount, any excess is recognised in a specific provision, where the Parent Company is required to meet the legal or construction obligations of the investee or, in any case, to cover its losses.

Translation of foreign currency items

Terna S.p.A. prepares its financial statements in euro, which is also the functional currency. In these 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 exchange rate differences are taken to the Income Statement.
Non-monetary assets and liabilities in foreign currency stated at historic 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 are recognised at historical cost, including costs directly attributable to putting the asset in the condition necessary for it to be capable of operating in the manner for which it was acquired. In the event of legal or constructive obligations, cost also includes the present value of the estimated cost of disposal or removal of the asset. The corresponding liability is recognised in provisions for risks and charges. Borrowing costs directly attributable to the acquisition, 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 recognised in the Income Statement when 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 (transition date), or previously, are recognised at the revalued amount, which is considered deemed cost at the date of the revaluation.
Property, plant and equipment are 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. The depreciation of assets begins when the assets become available for use.
Liabilities associated with items of property, plant and equipment are taken to a specific provision as a balancing entry to the related asset. The amount is taken to the Income Statement through the depreciation of the asset.
Property, plant and equipment are eliminated for accounting purposes either at the time of disposal or when no future economic benefit is expected from utilisation or disposal. Any profit or loss, recognised in the Income Statement, is determined as the difference between the net fee deriving from disposal and the net carrying amount of the assets eliminated.

The main depreciation rates calculated on the basis of the related asset's useful life are as follows.

DEPRECIATION RATES	
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 plants	5.00%
- Electronic calculation equipment	10.00%

Note that with reference to the transmission lines, the estimate of useful life was reviewed to take empirical evidence into account mainly related to physical deterioration and technical obsolescence. This indicated that for transmission lines it was reasonable to adjust expected technical economic life to 45 years (up from the 40 years assumed in previous years). The AEEGSI, on the basis of similar considerations, reviewed the useful life of lines for regulatory purposes (with Resolution 654/2015/R/eel).

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

Property, plant and equipment acquired under finance leases - and through which the Company has substantially acquired all the risks and rewards of ownership - are recognised as Company assets at the lower of fair value and the present value of minimum lease payments due, including any amounts to be paid to exercise the purchasing option. The corresponding liability to the lessor is recognised under financial payables. 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 taken in full to profits or losses over the term of the lease.

Intangible assets

Intangible assets, which all have finite useful lives, are recognised at cost, having obtained, if necessary, the approval 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 business, obtained by Terna S.p.A. on 1 November 2005, with acquisition of the TSO Business unit. As established in the Decree issued by the Ministry of Productive Activities on 20 April 2005, this concession runs for twenty-five years, renewable for another twenty-five years, from the date of effective transfer of the activities, functions, assets and legal arrangements of the concession from GSE (formerly GRTN) to Terna S.p.A.. This intangible asset was initially recognised at cost, which reflected fair value.

Other non-current intangible assets essentially refer to software developments and updates.

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; the asset can be used and it is possible to demonstrate that it will generate probable future economic benefits.

Financial expense directly attributable to the acquisition, construction or production of a non-current

asset which justifies capitalisation pursuant to IAS 23 are capitalised as part of the cost of the asset.
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

These include the property, plant and equipment and intangible assets employed in the dispatching activity, carried out under concession, which fall within the scope of application of IFRIC 12, since the relevant criteria apply: the services provided are regulated and control exists over the residual interest. More specifically, in view of the fee structure for dispatching activities, the Intangible Asset model has been applied, as provided for in the Interpretation.
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, fee revenue continues to be recognised in accordance with IAS 18 and financial expense continues 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 related legislation envisage that the NTG will return to public ownership, either via the payment of an indemnity or otherwise.

Goodwill

Goodwill, deriving from the acquisition of subsidiaries, is allocated to each or to groups of identified "Cash Generating Units" (CGU), coinciding with Group companies that own electricity transmission grids. Goodwill is not amortised after initial recognition. It 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 the accrued ancillary expenses. Net estimated realisable value means the estimated price of sale 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 proportionally to the ratio of costs for the works carried out up to the reporting date and total cost of the contract (cost-to-cost method). Differences between the value of completed contracts and payments on account received are recognised under Statement of Financial Position assets or liabilities, considering any impairment losses on the work carried out so as to take into account the risks of customers' refusal to recognise the work performed. Expected contract losses are immediately taken to the Income Statement. Contract costs include all those costs that relate directly to the specific contract, as well as fixed and variable costs incurred by the Company as part of normal 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 estimated future cash flows, discounted using the original interest rate. Financial assets are derecognised when, following their transfer or settlement, the Company is no longer involved in their management and no longer holds 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 impairment losses due to sums considered non-recoverable, which are taken to the specific allowance for impairment. Impairment losses are measured on the basis of the present value of estimated future cash flows, discounted at the original effective interest rate.
Receivables with due dates that fall under normal commercial terms are not discounted.

Cash and cash equivalents

Cash and cash equivalents are recognised at the 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 irrelevant risk of value changes.

Trade payables

Trade payables are initially recognised at fair value and subsequently stated at amortised cost. If their due date falls under 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 part of changes in the fair value qualifying as effective is initially recognised in the statement of comprehensive income and subsequently in the Income Statement, in line with the effects of the hedged transaction. The portion of the fair value of the hedging instrument that does not qualify as effective is taken to 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 the Income Statement. 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 are recognised in the Income Statement.
The fair value of instruments not traded in regulated markets is measured by discounting projected cash flows along a yield curve of interest rates at the reporting date, and by converting amounts in currencies other than the euro at the year-end exchange rate.
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 liabilities in respect of employee benefits payable upon or after termination of employment relate to defined benefit plans (deferred compensation benefits, additional month's pay, indemnity for lack of notice, energy discount, ASEM health benefits and other benefits) or other long-term employee benefits (loyalty bonus) and is recognised net of any plan assets. It is measured separately for each plan on the basis of actuarial calculations that estimate the amount of future benefits that employees have accrued at the reporting date. The liability is recognised on an accruals basis over the vesting period. It 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 towards others as a 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 obligation. Where the effect of the time value of money is material, provisions are measured by discounting estimated future cash flows using a discount rate that reflects current market assessment of the time value of money and the specific risk applicable to the liability, if present. Where discounting is used, the increase in the provisions due to the passage of time is recognised in the Income Statement as financial expense. If the liability relates to property, plant and equipment (site disposal and restoration, for example), the provision is recognised as a balancing 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 estimate are recognised within the Income Statement for the year in which the change occurs, except for costs expected for dismantling, removal and reclamation, which come as a result of changes in the timing and use of the economic resources necessary to extinguish the obligation or attributable to a material change in the discount rate, which are recognised as an increase or reduction of the related assets and recognised in the Income Statement through depreciation.

Grants

Public 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, for plants already operating as of 31 December 2002, among other liabilities and taken to the Income Statement in relation to the depreciation period of the assets in question. As of financial year 2003, for new plants beginning operation, the related grants are recognised as a direct reduction in the non-current assets themselves. Grants for operating expenses are expensed in full when the recognition requirements are satisfied.

Revenue

Revenue is recognised when it is probable that the economic benefits deriving from the operation will be used by the enterprise. 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 transaction. 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 is also adjusted for any penalties for delays attributable to the 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 non-Terna grid owners, as well as revenue recognised for managing activities related to the balancing of the national electrical system, which do not increase equity, are reported net of the related costs (pass-through energy items). This reporting method, which reflects the substance of transactions by offsetting revenue with the related costs arising from the “same transaction”, is discussed in full in the specific section of the Notes to the Financial Statements.

Financial income and expense

Financial expense directly attributable to the acquisition, construction or production of an asset that qualifies 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 before being ready for use. The directly attributable financial expense is that which would not have been incurred if the expenditure for the asset had not been incurred.
Where funds are borrowed specifically, costs eligible for capitalisation are the actual costs incurred less any income earned on the temporary investment of such borrowings. Where funds are raised through general borrowing, the eligible amount is determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate will be the weighted average of the financial expense applicable to the general pool, excluding any specifically borrowed funds. The amount of capitalised borrowing costs during a year shall in any case not exceed the amount of financial expense incurred during that year.
Capitalisation commences as from the date all the following conditions have been met: (a) expenditures have been incurred for the asset; (b) financial expense have been incurred; and (c) activities to prepare the asset for its intended use or sale are in progress.
Capitalisation ceases when the activities necessary to prepare the asset for its intended use or sale are substantially complete.
The capitalisation rate used for 2016 amounts to 1.38% and that for 2015 amounts to 2.05%.
Financial income and expense 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 investee companies 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 Shareholders' Meeting and the Board of Directors, respectively.

Income taxes

Current income taxes are recognised as "Tax liabilities", net of advances paid, or "Income 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 the 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 each year end.
Deferred tax liabilities are recognised in any case if they exist. Taxes relating to items recognized directly in the statement of comprehensive income are also allocated to the income statement.

New standards

International accounting standards taking effect from 1 January 2016

A number of new amendments to the accounting standards already applicable came into force as from 1 January 2016, but these had no impact on the Company. Specifically, we note:

Amendment to IAS 19 – Defined Benefit Plans: Employee Contributions

On 17 December 2014 the European Commission endorsed the amendment to IAS 19 which enables recognition of contributions paid by employees to reduce the service costs of a defined benefit plan for employees.

Improvements to IFRSs (2010–2012 Cycle)

Endorsed by the European Commission on 17 December 2014, the Annual Improvement related to the 2010–2012 cycle was approved, incorporating changes to the standards IFRS 2, IFRS 3, IFRS 8, IAS 16, IAS 24, IAS 37, IAS 38 and IAS 39.

Amendments to IFRS 11 – Accounting for Acquisitions of Interests in Joint Operations

On 24 November 2015 the European Commission endorsed the amendment to IFRS 11 that clarifies the accounting treatment in the event of acquisitions of interests in a joint operation the activities of which represent a business under the terms of IFRS 3, making reference to the recognition criteria in the standard itself.

Amendments to IAS 16 and IAS 38 – Clarification of Acceptable Methods of Depreciation and Amortisation

An amendment to IAS 16 and IAS 38 was endorsed on 2 December 2015 by the European Commission. This defines as the only acceptable method of depreciation and amortisation the one that reflects the expected ways of consuming the future economic benefits generated by an asset, excluding revenue-based amortisations methods, that is those based on revenue generated by an asset.

Improvements to IFRSs (2012–2014 Cycle)

The Annual Improvement related to the 2012–2014 cycle was endorsed on 15 December 2015. This contained minor amendments to a number of standards: IFRS 5, IFRS 7, IAS 19, IAS 34.

Amendments to IAS 27 – Equity Method in Separate Financial Statements

On 18 December 2015 an amendment to IAS 27 was endorsed; this extends to the separate financial statements, starting from financial year 2016, the option to apply the equity method in accounting for equity investments in subsidiaries, joint ventures and associates.

Amendments to IAS 1 – Disclosure Initiative

On 18 December 2015 an amendment to IAS 1 was endorsed; this provides some clarifications on the disclosure obligation provided for in the amended standard. In the short term, the project provides for limited changes to aspects regarding materiality, disaggregation of accounting items, structure of the Notes to the Financial Statements and disclosure on debt, the Income Statement (other comprehensive income) and accounting policies. In the medium term the Board’s intention is to arrive at a new IFRS to replace IAS 1 (Presentation of Financial Statements), IAS 7 (Statement of Cash Flows) and IAS 8 (Accounting Policies, Changes in Accounting Estimates and Errors).

International financial reporting standards endorsed but not yet in force

As of the date these financial statements were prepared, the European Commission has endorsed certain some new accounting standards and amendments to existing accounting standards. The possible impact of their application on the financial statements of the Terna Group is being evaluated. These accounting standards are listed below.

IFRS 15 – Revenue from Contracts with Customers

On 29 October 2016, the European Commission approved the new IFRS 15, on revenue recognition, which replaces 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”. The new IFRS 15 is valid for all transactions in all sectors and is based on a five-step model: identify the contract with the customer, identify the performance obligations provided for in the contract, determine the transaction price, allocate the transaction price and finally recognise revenue when the performance obligations are satisfied. Performance occurs when control over goods or services underlying the performance obligation is passed 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 new standard takes effect on 1 January 2018 and can be applied in advance and retrospectively.

IFRS 9 - Financial Instruments:

On 22 November 2016, the European Commission approved the final version of standard IFRS 9 - Financial Instruments, in its definitive version of 24 July 2014, which starts a complex and detailed process of replacing IAS 39, divided into the following phases: classification and assessment, derecognition, impairment and hedge accounting. The new standards takes effect on 1 January 2018. Early application is allowed. The main innovations of 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 management model adopted by the company to manage financial assets with reference to the collection of cash flows and on the characteristics of the contractual cash flows of the said 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, was superseded, as it was considered a weak point. The new IFRS 9 provides for a model characterised by 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 for recognition of losses on receivables. The new standard completed, in addition, the stage of the Hedge Accounting project, except for the rules on macro hedge accounting which will be published later and provides, among the other changes, substantial revision of hedge accounting so as to better reflect risk management activities in the financial statements.

International financial reporting standards not yet endorsed

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 its financial statements, taking account of the date on which they take effect. In particular, we note the following:

IFRS 16 - Leases

On 13 January 2016 the IASB published the new standard IFRS 16 which governs the accounting for leasing contracts, replacing the previous IAS 17. Among the changes the new standard, overcoming the distinction between operating and financial leasing, bases the accounting presentation on the "right of use" approach, which for the lessee makes the accounting uniform for any type of leasing. 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 two asset items with opposite signs: the right to use the asset among the assets, and the payable for the leasing among the liabilities. IFRS 16 will take effect on 1 January 2019, but early application is permitted for companies that adopt IFRS 15 (Revenue from contracts with customers).

Amendment to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses

On 19 January 2016 the IASB published an amendment to IAS 12 that intends to clarify the recognition of deferred tax assets for losses not recognised in the income statement on financial instruments carried at fair value.

Amendment to IAS 7: Disclosure Initiative

As part of the "Disclosure Initiative" project, on 29 January 2016 an amendment to IAS 7 was published, providing a number of clarifications on the disclosure obligations provided for in preparing the Statement of Cash Flows.

Clarifications to IFRS 15 Revenue from Contracts with Customers

On 12 April 2016, the IASB published a document clarifying certain aspects deriving from the TRG (Transition Resource Group for Revenue Recognition) discussions, providing guidance for the new IFRS 15: identifying performance obligations, principal versus agent consideration and an application guide for licenses.

Amendment to IAS 2: Classification and Measurement of Share-based Payment Transactions

Published by IASB on 20 June 2016, this is an amendment to IAS 2 that clarifies classification and measurement of share-based payments.

Amendment to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

An amendment published on 12 September 2016 by the IASB, which clarifies doubts about application that may arise based on the different initial application for the new IFRS 9 in relation to the date on which the new insurance contracts standard IFRS 4 takes effect, which has not yet been published.

Improvements to IFRSs (2014–2016 Cycle)

Published by the IASB on 8 December 2016, the annual Improvements related to the 2014–2016 cycle contain minor amendments to IFRS 1, IFRS 12 and IAS 28.

IFRIC 22: Foreign Currency Transactions and Advance Consideration

On 8 December 2016, the IASB published the interpretation for IAS 21 to provide guidance in the selection of an exchange rate to be used when recording a transaction in a foreign currency, in the case that the consideration in the foreign currency was received or paid in advance of the recognition of the related assets.

Amendment to IAS 40: Transfers of Investment Property

Published by the IASB on 8 December 2016, this amendment to IAS 40 has the aim of providing guidance related to the transfer of real estate investments when there is evidence of a change in use.

B. Notes to the income statement

Revenue

1. Revenue from sales and services – € 1,691.1 million

€ million	2016	2015	Δ
Grid transmission fees	1,494.8	1,519.9	(25.1)
Adjustments for prior year grid transmission fees	2.6	(0.2)	2.8
Quality of Service premiums/(penalties)	15.4	(4.7)	20.1
Other energy revenue	132.5	151.4	(18.9)
Other revenue from sales and services	45.8	51.1	(5.3)
TOTAL	**1,691.1**	**1,717.5**	**(26.4)**

Grid transmission fee

The item, of € 1,497.4 million, consists of the revenue of the "core business" referred to the remuneration due to the Company for use of the National Transmission Grid.
The decrease in revenue from the transmission fee (€ 22.3 million) reflects the overall effects of the new regulatory period 2016-2023, which involves a reduction in revenue related to the reduction in WACC, partially offset by the reduction in the time-lag.

Quality of Service premiums/(penalties)

This item, amounting to € 15.4 million at 31 December 2016, includes:

- contingencies recognised during the year related to 2015 performance, as defined in Resolution 668/2016/R/eel, for € 12.0 million;
- measurement of the RENS incentive mechanism envisaged in Resolution 653/2015/R/eel, calculated on a pro-rata basis with respect to the estimate of overall expected results during regulatory period 2016–2019, for € 3.4 million.

Compared to the previous year, the item increased by € 20.1 million, due to the cited contingency, compared to the penalties estimated the previous year (+€ 6.5 million), the 2016 performance results (+€ 3.4 million) and integration of the 2014 bonus recognised the previous year (-€ 1.8 million).

Other energy revenue

This essentially refers to the fee received for the dispatching service (DIS component, € 111.3 million) and revenue from the construction and development of dispatching infrastructures recognised following application of IFRIC 12 (€ 21.2 million).
The € 18.9 million decrease compared to the previous year is due to the overall effects of the new regulatory period (-€ 13.9 million) and lower investment in dispatching infrastructure (-€ 5.0 million).

Other revenue from sales and services

The item “Other revenue from sales and services” amounted to € 45.8 million and for the most part refers to revenue from:

- administrative services to the subsidiaries (€ 27.0 million, of which € 24.0 million for services rendered by Terna Rete Italia S.p.A.);
- non-regulated activities (for € 15.2 million), which include, among other things, the new contracts for the sale of usage rights on optical fibre (€ 2.2 million) and the activity of designing lines for interconnection with other countries (€ 1.6 million);
- NTG connection services (€ 2.4 million).

The difference in the item (-€ 5.3 million) compared to the previous year is mainly due to less services of an administrative nature provided to subsidiaries (-€ 2.5 million in particular to Terna Rete Italia S.p.A.) following the reduction in the perimeter of services provided and to lower revenue for the authorisation and design of interconnectors (-€ 3.0 million).

Pass-through revenue/costs

This item includes revenue and costs of a “pass-through” nature (whose balance is therefore nil). They arise in respect of daily purchases and sales with operators on the electricity market. To this end, the measurements at each point of input and withdrawal are taken and the differences from the energy market schedules are calculated. These differences (called imbalances) are measured using algorithms established by the regulatory framework. The net charge resulting from the measurement of these imbalances and of the buying and selling transactions executed by Terna on the DSM are billed on a pro rata basis to each consumer with an Uplift fee.
It also includes the remuneration paid by Terna to the other owners of the grid.

The components of these transactions are detailed below.

€ million	2016	2015	Δ
Revenue - Power Exchange:			
- foreign market - exports	2.6	1.7	0.9
- sale of energy on the Dispatching Services Market and others	335.7	358.0	(22.3)
- imbalances and other minor items	461.9	795.5	(333.6)
- resources procurement for the Market for Dispatching Services (uplift)	2,393.4	1,400.6	992.8
- congestion revenue and related financial hedges;	440.7	511.2	(70.5)
- other items - Power Exchange	212.8	57.1	155.7
- Interconnector/Shipper	73.7	72.9	0.8
- Market coupling	86.8	137.3	(50.5)
TOTAL REVENUE - POWER EXCHANGE	**4,007.6**	**3,334.3**	**673.3**
Fee to cover remuneration of essential units	685.3	726.7	(41.4)
Fee to remunerate electricity capacity availability	255.5	280.1	(24.6)
Fee to cover interruptibility service and other components	606.3	605.8	0.5
Other items	37.0	97.4	(60.4)
TF revenue to be paid to other owners	230.4	201.4	29.0
TOTAL REVENUE FROM NON - POWER EXCHANGE	**1,814.5**	**1,911.4**	**(96.9)**
TOTAL PASS-THROUGH ENERGY REVENUE	**5,822.1**	**5,245.7**	**576.4**
Energy purchases:			
- to provide the dispatching service	2,172.5	1,614.0	558.5
- for unbalancing	1,129.8	928.1	201.7
- foreign market - imports	1.1	1.4	(0.3)
- congestion revenue and related financial hedges	285.7	356.0	(70.3)
- other items from Power Exchange	49.8	45.6	4.2
- Interconnector/Shipper	364.0	379.1	(15.1)
- Market coupling	4.7	10.1	(5.4)
TOTAL COSTS - POWER EXCHANGE	**4,007.6**	**3,334.3**	**673.3**
Costs for remuneration of units essential to system security	685.3	726.7	(41.4)
Costs for remuneration of electricity capacity availability	255.5	280.1	(24.6)
Costs for interruptibility service and other components	606.3	605.8	0.5
Other items	37.0	97.4	(60.4)
Fees for the remuneration of NTGs of other owners	230.4	201.4	29.0
TOTAL SERVICES AND FEES	**1,814.5**	**1,911.4**	**(96.9)**
TOTAL PASS-THROUGH ENERGY COSTS	**5,822.1**	**5,245.7**	**576.4**

In 2016, total Uplift cost came to € 2,393.4 million, up with respect to the same period the previous year when it was € 992.8 million, mainly due to the increase in the DSM cost and unbalancing charges (in particular on the consumption unit side, which is currently being investigated by the related authorities).

2. Other revenue and income – € 88.5 million

€ million	2016	2015	Δ
Business unit rent	33.0	33.0	-
Rental income	21.3	22.1	(0.8)
Sundry grants	8.7	11.8	(3.1)
Net contingent assets	3.2	5.0	(1.8)
Sales to third parties	7.9	4.9	3.0
Gains on the disposal of plant components	8.0	1.8	6.2
Insurance settlements for losses	2.9	3.5	(0.6)
Other revenue	3.5	1.3	2.2
TOTAL	88.5	83.4	5.1

Under the item "Other revenue and income", the significant items refer to revenue from the subsidiary Terna Rete Italia S.p.A. deriving from the business unit rental accruing to the year (€ 33.0 million), rental income (€ 21.3 million) relating mainly to housing the Wind Group's optical fibre on the company owned network, sundry grants (€ 8.7 million), mainly for work orders for variants, capital gains on disposal of plant parts (€ 8.0 million) and sales to third parties (€ 7.9 million).
The increase in the item of € 5.1 million is essentially due to:

- increase in sales to third parties and capital gains from disposal of plant parts (€ 9.2 million), above all from revenue achieved from the sale of recovered copper in implementation of the "Copper Plan" (€ 5.2 million) and sales of certain assets to update the company vehicle fleet (€ 4.0 million);
- lower grants for variants at the request of third parties (-€ 3.1 million).

Operating expenses

3. Raw materials and consumables - € 4.5 million

This item, of € 4.5 million, includes the value of purchases of sundry materials and supplies, including fuel to operate the vehicle fleet. The decrease of € 3.7 million compared to the previous year is substantially ascribable to the lower costs for materials used in investments in dispatching infrastructures recognised in application of IFRIC 12.

4. Services - € 342.0 million

€ million	2016	2015	Δ
Services, technical and administrative inter-company services	297.3	291.0	6.3
Maintenance and sundry services	26.7	27.2	(0.5)
Leases and rentals	9.1	9.3	(0.2)
Insurance	5.5	5.5	-
Remote transmission and telephone	0.5	4.0	(3.5)
IT services	1.8	3.2	(1.4)
Tenders on plants	1.1	1.5	(0.4)
TOTAL	342.0	341.7	0.3

The most significant component of "technical and administrative inter-company services" consists of the costs accruing in execution of specific inter-company contracts (€ 297.3 million), referred generally to the subsidiary Terna Rete Italia S.p.A. for the maintenance and operation of plants owned (€ 254.2 million), for investments for the development of the Company's plants for the transmission and dispatching service (€ 22.2 million) and for activities and services carried out on third-party plants (€ 7.4 million); it also includes the bonus on performance associated with the transmission service quality attributed to Terna Rete Italia S.p.A. (+€ 10.0 million).

We specify that the costs relating to remuneration of the Board of Statutory Auditors for the period amounted to € 0.2 million.

Net of the costs recognised applying IFRIC 12 for the work on developing dispatching infrastructures (which decreased by € 2.4 million), the increase in the item "Services" was € 2.7 million and was mainly due to:

- impact of the performance associated with transmission service quality attributed to Terna Rete Italia S.p.A.. In particular, in 2016 Terna assigned to the subsidiary a bonus of € 10.0 million, in contrast to the penalty of € 10.0 million recorded in 2015, with an overall effect of +€ 20.0 million;
- lower costs related to the subsidiary Terna Rete Italia S.p.A. for technical maintenance and operation services (-€ 13.6 million, as adjustment of the annual amount to the change in the business perimeter);
- lower costs for remote transmission and IT services (-€ 4.0 million) essentially due to the change in the attribution of the related resources within the Group, starting in July 2015.

In the current organisational structure of the Terna Group, investments on developing and renewing the dispatching infrastructures are made not only by Terna S.p.A. but also by the subsidiary Terna Italia S.p.A.: the related cost is charged entirely under the item "Services" as a service received from the subsidiary. The table below breaks down the costs pursuant to IFRIC 12 recognised under this item:

€ million	2016	2015	Δ
IT services	0.3	0.4	(0.1)
Tenders on plants	-	0.4	(0.4)
Maintenance and sundry services	-	1.7	(1.7)
Costs for services from investments in dispatching infrastructures pursuant to IFRIC 12	**0.3**	**2.5**	**(2.2)**
Costs for services pursuant to IFRIC 12 - Services from Terna Rete Italia S.p.A.	19.3	19.5	(0.2)
Total costs for services from investments in dispatching infrastructures pursuant to IFRIC 12	**19.6**	**22.0**	**(2.4)**

5. Personnel expenses – € 82.2 million

€ million	2016	2015	Δ
Wages, salaries and other short-term employee benefits	48.1	40.9	7.2
Directors' fees	1.6	1.6	-
Deferred compensation benefits, electricity discount and other employment benefits	3.4	2.9	0.5
Early retirement incentives	32.1	1.7	30.4
Personnel expenses, gross	**85.2**	**47.1**	**38.1**
Personnel expenses, capitalised	(3.0)	(2.3)	(0.7)
TOTAL	82.2	44.8	37.4

Personnel expense saw an increase of € 37.4 million, mainly due to greater net provisions made for the redundancy plan, of € 30.4 million.

The following table shows the number of employees by category at year-end and the average number for the year.

	Average number		Final number	
	2016	2015	31.12.2016	31.12.2015
Senior Managers	35	30	36	31
Middle Managers	168	153	170	151
Office staff	254	228	259	245
TOTAL	457	411	465	427

6. Amortisation, depreciation and impairment – € 432.7 million

€ million	2016	2015	Δ
Amortisation of intangible assets	46.7	54.1	(7.4)
- of which: infrastructure rights	*27.5*	*34.5*	*(7.0)*
Depreciation of property, plant and equipment	383.1	383.5	(0.4)
Impairment of property, plant and equipment and tangible assets	0.5	15.9	(15.4)
Impairment of trade receivables	2.4	3.0	(0.6)
TOTAL	**432.7**	**456.5**	**(23.8)**

The € 23.8 million decrease in the item mainly reflects lower depreciation based on the review of the useful life of electrical lines (increased from 40 to 45 years), partially offset by new plants beginning operations, as well as greater impairment of certain plants recognised in 2015 (€ 15.9 million).

7. Other operating expenses - € 17.5 million

€ million	2016	2015	Δ
Net service quality expenses	(7.8)	7.9	(15.7)
of which estimated costs of Mitigation and Sharing	*(5.3)*	*2.2*	*(7.5)*
of which contributions to the Exceptional Events Fund	*(3.0)*	*5.7*	*(8.7)*
of which high-voltage users compensation mechanisms	*0.5*	*-*	*0.5*
Indirect and local taxes and duties	12.6	14.1	(1.5)
Net contingent liabilities	0.9	1.1	(0.2)
Allocations made to Provisions for disputes	5.3	1.9	3.4
Losses on disposal/decommissioning of plant	0.3	0.2	0.1
Other operating expenses	6.2	7.1	(0.9)
TOTAL	**17.5**	**32.3**	**(14.8)**

The most significant components of the item are costs for indirect and local taxes and duties (€ 12.6 million, of which € 9.5 million for IMU (*Imposta Municipale Unica*, single council tax) and € 2.8 million for TOSAP (*Tassa per l'Occupazione del Suolo Pubblico*, tax on the occupation of public spaces and areas), and TARES (*Tassa Rifiuti e Servizi*, the tax on waste and municipal services), net service quality expenses (-€ 7.8 million) and other operating expenses (€ 6.2 million) which include association fees, contributions related to entities/associations related to Company business (€ 4.3 million), gifts and other expenses.
The decrease in the item of € 14.8 million derives mostly from:

- measurement of net charges deriving from the service quality adjustment mechanism which decreased by € 15.7 million, mainly due to contingencies related to the Exceptional Events Provision (-€ 8.7 million, net of accruals during the year). Also of note were lower provisions for the Mitigation and Partnership mechanisms (-€ 7.5 million) and costs related to high-voltage user indemnity mechanisms, introduced in 2016 (+€ 0.5 million);
- greater allocations made to the provision for disputes and litigation (+€ 3.4 million), partially compensated for by lower costs for IMU (-€ 1.3 million) and for gifts (-€ 1.7 million).

8. Net financial income/(expense) - € (102.0) million

€ million	2016	2015	Δ
FINANCIAL EXPENSE			
Financial expense from Cassa Depositi e Prestiti	(4.5)	(5.2)	0.7
Financial expense to subsidiaries	-	(1.0)	1.0
Interest expense on medium/long-term loans and related hedges	(101.0)	(174.5)	73.5
Debt Adjustment (Bonds) and related hedges	(13.2)	-	(13.2)
Discounting of deferred compensation benefits and other personnel-related provisions	(0.6)	(0.8)	0.2
Capitalised financial expenses	15.6	28.3	(12.7)
Other financial expense	(0.4)	(0.9)	0.5
Impairment of equity investments in associates	(4.3)	-	(4.3)
Total expense	**(108.4)**	**(154.1)**	**45.7**
FINANCIAL INCOME			
Dividends from associates	1.1	1.1	-
Financial income from subsidiaries	1.0	4.2	(3.2)
Debt Adjustment (Bonds) and related hedges	-	1.1	(1.1)
Interest income and other financial income	4.3	10.3	(6.0)
Exchange gains	-	2.4	(2.4)
Total income	**6.4**	**19.1**	**(12.7)**
TOTAL	**(102.0)**	**(135.0)**	**33.0**

Net financial expense amounted to € 102.0 million comprising € 108.4 million of financial expense and € 6.4 million of financial income. The € 33.0 million decrease in financial expense with respect to the previous financial year is mainly the result of the following factors:

- decrease in financial expense related to medium- and long-term debt and the related hedging (+€ 73.5 million) attributable mainly to the general decrease in market rates during 2016 which more than offset the one-off costs connected with the Liability Management operation carried out on 20 July 2015 (€ 32.3 million);
- fair value adjustment of bonds and the related hedges (-€ 14.3 million);
- lower capitalised borrowing costs (-€ 12.7 million) due to the lower cost of net debt in 2016 compared with that recognised in 2015 and lower investments during the year;
- impairment of the equity investment in the associate CGES (€-4.3 million);
- lower financial income (-€ 6.0 million) attributable to lower liquidity invested during the year and the general decrease in market rates.

9. Income taxes of the year – € 263.2 million

€ million	2016	2015	Δ
Income taxes of the year			
Current taxes:			
- IRES (corporate income tax)	247.7	248.8	(1.1)
- IRAP (regional tax on productive activities)	47.4	49.6	(2.2)
Total current taxes	**295.1**	**298.4**	**(3.3)**
New temporary differences:			
- deferred tax assets	(14.0)	(11.2)	(2.8)
Reversal of temporary differences:			
- deferred tax assets	14.9	15.2	(0.3)
- deferred tax liabilities	(27.6)	(30.6)	3.0
IRES tax rate adjustment	1.5	(4.2)	5.7
Total change in deferred tax assets and liabilities	**(25.2)**	**(30.8)**	**5.6**
Adjustment of prior-year taxes	(6.7)	(5.0)	(1.7)
TOTAL	**263.2**	**262.6**	**0.6**

Current taxes decreased by € 3.3 million with respect to the balance in the previous year, essentially due to the effect of higher non-deductible items recognised in 2015, taking into account the higher pre-tax profit.
Net deferred taxes, equal to -€ 25.2 million, saw a change of +€ 5.6 million, mainly due to the adjustment of net deferred tax liabilities[38] recognised in the financial statements (€ 5.7 million).
Adjustment of prior-year taxes, of -€ 6.7 million, are related to the higher current taxes paid in previous years that arose from the tax return, up by € 1.7 million.
The effective proportion of income taxes (€ 263.2 million) to the profit before taxes was 33.0% in line compared with 33.6% in 2015.
For a clearer presentation of the differences between the theoretical and actual tax rates, the table below reconciles the theoretical tax rate with the effective tax rate for the year.

(38) In 2015, the Stability Law (Italian Law 208 of 28 December 2015) introduced a reduction in the IRES rate (art. 1 paragraphs 61-64), starting from 2017, from 27.5% to 24% for entities not classified as credit or financial institutions.

€ million	Taxable income	Tax	Δ %
Profit before taxes	798.7		
IRES - theoretical tax charge (27.5%)		219.5	
IRAP - theoretical tax charge (5.10% on operating profit of € 900.7 million)		45.9	
		265.4	
THEORETICAL TAX RATE			**33.2%**
Permanent IRES differences			
Employee benefits		0.6	0.1%
Contingencies		1.0	0.1%
IMU		2.6	0.3%
Impairment		1.3	0.2%
Other increases/decreases		0.9	0.1%
Super-amortisation		(1.1)	(0.1%)
IRAP - Art. 6 Law 28/01/2009		(2.7)	(0.3%)
ACE - Subsidy for economic growth		(3.5)	(0.4%)
Dividends		0.3	0.0%
Permanent IRAP differences			
Personnel expense		0.2	0.0%
Capitalised financial expenses and other changes		0.8	0.1%
Other increases/decreases		0.7	0.1%
Actual tax rate net of adjustments to income taxes of previous years			**33.4%**
Prior year taxes		(6.7)	(0.8%)
Difference between current/deferred rate		1.9	0.2%
Adjustment of IRES deferred taxes		1.5	0.2%
Total taxes for the year		**263.2**	
ACTUAL TAX RATE			**33.0%**

10. Profit for the year from discontinued operations and assets held for sale - € 0 million

The item, which has zero value in 2016, in 2015 showed the effects of the reversal of provisions set aside by Terna for probable expenses related to tax obligations deriving from the sale of Terna Participações (-€ 7.3 million).

C. Operating segments

Consistent with the provisions of "IFRS 8 - Operating Segments" concerning companies that publish the Consolidated Financial Statements of a parent company in the same document as the separate financial statements of that parent company, operating segment disclosures are provided for the Consolidated Financial Statements only.

D. Notes to the statement of financial position

Assets

11. Property, plant and equipment – € 10,368.3 million

€ million	Land	Buildings	Plant and machinery	Industrial and commercial equipment	Other assets	Assets under construction and payments on account	TOTAL
Cost at 01.01.2016	**121.0**	**1,513.0**	**12,716.8**	**83.7**	**135.6**	**1,850.8**	**16,420.9**
Investments	0.1	-	-	1.7	15.8	649.5	667.1
Entry into use	5.1	229.3	990.1	0.2	3.0	(1,227.7)	-
Disposals and impairment	-	-	(34.2)	-	(21.2)	(0.5)	(55.9)
Other changes (grants)	(1.3)	(4.4)	(55.8)	-	-	6.0	(55.5)
Cost at 31.12.2016	**124.9**	**1,737.9**	**13,616.9**	**85.6**	**133.2**	**1,278.1**	**16,976.6**
Accumulated depreciation and impairment at 01.01.2016	**-**	**(434.2)**	**(5,680.2)**	**(61.7)**	**(103.0)**	**-**	**(6,279.1)**
Depreciation charge for the year	-	(39.5)	(327.4)	(4.4)	(11.8)	-	(383.1)
Intra-group purchases	-	-	-	-	-	-	-
Disposals and impairment	-	-	32.9	-	21.0	-	53.9
Accumulated depreciation and impairment at 31.12.2016	**-**	**(473.7)**	**(5,974.7)**	**(66.1)**	**(93.8)**	**-**	**(6,608.3)**
Carrying amount							
At 31.12.2016	**124.9**	**1,264.2**	**7,642.2**	**19.5**	**39.4**	**1,278.1**	**10,368.3**
At 31.12.2015	**121.0**	**1,078.8**	**7,036.6**	**22.0**	**32.6**	**1,850.8**	**10,141.8**
Δ	**3.9**	**185.4**	**605.6**	**(2.5)**	**6.8**	**(572.7)**	**226.5**

The category "Plant and machinery" essentially includes the energy transportation network as well as the transformation stations.
The item "Property, plant and equipment" saw an increase with respect to the previous year, of € 226.5 million, essentially due to investments during the year (+€ 667.1 million), depreciation accruing during the year (-€ 383.1 million), other changes (-€ 55.5 million) specifically plant grants, directly reducing non-current assets in use and under construction, mainly related to those received for projects financed by MED/EU and disposals and impairment (-€ 2.0 million).

With reference to the Company's investments during the year in particular we note those related mainly to activities underway to create the "Italy - Montenegro" (€ 201.9 million) and "Italy - France" (€ 22.5 million) HVDC interconnections, the "Villanova-Gissi" (€ 25.5 million) and "Sorgente-Rizziconi" (€ 73.4 million) power lines, which began operating in January and May 2016, respectively, to create the 380 kV substations in Bari Nord and Melilli (respectively, € 14.3 million and € 12.1 million), the restructuring of the metropolitan area of Palermo (€ 11.5 million) and the creation of the Capri-Continent interconnection (€ 10.9 million) for which, in particular, laying and protection of the undersea cable was completed.

The investments also include the actions to purchase and/or renovate offices (€ 11.3 million).

12. Goodwill – € 88.6 million

Goodwill amounted to € 88.6 million and was unchanged from the balance of 2015.

Impairment testing

Cash Generating Unit – perimeter of Terna S.p.A. transmission activity

The goodwill shown above of € 88.6 million is referable entirely to the goodwill deriving from acquisition of RTL (merged in 2008).

For the purposes of the impairment, the Cash Generating Unit (CGU) related to the perimeter of Terna S.p.A Regulated Activities was considered. In order to determine the recoverable amount, "the fair value less cost of disposal" configuration was used. More specifically, the fair value less cost of disposal was determined taking into consideration the listing for the Terna stock at 31 December 2016, net of the fair value of financial liabilities and the estimated fair value of the segment for Non-Regulated Activities.

The result obtained is significantly higher than the value recorded in the balance sheet including goodwill.

13. Intangible assets – € 240.3 million

€ million	Infrastructure rights	Concessions	Other assets	Assets under development and payments on account	TOTAL
Cost	371.2	135.4	174.9	33.2	714.7
Accumulated amortisation	(255.9)	(56.9)	(154.2)	-	(467.0)
BALANCE AT 31.12.2015	**115.3**	**78.5**	**20.7**	**33.2**	**247.7**
Investments	-	-	0.1	39.2	39.3
Entry into use	16.0	-	18.1	(34.1)	-
Amortisation for the year	(27.5)	(5.6)	(13.6)	-	(46.7)
BALANCE AT 31.12.2016	**103.8**	**72.9**	**25.3**	**38.3**	**240.3**
Cost	387.2	135.4	193.1	38.3	754.0
Accumulated amortisation	(283.4)	(62.5)	(167.8)	-	(513.7)
BALANCE AT 31.12.2016	**103.8**	**72.9**	**25.3**	**38.3**	**240.3**
Δ	**(11.5)**	**(5.6)**	**4.6**	**5.1**	**(7.4)**

Intangible assets amount to € 240.3 million and in particular, include:

- the infrastructures used for the dispatching services, carried out under concession and booked as set out by "IFRIC 12 - Service Concession Arrangements", for a net book value at 31 December 2016 of € 103.8 million for infrastructures which came into operation and € 22.9 million for infrastructures under construction included in the category "Assets under development and payments on account" (€ 115.3 million and € 17.6 million respectively at 31 December 2015);
- the concession for the provision of electricity transmission and dispatching services in Italy (with net carrying amount of € 72.9 million at 31 December 2016).

Other intangible assets manly comprise application software developed internally or purchased when implementing systems development projects. The investments related to them (€ 18.0 million) were made essentially through internal development.
The difference with respect to the previous financial year (-€ 7.4 million) is due to the net effect of amortisation for the year (-€ 46.7 million, of which € 27.5 million relating to dispatching infrastructures and € 5.6 million relating to the concession) and investments (€ 39.3 million, of which € 21.3 million for infrastructure rights).

As for investments for the year in intangible assets (€ 39.3 million), we note in particular those for development and evolution of software for the Remote Management System for Dispatching (€ 9.6 million), for the Power Exchange (€ 4.3 million) and for the protection of the Electricity System (€ 1.1 million), as well as software applications and general use licenses (€ 16.3 million).

14. Financial assets

€ million	31.12.2016	31.12.2015	Δ
Investments in subsidiaries	1,446.2	1,418.1	28.1
Investments in associates	47.8	52.1	(4.3)
FVH derivatives	325.7	688.2	(362.5)
Interconnector Guarantee Fund	17.4	-	17.4
Revolving Credit Facility Commissions	4.3	3.6	0.7
NON-CURRENT FINANCIAL ASSETS	**1,841.4**	**2,162.0**	**(320.6)**
Short-term loan to Terna Interconnector S.r.l.	39.0	3.7	35.3
Deferred assets on FVH derivatives contracts	26.1	61.5	(35.4)
Other current financial assets	0.1	2.8	(2.7)
CURRENT FINANCIAL ASSETS	**65.2**	**68.0**	**(2.8)**

The value of “Investments in subsidiaries” (€ 1,446.2 million) relates to equity investments in subsidiaries held directly by Terna S.p.A. and recorded an increase of € 28.1 million compared to 31 December 2015 attributable, for € 28.0 million, to the share capital increase in Terna Crna Gora d.o.o..

The value of “Investments in associates” (€ 47.8 million) refers to the equity investments in the associates CGES – CrnoGorski Elektroprenosni Sistem AD (€ 30.0 million), CESI S.p.A. (€ 17.6 million) and CORESO S.A. (€ 0.2 million).

The -€ 4.3 million change in the item related to the previous year can be attributed to the reduction in the value of the investment in the associate CGES, due to impairment recognised during the year related to the value of the equity investment.

The following table summarises Terna S.p.A.’s direct investments in subsidiaries and associates and jointly controlled companies at 31 December 2016, with data related to the last approved financial statements.

Company Name	Registered office	Currency	Share capital	% held
COMPANIES CONTROLLED DIRECTLY BY TERNA S.P.A.				
Terna Rete Italia S.p.A.	Rome	€	120,000	100%
Business	Design, construction, management, development, operation and maintenance of grid structures and lines and of other infrastructures connected to the said grids, of plants and equipment functional to the said business in the sectors of electricity dispatch and transmission and in similar, related or connected segments.			
Terna Rete Italia S.r.l.	Rome	€	243,577,554	100%
Business	Design, construction, management, development, operation and maintenance of high-voltage power lines.			
Terna Storage S.r.l.	Rome	€	10,000	100%
Business	Design, construction, management, development and maintenance of diffused energy storage systems (including batteries), pumping and/or storage systems, as well as plants, equipment and infrastructure, including grids.			
Terna Crna Gora d.o.o.	Podgorica (Montenegro)	€	56,000,000	100%
Business	Authorisation, construction, and management of transmission infrastructures comprising the Italy-Montenegro electrical interconnection in Montenegro territory.			
Terna Plus S.r.l.	Rome	€	16,050,000	100%
Business	Design, construction, management, development, operation and maintenance of plants, equipment and infrastructures including grids and systems, including diffused energy accumulation, pumping and/or storage.			
Terna Interconnector S.r.l.	Rome	€	10,000	65%*
Business	Design, construction, management, development, operation and maintenance, also on behalf of third parties, of lines and network structures and other related infrastructures, plants and equipment functional to the said activities in the sector of electricity transmission or in analogous, related or connected sectors.			
Monita Interconnector S.r.l.	Rome	€	10,000	95%**
Business	Design, construction, management, development, operation and maintenance, also on behalf of third parties, of lines and network structures and other related infrastructures, plants and equipment functional to the said activities in the sector of electricity transmission or in analogous, related or connected sectors.			
Rete S.r.l.	Rome	€	387,267,082	100%
Business	Design, construction, management, development, operation and maintenance of high-voltage power lines.			
Difebal S.A.	Montevideo (Uruguay)	Uruguayan pesos	140,000	100%
Business	Design, construction and maintenance of electricity infrastructure in Uruguay.			

* 5% held by Terna Rete Italia S.p.A. and 30% held by Transenergia S.r.l..
** 5% held by Terna Rete Italia S.p.A..

Company Name	Registered office	Currency	Share capital	% held
COMPANIES CONTROLLED THROUGH TERNA PLUS S.R.L.				
Tamini Trasformatori S.r.l.	Melegnano (Milan)	€	3,000,000	70%*
Business	Construction, repair and sales of electrical machinery.			
Terna Chile S.p.A.	Santiago de Chile (Chile)	CLP	1,000,000	100%
Business	Design, construction, administration, development, operation and maintenance of any type of structure, plant, equipment and electrical infrastructure, including those of interconnection; production of all kinds of products and services, constructions, electrical and civil engineering works; research, consulting and assistance on questions related to the core business; carrying out any other activity that can improve the use and development of plants, resources and skills.			
COMPANIES CONTROLLED THROUGH TAMINI TRASFORMATORI S.R.L.				
V.T.D. Trasformatori S.r.l.	Valdagno (Vicenza)	€	774,000	100%
Business	Production, repair and sales in any form allowed by current laws of electrical and electro-mechanical instruments and machinery.			
Tamini Transformers USA LLC	Oakbrook (Chicago - Illinois)	USD	42,904	100%
Business	Sales of industrial and power electrical transformers			
Transformer Electro Service S.r.l.	Ospitaletto (Brescia)	€	1,134,000	100%
Business	Production of electricity transformers for industrial use and for the sector of electricity production and transmission. It is noted that the company holds 100% of the share capital of the Indian manufacturing company known as “Tes Transformer Electro Service Asia Private Limited” (share capital equal to 100,000.00 Indian rupees).			
COMPANIES CONTROLLED THROUGH TERNA INTERCONNECTOR S.R.L.				
Piemonte Savoia S.r.l.	Rome	€	10,000	100%
Business	Design, construction, management, development, operation and maintenance, also on behalf of third parties, of lines and network structures and other related infrastructures, plants and equipment functional to the said activities in the sector of electricity transmission or in analogous, related or connected sectors.			

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

Company Name	Registered office	Currency	Share capital	% held
ASSOCIATES				
Cesi S.p.A.	Milan	€	8,550,000	42.698%
Business	Experimental electro-technical research.			
Coreso S.A.	Brussels (Belgium)	€	1,000,000	16.67%*
Business	Technical centre owned by various electricity transmission companies which implements joint TSO technical coordination activities in order to improve and strengthen security and coordination of the electricity system in central/western Europe.			
CGES A.D.	Podgorica (Montenegro)	€	155,108,283	22.0889%
Business	Electricity dispatch and transmission operator in Montenegro.			
COMPANY SUBJECT TO JOINT CONTROL				
ELMED Etudes Sarl	Tunism (Tunisia)	Tunisian Dinar	2,700,000	50%
Business	Study activity concerning the connection of the Italian and Tunisian electricity grids.			

* Falling from 20% to 16.67% during October 2016.

The fair value of the FVH derivatives hedging the Company's bonds, equal to € 325.7 million, is calculated by discounting forecast cash flow with the market interest rate curve at the reporting date. The decrease in the fair value of derivatives (-€ 362.5 million) compared to 31 December 2015 is mainly attributable to the cancellation of FVH derivatives for a notional amount of € 1.8 billion (€ 0.6 billion with expiring in 2019, € 0.7 billion expiring in 2021 and € 0.5 billion expiring in 2023) with a view to simplifying the derivatives portfolio carried out during the second quarter of 2016, partially offset by the increase in the value of the residual portfolio following a decrease in the reference interest rate curve compared to December 2015.
The item also includes the deposit for the Interconnector Guarantee Fund (€ 17.4 million) established for the creation of interconnection works pursuant to article 32 of Italian Law 99/09.

The item "Current financial assets" showed a balance of € 65.2 million (€ 68.0 million at 31 December 2015) and recorded a decrease compared to the previous year of -€ 2.8 million due mainly to:

- the reduction in net financial income accruing on the related financial instruments, but not yet paid (-€ 35.4 million);
- the loan granted to the subsidiary Terna Interconnector S.r.l. in 2016 by Terna S.p.A. with expiry date in March 2017 (+€ 35.3 million, net of the repayment of the € 3.7 million loan disbursed in 2015).

15. Other assets

€ million	31.12.2016	31.12.2015	Δ
Loans and advances to employees	3.1	3.1	-
Deposits with third parties	0.5	0.5	-
OTHER NON-CURRENT ASSETS	**3.6**	**3.6**	**-**
Receivables from subsidiaries	36.2	-	36.2
Other tax assets	27.1	107.2	(80.1)
Interconnector Guarantee Fund	2.0	-	2.0
Contractual advances to suppliers	5.5	1.7	3.8
Prepayments of operating expenses and accrued income	4.3	1.3	3.0
Receivables due from others:	1.9	2.7	(0.8)
OTHER CURRENT ASSETS	**77.0**	**112.9**	**(35.9)**

"Other non-current assets" (€ 3.6 million) are in line with the amounts of the previous year and mainly comprise loans and advances paid to employees (€ 3.1 million).
The item "Other current assets", equal to € 77.0 million, showed a decrease of € 35.9 million with respect to 31 December 2015, mainly owing to:

- lower "other tax assets" (-€ 80.1 million), in particular due to the effects of the reduction in the Company's receivables from the tax authorities for VAT (-€ 79.7 million, in consideration of the € 102.3 million receivable existing at 31 December 2015) mainly due to the decrease in energy-related payables;
- recognition of receivables from the subsidiaries Terna Rete Italia S.r.l. and Terna Rete Italia S.p.A. for IRES payments on account paid by the Company for tax consolidation (respectively € 35.0 million and € 1.2 million);
- recognition of payments on account and prepayments related to the optic fibre housing contract signed with Clouditalia during the last quarter of the year to acquire optic fibre that will be finalised in 2017 (€ 4.8 million and € 2.7 million, respectively).

16. Inventories – € 0.1 million

Current inventories showed a balance of € 0.1 million, substantially in line with the previous year, when the amount was zero.

17. Trade receivables – € 1,373.2 million

€ million	31.12.2016	31.12.2015	Δ
Energy-related receivables	997.8	826.0	171.8
Grid transmission fee receivables	324.0	400.0	(76.0)
Other trade receivables	33.4	29.1	4.3
Receivables from subsidiaries	18.0	30.7	(12.7)
TOTAL	**1,373.2**	**1,285.8**	**87.4**

Trade receivables amounted to € 1,373.2 million and are recognised net of impairment losses, referred to items considered non-collectable, recognised in allowances for doubtful accounts (€ 25.6 million for energy items and € 11.2 million for other items in 2016, compared with € 25.5 million for energy items and € 8.9 million for other items in 2015); the carrying amount shown approximates substantially the fair value.

Energy-related receivables – € 997.8 million

The item includes receivables for “pass-through items” under Resolution 111/06 (€ 976.4 million) and receivables due from NTG operators for margin fees (€ 18.0 million). It also includes the receivable due from Fund for Energy and Environmental Services (*Cassa per i Servizi Energetici e Ambientali* - CSEA) related to the measurement of RENS performance recognised in 2016 (€ 3.4 million).
The balance as a whole increased by € 171.8 million with respect to the previous year due to pass-through energy-related receivables (+€ 171.3 million), mostly due to the increase in the net receivable (€ 181.1 million) related to the uplift fee for supplying resources on the Dispatching Services Market (DSM) and energy-related items associated with the same, mainly for the greater final cost in the DSM and greater charges for unbalancing (including the effects of Resolution 333/2016/R/eel).

Grid transmission fee receivables – € 324.0 million

Grid transmission fee receivables, of € 324.0 million, is related to the remuneration awarded for the use of the National Transmission Grid by electricity distributors. The above receivables show a decrease of € 76.0 million compared to the previous year, attributable mainly to the payment made by *Cassa per i Servizi Energetici e Ambientali* (CSEA) for the supplement to the TF revenues of Terna S.p.A. for the years 2014 and 2015 (€ 63.3 million) and the recognition of the TF accruing in the last two months of the year on the basis of the new tariffs established for 2016, the first year of the new 2016-2023 regulatory period.

Other trade receivables – € 33.4 million

Other trade receivables mainly regard receivables due from third party clients of the Company for the non-regulated businesses; they show an increase of € 4.3 million with respect to the previous year.

Receivables from subsidiaries – € 18.0 million

The item, equal to € 18.0 million, essentially refers to the receivable due from the subsidiary Terna Rete Italia S.p.A. (€ 15.3 million), mainly due to administrative services provided in the last quarter as part of the existing contract (€ 3.9 million), to the leasing fee for the business unit (€ 9.5 million), as well as other receivables (€ 1.9 million) mainly related to the sale of recovered copper to third parties carried out by the subsidiary on behalf of the Company. The item shows a decrease with respect to the previous year of

-€ 12.7 million, substantially due to the receipt during the current year of the receivable at 31 December 2015 from the subsidiary Terna Rete Italia S.p.A with reference to Quality of Service (-€ 10.0 million), and the reduction in the annual fee for administrative services provided to the same subsidiary (-€ 2.0 million, which reflects the adjustment made to the fee in line with the change in the scope of activities).

The amount of the guarantees issued to third parties by Terna S.p.A., at 31 December 2016 came to € 52.0 million, of which € 26.0 million for sureties issued to secure the contractual obligations arising under the scope of operations and € 26.0 million as follows: € 14.3 million in the interest of the subsidiary Terna Rete Italia S.p.A., € 6.3 million in the interest of the subsidiary Terna Plus S.r.l., € 4.8 million in the interest of the subsidiary Difebal S.A., € 0.6 million for guarantees issued in the interest of the subsidiary Terna Rete Italia S.r.l.; all issued on the credit lines of Terna S.p.A..

18. Cash and cash equivalents – € 927.8 million

Cash and cash equivalents at 31 December 2016 amounted to € 927.8 million, of which € 258.8 million liquid funds related to the simplification of the derivatives portfolio carried out in 2016 and € 669.0 million of positive net liquidity in bank current accounts (of which -€ 163.2 million associated with the net position in the inter-company current accounts).

19. Income tax assets – € 10.4 million

Income tax assets amounted to € 10.4 million and recorded a decrease of € 11.6 million compared to the previous year owing mainly to the use of the IRAP credit recognised in 2015 when the 2014 tax return was filed (-€ 9.8 million).

Liabilities

20. Equity – € 3,024.8 million

Share capital – € 442.2 million

The share capital of Terna is represented by 2,009,992,000 ordinary shares, par value € 0.22 each.

Legal reserve – € 88.4 million

The legal reserve is 20% of the Company's share capital; it did not change with respect to the previous year.

Other reserves – € 731.4 million

Other reserves decreased by € 12.6 million, due to Other Comprehensive Income, in particular due to:

- adjustment to fair value of derivative instruments hedging the Company's floating-rate loans - cash-flow hedges (-€ 13.4 million, net of the related tax effect of € 3.9 million);
- recognition of the actuarial gains and losses on employee benefits (+€ 0.8 million, considering the related tax effect of € 0.4 million).

Retained earnings and losses – € 1,373.2 million

The increase of € 125.1 million of the item "Retained earnings and losses" regarded the allocation of the residual profit for 2015, compared to the distribution of the dividend in the same year (a total of € 402.0 million).

Interim dividend 2016

After receiving the report of the Independent Auditors required by Art. 2433-*bis* of the Italian Civil Code, on 04 November 2016 the Company's Board of Directors approved the distribution of an interim dividend amounting to € 144.9 million, equal to € 0.0721 per share, which is payable from 23 November 2016, with an ex-dividend date (coupon no 25) of 21 November 2016.
The following table shows the origin, availability and possibility of distribution of the equity components at the reporting date.

€ million	31.12.2016	Possibility of use	Available portion
Share capital	442.2	-	-
Legal reserve	88.4	B	88.4
Other reserves			
- equity-related	416.1	A,B,C	416.1
- income-related*	315.3	A,B,C	315.3
Retained earnings	1,372.2	A,B,C	1,372.2
Interim dividend	(144.9)	A,B,C	-
TOTAL	**2,489.3**		**2,192.0**

KEY:
A - for share capital increase
B - to cover losses
C - for distribution to shareholders

* Includes the negative reserve that contains the effective portion of the fair value changes of cash flow hedging equal, net of the tax effect, to € 18.2 million.

€ 549.9 million of the total distributable portion refers to untaxed income-related reserves.

21. Loans and financial liabilities

€ million	31.12.2016	31.12.2015	Δ
Bonds	6,420.5	6,406.1	14.4
Bank loans	1,979.5	2,103.8	(124.3)
LONG-TERM LOANS	**8,400.0**	**8,509.9**	**(109.9)**
CFH derivatives	12.7	6.4	6.3
NON-CURRENT FINANCIAL LIABILITIES	**12.7**	**6.4**	**6.3**
Short-term loans	-	398.2	(398.2)
SHORT-TERM LOANS	**-**	**398.2**	**(398.2)**
Bonds	769.9	-	769.9
Current portion of long-term loans	132.4	120.7	11.7
CURRENT PORTION OF LONG-TERM LOANS	**902.3**	**120.7**	**781.6**
TOTAL	**9,315.0**	**9,035.2**	**279.8**

Gross debt for the year, of € 9,315.0 million, increased with respect to the previous year by € 279.8 million.

The increase in the value of bonds (+€ 784.3 million) is attributable for € 750.0 million to the bond issue of 11 October 2016, for € 80.0 million to bond issue on 3 March 2016, and for -€ 45.2 million to the changes in fair value of the hedged risk, net of the amortised cost effect.

The last official prices at 31.12.2016 for the bonds listed on the Luxembourg Stock Exchange are detailed below:

- bond maturity 2024: 2016 price € 130.48 and 2015 price € 127.94;
- bond maturity 2023: 2016 price* € 131.96 and 2015 price € 124.45;
- bond maturity 2019: 2016 price € 113.07 and 2015 price € 115.86;
- bond maturity 2026: 2016 price € 103.09;
- bond maturity 2021: 2016 price € 118.33 and 2015 price € 119.08;
- bond maturity 2017: 2016 price € 100.86 and 2015 price € 104.32;
- bond maturity 2018: 2016 price € 103.20 and 2015 price € 105.35;
- bond maturity 2022: 2016 price € 101.61 and 2015 price € 98.15;
- bond maturity 2028: 2016 price € 94.60.

*Source BNP Paribas, in the absence of up-to-date prices sources Reuters and Bloomberg.

The debt which was originally floating rate, shows a decrease of -€ 112.6 million compared to the previous financial year, due to:

- decrease in bank loans for € 120.6 million, due to the reimbursement of the due instalments of the existing loans;
- drawdown of a new EIB loan for +€ 8.0 million.

Long-term loans

€ million	Maturity	31.12.2015	31.12.2016	Portion with maturity within 12 months	Portion with maturity beyond 12 months	2018	2019	2020	2021	2022	After	Average interest rate as of 31.12.2016	Average interest rate net of hedging as of 31.12.2016
Bonds	2024	1,050.1	1,054.2	-	1,054.2	-	-	-	-	-	1,054.2	4.90%	0.25%
Bonds IL	2023	712.8	710.2	-	710.2	-	-	-	-	-	710.2	2.73%	0.87%
Bonds PP	2019	677.2	660.4	-	660.4	-	660.4	-	-	-	-	4.88%	3.17%
Bonds PP	2026	-	78.7	-	78.7	-	-	-	-	-	78.7	1.60%	1.60%
Bonds 1250	2021	1,453.3	1,432.5	-	1,432.5	-	-	-	1,432.5	-	-	4.75%	2.15%
Bonds 1250	2017	769.2	769.9	769.9	-	-	-	-	-	-	-	4.13%	4.13%
Bonds 1000	2022	995.3	996.1	-	996.1	-	-	-	-	996.0	-	0.88%	0.88%
Bonds 750	2018	748.2	749.1	-	749.1	749.1	-	-	-	-	-	2.88%	2.88%
Bonds 750	2028	-	739.3	-	739.3	-	-	-	-	-	739.3	1.00%	1.00%
Total fixed rate		**6,406.1**	**7,190.4**	**769.9**	**6,420.5**	**749.1**	**660.4**	**-**	**1,432.5**	**996.0**	**2,582.4**		
EIB	2015-2030	1,724.5	1,611.9	132.4	1,479.5	132.4	111.3	116.1	112.1	112.1	895.5	0.37%	0.63%
CDP	2019	500.0	500.0	-	500.0	-	500.0	-	-	-	-	0.79%	0.91%
Total floating rate		**2,224.5**	**2,111.9**	**132.4**	**1,979.5**	**132.4**	**611.3**	**116.1**	**112.1**	**112.1**	**895.5**		
TOTAL		**8,630.6**	**9,302.3**	**902.3**	**8,400.0**	**881.5**	**1,271.7**	**116.1**	**1,544.6**	**1,108.1**	**3,477.9**		

The total amount of the Terna's loans at 31 December 2016 was € 9,302.3 million (€ 902.3 million due within 12 months and € 8,400.0 million due after more than 12 months), of which € 3,477.9 million is due after more than five years.

The following table shows changes in long-term debt for the year, with an indication of the notional debt:

	31.12.2015							31.12.2016		
€ million	Notional debt	Carrying amount	Market value	Repay. and capitalis.	Drawdowns	Δ Fair Value 31.12.2015 31.12.2016	Δ carrying amount	Notional debt	Carrying amount	Market value
2024 Bond	800.0	1,050.1	1,023.5	-	-	4.1	4.1	800.0	1,054.2	1,043.8
IL Bond	565.9	712.8	704.3	(0.5)	-	(2.1)	(2.6)	565.4	710.2	746.1
Private Placement 2019	600.0	677.2	695.1	-	-	(16.8)	(16.8)	600.0	660.4	678.4
Private Placement 2026	-	-	-	-	80.0	(1.3)	78.7	80.0	78.7	82.5
2021 Bond	1,250.0	1,453.3	1,488.5	-	-	(20.8)	(20.8)	1,250.0	1,432.5	1,479.2
2017 Bond	770.0	769.2	803.2	-	-	0.7	0.7	770.0	769.9	776.6
2022 Bond	1,000.0	995.3	981.5	-	-	0.8	0.8	1,000.0	996.1	774.0
2018 Bond	750.0	748.2	790.2	-	-	0.9	0.9	750.0	749.1	1,016.1
2028 Bond	-	-	-	-	750.0	(10.7)	739.3	750.0	739.3	709.5
Total bonds	**5,735.9**	**6,406.1**	**6,486.3**	**(0.5)**	**830.0**	**(45.2)**	**784.3**	**6,565.4**	**7,190.4**	**7,306.2**
Bank loans	2,224.5	2,224.5	2,224.5	(120.6)	8.0	-	(112.6)	2,111.9	2,111.9	2,112.0
Total bank loans	**2,224.5**	**2,224.5**	**2,224.5**	**(120.6)**	**8.0**	**-**	**(112.6)**	**2,111.9**	**2,111.9**	**2,112.0**
Total Financial debt	**7,960.4**	**8,630.6**	**8,710.8**	**(121.1)**	**838.0**	**(45.2)**	**671.7**	**8,677.3**	**9,302.3**	**9,418.2**

Compared to 31 December 2015, long-term debt recorded overall an increase of € 671.7 million, due mainly for € 830.0 million to the issue of two new Bonds, for € 120.6 million to repayment of the instalment

of EIB loans, for -€ 45.2 million to the reduction in the fair value of the bonds, also considering the amortised cost of all loans and for € 8 million to the drawdown of a new EIB loan.
At 31 December 2016, Terna had an additional debt capacity of € 2,050.0 million represented by three revolving credit facilities entered into in December 2014, December 2015 and July 2016, to which must be added the additional capacity of approximately € 903.0 million represented by uncommitted bank lines.
In addition, as provided for in IFRS 7, the table shows the fair value of financial payables which for bond loans is their market value on the basis of the prices at the reporting date, while for floating-rate loans it was assumed to be substantially equal to the notional amount of repayment.

Non-current financial liabilities

€ million	31.12.2016	31.12.2015	Δ
CFH derivatives	12.7	6.4	6.3
TOTAL	**12.7**	**6.4**	**6.3**

The item "Non-current financial liabilities", of € 12.7 million at 31 December 2016, includes the fair value measurement of cash-flow hedging derivatives.
Fair value was measured by discounting the expected cash flows using the market yield curve at the reporting date. The change in the interest rate curve compared with 31 December 2015 resulted in a change amounting to +€ 6.3 million.

Short-term loans

The item stands at zero at 31 December 2016. The change with respect to the previous year (-€ 398.2 million) is due to the Company repaying the credit lines existing at 31 December 2015.

Current financial liabilities

Current financial liabilities include at 31 December 2016 the value of net financial expenses accrued on financial instruments and not yet paid. This item shows a decrease, compared with the previous year, of € 0.7 million.

€ million	31.12.2016	31.12.2015	Δ
DEFERRED LIABILITIES ON:			
Hedging derivatives	0.7	3.1	(2.4)
Bond	123.5	120.6	2.9
Loans	2.2	3.4	(1.2)
TOTAL	**126.4**	**127.1**	**(0.7)**

Net financial position

Pursuant to CONSOB Communication of 28 July 2006 and in compliance with Recommendation ESMA/2011/81 of 23 March 2011, the Company's net financial position is as follows:

€ million		31.12.2016
A.	Cash	832.2
B.	Short-term deposits	258.8
C.	Net intercompany treasury current account position	(163.2)
D.	**Cash and cash equivalents (A) + (B) + (C)**	**927.8**
E.	Current portion of long-term payables	902.3
F.	Short-term loan to Terna Interconnector S.r.l.	(39.0)
G.	Other financial liabilities	95.9
	of which to related parties	*0.1*
H.	**Current financial debt (E) + (F) + (G)**	**959.2**
I.	**Net current financial debt (H) - (D)**	**31.4**
J.	Non-current bank payables	1,979.5
	of which to related parties	*500.0*
K.	Bonds issued	6,420.5
L.	Derivative financial instruments in portfolio	(313.0)
M.	Other non-current financial assets (Interconnector guarantee fund)	(17.4)
N.	**Net non-current financial debt (J) + (K) + (L) + (M)**	**8,069.6**
O.	**Net financial debt (I) + (N)**	**8,101.0**

For more information on the contractual provisions of outstanding loans at 31 December 2016, please see the Notes to the Consolidated Financial Statements.

22. Employee benefits – € 29.7 million

Terna provides benefits to its employees during their period of employment (loyalty bonus), at the termination of their employment (deferred compensation benefits, additional month's pay and allowance in lieu of notice), and in the period after the termination of employment (electricity discount and the ASEM health plan).
The loyalty bonus is awarded to employees and managers of the Company when they reach certain seniority levels (25 and 35 years of service).
The benefits granted at the termination of employment are recognised for all employees (termination indemnities), managers hired or appointed before 28 February 1999 (Indemnity for Lack of Notice), and employees (blue-collar workers, white-collar workers and junior executives) hired before 24 July 2001 (Additional Month's Pay Indemnity).
Post-employment benefits consist of the following:

- discount on electricity consumed for domestic use. This benefit is offered to all employees hired before 30 June 1996 (energy discount);
- a healthcare plan complementing the national health service, as agreed under the terms of the national contract for industrial managers (the ASEM health plan).

The composition of deferred compensation benefits and other employee-related provisions at 31 December 2016 is detailed below along with changes in the period.

€ million	31.12.2015	Provision	Interest cost	Utilisa-tions and other changes	Actuarial gains/ (losses)	31.12.2016
Benefits payable to employees						
Loyalty bonus	0.5	0.1	-	-	-	0.6
Total	**0.5**	**0.1**	**-**	**-**	**-**	**0.6**
Benefits payable upon termination of employment						
Deferred compensation benefits	3.9	-	0.1	0.3	0.1	4.4
Additional month's pay	0.3	-	-	-	-	0.3
Indemnities for lack of notice and similar	0.3	-	-	-	-	0.3
Total	**4.5**	**-**	**0.1**	**0.3**	**0.1**	**5.0**
Post-employment benefits						
Energy discount	16.9	0.1	0.4	2.7	(2.2)	17.9
ASEM	5.2	0.1	0.1	(0.1)	0.9	6.2
Total	**22.1**	**0.2**	**0.5**	**2.6**	**(1.3)**	**24.1**
Total	**27.1**	**0.3**	**0.6**	**2.9**	**(1.2)**	**29.7**

The item, equal to € 29.7 million at 31 December 2016 (€ 27.1 million at 31 December 2015), shows an increase of € 2.6 million compared to the previous year, mainly due to utilisations and other changes during the year (+€ 2.9 million, essentially due to transfers of personnel from Group companies), offset by the recognition of actuarial gains/losses (-€ 1.2 million, with impact on other comprehensive income).
Details of the pension cost relating to current employment and interest income and expense are shown below.

€ million	Loyalty bonus	Deferred compensation benefits	Energy discount	ASEM	TOTAL
Net impact recognised in profit or loss					
- cost relating to current work performed	0.1	-	0.1	0.1	**0.3**
- *revenue for curtailment*	-	-	-	(0.1)	**(0.1)**
- interest income and expense	-	0.1	0.4	0.1	**0.6**
TOTAL RECOGNISED IN INCOME STATEMENT	**0.1**	**0.1**	**0.5**	**0.1**	**0.8**

Revaluation of the net liability for employee benefits is illustrated in the table below, where the types of actuarial gains and losses, recognised among Other Comprehensive Income, are detailed.

€ million	Deferred compensation benefits	Energy discount	ASEM	TOTAL
Actuarial gains/(losses)				
- based on past experience	(0.1)	(0.8)	(0.1)	**(1.0)**
- due to changes in demographical assumptions	-	1.0	0.1	**1.1**
- due to changes in other economic assumptions	(0.1)	(4.2)	0.3	**(4.0)**
- due to changes in discount rate	0.3	1.8	0.6	**2.7**
TOTAL OCI IMPACTS	**0.1**	**(2.2)**	**0.9**	**(1.2)**

The statements below, finally, show that main actuarial assumptions used, a sensitivity analysis on the movements in these assumptions and the payment schedule envisaged in the plan. It should be noted that the interest rate used to determine the current value of the obligation was calculated, in line with 2015, considering the yield of the Iboxx Eurozone Corporates AA index at 31 December 2016 in line with the duration of the group of workers measured.

	Loyalty bonus	Deferred compensation benefits	Additional month's pay	Indemnities for lack of notice and similar	Energy discount	ASEM
Discount rate	1.31%	1.31%	0.39%	0.13%	1.31%	2.03%
Inflation rate	1.50%	1.50%	-	1.50%	1.50%	3.00%
Duration (in years)	12.65	10.98	8.00	3.00–3.50	14.57	13.40

€ million	Loyalty bonus	Deferred compen-sation benefits	Additional month's pay	Indemnities for lack of notice and similar	Energy discount	ASEM	TOTAL
Discount rate +0.25%	0.6	4.3	0.3	0.3	17.4	5.9	**28.9**
Discount rate -0.25%	0.6	4.5	0.4	0.3	18.6	6.4	**30.9**
Inflation rate +0.25%	0.6	4.5	n/a	n/a	18.6	n/a	**23.7**
Inflation rate -0.25%	0.6	4.3	n/a	n/a	17.4	n/a	**22.3**
Annual rate of increase in healthcare +3%	n/a	n/a	n/a	n/a	n/a	10.3	**10.3**
Annual rate of increase in healthcare -3%	n/a	n/a	n/a	n/a	n/a	4.0	**4.0**
Conversion value of KW/h +5%	n/a	n/a	n/a	n/a	19.1	n/a	**19.1**
Conversion value of KW/h -5%	n/a	n/a	n/a	n/a	17.3	n/a	**17.3**

€ million	Loyalty bonus	Deferred compensation benefits	Indemnities for lack of notice and similar	Energy discount	ASEM	TOTAL
By the end of 2017	-	0.1	-	0.8	0.2	**1.1**
By the end of 2018	-	0.2	-	0.8	0.2	**1.2**
By the end of 2019	-	0.1	-	0.8	0.3	**1.2**
By the end of 2020	-	0.2	-	0.8	0.3	**1.3**
By the end of 2021	0.1	0.1	0.1	0.8	0.4	**1.5**

23. Provisions for risks and charges – € 212.0 million

€ million	Provision for disputes and litigation	Provisions for sundry risks and charges	Provision for early retirement	Total
Balance at 31.12.2015	**10.6**	**108.4**	**38.8**	**157.8**
Provision	5.3	56.7	32.3	94.3
Utilisations and other changes	(3.1)	(22.5)	(14.5)	(40.1)
Balance at 31.12.2016	**12.8**	**142.6**	**56.6**	**212.0**

Provision for disputes and litigation – € 12.8 million

The provision is set aside to cover the liabilities at year-end that may arise from lawsuits and out-of-court disputes relating to Company activities. The amount set aside takes into account the opinions both of internal and external legal counsel. The balance at 31 December 2016 of € 12.8 million, shows an increase of € 2.2 million compared to the previous year, due to net provisions recognised during the year.

Provisions for sundry risks and charges – € 142.6 million

The final balance of the provision at 31 December 2016 is € 142.6 million, up over the previous year (+€ 34.2 million), due in particular to:

- net provisions for charges following plants beginning operations (for € 32.9 million, particularly related to urban and environmental restoration projects and the provision related to the Sorgente-Rizziconi and Villanova-Gissi works);
- provisions for risks associated with IMU (*Imposta Municipale Unica* - Single Council Tax) (+€ 4.0 million);
- net utilisations referred to management incentive schemes, for € 1.7 million;
- net reduction of € 7.9 million of provisions associated with regulation of transmission service quality (mitigation and participation mechanism pursuant to AEEGSI Resolution 653/2015/R/eel) which, net of provisions for the estimate of the penalty linked to the outage events in the year, reflects the payments to distribution companies and reversals consequent to definition of the penalties related to previous years.

Provision for early retirement incentives – € 56.6 million

This provision reflects the estimated extraordinary charges related to the voluntary early termination of the working relationship of employees of the Company who are eligible for retirement. The item shows a net increase of € 17.8 million, due to the provision recognised against the redundancy plan of € 32.2 million, offset by disbursements made during the year (€ 14.5 million).

24. Deferred tax liabilities – € 1.6 million

		Impact recognised in profit or loss				
€ million	31.12.2015	Provi-sions	Utilisa-tions	Other financial changes	Impact recognised in statement of comprehensive income	31.12.2016
DEFERRED TAX LIABILITIES						
Property, plant and equipment	109.1	-	(25.3)	-	-	83.8
Employee benefits and financial instruments	3.1	-	-	-	-	3.1
Total deferred tax liabilities	**112.2**	**-**	**(25.3)**	**-**	**-**	**86.9**
DEFERRED TAX ASSETS						
Provisions for risks and charges	(28.4)	(11.6)	9.7	-	-	(30.3)
Allowance for doubtful accounts	(2.9)	-	-	-	-	(2.9)
Employee benefits	(7.8)	(2.4)	1.5	(1.0)	0.4	(9.3)
CFH derivatives	(1.8)	-	-	-	(3.9)	(5.7)
Release of goodwill	(40.0)	-	2.9	-	-	(37.1)
Total deferred tax assets	**(80.9)**	**(14.0)**	**14.1**	**(1.0)**	**(3.5)**	**(85.3)**
NET DEFERRED TAX LIABILITIES	**31.3**	**(14.0)**	**(11.2)**	**(1.0)**	**(3.5)**	**1.6**

This balance, equal to € 1.6 million, reflects the net movements in the Company's deferred tax assets and liabilities.

Deferred tax liabilities (€ 86.9 million) recorded a decrease of € 25.3 million compared to the previous year, due to:

- utilisation of previous provisions to cover the difference between additional depreciation and amortisation calculated using ordinary technical rates (€ 27.6 million), including the net reversal in respect of the amortisation/depreciation charge for the period attributable to the difference from merger eliminations allocated to property, plant and equipment following mergers carried out in previous years (€ 1.3 million);
- adjustment of net deferred tax liabilities (-€ 2.3 million) consequent to the provisions of the Stability Law for 2016 (Italian Law no. 208 of 28 December 2015) provided for a reduction in the IRES rate (Art. 1 paragraphs 61–64), starting from 2017, from 27.5% to 24% for entities not classified as credit or financial institutions.

Deferred tax assets (€ 85.3 million) show a net increase of € 4.4 million compared to the previous year, related to the following changes:

- net provisions of € 3.5 million, attributable to the tax effect, which has no impact on the Income Statement, of changes in cash flow hedging financial instruments (€ 3.9 million) and of actuarial gains and losses on employee benefits (-€ 0.4 million);
- net provisions of € 1.9 million related to changes in the year in provisions for risks and charges mainly with reference to provisions for staff redundancy (+€ 3.8 million), disputes and management staff incentives (respectively, +€ 0.7 million and -€ 0.2 million), partially offset by the tax effect of changes in provisions related to Quality of Service (-€ 3.2 million);
- utilisation, amounting to € 2.9 million, of the portion accruing of deferred tax assets allocated for the release of goodwill recognised following the merger of RTL;
- net provisions of € 1.9 million related changes in employee benefits, substantially for transfers of personnel from the Group companies.

25. Other non-current liabilities – € 169.6 million

The item, of € 169.6 million at 31 December 2016, encompasses the payable to Terna Rete Italia S.p.A. originated with the transfer of the net liabilities included in the business unit (€ 48.7 million), the deferred positions of set-up grants (€ 101.2 million) and also the Interconnector Guarantee Fund (€ 19.7 million) established by the 2016 Italian Stability Law for the creation of interconnection works pursuant to article 32 of Italian Law 99/09.
The increase in this item, of € 12.9 million compared to the previous financial year, essentially derives from the recognition of the Interconnector Guarantee Fund commented on above, in part offset by the release of portions of plant set-up grants (of -€ 5.6 million).

26. Current liabilities

€ million	31.12.2016	31.12.2015	Δ
Short-term loans*	-	398.2	(398.2)
Current portion of long-term loans*	902.3	120.7	781.6
Trade payables	1,962.4	1,957.9	4.5
Tax liabilities	7.6	18.5	(10.9)
Current financial liabilities*	126.4	127.1	(0.7)
Other current liabilities	146.8	148.1	(1.3)
TOTAL	**3,145.5**	**2,770.5**	**375.0**

* For these items see the comments in Note 21. Loans and financial liabilities.

Trade payables – € 1,962.4 million

€ million	31.12.2016	31.12.2015	Δ
Suppliers:			
- Energy-related payables	1,556.2	1,459.2	97.0
- Non-energy-related payables	88.7	85.6	3.1
Non energy-related payables due to subsidiaries	315.1	411.0	(95.9)
Payables due to associates	1.6	1.2	0.4
Payables for contract work in progress	0.8	0.9	(0.1)
TOTAL	**1,962.4**	**1,957.9**	**4.5**

Suppliers

Energy-related/adjusted payables – € 1,556.2 million

The increase in the item of € 97.0 million compared to the previous year is essentially attributable to:

- Payables for pass-through energy items: up by € 106.3 million due mainly to the following items:
  - payables associated with capacity payments (+€ 69.1 million), substantially due to lower payments approved by the Authority in favour of production unit users;
  - payables associated with remuneration of essential units - UESS (+€ 23.2 million), substantially due to greater amounts associated with collection against payments, which were substantially aligned at the end of the period;
  - payables of amounts deriving from electricity market transactions (+€ 18.5 million) mainly associated with the Dispatching Services Market (DSM);
- Payables due to the Cassa per i Servizi Energetici e Ambientali (CSEA): this fell by € 9.7 million, essentially due to the recognition of lower charges deriving from bonus/penalty mechanisms connected with transmission service quality. In particular, the balance at the end of 2015 included the negative performance estimate for RENS (€ 6.5 million against the bonus recognised in 2016), and greater grants to the Exceptional Events Provision with CSEA (€ 6.1 million in 2015 against € 3.0 million recognised in 2016).

Non-energy-related payables

Amounts due to suppliers refer to invoices both already received and yet to be received for tenders, services and the purchase of materials and equipment.
The increase compared to the previous year (+€ 3.1 million), is mostly attributable to the greater investment activities implemented in the last period of the year.

Non energy-related payables due to subsidiaries

The item, of € 315.1 million, shows a decrease of € 95.9 million compared to the previous year, mainly attributable to lower payables to the subsidiary Terna Rete Italia S.p.A. (-€ 68.6 million) in particular for the change in distribution of business and the schedule for liquidation of the related payable items with respect to the previous year, as well as the effect of lower investment during the last period of the year and the adjustment in the annual fee for technical maintenance and operation services. These effects were partially offset by the payables due to the subsidiary associated with Quality of Service,, commented on above (+€ 10.0 million). Also of note was the reduction in payables due to the subsidiary Terna Storage S.r.l. (-€ 26.5 million), owing to the lower investment activities recorded in the year.

Payables due to associates

This item, of € 1.6 million shows an increase of € 0.4 million compared with the same figure for the previous year, due to payables to the associate CESI S.p.A. for services provided to the Company in studies and research in the electrotechnical sector.

Company commitments to suppliers totalled approximately € 301.6 million and refer to purchase commitments relating to the normal “operating cycle” planned for the period 2017–2021.

Tax liabilities – € 7.6 million

The item relates to the Company's IRES and IRAP tax payables relating to the year and shows a balance of € 7.6 million at 31 December 2016, down with respect to the figure at 31 December 2015 of € 10.9 million attributable substantially to payment in the year of higher tax advances.

Other current liabilities – € 146.8 million

€ million	31.12.2016	31.12.2015	Δ
Payments on account	46.6	56.4	(9.8)
Other tax liabilities	1.3	1.5	(0.2)
Payables to social security institutions	7.1	6.2	0.9
Payables to employees	10.3	13.6	(3.3)
Payables due to subsidiaries	0.8	-	0.8
Other payables to third parties	80.7	70.4	10.3
TOTAL	**146.8**	**148.1**	**(1.3)**

Payments on account

This item (€ 46.6 million) includes the set-up grants received by the Company in relation to assets under construction at 31 December 2016.
With respect to the balance in 2015 (€ 56.4 million), a € 9.8 million decrease was seen, mainly due to the net effect of new payments on account received from third parties (€ 45.7 million, including plant grants received for projects financed by MED/EU) and grants made directly to reduce the carrying amount of assets for € 55.5 million.

Other tax liabilities

The other tax liabilities, of € 1.3 million, include payables for income tax (IRPEF) withheld on salaries recognised at the end of the year and were substantially in line with the amount in the previous year.

Payables to social security institutions

Payables to social security institutions, essentially relating to payables to the pensions agency INPS for employee contributions, showed a balance of € 7.1 million, an increase of € 0.9 million compared to the balance recognised in the previous year, mainly due to greater contributions recognised for personnel incentives (+€ 0.6 million).

Payables to employees

Payables to employees show a balance of € 10.3 million and mainly regard:

- amounts relating to staff incentives and to early retirement to be paid the following year (€ 6.7 million);
- payables due to employees for unused holiday time and abolished public holidays (€ 2.2 million).

The decrease compared to the previous year (€ 3.3 million) is attributable mainly to higher payables recognised in 2015 for amounts to be paid following employees' acceptance of the generational turnover plan launched by the Company in 2014 (-€ 5.9 million), partially offset by higher payables for incentives for personnel (+€ 2.3 million).

Other payables to third parties

Other payables to third parties, equal to € 80.7 million, essentially regard security deposits (€ 66.3 million) received from electricity market operators securing their contractual obligations in respect of dispatching and virtual interconnection contracts and also deferred income (€ 6.5 million, mainly related to the Non-Regulated business).
The change in the item, +€ 10.3 million compared to the previous year, is attributable mainly to the increase in security deposits (+€ 9.6 million).

E. Commitments and risks

Risk management

Terna S.p.A.'s market and financial risks

During the financial year, in conducting its operations, Terna is exposed to various different financial risks: market risk (namely interest rate risk and inflation risk), liquidity risk and credit risk.
This section provides comprehensive 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 measure them, with further quantitative disclosures concerning the 2016 separate financial statements.
Terna's risk management policies seek to identify and analyse the risks the Company is exposed to, establishing appropriate limits and controls and monitoring risks and compliance with such limits. These policies and related systems are revised on a regular basis in order to reflect any changes in market conditions and the Company's activities.
As a part of the financial risk management policies approved by the Board of Directors, Terna S.p.A. has established the responsibilities and operating procedures for financial risk management, specifically as concerns the instruments to be used and the precise operating limits in managing them.

	31.12.2016			31.12.2015		
€ million	Receivables at amortised cost	Hedging derivatives	TOTAL	Receivables at amortised cost	Hedging derivatives	TOTAL
Assets						
Derivative financial instruments	-	325.7	**325.7**	-	688.2	**688.2**
Cash on hand and deposits	945.2	-	**945.2**	435.4	-	**435.4**
Trade receivables	1,373.2	-	**1,373.2**	1,285.8	-	**1,285.8**
TOTAL	**2,318.4**	**325.7**	**2,644.1**	**1,721.2**	**688.2**	**2,409.4**

	31.12.2016				31.12.2015			
€ million	Payables at amortised cost	Loans at fair value	Hedging derivatives	TOTAL	Payables at amortised cost	Loans at fair value	Hedging derivatives	TOTAL
LIABILITIES								
Long-term debt	2,111.9	7,190.4	-	**9,302.3**	2,224.5	6,406.1	-	**8,630.6**
Derivative financial instruments	-	-	12.7	**12.7**	-	-	6.4	**6.4**
Trade payables	1,962.4	-	-	**1,962.4**	1,957.9	-	-	**1,957.9**
TOTAL	**4,074.3**	**7,190.4**	**12.7**	**11,277.4**	**4,182.4**	**6,406.1**	**6.4**	**10,594.9**

Market risks

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 risks include three types of risks: 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 corporate Risk Management policy. Speculative activity is not envisaged in the corporate mission.
Terna S.p.A. seeks to adopt a dynamic approach to financial risk management. This approach is characterised by risk aversion, aiming at minimising risk through continuous monitoring of financial markets in order to plan hedging transactions in favourable market conditions.
The fair value of 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 conducting its operations, Terna is exposed to the risk of fluctuations in interest rates. Its main source of interest rate risk is associated with items of net financial debt and the related hedging positions in derivative instruments that generate financial expense. Terna's borrowing strategy focuses on long-term loans, whose term reflects the useful life of company assets. It pursues an interest rate risk hedging policy that aims to guarantee at least a percentage of fixed-rate debt of 40% as provided for in the corporate policies. Taking into account the low level of interest rates and the new regulatory review, this percentage was taken at 31 December 2016 to more than 80%. Accordingly, the hedging instruments used, at various maturity dates, include both derivatives that transform fixed rates into floating rates and derivatives that transform floating rates into fixed rates.
The financial assets and liabilities in respect of derivative instruments in place during the year can be classified as:

- cash flow hedging derivatives, mainly related to hedging the risk of changes in cash flows associated with long-term floating-rate loans;
- fair value hedging derivatives, related to 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 subscribed by Terna:

	31.12.2016		31.12.2015		Δ	
€ million	Notional amount	Fair value	Notional amount	Fair value	Notional amount	Fair value
FVH derivatives	1,350.0	325.7	3,150.0	688.2	(1,800.0)	(362.5)
CFH derivatives	2,974.1	(12.7)	3,050.2	(6.4)	(76.1)	(6.3)

Sensitivity to interest-rate risk

As regards interest rate risk management, Terna has, on the one hand, entered into fixed-to-floating interest rate swaps (FVHs) to hedge the fair value of fixed-rate risk bonds and, on the other hand, floating-to-fixed interest rate swaps (CFHs) to hedge the expected cash flows in respect of all other floating-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 the perfect temporal matching 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 the income statement at the same time. Accordingly, for FVH derivatives, any changes in the fair value of the hedged item attributable to the risk being hedged must be booked in the income statement, thereby offsetting the changes in the fair value of the derivative booked in the income statement. For CFH derivatives, the changes in the fair value of the derivative must be booked in "Other comprehensive income" (in Shareholders' Equity, recognising any ineffective portion of the hedge directly in the income statement) and then reversed through the income statement in the same period in which the cash flows of the hedged instrument materialise. The characteristics of the CFH derivatives mirror those of the underlying hedged asset so the related cash flows will materialise at the same maturities as the interest on the debt, with no impact of the changes in fair value on the income statement.
The following table reports the amounts booked in the income statement and in "Other comprehensive income" for positions that are sensitive to changes in interest rates, the theoretical value of the positions following a positive or negative shift in the yield curve and the differential impact of such changes recognised in the income statement and in "Other Comprehensive Income". A hypothetical 10% variation in interest rates with respect to market interest rates at the reporting date was assumed:

	Profit or loss			Equity		
€ million	Current rates +10%	Current amounts	Current rates -10%	Current rates +10%	Current amounts	Current rates -10%
31.12.2016						
Positions sensitive to interest rate variations (FVH, bonds, CFH)	(11.1)	**(11.2)**	(11.3)	(12.3)	**(12.8)**	(13.3)
Hypothetical change	0.1	**-**	(0.1)	0.5	**-**	(0.5)
31.12.2015						
Positions sensitive to interest rate variations (FVH, bonds, CFH)	1.1	**1.1**	1.1	(4.9)	**(6.4)**	(7.5)
Hypothetical change	-	-	-	1.5	-	(1.2)

Inflation risk

As regards inflation rate risk, the rates established by Regulators to remunerate Terna S.p.A.'s activities are determined so as to allow coverage of the sector's recognised costs. Such cost components are updated on an annual basis to consider the accrued impact of inflation. Having used an inflation-linked bond issue in 2007, the Company 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 expense.

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 of 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 2016 (as at 31 December 2015), no financial instruments exposed to exchange rate risk were present.

Liquidity risk

The liquidity risk is the risk Terna might encounter difficulty in discharging its obligations in respect of its financial liabilities and operational cycle. Liquidity risk management seeks to ensure adequate coverage of financial needs by obtaining adequate lines of credit and appropriate management of any surplus liquidity. At 31 December 2016, Terna had available short-term credit lines for approximately € 903.0 million and revolving credit lines for € 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 trade receivables and the financial investments of the Company.

The credit risk originated by open positions on transactions in financial derivatives is considered to be marginal since the counterparties, in compliance with financial risk management policies, are leading international credit institutions with high ratings, while in the measurement we take into account the CVA.
Terna provides its services essentially to counterparties considered solvent by the market, and therefore with a high credit standing, and does not have highly concentrated credit risk.
Credit risk management is guided by the provisions of AEEGSI Resolution no. 111/06, which, in Art. 49, introduced instruments for the limitation of risks related to the insolvency of dispatching customers, both on a preventive basis and in the event of 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 defined by the Authority.

The following table summarises the exposure to such risk as at the reporting date.

€ million	31.12.2016	31.12.2015	Δ
FVH derivatives	325.7	688.2	(362.5)
Cash and cash equivalents and other financial assets	945.2	435.4	509.8
Trade receivables	1,373.2	1,285.8	87.4
TOTAL	**2,644.1**	**2,409.4**	**234.7**

The total amount of the exposure to credit risk at 31 December 2016 is represented by the carrying amount of financial assets, 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.

€ million	31.12.2016	31.12.2015
Italy	1,356.7	1,223.9
Euro-area countries	11.9	56.9
Other countries	4.6	5.0
TOTAL	**1,373.2**	**1,285.8**

€ million	31.12.2016	31.12.2015
Distributors	322.9	335.6
CSEA	73.8	82.9
Input dispatching contractors	190.4	189.5
Withdrawal dispatching contractors	718.3	598.3
Parties which have signed virtual import contracts and virtual import services (interconnectors and shippers)	13.0	18.2
Sundry receivables	54.8	61.3
TOTAL	1,373.2	1,285.8

The following table breaks down customer receivables by due date, reporting any potential impairment.

	31.12.2016		31.12.2015	
€ million	Impairment	Gross	Impairment	Gross
Not yet past due	-	1,322.4	-	1,228.8
0-30 days past due	-	31.7	-	1.8
31-120 days past due	-	4.9	-	11.1
More than 120 days past due	(36.8)	51.0	(34.4)	78.5
TOTAL	(36.8)	1,410.0	(34.4)	1,320.2

Changes in the allowance for doubtful accounts in the course of the year were as follows.

€ million	31.12.2016	31.12.2015
Balance at 1 January	(34.4)	(32.2)
Reversal of provision	0.4	0.8
Impairment for the year	(2.8)	(3.0)
TOTAL	(36.8)	(34.4)

The value of guarantees received from eligible electricity market operators is illustrated below.

€ million	31.12.2016	31.12.2015
Input dispatching activity	215.4	246.8
Withdrawal dispatching activity	1,015.4	1,024.1
Grid transmission fees - distributors	287.3	262.1
Virtual importing	93.8	80.0
TOTAL	1,611.9	1,613.0

In addition, non-regulated activities are exposed to “counterparty risk”, in particular with subjects with which contracts involving income are signed, in consideration of the credibility and solvency of the parties in question and the impact that their possible insolvency could have on the financial balance of the business. Counterparty risk is mitigated by implementing special procedures to assess counterparties, which measure economic, financial and reputational aspects of the subjects in question.

Default risk and debt covenants

This risk is associated with the possibility that the loan contracts or bond rules to which the Company is party may contain provisions authorising counterparties to call in such loans immediately upon the occurrence of certain events, thereby generating liquidity risk. For more information on the contractual provisions of outstanding loans at 31 December 2016, please see the section “Loans and financial liabilities” in the notes to Terna S.p.A.’s Consolidated Financial Statements.

Parent company guarantees issued in favour of suppliers of subsidiaries

The Company has issued parent company guarantees in favour of a number of suppliers of the subsidiaries Terna Rete Italia S.p.A. and Terna Crna Gora d.o.o. for contracts connected with construction of the interconnection between Italy and Montenegro. The Company's maximum exposure at 31 December 2016 amounted to € 94.9 million.

Legal disputes

The main off-balance sheet commitments and risks of the Company at 31 December 2016 are as follows.

Litigation concerning licensed activities

Given that it has been the licensee for transmission and dispatching activities since 1 November 2005, the Parent has been involved as a party in a number of cases appealing AEEGSI, MED and/or Terna measures relating to activities operated under the license. Only in cases in which the plaintiffs not only claim defects in the measures, but also allege that Terna violated the rules established by such authorities, or in cases in which the measure had an impact on Terna, the Company appeared before the Court. Within the scope of this litigation, although a number of cases have seen the AEEGSI Resolutions struck down in the first and/or second instance, together with, where applicable, the consequent measures adopted by Terna, it is felt that there is little risk of adverse outcomes for Terna, since the matters generally regard pass-through items. This position is supported by the information provided by the external legal counsel representing the Company in the cases involved. As the licensee for transmission and dispatching activities, the measures taken by the Parent Company Terna when applying the Resolutions adopted by the Authority are sometimes the subject of challenges. In appropriate circumstances, the costs of such challenges may be borne by the Authority.

The Revenue Agency

On 27 March 2012, the Company, as jointly and severally responsible with Enel Distribuzione S.p.A. ("Enel Distribution"), received a notice for the payment of greater taxes due as a result of the sale transaction of the holding owned by Enel Distribuzione in Elat S.r.l. (later Telat S.r.l., today Terna Rete Italia S.r.l.) to Terna S.p.A. (for the amount of approximately € 38 million, including interest). The appeal lodged by Terna against the notice of liquidation was accepted by the Provincial Tax Commission of Rome, with a ruling than confirmed in appeal by the Regional Tax Commission of Rome. The Revenue Agency did not lodge an appeal with the Supreme Court. The favourable ruling, therefore, became definitive; consequently, there is no longer any risk of future financial outlays for the Company.

F. Business combinations

There were no business combinations during FY 2016.

G. Related-party transactions

Terna S.p.A.'s transactions with related parties during the year, taking account of the de facto control exercised over the Company by Cassa Depositi e Prestiti S.p.A. ascertained in 2007, regarded - in addition to the subsidiaries (Terna Rete Italia S.p.A., Terna Rete Italia S.r.l., Terna Crna Gora d.o.o., Terna Plus S.r.l. Terna Storage S.r.l., Rete S.r.l., Terna Interconnector, Monita Interconnector S.r.l., Terna Chile S.p.A., Tamini Trasformatori S.r.l. and the companies controlled by this last – "Tamini Group"), - the associate companies (Cesi S.p.A., CGES A.D. and Coreso S.A.), the employee pension funds (Fondenel and Fopen), Cassa Depositi e Prestiti, CDP Reti S.p.A. as well as companies directly or indirectly controlled by the Ministry of Economy and Finance.
Given that Terna S.p.A. and the subsidiaries specified above fall within the definition of "Government-related entities" as per IAS 24 - "*Related party disclosures*", the Group adopts the partial exemption provided by the same standard, which dispenses with the required disclosures of relationships with other companies controlled, connected or under joint control of the same government body; in particular, the qualitative and quantitative indications of relationships with Government-related entities which have a significant impact on the Group's results are reported below in this section; no amounts relating to "pass-through items" are given here.
Related party transactions in the financial year 2016 are mainly services that are part of core business and regulated by market conditions.
It should be remembered that, in the current organisational structure of the Terna Group, in signing the business unit rental agreement with the Company, and the consequent specific infra-group contracts, the subsidiary Terna Rete Italia S.p.A. is tasked with performing all operational activities, ordinary and extraordinary maintenance of the section of the NTG owned, and management and performance of work on developing the grid as provided for in the Concession for transmission and dispatching, and on the basis of the provisions of Terna's Development Plan.
Terna also provides for the operative management of all subsidiaries by means of specific service agreements that not only assure the administrative and financial coordination and the coordination of institutional relations, but also enable it to act on behalf of the subsidiaries, or for and on their behalf.
Please also note that the Company has entered into a two-year contract with the subsidiary Terna Storage, for "safeguarding the construction" of diffused energy storage systems projects, as well as the related "coordination", "study" and "research" activities.
As concerns the non-regulated activities, the Company uses the services offered by the subsidiary Terna Plus S.r.l., in accordance with the current intercompany service agreement.

From the financial point of view, Terna is involved in the management of cash demands of subsidiaries through specific Treasury contracts that ensure the guidance and coordination of all transactions in relation to financial resource and needs management and treasury services, as well as the implementation of all related transactions.

The table below also sets out the contractual terms and conditions of the financial contracts in place with the subsidiaries.

	Intercompany current a/c		
	Loan	Inventories	Utilisations
Terna Rete Italia S.r.l.	-	Euribor monthly average 1 month + 0.30%	Euribor monthly average 1 month + 0.80%
Terna Rete Italia S.p.A.	-	Euribor monthly average 1 month + 0.30%	Euribor monthly average 1 month + 0.80%
Terna Plus S.r.l.	-	Euribor monthly average 1 month + 0.30%	Euribor monthly average 1 month + 0.80%
Terna Storage S.r.l.	-	Euribor monthly average 1 month + 0.30%	Euribor monthly average 1 month + 0.80%
Rete S.r.l.	-	Euribor monthly average 1 month + 0.30%	Euribor monthly average 1 month + 0.80%
Monita Interconnector S.r.l.	-	Euribor monthly average 1 month + 0.30%	Euribor monthly average 1 month + 0.80%
Terna Interconnector S.r.l.	Euribor 12 months +0.31%	-	-

Below is a summary of the main intercompany contracts in place at 31 December 2016.

Counterparty	Type	Annual price
Terna Rete Italia S.p.A.	**Service agreement:**	
	Operation & Maintenance	€ 254,164,086
	Renewal and development	equal to costs incurred + 5.82% on the personnel expenses incurred
	Administrative, assistance and consulting services	
	- from Terna S.p.A. to Terna Rete Italia S.p.A. (receivable)	€ 24,027,367
	- from Terna Rete Italia S.p.A. to Terna S.p.A. (liabilities)	€ 2,776,885
	Lease of areas able to be set up as employee workstations	
	- from Terna S.p.A. to Terna Rete Italia S.p.A. (assets)	€ 1,575,668
	- from Terna Rete Italia S.p.A. to Terna S.p.A. (liabilities)	€ 239,630
	Business unit rent	€ 32,996,772
Terna Rete Italia S.r.l.	**Admin., assist. and consult. service agreement (assets)**	€ 397,476
Rete S.r.l.	**Service agreement:**	
	Renewal and development	equal to costs incurred + 5.82% on the personnel expenses incurred
	Admin., assist. and consult. service agreement (assets)	€ 1,044,893
Terna Plus S.r.l.	**Service agreement:**	
	Non-traditional activities by Terna (liabilities)	€ 42,249
	Management fee (assets)	€ 713,528
	Other administrative services att. to contract (assets)	€ 53,428
	Lease of areas able to be set up as employee workstations (receivable)	€ 227,197
Tamini Group	**Administrative service agreement (receivable)**	€ 289,109
Terna Storage S.r.l.	**Administrative, assistance and consulting service agreement (receivable)**	€ 233,214
	Service agreement (payable)	
	Coord., study and monitoring of storage system dev. activities	€ 800,000
	Lease of areas able to be set up as employee workstations (receivable)	€ 6,682
Terna Interconnector S.r.l.	**Administrative service agreement (receivable)**	€ 675,750
	Oversight and coordination for construction of the civil works of the Italy-France connection (payable)	equal to costs incurred + 5.82% on the personnel expenses incurred
Monita Interconnector S.r.l.	Administrative services, support for operations and preparations for implementation of the project	€ 144,396
Terna Chile S.p.A.	Management fee (assets)	€ 83,000
Terna Crna Gora d.o.o.	**Service agreement:**	
	Technical services	equal to costs incurred + 5.82%
	Administrative services	€ 90,074

We note that as regards taxation Terna S.p.A. is the consolidator in the context of the IRES tax consolidation in which the following subsidiaries are included: Terna Rete Italia S.p.A., Terna Rete Italia S.r.l., Rete S.r.l., Terna Storage S.r.l., Terna Plus S.r.l., Tamini Trasformatori S.r.l. and the related Italian subsidiaries.

The following tables specify the nature of the transactions implemented by the Company with related parties[39] and the respective income and expense totalled during the year, in addition to the respective receivables and payables in place as of 31 December 2016.

Related party	Revenue transactions	Cost transactions
Parent Company		
Cassa Depositi e Prestiti S.p.A.		Credit line.
Related parties – Subsidiaries – Regulated Activities		
Terna Rete Italia S.p.A.	Rental charges, administrative services, lease of employee workstations and other services.	Maintenance and other technical services, grid renewal and development, Quality of Service exemption, administrative services, employee workstation leasing.
Terna Rete Italia S.r.l.	Management fees, other services.	Grid transmission fee (TF).
Terna Storage S.r.l.	Administrative, assistance and consulting services, workstation and HQ common area leasing and other services.	Coordination of system dev. activities
Rete S.r.l.	Provision of technical and administrative services.	Grid transmission fee (TF).
Terna Crna Gora d.o.o.	Administrative services, provisions of seconded and transferred staff.	
Related parties – Subsidiaries – Non-Regulated Activities		
Terna Plus S.r.l.	Technical, administrative and financial services, space and workstation leasing	Management of Non-Regulated Activities
Tamini Group	Administrative services and other services.	
Terna Interconnector S.r.l.	Administrative and consultancy services, loan contract.	Oversight and coordination for construction of the civil works of the Italy-France connection.
Monita Interconnector S.r.l.	Administrative services, support for operations and preparations for implementation of the interconnection project.	
Piemonte Savoia S.r.l.	Reversal of costs incurred for development of the interconnection project.	
Terna Chile S.p.A.	Administrative services	
Associates		
Cesi S.p.A.	Leasing of laboratories and other similar structures for specific purposes, dividends.	Studies and technical consultancy services, research, design and experimentation
CORESO S.A.		Technical TSO coordination services.
Other related companies		
GSE Group	MIS component, dispatching fee.	Leasing of spaces and workstations.
Enel Group	TF fee and aggregation of measures, dispatching fee, leasing and rentals, line maintenance, works to move/vary lines, optical fibre housing and maintenance of power line communication on company-owned power lines.	Return of electricity discount, building services, supply of MV power to new stations, specialised services for connection to Terna control and protection systems.
Ferrovie Group	Dispatching fee, line moving work.	Right-of-way fees.
ENI Group	Dispatching fee.	Contributions for NTG connections, sundry services.
Poste Italiane		Sundry services.
CONI Servizi S.p.A.		Sundry services.
ANAS S.p.A.	Work on line moving/variants	Right-of-way fees.
Fondenel and Fopen		Pension contributions borne by the Terna Group

(39) The natures of the items related to centralised treasury management and the tax consolidation already described above are excluded from the table.

ECONOMIC TRANSACTIONS

€ million	Income items			Negative income components
	Grid transmission fees and other energy-related items	Non energy-related items	Dividends	Non energy-related items
Subsidiaries:				
Terna Rete Italia S.p.A.	-	57.1	-	277.4
Terna Rete Italia S.r.l.	-	1.4	-	-
Tamini Group	-	0.3	-	0.3
Terna Crna Gora d.o.o.	-	1.3	-	-
Terna Plus S.r.l.	-	1.1	-	-
Terna Storage S.r.l.	-	0.3	-	0.8
Rete S.r.l.	-	1.1	-	-
Terna Interconnector S.r.l.	-	0.9	-	-
Monita Interconnector S.r.l.	-	0.1	-	-
Piemonte Savoia S.r.l.	-	1.6	-	-
Terna Chile S.p.A.	-	0.1	-	-
Total subsidiaries	**-**	**65.3**	**-**	**278.5**
De facto parent company:				
Cassa Depositi e Prestiti S.p.A.	-	-	-	4.7
Total de facto parent company	**-**	**-**	**-**	**4.7**
Associates:				
Cesi S.p.A.	-	-	1.1	0.1
CORESO S.A.	-	-	-	1.6
Total associates	**-**	**-**	**1.1**	**1.7**
Other related companies:				
GSE Group	22.9	-	-	0.4
Poste Italiane Group	-	0.1		0.1
Enel Group	1,485.3	-	-	0.1
Eni Group	4.5	-	-	-
Ferrovie Group	2.3	-	-	0.1
CONI Servizi S.p.A.	-	-	-	0.1
Total other related companies	**1,515.0**	**0.1**	**-**	**0.8**
Pension funds:				
Fondenel	-	-	-	0.3
Fopen	-	-	-	0.3
Total pension funds	**-**	**-**	**-**	**0.6**
TOTAL	**1,515.0**	**65.4**	**1.1**	**286.3**

€ million	EQUITY TRANSACTIONS					
	Property, plant and equipment	Receivables and other assets		Payables and other liabilities		
	Capitalised costs	Other	Financial	Other	Financial and position of inter-company current account	Guarantees**
Subsidiaries:						
Terna Rete Italia S.p.A.*	49.3	16.5	-	360.5	236.4	-
Terna Rete Italia S.r.l.*	-	35.1	-	26.4	(132.4)	-
Tamini Group*	4.7	0.3	-	0.3	-	-
Terna Crna Gora d.o.o.	1.1	0.7	-	-	-	-
Terna Plus S.r.l.*	-	0.3	-	0.4	27.5	-
Terna Storage S.r.l.*	-	-	-	3.4	6.6	-
Rete S.r.l.*	-	0.7	-	6.1	25.2	-
Terna Interconnector S.r.l.	0.8	0.2	39.0	0.3	-	-
Monita Interconnector S.r.l.	-	0.2	-	-	(0.1)	-
Terna Chile S.p.A.	-	0.2	-	-	-	-
Total subsidiaries	**55.9**	**54.2**	**39.0**	**397.4**	**163.2**	**-**
De facto parent company:						
Cassa Depositi e Prestiti S.p.A.	-	-	0.5	0.1	500.6	-
Total de facto parent company	**-**	**-**	**0.5**	**0.1**	**500.6**	**-**
Associates:						
Cesi S.p.A.	2.0	0.1	-	1.6	-	1.2
Total associates	**2.0**	**0.1**	**-**	**1.6**	**-**	**1.2**
Other related companies:						
GSE Group	-	4.2	-	-	-	-
Enel Group	0.6	281.0	-	4.7	-	509.9
Eni Group	-	0.8	-	0.9	-	19.9
Ferrovie Group	0.1	0.6	-	0.1	-	24.2
ANAS S.p.A.	-	0.5	-	0.3	-	-
Total other related companies	**0.7**	**287.1**	**-**	**6.0**	**-**	**554.0**
Pension funds:						
Fopen	-	-	-	0.2	-	-
Total pension funds	**-**	**-**	**-**	**0.2**	**-**	**-**
TOTAL	**58.6**	**341.4**	**39.5**	**405.3**	**663.8**	**555.2**

* The balances of the item "Others" include payable/receivable items related to the IRES Tax Consolidation.

** The guarantees refer to the bank guarantees received on contracts.

H. Significant non-recurring events and transactions, and atypical or unusual transactions

No significant, non-recurring, atypical or unusual transactions - with the exception of those described above - were carried out during 2016, either with third parties or with related parties.

I. Notes to the statement of cash flows

The cash flow generated from **continuing operations** in the year amounted to around € 1,266.4 million, which reflects around € 1,368.0 million in cash from operating activities (self-financing) and around € 101.6 million in financial resources generated by the management of net working capital.
Investing activities used net financial resources of around € 649.9 million, and mainly included € 611.6 million of investment in property, plant and equipment (€ 667.1 million net of plant grants totalling € 55.5 million) and € 39.3 million of investment in intangible assets.
The cash flow for investing activities also reflects the change in the equity investments held by the Company, mainly for the capital increase subscribed in the subsidiary Terna Crna Gora d.o.o. (€ 28.0 million), and for the impairment of the equity investment in the associate CGES (€ 4.3 million).
The net change in **loan flows** in relation to shareholders' equity drops by € 406.2 million due to the disbursement of the 2015 dividend balance (€ 261.3 million) and the 2016 interim dividend (€ 144.9 million).

Consequently, the financial resources used in investing activities and the remuneration of equity during the year, led to total financial requirements of € 1,056.1 million, covered totally by the cash flows generated by operating activities (€ 1,266.4 million). During the year the net financial debt shows an increase in line with the Strategic Plan.

L. Proposal for the allocation of profits for the year

For FY 2016, Terna S.p.A.'s Board of Directors proposes distributing a total dividend of € 414,058,352.00, equal to € 0.206 per share (corresponding to +3% compared to the dividend distributed in the previous year), of which € 0.0721 per share resolved as an interim dividend on 04 November 2016 in keeping with the dividend policy communicated to the market .

The Board of Directors therefore proposes to allocate the net profit for FY 2016 of Terna S.p.A., totalling € 535,483,732.96, as follows:

- € 144,920,423.20 to cover the interim dividend payable as from 23 November 2016;
- € 269,137,928.80 as a final dividend to be distributed in the amount of € 0.1339 for each one of the 2,009,992,000 ordinary shares at the date of the present Board of Directors meeting to be paid on 21 June 2017, with "ex-dividend date" of coupon no. 26 on 19 June 2017 (record date, pursuant to Art. 83-*terdecies* of Italian Legislative Decree no. 58 of 24 February 1998, the "Consolidated Law on Finance": 20 June 2017);
- € 121,425,380.96 as Profits Carried Forward.

M. Subsequent events

Agreement for the acquisition of two concessions for the construction and operation of grids in Brazil

On **2 February 2017**, through its subsidiary Terna Plus, Terna signed an agreement with Planova, a Brazilian company that constructs civil works and infrastructure, aimed at acquiring two concessions to create a total of around 500 km of electricity infrastructure in the South American nation. The operation comes within the scope of Terna's strategy for development of electricity grids and infrastructures abroad, thanks to the know-how gained in the core business of electricity transmission.
The two concessions, which will last for thirty years, will involve the construction of 158 km of new lines in the state of Rio Grande do Sul and 350 km in the state of Mato Grosso. The total value of the contract is around $ 180 million. The agreement envisages that the Terna Group will have ownership of the lines concession and operation, while engineering, planning and construction (EPC) will be assigned to Planova, as the "executor" on Terna's account. The deal will enable Terna to make use of its industrial role through a project of dimensions and characteristics in compliance with the corporate strategy, in support of long-term growth and value creation. Final closing of the contract signed by Terna Plus and Planova is conditional on the following: Planova must obtain all permits and licenses needed for construction and operation of the infrastructure, and the go ahead from the Brazilian anti-trust authorities (Cade - Conselho Administrativo de Defesa Econômica) and the Regulator (Aneel - Agência Nacional de Energia Elétrica).

"Udine Ovest-Redipuglia" power line: the authorisation decree relaunches work on the project

On **14 February 2017**, the Ministry of Economic Development issued the authorisation decree for the "Udine Ovest-Redipuglia" power line and associated creation, no. 239/EL-146*bis*/245/2017 of 14 February 2017. Terna accepted with satisfaction the new authorisation decree, which closes the procedure opened at the end of 2015 and will make it possible to reopen the construction site and to finish a project necessary for electrical security of Friuli Venezia Giulia, already 80% complete.
On 12 November 2015 Terna had received approval, from the Ministry of Economic Development, for the launch of the redetermination procedure. The new procedural process also entailed an Environmental Impact Assessment (EIA) proceeding, which ended with a positive decree (9 September), the Services Conference at the Ministry of Economic Development (on 18 October) and the positive opinion on the State-Region Understanding of the FVG executive committee (9 December).
The 40 km of new line, built thanks to an investment of approximately € 110 million, will make secure the electricity grid in the Region which is based on infrastructures created at the beginning of the 1980s, and will make it possible to demolish 110 km of old lines and around 400 pylons in 30 Municipalities of lower Friuli. 680 buildings located today at 100 metres from the lines to be demolished will benefit from this decommissioning and 367 hectares of land will be freed from power line easements.

Disclosure pursuant to art. 149-*duodecies* of the CONSOB issuer regulations

The following table, prepared in accordance with Art. 149-*duodecies* of the CONSOB Issuer Regulations, presents the fees for 2016 for the audit and non-audit services provided to Terna S.p.A. by the auditing companies.

In €	Entity providing service	Fees due for the year
Statutory audit	PwC	222,888
Attestation services	PwC	171,000
Total		**393.888**

Certification of the separate financial statements pursuant to Art. 81 ter of Consob Regulation no. 11971 dated 14 May 1999 and subsequent amendments and additions

"Terna S.p.A. Financial Statements"

1. The undersigned Matteo Del Fante, as CEO, and Tiziano Ceccarani, as Executive officer responsible for preparation of the financial report for TERNA S.p.A., also considering that established by art. 154 *bis,* paragraphs 3 and 4 of Italian Legislative Decree no. 58 of 24 February 1998, certify:
   - the suitability in relation to the business characteristics; and
   - the effective application of the administrative and accounting procedures for the preparation of the separate financial statements during financial year 2016.
2. The assessment of the suitability of the administrative and accounting procedures for the preparation of the separate financial statements as at 31/12/2016, is based on a set of standards and methodologies defined by Terna S.p.A. in line with the Internal Control – Integrated Framework model issued by the Committee of Sponsoring Organizations of the Treadway Commission, which represents a set of reference standards for the internal control and risk management system, generally accepted worldwide.
3. It is also specified that:

   3.1. the separate financial statements at 31 December 2016:

   a. are prepared in compliance with the applicable international accounting standards recognised in the European Community in accordance with Regulation (EC) no. 1606/2002 of the European Parliament and Council of 19 July 2002 and the provisions issued in implementation of art. 9 of Italian Legislative Decree no. 38/2005;

   b. correspond to the entries in the books and accounting records;

   c. are suitable to providing a true and fair view of the economic and financial position of the issuer;

   3.2. the report on operations includes a reliable analysis of the trend and operating result, in addition to the position of the issuer and a description of the main risks and uncertainties to which it is exposed.

Rome, 15 March 2017

Chief Executive Officer (Matteo Del Fante)	Executive officer responsible for the preparation of the Company's financial report (Tiziano Ceccarani)

This certification is an English translation of the original certification, which was issued in Italian. This certification has been prepared solely for the convenience of international readers.

Report of the Board of Statutory Auditors to Terna S.p.A.'s Shareholders' Meeting under the terms of 153 of Italian Legislative Decree No. 58 of February 24, 1998 (Consolidated Law on Finance) and of Article 2429, third paragraph, of the Italian Civil Code

Dear Shareholders,

During the year ended December 31, 2016, the Board of Statutory Auditors carried out supervisory activities in accordance with the law, adapting its operations to the code of conduct of the Board of Statutory Auditors of listed companies issued by the Italian National Board of Chartered and Public accountants (Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili), the recommendations of the National Commission for Companies and the Stock Exchange (CONSOB) regarding corporate controls and activities of the Board of Statutory Auditors and the guidelines of the Corporate Governance Code of the Italian Stock Exchange (Corporate Governance Code).

The statutory audit duties pursuant to Legislative Decree No. 39 of January 27, 2010, (Legislative Decree No. 39/2010) have been assigned to the auditing firm PricewaterhouseCoopers S.p.A., appointed by the Shareholders' Meeting of May 13, 2011 for the nine years from 2011 to 2019.

Also in compliance with the provisions issued by CONSOB with Notice DEM/1025564 dated April 6, 2001 and subsequent updates, we report the following:

- We monitored that the Law and the By-laws were complied with.
- We attended the meetings of the Board of Directors and specific preparatory meetings regarding the items on its agenda, as well as the meetings of the Audit and Risk, Corporate Governance and Sustainability Committee (former Audit, Risk and Corporate Governance Committee) and were regularly informed by the Directors regarding the activities carried out, the expected outlook and the most significant economic, financial and equity transactions of the Company, and we were satisfied

that the resolutions adopted and implemented were compliant with the Law and the By-laws and were not manifestly imprudent, risky, and did not represent a potential conflict of interest, or contradict the resolutions passed by the Shareholders' Meeting or compromise the Company's assets. During the assessments, no atypical and/or unusual operations were identified. In fulfilling our mandate, we analysed the information flows from various corporate structures and we also conducted interviews with senior management of the Company, with the auditing firm and with the supervisory bodies of the subsidiaries.

- The Board of Directors, at the meeting of March 15, 2017, on the proposal 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 the compliance and effective application of the "Procedure for Related-Party Transactions" recently updated by the Board of Directors on December 15, 2016 and governed by Article 4 of the CONSOB Regulation referred to in Resolution No. 17221 of March 12, 2010, as subsequently amended and updated.
- The Company drafted the 2016 financial statements according to International Accounting Standards (IAS/IFRS). These financial statements were audited by PricewaterhouseCoopers S.p.A., which issued its own report on April 5, 2017 without objections or calls for further disclosure. The financial statements, together with the Report on Operations, was made available to us in the terms of the law and we have no particular comments.
- The Company drafted the 2016 consolidated financial statements of the Terna Group according to International Accounting Standards (IAS/IFRS). These financial statements were also audited by PricewaterhouseCoopers S.p.A., which issued its own report on April 5, 2017 without objections or calls for further disclosure.
- Among the most significant operations carried out during 2016, we note the following, referring you to the Report on Operations for a more detailed analysis:

– issue of a bond of € 750 million at 1% interest rate;

– resolution of merger by incorporation of the subsidiaries Terna Rete Italia S.r.l. and Terna Storage S.r.l..

- We collected information and monitored, as far as our authority allowed, the adequacy of the Company's corporate structure, compliance with the principles of proper management and the adequacy of the provisions issued by the Company to the subsidiaries pursuant to Article 114, paragraph 2 of the Consolidated Law on Finance, by acquiring information from the Heads of the designated company departments, through meetings held with the Auditing firm and through meetings held with the audit bodies of the most important subsidiaries in terms of size.
- We monitored the adequacy of the administrative and accounting system, assessing the reliability of the latter 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 auditing firm PricewaterhouseCoopers S.p.A. The Chief Executive Officer and the Executive in charge of preparing the Company's accounting documents have, with a special report attached to the 2016 financial statements, attested: a) the adequacy and effective application of accounting and administrative procedures; b) the conformity of the contents of financial reports to international accounting standards; c) the alignment of the documents themselves to the books and records and their ability to accurately reflect the assets, and economic and financial position of the Company. A similar attestation is attached to the Terna Group Consolidated Financial Statements.
- We assessed the adequacy of the internal audit system through: a) examination of the report of the Head of Internal Audits 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 supervisory bodies of the main subsidiaries pursuant to the first and second paragraph of Article 151 of the Consolidated Law

on Finance; d) participation in meetings of the Audit and Risk, Corporate Governance and Sustainability Committee and the acquisition of the relevant documentation; e) meetings with the Executive in charge of preparing the Company's accounting documents and the Chief Risk Officer. Attending the Audit and Risk, Corporate Governance and Sustainability Committee meetings allowed the Board of Statutory Auditors to coordinate with the activities of the said Committee for the performance of its own functions as "Internal Audit and Accounting Committee" assumed on the basis of Article 19 of Italian Legislative Decree No. 39/2010 and, in particular, to oversee: a) the financial reporting process; b) the effectiveness of internal audit, accounting and risk management systems; c) the statutory audit of accounts; d) matters relating to the independence of the auditing firm.

On the basis of the activity carried out, considering the evolutionary nature of the Internal Audit System, the Board of Statutory Auditors expresses an evaluation of its overall adequacy and notes that there are no observations to report to the Shareholders' Meeting. With reference to the provisions of par. 9, point a) of Article 17 of Italian Legislative Decree No. 39/2010, the auditing firm PricewaterhouseCoopers S.p.A. has defined total fees for the Auditing of the Terna S.p.A.'s Separate and Consolidated financial statements as at December 31, 2016, as well as the limited auditing of the Interim financial statements, for the activities of assessment of regular accounting activities, and for the other assignments. The fees for these services (including expenses) totals € 223,800, composed as follows:

- Audit of unbundling for AEEGSI 35,200
- Audit of reporting package 17,600
- Opinion on interim dividends 35,200
- Certification of Sustainability Report 44,000
- Issue of EMTN comfort letter 91,800.

Moreover, Pricewaterhouse Coopers has notified that, based on the best information available, taking into account prescribed and professional requirements that discipline the auditing activity, it has maintained in the reference period its position of independence and objectivity towards Terna S.p.A. and that there have been no changes in the non-existence of elements of incompatibility with reference to the situations and the subjects provided for by Article 17 of Legislative Decree No. 39/2010 and of the articles referred to in Heading I-*bis* of Title VI of the Issuer Regulation adopted with CONSOB Resolution No. 11971 of May 14, 1999.

- We held periodic meetings with the representatives of the auditing firm, Pricewaterhouse Coopers S.p.A., pursuant to Article 150, paragraph 3 of the Consolidated Law on Finance, and no facts worthy to be mentioned in this Report emerged. We also note that on April 5, 2017 the Auditing firm has submitted its report, pursuant to the third paragraph of Article 19 of Legislative Decree No. 39/2010, reporting that in completing the auditing activities, no fundamental issues or significant lacks in the internal control system, with reference to the process of financial information reporting, have emerged.
- We monitored the procedures for effective implementation of the Corporate Governance Code adopted by the Company, as set forth in the Report on Corporate Governance and Ownership Structure approved by the Board of Directors on March 21, 2016. With reference to the recommendations within the competence of the Board of Statutory Auditors, we point out that:
  - we verified the correct application of the criteria and procedures for assessing independence, adopted by the Board of Directors;
  - regarding the self-assessment of the independence requirements of the members of the Board of Statutory Auditors, we verified its existence during the Board meeting of February 20, 2017, with methods consistent with those adopted by the directors;

- we complied with the provisions of the regulation for managing and handling confidential and privileged company information.

Finally, it should be noted that the Auditing firm expressed its opinion regarding coherence of information with respect to the separate and consolidated financial statements pursuant to paragraph 4 of Article 123-*bis* of the Consolidated Law on Finance provided in the Report on Corporate Governance and Ownership Structure.

- With reference to Legislative Decree No. 231 of June 8, 2001, the Company has, for some time, adopted an organisational and management model, constantly updated, which is compliant with best practices. Similar models have been adopted by the subsidiaries. During the year, the Board of Statutory Auditors maintained a constant information flow 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 that should be mentioned in this report.
- We have received no complaints under Article 2408 of the Civil Code, nor do we have knowledge of facts or statements which need to be passed on to the Shareholders' Meeting.
- We have verified compliance with the laws regarding the drawing up of the separate and consolidated financial statements and the Report on Operations, directly and with the collaboration of the Heads of departments and through information obtained by the Auditing firm, 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 Civil Code (remuneration of directors holding special office).
- The auditing firm issued the opinion referred to in paragraph 5 of Article 2433-*bis* of the Italian Civil Code (interim dividends).
- The members of the Board of Statutory Auditors have complied with the obligation to notify administration and audit assignments in Italian companies with the

timeframes and methods provided for in Article 148-*bis* of the Consolidated Law on Finance and Heading II of title V-*bis*, Part III of the cited Issuer Regulation.

- During 2016, the Board of Statutory Auditors met seven times, attended the nine meetings of the Board of Directors, the eight meetings of the Audit and Risk, Corporate Governance and Sustainability Committee and the Shareholders' Meeting of May 30, 2016.

On the basis of its activities and the information acquired, the Board of Statutory Auditors found no omissions, reproachable facts, irregularities, or other circumstances that require reporting to the supervisory authorities or mention in this report.

Having reviewed the financial statements at December 31, 2016, the Board of Statutory Auditors has no objections to raise as regards the proposed resolutions presented by the Board of Directors.

Rome, April 5, 2017

On behalf of the Board of Statutory Auditors
The Chairman
Riccardo Schioppo

INDEPENDENT AUDITORS REPORT IN ACCORDANCE WITH ARTICLES 14 AND 16 OF LEGISLATIVE DECREE 39 OF 27 JANUARY 2010

To the shareholders of
Terna SpA

Report on the separate financial statements

We have audited the accompanying separate financial statements of Terna SpA, which comprise the statement of financial position as of 31 December 2016, 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, a summary of significant accounting policies and other explanatory notes.

Directors responsibility for the separate financial statements

The directors of Terna SpA are 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, as well as with the regulations issued to implement article 9 of Legislative Decree 38/2005.

Auditors responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (ISA Italia) drawn up pursuant to article 11 of Legislative Decree 39/10. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The audit procedures selected depend on the auditor professional judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity preparation of financial statements that give a true and fair view, to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the separate financial statements give a true and fair view of the financial position of Terna SpA as of 31 December 2016 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, as well as with the regulations issued to implement article 9 of Legislative Decree 38/2005.

Report on compliance with other laws and regulations

Opinion on the consistency of the report on operations and of certain information set out in the report on corporate governance and ownership structure with the separate financial statements

We have performed the procedures required under auditing standard (SA Italia) 720B to express an opinion, as required by law, on the consistency of the report on operations and of the information set out in the report on corporate governance and ownership structure referred to in article 123-bis, paragraph 4, of Legislative Decree 58/98, which are the responsibility of the directors of Terna SpA, with the separate financial statements of Terna SpA as of and for the year ended 31 December 2016. In our opinion, the report on operations and the information in the report on corporate governance and ownership structure mentioned above are consistent with the separate financial statements of Terna SpA as of and for the year ended 31 December 2016.

Rome, 5 April 2017

PricewaterhouseCoopers SpA

Signed by

Paolo Caccini
(Partner)

This report has been translated into English from the Italian original solely for the convenience of international readers

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