

3.3 Wholesale and Retail

Regulatory environment of the business

Spain

- Royal Decree Law 15/2018 on urgent measures for the ecological transition and consumer protection was approved in October 2018. Among other measures, it expands coverage of subsidised electricity rates (*bono social*) (adding special groups and increasing the limits on annual consumption with the right to a discount), and establishes the creation of a new subsidised thermal rate (annual direct assistance for the same beneficiaries of the electric rate as at 31 December of each year).
- This Royal Decree Law also contains tax measures, including:
 - The suspension for six months (October 2018 – March 2019) of value added tax on the production of electric energy.
 - Exemption from the hydrocarbon tax for products destined for electricity production at electric plants or the production of electricity or cogeneration of electricity and heat at combined cycle plants.

Mexico

- In 2018 there was a change in the method for calculating the electricity tariff for medium- and high-voltage customers, which went from an integral rate to an additive rate. This cost recovery for the system was less than the actual costs during the first quarter, creating a deficit that has to be recovered during the next three quarters.

United Kingdom

- In November 2018, *Ofgem* for the first time published price limits for standard tariffs and other default tariffs. The new limits that will apply from April to October 2019 were published on 7 February: 1,254 pounds annually for dual customers (electricity and gas customers with direct debit). The price limits will apply until no later than 2023 and will be updated on a half-yearly basis.
- The T-4 capacity auction for 2021/22 was held in February 2018, resulting in the award of a total of 2,299 MW to Iberdrola at a price of £8.40/MW.
- That same month there was the 2018/19 T-1 capacity auction, in which Iberdrola's plants did not participate as they won the T-4 auction held in 2014.
- In November 2018 the EU Court of Justice rendered a judgement nullifying approval of the capacity auctions in the United Kingdom as being state subsidies. The government is working with the European Commission to re-establish the Capacity Market as soon as possible.

Brazil

- In December 2018 Ministerial Decree no. 514/2018 was published, advancing with the liberalisation of the electric market and providing that consumers supplied with conventional energy with a capacity of more than 2.5 MW (as from July 2019) and with a capacity of more than 2 MW (as from January 2020) can migrate to the free market.

Objectives, risks and principal activities

Objectives

- Competitive supply and excellence in service to customers.
- Occupational safety.
- Environmental management and protection of biodiversity.
- Operational excellence and continuous improvement in efficiency.
- Risk identification and minimisation.
- Development of growth opportunities and new energy solutions.

Significant risks

- Regulatory risk: Changes in regulations in the countries in which it operates.
- Operational risks: Availability rate of facilities and potential incidents with environmental impact.
- Market risk: Fuel prices and competition levels in liberalised markets.
- Credit, exchange-rate and interest-rate risks.
- Technological and cybersecurity risks affecting the security of the facilities or the information of our customers.

Principal activities 2018

- **Spain:** Continued development of products and services adapted to the needs of customers (*Customised Plans, Smart services, Smart mobility, Smart solar, Smart home*).
- **United Kingdom:** In June 2018 and in October 2018 the increases in the dual tariffs for domestic customers (5.5% and 3.7%, respectively) became effective. At year-end 2018 a cumulative total of 1.2 million smart meters had been installed, meeting the goal set by *Ofgem*.

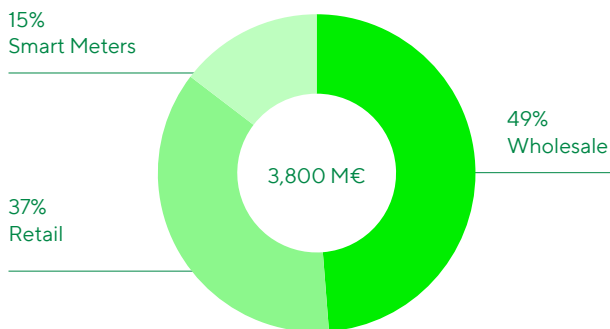
The generating assets in the country were also sold, which for conventional generation meant a reduction in installed thermal capacity of 2,000 MW.

- **Mexico:** Placement into service of 952 MW (878 MW Escobedo CC, 52 MW Bajío cogeneration and 22 MW repowering). Approximately 2,600 MW thermal under construction.
- **Europe:** Growth in retail activity. 734,000 contracts in portfolio reached during 2018.

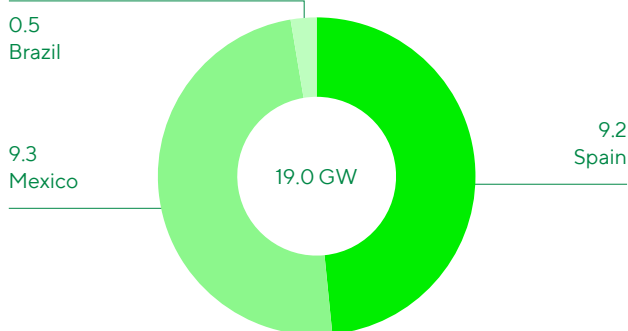
Outlook 2018-2022

- Net investments of €3,800 million during the period for retail growth in the core markets and international expansion, continued deployment of meters in the United Kingdom and growth in installed capacity in Mexico.
- *Smart Solutions* and cost efficiencies will allow for 32 million contracts with customers to be reached by 2022. In addition, 3.5 GW of regulated generation will enter into service in Mexico during the period.
- Efficiencies deriving from digitisation, the deployment of smart meters and preventative maintenance based on artificial intelligence and data analytics.

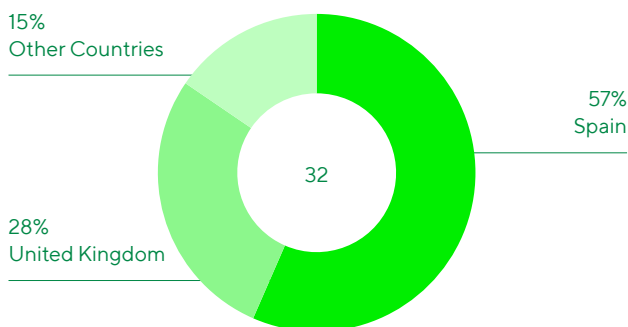
Net investment 2018-2022 (€M)



Installed Capacity in 2022 (GW)



Contracts with customers in 2022 (M contracted)



The Wholesale and Retail Business concentrates its efforts on the safety of operations, environmental management, operational efficiency, customer loyalty, development of new products and services, and growth in Mexico, which will provide stability in results and the generation of funds for the group.

Key figures of the Wholesale and Retail Business

Item	Unit	Spain		United Kingdom		United States		Brazil		Total	
		2017	2018	2017	2018	2017	2018	2017	2018	2017	2018
Gross margin	€M	2,293	2,415	743	863	75	134	646	757	3,757	4,168
EBITDA	€M	779	1,001	108	307	51	92	525	638	1,464	2,038
Electricity contracts	Millions	10.17	10.15	2.88	3.01 ¹	-	-	-	-	13.05	13.16 ¹
Gas contracts	Millions	0.99	1.03	1.90	2.01 ¹	-	-	-	-	2.89	3.04 ¹
Smart solutions contracts	Millions	5.3	5.7	0.9	1.4	0.1	0.1	-	-	6.3	7.1
Total retail contracts	Millions	16.6	17.2	6.0	6.4	0.1	0.1	-	-	22.7	23.7
Investments	€M	138	229	220	194	18	12	694	616	1,071	1,050
Workforce	No. of people	2,815	2,817	1,968	1,609	98	98	711	855	5,592	5,379

International Financial Reporting Standard (IFRS) 11 has been applied to the financial information.

(1) Data from United Kingdom customers at close of nine months 2018.

Efficiency

- Optimisation of thermal production.
- Facilitating operations in complementary markets.
- Operating improvements and increase in availability and energetic yield of the thermal facilities in Mexico and Spain.

Prices

- Management of risks through appropriate hedging of all generation, including renewable generation.

Growth

- Mexico: Approximately 2,600 MW under construction, with the most significant projects including:
 - Topolobampo II CCGT (911 MW).
 - El Carmen CCGT (866 MW).
 - Topolobampo III CCGT (779 MW).
- United Kingdom: Continued widespread deployment of smart meters that began in 2016.

Customers

- Loyalty-building and development of new digital products and smart solutions adapted to the needs of customers, which promotes efficiency and the consumption of clean energy.
- Retail development in Mexico pursuant to changes in legal provisions on energy reform.
- Leaders in industrial customers in Portugal.
- Sustained growth of retail activities of electricity, gas and *Smart Solutions* in the rest of Europe.