

QUALITATIVE AND QUANTITATIVE ANALYSIS OF IBERDROLA

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IBERDROLA



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Commercial situation

Analysis of the general aspects of the company to have an overview about the activity they develop, their position in the market, their geographical presence, how is it organised, shareholders and the group they belong to, between other aspects. Our main objective is to learn about the main general traits of the company.

I. COMMERCIAL SITUATION

1. COMPANY DESCRIPTION

1.1 Activity

IBERDOLA SA is one of the most important European energetic companies and it's the leader in the Spanish liberalized energy market. IBERDROLA's activity covers the generation, transmission, distribution and marketing and commercialization of electricity and gas natural. The company has evolved to offer its customers new products and services, energy solutions tailored to their needs to improve their quality of life and the productivity of their businesses. Some of these new products and services are energy, technical and environmental consulting, home automation, telecommunications, financial products...

The corporate purpose of IBERDROLA is as follows:

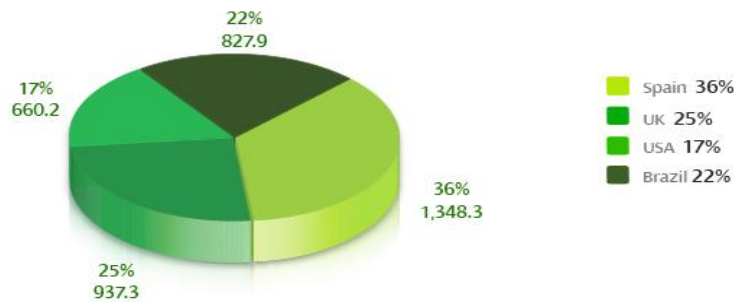
- To carry out all manner of activities and provide services required for the production, transmission, switching and distribution or retailing of electric power or electricity by-products and their applications, and involving the raw materials or primary energies required for electric power generation, energy, engineering, computer and telecommunications services, services relating to the Internet, the treatment and distribution of water, the integral provision of urban and gas retailing services, and other gas storage, regasification, transport or distribution activities.
- To distribute, represent and market all manner of goods and services, products, articles, merchandise, computer programs, industrial equipment-machinery, machine and hand tools, spare parts and accessories.
- To engage in the research, study and planning of investment and corporate organization projects, and to promote, set up and develop industrial, commercial and service companies.
- To provide assistance and support services to the Group companies and other investees, providing for them the guarantees and collateral required for this purpose.

1.1.1 Business lines

For generating the energy IBERDROLA disposes of hydroelectric power plants, nuclear plants, combined cycles thermal plants, Coal thermal plants and Fuel oil/gas thermal plants.

As of 2011, the operating, economic and financial information of IBERDROLA Group is structured as follow business lines: Network Business, Wholesale and Retail Business, Renewable Energy Business and Other Businesses.

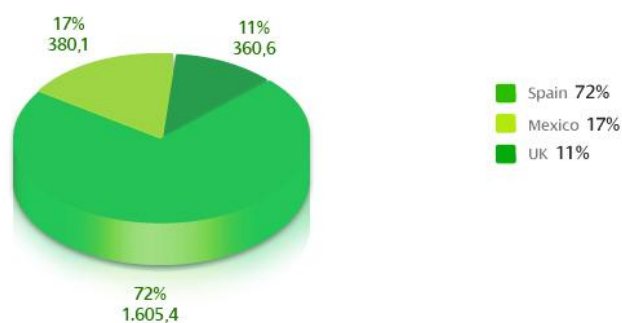
- a) Networks Business: Includes the energy transmission and distribution businesses, as well as those of any other regulated nature, originating in Spain, the United Kingdom, the United States and Brazil.



Breakdown EBITDA of Networks business in % and million €

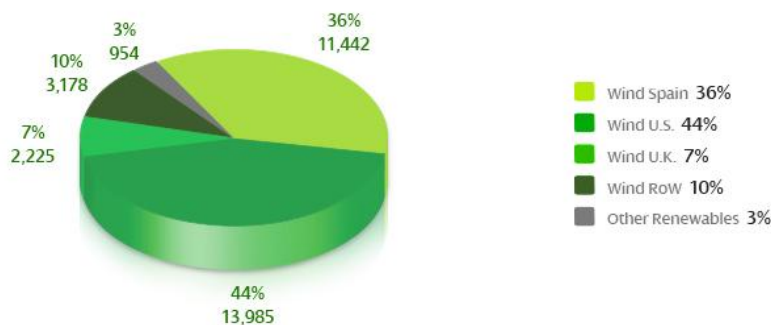
- b) Wholesale and Retail Business: Includes the integration of the wholesale and retail business of Spain, Portugal, United Kingdom, Mexico and Continental Europe
 This integration focuses on launching a new form of management to maximize the benefits of Group working on key points:

- Optimization of the organizations
- Delivery of additional synergies
- Increased operational efficiency
- Identify activities with growth potential



Breakdown EBITDA of Wholesale and retail business in % and million €

- c) Renewable energy business: Most of the renewable energy business corresponds to wind energy. The company develops onshore wind energy (turbines overland), offshore wind energy (turbines at the sea) and marine energy (exploitation of wave energy).



2012
Renewables
production by
region (GWh)

- d) Other Businesses: The non-energy businesses carried out by IBERDROLA are basically two:
- i. Engineering and Construction → Leads in installations for electrical power generation, distribution and control. The portfolio of services includes project management in all of its stages, engineering, supply, construction and commissioning, turnkey projects and operational support.
 - ii. Estate → a wide portfolio of products ranging from first homes to holiday homes, offices, factory premises and shopping centers.

1.2 Industry/Sector

IBERDROLA operates basically in the wind energy industry and in the electric power industry.

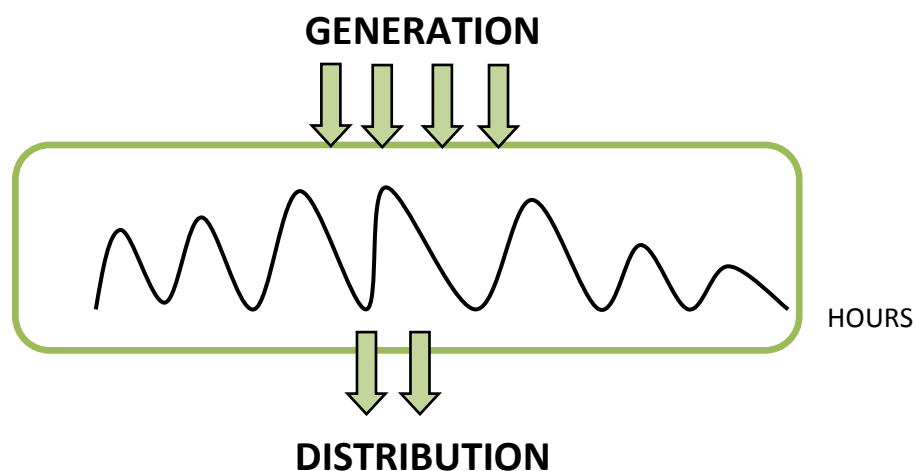
The energy sector activities of IBERDROLA are subject to the regulatory framework in each of the countries and areas where it operates, all of them equipped with strict regulations. Progressively, the liberalization of the energy sector has allowed developing some activities such as production and sale of electricity and natural gas in a perfect competition market structure, compared to others that, by their nature, have to be provided on a monopoly basis, among which are included the regulated transmission and distribution of electricity and gas.

Another industry where IBERDROLA operates is the renewable energy sector, basically in the wind energy industry. Nowadays in Spain the renewable energy sector in general is in danger

because of the Royal Decree Law 2-2013. This law includes time constraints of the existing production plants and a tax rate increase among others. Moreover the Spanish Government has reduced the investment in this sector by almost €500 million while the rest of the electrical system experiences an increase in revenue from the state. However at an international level the investment in renewable energy was increased significantly during 2011.

Logically, the wind energy industry, where IBERDROLA mostly operates, is greatly affected by the current situation of renewable energy. In 2011, in Spain, the wind industry installed 5.1% of the cumulative wind power. This is the weakest growth of the industry's history in Spain in percentage terms. The state subsidies received by consumers of fossil fuels, 409,000 million dollars in 2010 were nearly six times higher than those granted to the renewable energy sector, 66,000 million in the same period, according to the International Energy Agency. Having seen this we can say that the wind energy industry is in a difficult situation of uncertainty.

In the figure on text page we can see how the energy industry works. In this industry there are several companies that generate energy which goes directly to a market where its price fluctuates depending on many variables as the hour of the day, the supply, the demand... Once the energy is in this market other companies can buy it to sell it to the final consumers. It could happen that a company generates energy in a place where it doesn't have consumers, so this company will sell the energy to this market and get profits, then another company that has consumers in this area but it doesn't have a generation plant in it will buy this energy to sell it afterwards to its local costumers.



1.3 Geographical area

IBERDROLA develops its activity both in Spain and abroad Atlantic axis, with a significant presence in the UK, USA and Latin America.

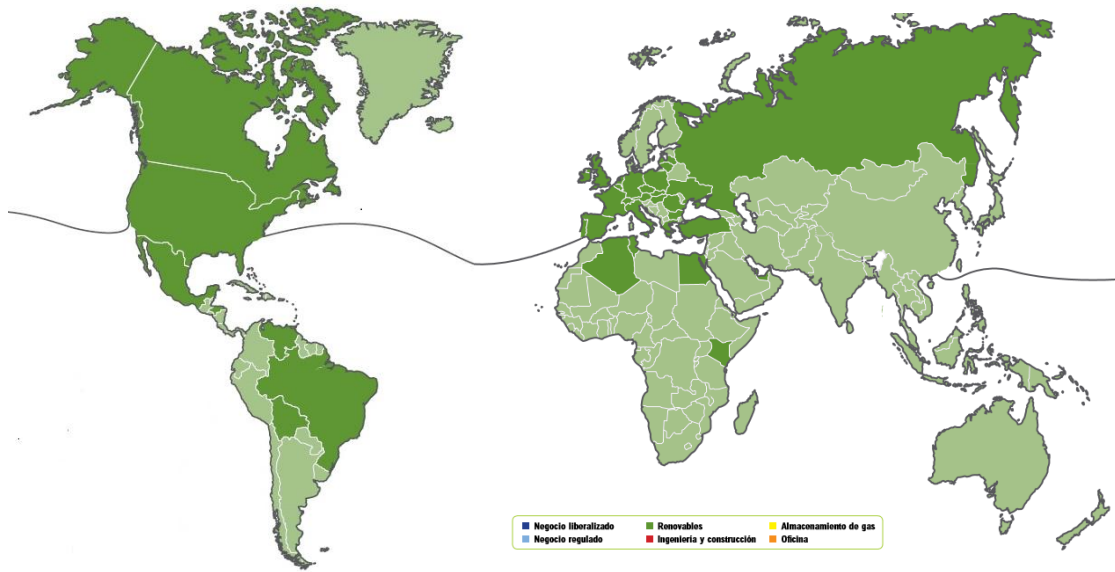
1.3.1 International presence

IBERDROLA has undergone a deep transformation since the start of the century that has enabled it to grow to become the leading Spanish energy group, the fifth largest Spanish company on the Ibex 35 stock index by market capitalization, world leader in wind and one of the five biggest electricity companies in Europe. This has been made possible by a strategic vision that anticipated emerging energy trends and involved large investments between 2001 and 2012.

Between 2001 and 2006 the company focused basically on energy business growth principally in Spain and Latin America. Then, between 2007 and 2012 the strategy has been marked by strong international expansion, with the integration of SCOTTISHPOWER, Energy East (today Iberdrola USA) and Brazil's ELEKTRO, as well as the rapid growth of its renewable energy business which today is the world's largest.

Now, IBERDROLA works on consolidating the international presence attained in recent years, mainly in the United Kingdom, the United States, Brazil and Mexico. The company will invest a large amount of billion € in the period 2012-2014 to consolidate its international expansion. IBERDROLA will focus this new phase in the UK, which accounts for 42% of total investments, followed by Latin America, mainly Brazil which will receive nearly 23%, Spain with 19% and the with U.S 16%. IBERDROLA will thus concentrate on the Atlantic area, tailoring its investments to economic and regulatory conditions in each country.

As we can see in the maps below, IBERDROLA works in many countries all over the world, but we can say that nowadays the company is working particularly in Spain, UK, USA, Latin America, including mainly Brazil and Mexico, and in other European countries as France, Greece, Hungary, Italy, Poland, Portugal and Romania. Is in these countries where IBERDROLA has more business lines including liberalized and regulated business, renewables, engineering and construction, gas storage and office.

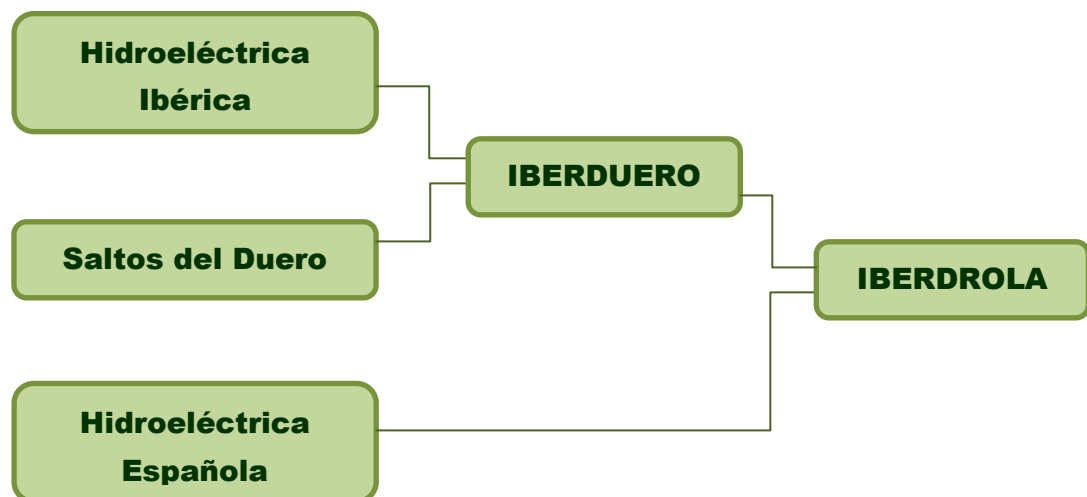


1.4 History

The first reference of a similar company comes from the American energy company called Energy East. This business model was begun to be applied in Spain in 1901 when HIDROELÉCTRICA IBÉRICA was found. It worked successfully and in a few years they started to supply regions like Madrid and Valencia.

During the civil war period most of the firm's facilities were destroyed and due to the restrictions in the access of international technology they had wide difficulties to keep up with international energy companies. Late in 1944 IBERDUERO was created from the fusion of the companies HIDROELÉCTRICA IBÉRICA and SALTOS DEL DUERO.

In 1992 IBERDROLA was founded from the fusion of HIDROELÉCTRICA ESPAÑOLA and IBERDUERO. Since 2001 the relatively new company has been focused in the renewable energies. Furthermore, for the last 6 years the Spanish energy firm has been increasing its presence in United Kingdom, United States and Brazil through the integrations with Scottish Power, Energy East and ELEKTRO, respectively.



1.5 Vision and values

IBERDROLA works to be an energy Company committed to ethics and respect for the environment as the foundation for a sense of belonging and for the trust of all persons and its various stakeholders. This is reflected in the Company's vision, which applies to the whole IBERDROLA Group:

"We aspire to be the preferred Global Energy Company because of our commitment to the creation of value, quality of life, the safety of people and of supply, the protection of the environment and customer focus".

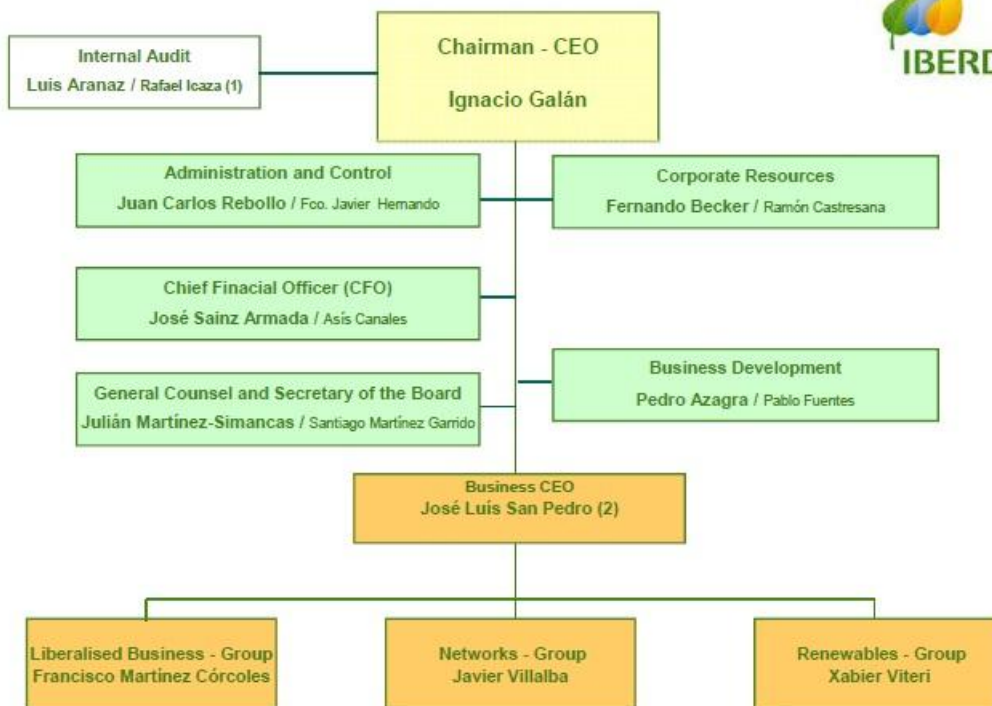
IBERDROLA's vision encompasses six values referred to economic, social and environmental aspects of sustainability:

- **Corporate ethics and responsibility:** It always behaves to be the clear image of the corporation in order to represent all the shareholders and stakeholders.
- **Economic results:** The firm's commitment is to achieve the growth and profitability objectives spelled out in the Company's Strategic Plan in order to ensure the success of the corporate plan.
- **Respect for the environment:** Development of clean energy and respect for the environment are some of the pillars of IBERDROLA Group.
- **Sense of belonging and trust:** The Energy Company is always doing great efforts to establish permanent ties with its stakeholders because they want them to feel as an integral part.
- **Safety and reliability:** IBERDROLA strives to offer its energy supply and to carry out the other activities undertaken by the Group within a safe and reliable environment.
- **Customer focus:** IBERDROLA's objective is to provide the highest service quality while complying with its regulatory obligations.

1.6 Organization chart

IBERDROLA's human workforce has been growing significantly over the past decade. After friendly integrations of Scottish Power, Energy East (now IBERDROLA USA) and the Brazilian Elektro, the amount of personnel working at the Group has reached a figure of 31.338 employees in nearly 40 countries.

The management team of the company focuses its activity, on the definition, supervision and monitoring of the strategies and general guidelines that must be followed by the Company and the Group.



Companies' structure approved by the Board of Directors

1.6.1 CEO

The IBERDROLA's chairman is Ignacio S. Galán. He is graduated in electromechanical industrial engineering at ICAI; he also holds a diploma in Business Administration from ICAE and in Business Administration and Foreign Trade from EOI. He has worked in several leading industrial and technology companies and left a strong mark on all those he has managed, using his strategic vision to anticipate the evolving needs of different sectors.

Key elements in his management philosophy have been to invest in sound and sustainable industrial projects, advance in corporate governance, maximize efficiency, maintain solid finances, careful balance sheet management and profit growth. A constant priority for Galán has been to integrate culturally diverse teams in order to meet his strategic goals.



Ignacio Galán began his professional career in 1972 at *Sociedad Española del Acumulador Tudor*, where from various executive posts he managed the company's international expansion.

In the early 1990s, Ignacio Galán managed *Industria de Turbopropulsores* (ITP) from its foundation, promoting the design, manufacturing and maintenance of aircraft engines and gas turbines.

Between 1993 and 1995 he was chairman of Eurojet, the European consortium which developed and manufactured Eurojet 200 engines used by Eurofighter. In 1995, he was appointed CEO at the newly created Airtel Móvil (today Vodafone Spain), which opened up the telecommunications sector in Spain to competition.

Ignacio Galán's appointment in 2001 as executive vice-president and CEO of IBERDROLA marked the beginning of one of the most important and successful business transformations in recent Spanish corporate history. In 2006 he was named executive chairman of the company.

1.6.2 Board of directors

| Position on Board | | Status |
|-------------------------|---------------------------------------|----------------------------|
| Chairman & CEO | José Ignacio Sánchez Galán | Executive |
| Vice Chairman | Víctor de Urrutia Vallejo | Independent |
| Director | Julio de Miguel Aynat | Independent |
| Director | Sebastián Battaner Arias | Independent |
| Director | Xabier de Irala Estévez | Proprietary ⁽²⁾ |
| Director | Íñigo Víctor de Oriol Ibarra | Independent |
| Director (*) | Inés Macho Stadler | Independent |
| Director | Braulio Medel Cámara | Independent |
| Director | Francisco Pons Alcoy | Proprietary ⁽³⁾ |
| Director | Samantha Barber | Independent |
| Director | María Helena Antolín Raybaud | Independent |
| Director | Santiago Martínez Lage | Independent |
| Chief Operating Officer | José Luis San Pedro Guerenabarrena | Executive |
| Director | Ángel Jesús Acebes Paniagua | Other External |
| Secretary | Julián Martínez-Simancas Sánchez | |
| Counsel | Rafael Mateu de Ros Cerezo | |

⁽¹⁾ Composition as of 23 May 2012. (2) Mr. Xabier de Irala Estévez was appointed at the request of Kutxabank, S. A.

⁽³⁾ Francisco Pons Alcoy was appointed on an interim basis to replace José Luis Olivas Martínez, at the request of Banco Financiero y de Ahorros, S.A. (BFA). The mandate of Mr. Pons Alcoy expires on the date of the holding of the General Shareholders' Meeting. Also at the request of BFA, the Board of Directors has proposed to the shareholders

the appointment of Mr. Francisco Pons Alcoy as a director. (*) Lead Independent Director.

RELEVANT INFORMATION ABOUT BOARD OF DIRECTORS:

Mr. de Urrutia Vallejo: He served as a Director of **HIDROELÉCTRICA Española**, S.A. as he was a member of the Board of Directors of Babcock Wilcox Española, S.A. (a company engaged in the construction of machinery and the turnkey construction of thermal and combined-cycle plants). Nowadays, he serves as Vice Chairman of IBERDROLA RENOVABLES SA as he has been an External Independent Director at IBERDROLA SA since 1978.

Mr Julio de Miguel Aynat: He served as Director of Caja de Ahorros de Valencia, Castellón y Alicante, **BANCAJA** which is one of the main shareholders of IBERDROLA S.A.

Mr Sebastián Battaner Arias: He was the founder and Executive Chairman of Grupo de Negocios Duero, S.A.U., a company with interests in the Spanish energy industry. He serves as a Director at **IBERDROLA RENOVABLES SA**.

Mr Xabier de Irala Estévez: He serves as the director of **BBK BANK**, S.A. and **IBERDROLA RENOVABLES S.A.** He is also the Chairman of Management Team of **BILBAO BIZKAIA KUTXA** which is one of the main shareholders of IBERDROLA. He serves as a Vice Chairman of Finance at General Electric CGR in Paris and as a Director of Financial Programs of General Electric of International Operations in London, which are competing in the same industry. He serves as a Director of ITALTEL S.P.A, BBK Bank, S.A. and IBERDROLA RENOVABLES SA.

Mr Iñigo Víctor de Oriol Ibarra: He has spent his professional career at the **IBERDROLA Group**, where he served as Director of Management Control at Amara, S.A. and financial analyst within the Financial Division of IBERDROLA, S.A. and others. Nowadays, he serves as a Director of IBERDROLA RENOVABLES SA.

Ms Inés Macho Stadler: She serves as a Director of IBERDROLA RENOVABLES SA. She has been placed in the board of directors because she is a brilliant expert in industrial economy problems, contracts and regulation.

Mr Braulio Medel Cámara: He serves as Independent Director at IBERDROLA RENOVABLES SA. He is the Director of UNICAJA S.A. which owned 1,246% of IBERDROLA, S.A. and he has always been a significant person in the banking sector in Spain.

Ms Samantha Barber: She serves as Director of IBERDROLA RENOVABLES SA whereas she is also a Member of the Business Advisory Board for **SCOTTISHPOWER S.A.**

Ms María Helena Antolín Raybaud: She served as Director of IBERDROLA RENOVABLES SA since May 11, 2007 until April 26, 2010. Ms. Nowadays, he is being the director of IBERDROLA RENOVABLES S.A. again.

Mr Santiago Martínez-Lage: He serves as Director of IBERDROLA RENOVABLES S.A. He comes from the telecommunication industry.

Mr José Luis San Pedro Guerenabarrena: He has spent most of his professional career at the IBERDROLA Group.

Mr Ángel Jesús Acebes Paniagua: He has been a director of Banco Financiero y de Ahorros, S.A. (BFA) which take part in BFA-Bankia Group and he has participated in direct activities with energy industry firms as IBERDROLA S.A.

Mr Manuel Lagares Gómez-Abascal: He is a director of affiliated companies of the BFA-Bankia Group

Julián Martínez-Simancas Sánchez: He has held various key positions since joining IBERDROLA, S.A. in 2002. Among other roles, he has served as assistant to the vice-chairman and chief executive officer, vice-secretary of the Board of Directors, executive director of IBERDROLA México, S.A. de C.V., and member of IBERDROLA's Advisory Committee in Andalusia.

Rafael Mateu de Ros Cerezo: He is the manager of BANKINTER S.A. and he is also a well-known lawyer in Spain and a partner in the lawyer gabinet Ramón & Cajal. Whereas Rafael is a member of the "Centro de Gobierno Corporativo" which is compassed by "Instituto de Empresa", PriceWaterhouseCoopers and IBERDROLA S.A.

1.7 Future outlook

IBERDROLA nowadays is developing a strategy that will extend from 2012 to 2014, consisting of establishing a platform for future growth. The goals for the three-year period are based on consolidating its financial strengths by moderating the level of investments, which will focus

mainly on business networking and renewable, as well as on divesting assets where considered non-strategic, and on efficiency gains.

OUTLOOK

- Reduction in debt (€6 billion) and improve its solvency ratios (as a product of cash flow generated, lower investments and €2 billion in divestments).
- Invest €10.5 billion in the three years (37% lower than in 2010-2012), mainly in electricity transmission networks (59%) and renewable (25%).
- Centre investment efforts in the UK (42%) and Latin America, mainly Brazil, (23%).
- Get an EBITDA that will enable the company to continue remunerating shareholders at a gross annual average of about €0.3 per share.

2013: GROWTH IN THE UNITED KINGDOM, THE UNITED STATES AND LATIN AMERICA

IBERDROLA will seek growth in 2013 in the United Kingdom, the United States and Latin America where the company is concentrating its investments.

At the same time, it will continue to reduce debt while generating positive cash flow in all businesses, with sufficient liquidity to cover financing needs for three years and divesting non-strategic assets.

Regarding business areas:

- UK and US: growth in networks.
- UK: increase customer base and sales.
- SPAIN: higher hydro and wind production.

So in the year 2013 they will mainly focus in getting a strong balance sheet, international diversification and low-risk business mix focused on stable and predictable activities.

MAJOR PROJECTS

2012-2014:

- Electricity transmission: Iberdrola will continue developing major transmission and distribution infrastructure in the US, including the inter-connection with Canada

through the Maine Power Reliability Program, and in the UK including the first subsea cable between Scotland and England.

- Renewable energy: the Group expects to increase capacity through offshore wind farms including West of Duddon Sands and at least 10 onshore new installations in Brazil to add to the Rio do Fogo wind farm that is already operational.
- Hydro generation: the company has many new projects under way in Brazil, for example the Teles Pires plant, through Neoenergia, that is rojected to come on stream in 2014.

After 2015:

From 2015, and in addition to the networks projects referred to as well as others in the US and UK, and the hydro projects in Brazil, IBERDROLA will advance with offshore and onshore wind projects in the UK, Germany, France, Mexico and Brazil. It also plans to develop combined cycle gas capacity in the UK.

1.8 IBERDROLA foundation

Since it was founded over 150 years ago, IBERDROLA has been committed to the energy, cultural and social development of the communities where it operates.

The Fundación IBERDROLA represents a step further in the materialization of this firm commitment by carrying out initiatives that make an effective contribution towards enhancing people's quality of life in the territories and countries where the IBERDROLA Group operates, particularly in the fields of training and research, energy sustainability and biodiversity, art and culture, as well as solidarity and social initiatives.



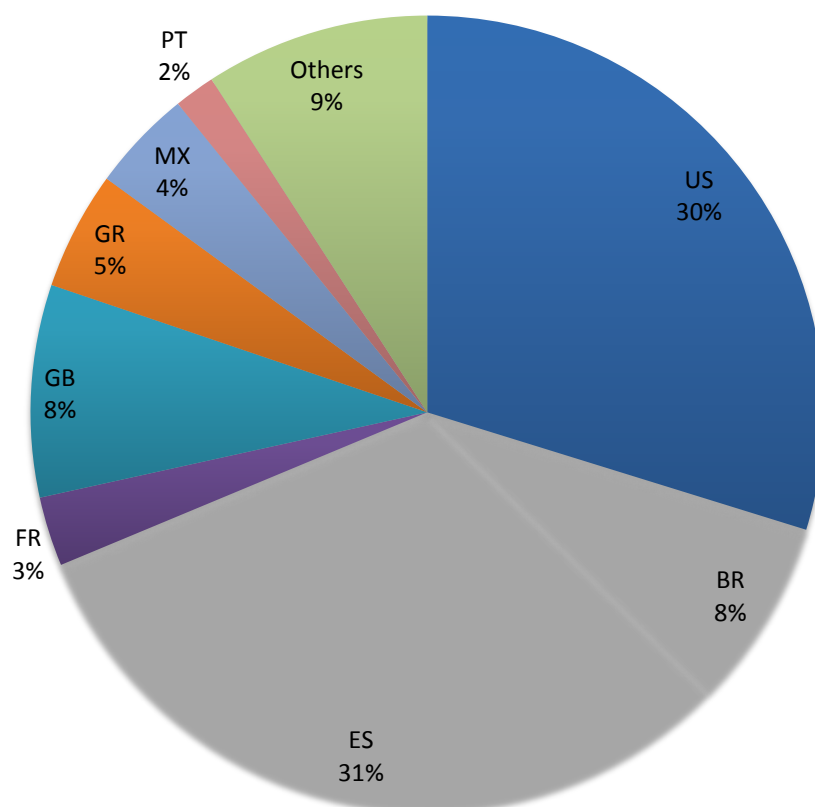
1.9 Corporative governance

The concept of corporate governance refers to the set of principles and rules that regulate the design, integration and operation of the governing organs of the company, as Shareholders, Directors and Senior Management.

IBERDROLA, S.A. maintains a continuously updated Corporate Governance System, which is the set of documents made up of the *By-Laws* , the *Corporate Policies* , the internal corporate governance rules and the other internal codes and procedures approved by the appropriate bodies of the Company. Such System has been developed taking into account the good governance recommendations generally recognized in international markets. The development, revision, and ongoing improvement of corporate governance regulations is part of the strategy that IBERDROLA and the companies belonging to the group of companies of which IBERDROLA is the controlling entity, have been following for years.

2. IBERDROLA GROUP

IBERDROLA Group



IBERDROLA Group consists of 601 subsidiaries spread all over the world in more than 30 countries. At the end of the exercise 2011 the Group generated operating revenue of 32,370,549 thousand EUR.

Spain and the United States are the countries where more subsidiaries are located, with more than 100. Then there is Brazil and the United Kingdom with approximately 50 subsidiaries and France, Greece, Mexico and

| | | |
|--------|----------------|------------|
| US | United States | 179 |
| BR | Brazil | 46 |
| ES | Spain | 188 |
| FR | France | 17 |
| GB | United Kingdom | 52 |
| GR | Greece | 29 |
| MX | Mexico | 25 |
| PT | Portugal | 10 |
| Others | | 55 |
| | TOTAL | 601 |

Portugal with more or less 20 affiliates. In addition IBERDROLA has subsidiaries in other countries like the Arab Emirates, Russian Federation, Canada and Venezuela.

We could say that the principal subsidiaries are:

COUNTRY SUBHOLDING COMPANIES:

| COUNTRY COMPANIES | SUBHOLDING | INTEREST HELD BY IBERDROLA S.A | MAIN ACTIVITY |
|--------------------------|-------------------|---------------------------------------|---|
| IBERDROLA BRASIL S.A. | | 99,99 % | Country subholding company in Brazil. |
| SCOTTISH POWER LTD. | | 100 % | Country subholding company in the United Kingdom. |

BUSINESS SUBHOLDING COMPANIES:

| BUSINESS COMPANIES | SUBHOLDING | INTEREST HELD BY IBERDROLA S.A | MAIN ACTIVITY |
|------------------------------|-------------------|---------------------------------------|--|
| ELEKTRO SERVIÇOS, S.A. | ELECTRICIDADE E | 99,68 % | Grid business sub holding company in Brazil. |
| IBERDROLA ELÉCTRICA, S.A. | DISTRIBUCIÓN | 100 % | Grid business sub holding company in Spain. |
| IBERDROLA HOLDINGS, LLC | ENERGY | 100 % | Gas business sub holding company in the United States and Canada |
| IBERDROLA GENERACIÓN, S.A. | | 100 % | Deregulated business sub holding company. |
| IBERDROLA CONSTRUCCIÓN, S.A. | INGENIERÍA Y | 100 % | Engineering and construction sub holding company. |
| IBERDROLA S.A. | INMOBILIARIA, | 100 % | Real estate sub holding company. |
| IBERDROLA MEXICO, S.A. DE | | 100 % | Deregulated business sub holding company |

| | | |
|---|-------|--|
| C.V. | | in Mexico. |
| IBERDROLA RENEWABLES, LLC. | 100 % | Renewable business sub holding company in the United States. |
| IBERDROLA USA INC. | 100 % | Business sub holding company in the United States. |
| SCOTTISH POWER ENERGY NETWORKS HOLDINGS, LTD. | 100 % | Grid business sub holding company in the United Kingdom. |
| SCOTTISH POWER GENERATION HOLDINGS, LTD. | 100 % | Deregulated business sub holding company in the United Kingdom |
| SCOTTISH POWER RENEWABLE ENERGY LTD. | 100 % | Renewable business sub holding company in the United Kingdom. |

3. REPUTATION AND SUSTAINABILITY

3.1 Commitments

IBERDROLA develops its Social Responsibility policy and practices as part of its contribution to Sustainable Development. The company has different areas of commitments:

- To their shareholders, offering a direct, personal and stable relationship by paying permanent attention to their needs and guaranteeing the transparency, truthfulness and reliability of the information provided.
- To their employees, where the company wants to respect all human rights and to develop a favorable labor relations framework (equal opportunities, non-discrimination...).
- To their customers and suppliers with the aim of creating value for them.
- To the media, based on the principles of information transparency, professionalism and rigorous treatment of all the news related to the company.
- To the environment resulting in reduced emissions and greater efficiency in goods and services production and usage.
- To the society maintaining a strategy based on strong involvement in the communities where it operates. IBERDROLA's fundamental contribution to society is based on the main impacts of

its own business activity: supplying a product as essential as energy, significant investments in basic infrastructures, promotion of local supplier networks in the countries where it operates...

3.2 Initiatives

During the last 10 years IBERDROLA has carried out many activities as regards Corporate Social Responsibility. As being one of the signatories to the Global Round Table on Climate Change (2009) or the participation, as Founding Partner, in the Club of Excellence in Sustainability.

3.3 Environment

For IBERDROLA, the environmental side of its activity is a priority in the planning of all its business areas, and it means all of them are obliged to promote innovation, eco-efficiency, and the gradual reduction of the environmental impact of the activities they carry out.

3.4 Social action

IBERDROLA's commitment to the communities in which it operates is achieved through community activities in collaboration with significant governmental bodies and civil society institutions.

The IBERDROLA Group's community activities are coordinated and furthered by Fundación IBERDROLA.

3.5 Quality

IBERDROLA endeavors to implement a culture of continuous improvement for managing all of the Company's processes and activities through the highest quality standards. The goal is to enhance competitiveness and create value.

In 2010, ISO 9001 certification was obtained for all of the 56 Territorial Maintenance Units of the Network business in Spain.

3.6 Innovation

Over the last decade IBERDROLA has implemented an innovative management technology strategy. The company has invested R&D in generation area, in the area of networks, in renewables and in other areas. This investment in R&D is in service of efficiency, technology strategy and sustainability.

4. CUSTOMERS

One of IBERDROLA's goals is to create value for its customers, seeking to meet their expectations in a manner which is compatible with respect for the environment, responsible labor practices, and alignment of business values with those of our social setting.

Around the world, IBERDROLA provides 30.7 million supply points with power, of which 27.4 million are electricity and 3.3 million are natural gas.

Customer relationships are managed by the Deregulated Business Division or the Regulated Business Division, depending on whether the market has been liberalized or remains regulated. Specifically, the Deregulated Business Division manages the relationship with customers in Europe, basically in Spain, Portugal and the United Kingdom, while the Regulated Business Division manages the relationship with customers in the United States and Latin America.

IBERDROLA has a wide range of customers as they supply homes, self-employers offices, small size companies and even large companies with high needs of voltage and gas.

The Spanish energy company offers plenty different plants in order to be completely adaptable to the customers' needs. They are innovating in many fields attracting new customers day by day. Some of the innovations would be:

- Fixed fee: the customer will be able to pay the same amount of money day by day. It is done to facilitate the clients the forecasting of their receipts.
- E-billing: to be in accordance to its environmental policy they are applying the billing by email. By this way they avoid wasting paper and to create garbage.
- Offer sun's power: IBERDROLA is offering Solar Photovoltaic Energy and Solar Thermal Energy in order to maintain its strategy of being environmentally clean.
- Payment Protection for Self-Employed Workers Insurance: They offer the option of paying a monthly insurance fee for the possible harsh situations of being unemployed or being nearly bankruptcy.

What distinguishes IBERDROLA to other companies is the way they treat its customers. The firm is always reliable about its offers and its commitment with the environment. Furthermore, it is a leading company what regards to Customer Service.

5. SUPPLIERS

IBERDROLA is being supplied by a wide range of suppliers. Thus, in its relationship with suppliers, IBERDROLA has chosen to:

- Promote among its suppliers principles of responsible behavior toward the social and natural environments, which inspire our Company.
- Use selection and awarding processes based on practices that seek to ensure transparency, equal opportunities and mutual interest.

IBERDROLA has a GLOBAL SUPPLIER MANAGEMENT MODEL (TSMS) that enables the Company to register and classify its suppliers into two levels:

- Level 1 (basic registration). This is the access level for all the suppliers who want to work with IBERDROLA and is openly available to them on the Company's website (Suppliers area). Based on the information provided and on IBERDROLA's internal criteria, a supplier can be kept at this level or moved to a higher level (RePro registration).
- Level 2 (RePro registration). This is the registration level for those suppliers who are considered to be strategic, well-established or relevant to IBERDROLA. The RePro system, in which IBERDROLA has participated for a number of years, is the database used by the main companies in our sector and, therefore, the suppliers who register can simplify the procedures with their other customers.



The suppliers are assessed taking into account their technical and productive capacity, among other criteria, and their situation is weighted in the following areas:

- Quality
- Safety and occupational risk prevention
- Environment
- Social responsibility
- Economic-financial situation

Some IBERDROLAs suppliers are:

- INCOESA: leading company in the manufacture of power and distribution transformers and ecological substation transformers. Nowadays is an important supplier of Scottish Power, a IBERDROLAs subsidiary.
- ARTECHE: ARTECHE Group is specialized in components for the power sector. The company supplies electrical transformers and high voltage to the Brazilian company ELEKTRO, where IBERDROLA is the principal shareholder.
- INGETEAM: The company specialized in electronic engineering has a contract with IBERDROLA Group for the automation of five substations in Brazil that will allow the evacuation of the energy produced by a dozen wind farms
- ORMAZABAL: IBERDROLA has a contract with this Basque company for the manufacture, installation and commissioning of the cells to be installed in substations which owns the U.S. subsidiary of IBERDROLA.
- MESA: A supplier of IBERDROLA that works for the Scottish Power Group subsidiaries and IBERDROLA USA.
- ZIV, LANDIS&GYR, SAGEMCOM, SOGECAM, ORBIS, ELSTER and GE: companies that will supply one million meters with remote management capabilities, which will serve IBERDROLA to advance its smart grid projects in Spain.

6. SHAREHOLDERS

6.1 Capital share

IBERDROLA, S.A. has share capital amounting to 4,710,888,000.00 euros, which consists of 6,281,184,000 shares at a par value of 0.75 euros each and to get an idea the market value at 2nd April 2013 was 3,715 euros/share. It is totally subscribed and paid up.

All shares are ordinary and are represented by book entries. The accounting record is kept by Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A. Unipersonal (IBERCLEAR), with its registered address in Madrid at Plaza de la Lealtad nº 1. In addition, they are listed on the Madrid, Barcelona, Bilbao and Valencia Stock Exchanges and are traded through the Automated Quotation System (Continuous Market).

6.2 Significant interests

The following table includes all significant interests, both direct and indirect, in the share capital of IBERDROLA S.A.

| CORPORATE NAME OF DIRECT HOLDER OF SHARES | NUMBER OF DIRECT VOTING RIGHTS | % TOTAL VOTING RIGHTS |
|---|--------------------------------|-----------------------|
| ACS ⁽¹⁾ | | |
| Residencial Montecarmelo, S.A. | 360,619,672 | 6.576 |
| Nexgen Capital Limited, S.A. (1) | 277,971,800 | 5.069 |
| Corporate Funding, S.L. | 173,517,307 | 3.164 |
| Roperfeli, S.L. | 70,577,059 | 1.287 |
| Villa Aurea, S.L. | 13,287,487 | 0.242 |
| BBK | | |
| Kartera 1, S.L. (2) | 359,380,724 | 6.553 |
| BANCAJA | | |
| Bancaja Inversiones, S.A. (3) | 301,282,820 | 5.7362 |
| TOTAL | 1,556,636,869 | 22.891 |

There are some others investment funds, like Qatar Investment Authority and Blackrock Inc, that acquires the 8,32% of shares of Iberdrola and 3,012 respectively.

6.3 Treasury stock

| | OWN | SHARES | |
|---------------|------------|----------|------------|
| | Direct | Indirect | Total |
| SHARES | 34,718,407 | 0 | 34,718,407 |

| | | | |
|----------------------|---------------|---|---------------|
| PAR VALUE (€) | 26,038,805.25 | 0 | 26,038,805.25 |
| % | 0,590 | - | 0,590 |

The treasury stock IBERDROLA has is quite insignificant. It could be like that because they have usually been well positioned in the stock market. In addition, they have been always widely supported and being trusted.

6.4 Dividends

IBERDROLA's objective concerning the payout policy seeks to maintain shareholder remuneration compatible with the compliance of objectives concerning solvency ratios and liquidity levels.

The average amount of the dividend paid out by IBERDROLA falls within the range of 0,3 Euros per share (gross). This shareholder remuneration is traditionally paid twice yearly, in January and July.

The final dividend for the year 2012 has been called "IBERDROLA Dividendo Flexible" and it compasses some changes comparing within the traditional dividend payment. Through this new remuneration formula, shareholders automatically receive one free allocation right for each IBERDROLA share owned.

The Scrip Dividend ("IBERDROLA Dividendo Flexible") enables shareholders to receive:

- Free IBERDROLA shares for an amount equivalent to the dividend, without withholding tax.
- An amount in cash without withholding tax by selling the rights on the market.
- An amount in cash, subject to withholding tax, by selling the rights to IBERDROLA at a fixed guaranteed price.

What concerns to the past year 2012, the dividends were paid following the next criteria:

| Thousands of euros | 2012 |
|--------------------------------|------------------|
| Proposed appropriation: | |
| Retained earnings | 206,477 |
| Profit for 2012 | 3,726,622 |
| Total | 3,933,099 |
| Appropriation: | |
| To legal reserve | 81,893 |
| To dividends | 188,436 |
| To retained earnings | 3,662,770 |
| Total | 3,933,099 |

The IBERDROLA Board of Directors has agreed to call a General Shareholders' Meeting, to propose, chargeable to the results of 2012 and the retained earnings from previous years, a gross dividend of 0.03 euro for each IBERDROLA share with dividend entitlement, outstanding at the date on which payment is made.

7. COMPETITORS

IBERDROLA has many competitors, some of them are:

- ENERGIAS de PORTUGAL Group: is one of the leading electric power groups in Europe, and the largest in Portugal. It is also present in the electricity sectors of Latin America (mainly Brazil), Africa and Macao, in the generation, distribution and retail businesses.
 - EDPR: it is a company of the ENERGIAS de PORTUGAL Group operating in the field of renewable energy. It is the world's third largest renewable energy company (after IBERDROLA Renewables and NEXTERA Energy Resources).
- ACCIONA: It is a Spanish company that works in infrastructures, energy and water. It is also a pioneering company in development and sustainability in Spain.
- ENDESA: it is one of the largest electric power companies in the world, mainly present in Spain. It is also the leading private multinational enterprise in Latin America and is a major player in other energy sectors, such as gas.
- GAS NATURAL FENOSA: multinational group in the energy sector. Its business lines are based on the natural gas supply, electricity generation, distribution and commercialization of gas natural and electricity, trading and telecommunication.
- GAMESA ENERGIA: It is a company mainly focused on the wind energy production (wind turbines, wind farms, operation and maintenance services). It a producer of electric power.
- ALSTOM WIND: a company that produces and offers transport infrastructure, power generation and electrical grid. The company is the world leader in integrated power plants for the production of electricity and air quality control systems.
- ECOTECNIA: a company based on the manufacture of wind turbines; and projects and installations of alternative energies (solar and wind).

- SIEMENS: German company that produces a wide range of products, from building technologies to energy, healthcare and electrical appliances.
- ENERCON: is the largest German company dedicated to the wind turbine construction.
- NORDEX: it also manufactures wind turbines.

8. FINANCIAL INFORMATION

An important thing to take into account about the Balance sheet of IBERDROLA is that the equity has increased from 2011 to 2012 because of the new “Dividendo Flexible” policy.

The net profit for the year 2011 was of 2,804,545 thousand € whereas in 2012 has been of 2,840,685 thousand €. Net profits of the company have increased, approximately, in 40.000€ from one year to another. At the same time net revenues have increased being of 31,648,035 thousand € in 2011 and 34,201,193 thousand € in 2012.

| 2011 | | 2012 | |
|----------------------------|------------------------------------|----------------------------|------------------------------------|
| ASSETS | EQ+LIAB | ASSETS | EQ+LIAB |
| non current: 81.144.013 | equity: 33.207.800 | non current: 80.877.182 | equity: 34.084.801 |
| | non current liab: 49.247.118 | | non current liab: 48.174.606 |
| current: 15.872.516 | current liab: 13.979.274 | current: 15.939.193 | current liab: 14.079.587 |



Risk analysis

Analysis about the short term and long term risk of the company and about the way the company manages it. This part also includes a comparison of the risk of IBERDROLA with the one of the EUROSTOXX 50 and a forecast of the evolution of this risk.

II. RISK ANALYSIS

MARKET RISK

1. IBERDROLA vs EUROSTOXX50

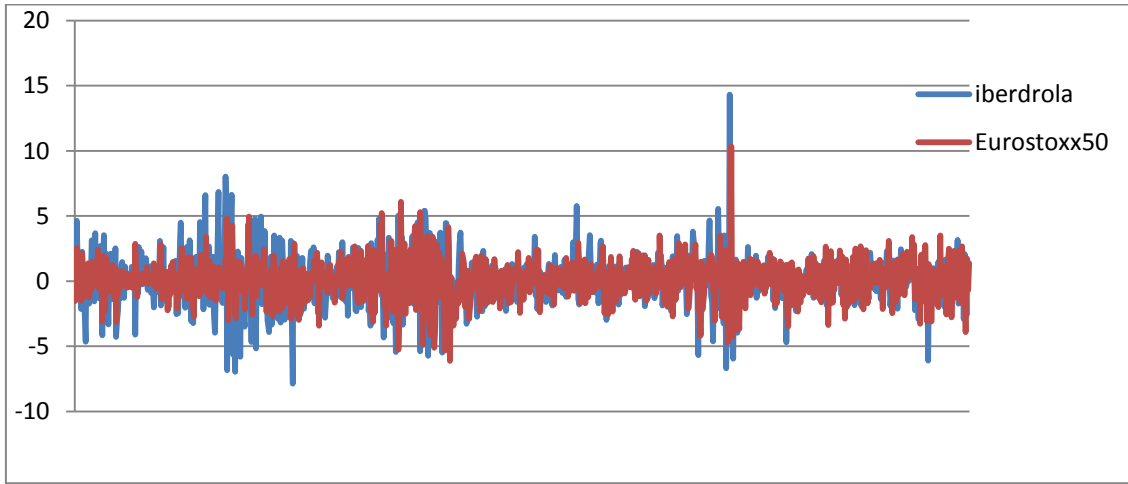
Standard deviation: the standard deviation in the case of IBERDROLA is 1,054 and in the case of EUROSTOXX50 is 249,359. This means that the level of dispersion of the closing price in the last four years regarding its average is much higher in EUROSTOXX50 than in IBERDROLA. With these results it could seem that there is more volatility (more variation in the price) in the case of EUROSTOXX50, but the standard deviation value can't be used to compare our company with the index. We'll use the coefficient of variation to compare them.

Coefficient of variation: the coefficient of variation of IBERDROLA is 0,20366 and in EUROSTOXX50 is 0,094. The comparison of this two values reveals that the volatility of IBERDROLA's share price is higher than the Eurostoxx50 index price in the last 4 years. We cannot conclude that IBERDROLA hold more risk, but what we can see is that the price of the shares of IBERDROLA fluctuates more than Eurostoxx50 do.

Furthermore, if we work out the coefficient of variation of the last year, we could see that the volatility of IBERDROLA has drop significantly until the coefficient is 0,096. In comparison with the 0,076 of the EUROSTOXX50 for the last year, we could ensure that the volatility of IBERDROLA for this last period is lesser in percentage that it has been during the whole 4 years period.

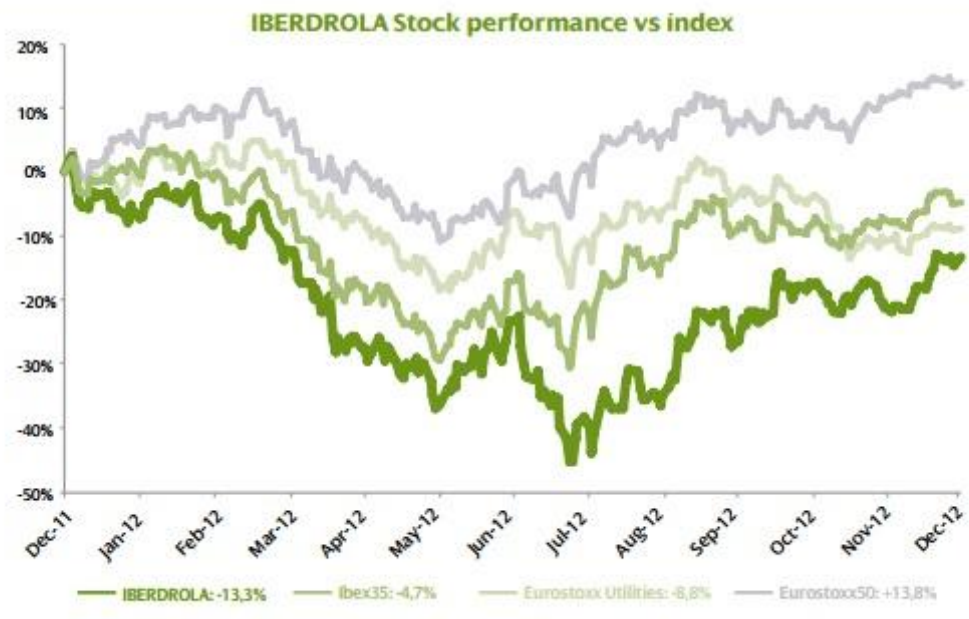
Semi variance negative: It is used when the investor is worried about not obtaining the profitability expected previously. For instance, during the last 4 years in IBERDROLA the 39'8% of the closing prices have been lower than the average price, so, it does not mean that investors will compulsory be in a losses position but they would not have been winning as much as they expected.

Beta: The coefficient Beta for the last 4 years is not very significant due to it is nearly 0. From this result we can ensure that there are not correlation between the values from IBERDROLA and EUROSTOXX50.



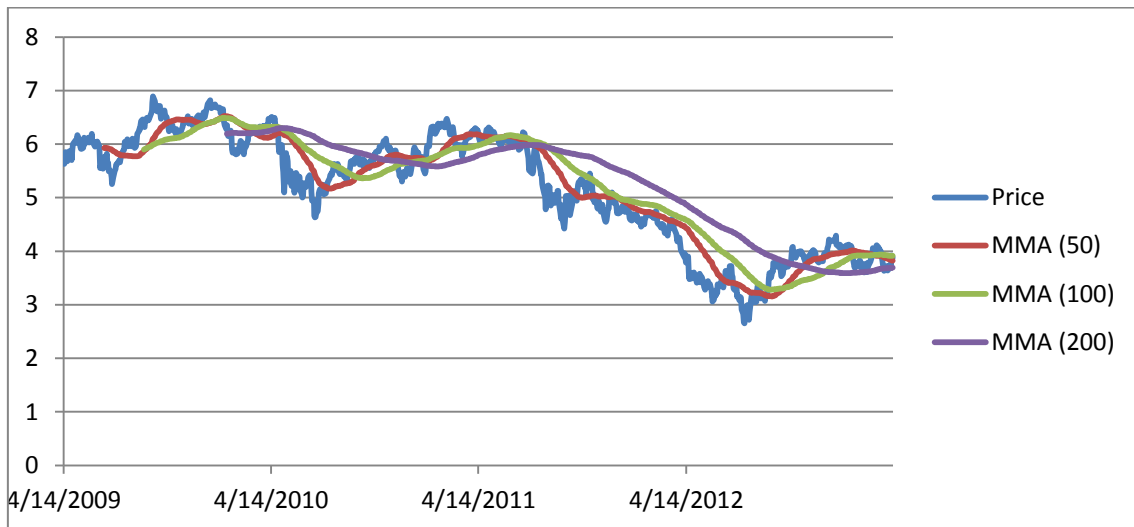
In this last graph of the Var (%), it is reflected the fact that generally speaking IBERDROLA fluctuates independently from Eurostoxx50.

But considering just the data of the last year we have obtained a new Beta and a new graph;

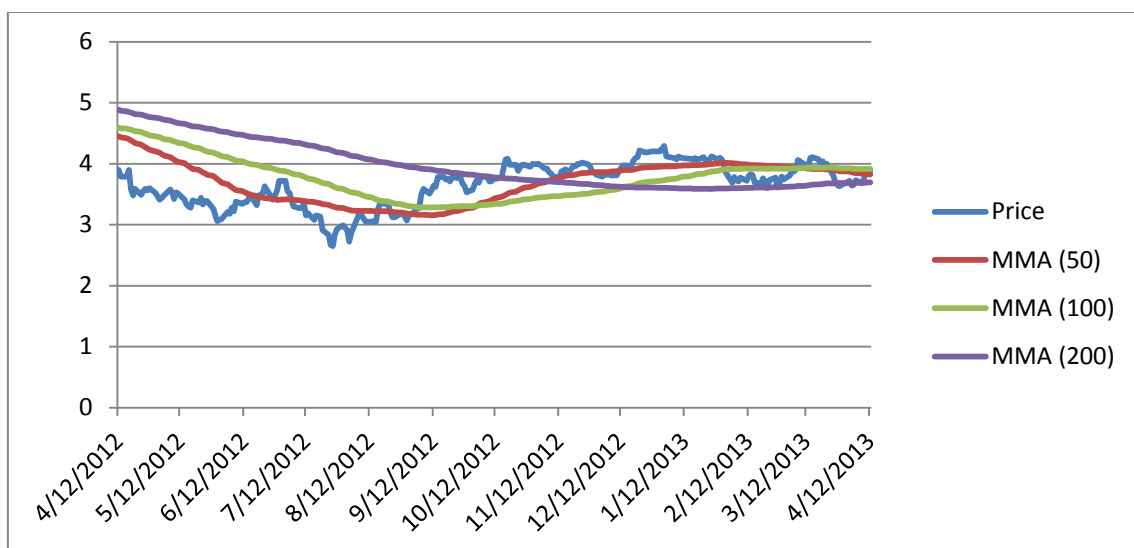


The new Beta worked out, 0,23, reflects that now there is more relation between the Index and IBERDROLA performance. It can be seen in the graph above where both evolve similarly. Although checking the graph we would say that Beta might be closer to one, in average, it is just 0,23 due to some moments that both indicators behave differently and where Beta is even negative.

2. Forecast:



Looking at the graph of the fluctuation for the last 4 years, we could observe that the price have gone down from nearly six to nearly four. Then, the price has dropped approximately 33% of its price since 2009. It might be a result of the economic crisis that affects worldwide and more intensively in Spain.



In order to predict the trend for the future weeks we will look at the graph of the fluctuation of the price of the last year.

On the whole, we have to consider the fact that the fluctuation of the price of the share follows a lateral movement due to the price at the beginning and at the end of the period is nearly four. Deeply checking the graph in the recent months, the trend is not easily predictable. At first, the MMA (100) crossed the MMA (50) and then the MMA (200) did the

same. These movements could be seen as the beginning of an uptrend but some month later the MMA (100) crossed the MMA (50) from the below side and this would be interpreted as a change in the trend. However, the three MMA are getting closer so the trend is not predictable at all.

To sum up, we could say that IBERDROLA have been punished by the economic crisis since 2009. It may be because one of the most well-known markets of the firm is the renewable energy; this market was mainly supported by governmental grants that were taken out when the recession started. These facts and some other fears about the whole financial situation of Spain may have been heavily affecting the confidence of the investors, and this was translated in a decrement of the share price. However, this last year it has shown a solid state in the stock market moving in a lateral way.

STRUCTURAL RISK

3. SHORT TERM RISK

| | 2009 | 2010 | 2011 | 2012 |
|---|-------|-------|-------|-------|
| Solvency ratio | 1,092 | 1,024 | 1,135 | 1,132 |
| Solvency ratio (*without including inventories) | 0,945 | 0,914 | 0,984 | 0,997 |
| Acid test | 0,074 | 0,118 | 0,149 | 0,216 |

Solvency:

- **Solvency ratio (including all current assets):** It provides a measurement of how likely a company will be to continue meeting its short term debt obligations. The ratio is higher than one all these four years which means that the company can face all its short term debt with its current assets and they have still some assets in the balance sheet. If we compare the ratio of 2009 with the ratio of 2012 the situation has enhanced and it has been possible due to the firm has decreased its current liabilities.

- **Solvency ratio (without including inventories):** It provides a measurement of how likely a company will be to continue meeting its short term debts obligations without the need of selling its inventories. IBERDROLA has not always been capable to face the whole current liabilities payments with its cash and receivables. Eventhough, in 2012 the value is nearly 1 (0,997) which means that it might easily pay all short term debts. Deeply analyzing it, on the one hand, we could observe that the cash of the firm has increased a 179% since 2009. On the other hand, the receivables have also increased but just in a 11,5 %. To sum, the company has become more solvent and solid because nowadays its ability to pay depends much less of the possibility of selling the inventory than before.

- **Acid test:** it measures the ability to cover the immediate liabilities just with its own cash. In 2012 the firm can face a bit more than 21% of its current liabilities while in 2009 it could just covered 7,4 %. This enhancing of the ability to pay of 190% is because of two reasons: the huge increase of the cash account and the slightly decrease of the liabilities.

- **Working capital:** The working capital indicates whether a company has enough short term assets to cover its short term debt. It's a measure of solvency which is the ability of a company to meet its short term financial obligations. Here the risk appears when a company doesn't have enough current assets to cover all its short term debts. In the case of IBERDROLA working capital has been positive in the last four years, so the company hasn't had solvency problems and it has been able to cover all its short term debt with its current assets. Although current assets have decreased (0,3%) from 2009 to 2012, the working capital has increased in a 37, 77 % due to a higher reduction in the current liabilities (almost 4%).

EXECUTIVE RESUME: To sum up, the company has become more **solid** and **solvent** with time. After the great crash of 2009, when the company had to indebt itself in order to keep on with his current level of activity, they started to **shorten its debt** until levels lower than 2009. Another policy applied was to **widen the cash** of the company, which grew up 179 % in four years.

Liquidity:

| | 2009 | 2010 | 2011 | 2012 |
|----------------------------|------|-------|-------|-------|
| Average period Cash | 71,9 | 69,8 | 61,9 | 60,7 |
| Average Period Pay | 132 | 120,6 | 112,4 | 103,2 |
| Cash Cycle | 60,1 | 50,82 | 50,56 | 42,5 |

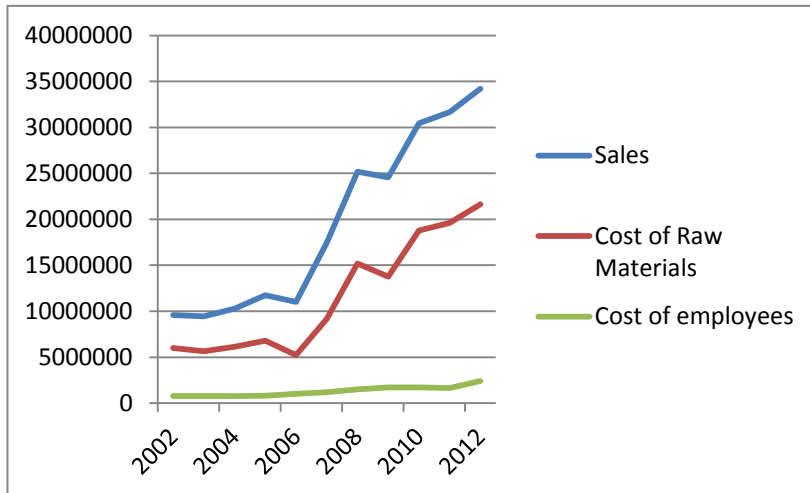
- **Average period cash:** IBERDROLA use to receive the money after 61 days from its sales in 2012. On the contrary, it needed 71 days in 2009. Then, this evolution is positive due to it has reduced the period which the firm has to finance the sales.
- **Average period pay:** The firm had 132 days to pay its suppliers in 2009 and nowadays it just has 103. This variation is negative due to it has to be prepared sooner to face its payments.
- **Cash cycle:** The cash conversion cycle is the length of time, in days, that it takes for a company to convert resource inputs into cash. If we look at IBERDROLA's cash cycle we can see that in the last four years it has been positive and we can also see that it has been reduced. In 2009 was 60 days and in 2012 it has been just 42,5 days. This means that the company is able to recover its investments more rapidly and also that the capital is tied up in the business for a shorter time.

4. LONG TERM RISK

Leverage ratio: The financial leverage ratio is a measure of how much assets a company holds relative to its equity. When we see a financial leverage ratio higher than one, it means that the company is using debt and other liabilities to finance its assets. A financial leverage ratio of 2.1 is fairly conservative, even for a fast growing retailer. It's when we see ratios of four, five or more that companies start to get really risky. In the case of our company, IBERDROLA, the leverage ratio is between 2 and 3 in the last four years, which means that the company is not able to finance its assets only with its equity so they must use debt and other liabilities to

finance them. However, as we have said before, a leverage ratio lower than 5 is a good result. Moreover the ratio has been reduced from 2009 to 2012 in a 5% due to the increase in equity (17'4%) is higher than the increase in assets (11%).

Risk in profit and loss account



As we can see in the graph sales have increased in a strong and regular way during the last 10 years. IBERDROLA has increased its sales in a 257% from 2002 to 2012. While in 2009 its sales were approximately 9.500.000€ in 2012 the company achieved a number of sales of approximately 34.000.000 €. During these ten years, the cost of sales, including salaries and cost of raw materials, have also increased in a 254% which is not as much as sales did. To sum up, after studying this data evolution we can affirm that IBERDROLA has had a positive and usually growing EBITDA for the last ten years.

| 2009 | 2010 | 2011 | 2012 |
|---------|---------|---------|---------|
| 7169819 | 7557887 | 7439273 | 7726591 |

EBITDA (2009 – 2012)

5. DIVIDENDS:

2011

| ASSETS | EQ+LIAB |
|----------------------------|-------------------------------------|
| non current: 81.144.013 | equity: 33.207.800 |
| | non current liab: 49.247.118 |
| current: 15.872.516 | current liab: 13.979.274 |

2012

| ASSETS | EQ+LIAB |
|----------------------------|-------------------------------------|
| non current: 80.877.182 | equity: 34.084.801 |
| | non current liab: 48.174.606 |
| current: 15.939.193 | current liab: 14.079.587 |

If we analyze the evolution of the equity we can see that it has increase in the period 2011-2012. The main reasons are the following ones:

1. Two share issuances in 2012, one in January (67.781.250 €) and another one in July (124.521.000 €).
2. Flexible dividend: This system consist in making a full-paid capital increase (1 share = 1 right). The shareholders have the possibility to receive new issued IBERDROLA shares, to receive cash by selling rights to IBERDROLA or to receive cash by selling their rights on the market. It is when the shareholder chooses the first option when there is a capital increase.

On 23 January 2013, the 6th edition of this remuneration programme was closed, where the investors who hold 64,9% of the capital of IBERDROLA has chosen to receive shares from the Company free of charge, without expenses or commissions, in exchange for a new title for every 23 allocated rights. In order to cover the delivery of these new shares, the Company increased its share capital by 2.32%, equivalent to

issuing 142,29 million new IBERDROLA shares. This choice of the shareholders shows that they want to firm up the company with capital increase. In addition, 35.1% of shareholders have chosen to receive the traditional cash dividend. Thus, they are agreeing to the purchase commitment undertaken by the Group, which guaranteed the payment of 0.143 Euros gross per share, with a tax withholding of 21%.

6. FINANCIAL RISK MANAGEMENT POLICY

The IBERDROLA Group is exposed to various inherent risks in the countries, industries and markets in which it operates and the businesses it carries out, which could prevent it from achieving its objectives and executing its strategies successfully.

1. Interest rate risk

The IBERDROLA Group is exposed to the risk of fluctuations in interest rates affecting cash flows and fair value in respect of items in the statement of financial position (debt and derivatives). In order to adequately manage and limit this risk the IBERDROLA Group manages annually the proportion of its debt that bears fixed interest to that which bears floating interest and establishes the actions to be carried out throughout the year: new sources of

| | Thousands of euros | |
|---------------------------------------|---------------------------|-----------------------|
| | 31 - 12 - 2012 | 31 - 11 - 2011 |
| Fixed interest rate | 21.334.405 | 18.343.654 |
| Floating interest rate | 10.222.359 | 13.652.795 |
| Limited floating interest rate | 1.327.338 | 1.232.051 |

financing (at a fixed, floating or indexed rate) and/or the use of interest rate derivatives.

2. Exchange rate risk

As the IBERDROLA Group's functional currency is the euro, fluctuations in the value of the currencies, mainly the sterling pound and the US dollar, in which borrowings are instrumented and transactions are made, with respect to the euro may have an effect on the finance costs, on the profit for the year and on the Group's equity. The IBERDROLA Group reduces this risk by

ensuring that all its economic flows are denominated in the presentation currency of each Group company, provided that this is possible and economically practicable and efficient. The resulting open positions are integrated and managed through the use of derivatives, within the approved limits and maintaining foreign currency-denominated debt.

3. Commodity price risk

The activities of the IBERDROLA Group are exposed to a range of business risks related to the uncertainty of the main variables affecting it, such as the evolution of the demand for electricity and gas, changes in hydroelectric and wind power output and changes in the price of fuel and CO2 emission allowances.

4. Liquidity risk

IBERDROLA Group's liquidity policy is designed to ensure that it can meet its payment obligations without having to obtain financing under unfavourable terms. For this purpose, it uses various management measures such as the arrangement of committed credit facilities of sufficient amount, term and flexibility, diversification of the coverage of financing needs through access to different markets and geographical areas, and diversification of the maturities of the debt issued.

5. Credit risk

This risk is defined as the risk that a third party will not fulfil its contractual obligations and, therefore, generate losses for the group. With regard to credit risk relating to trade accounts receivable, this risk is historically very low. The cost of doubtful debts has historically remained at moderate levels, despite the current difficult economic situation, although it has mildly increased.

The IBERDROLA Group is also exposed to the risk that its counterparties will not meet their obligations in transactions with derivatives, the placement of cash surpluses, energy trading operations and guarantees received by third parties. The corporate risk function of the IBERDROLA Group establishes strict criteria in selecting counterparties based on the creditworthiness of the entities, which translates into a highly creditworthy and highly solvent counterparty portfolio. It should be noted that in 2012 and 2011 there were no material non-payments or losses. At 31 December 2012 and 2011 there was no material credit risk concentration at the IBERDROLA Group.

HEDGES

For accounting purposes, hedges are classified as follows:

- Fair value hedges: where the risk hedged is a change in the fair value of an asset or liability or a firm commitment.
- Cash-flow hedges: where the risk hedged is the variation in cash flows attributable to a specific risk associated with an asset or liability or a likely transaction, or to exchange rate risk in a firm commitment.
- Hedge of a net investment in a foreign operation.

HEDGING INTERES RATE AND FOREIGN CURRENCY

The two more important risks IBERDROLA face are the interest rate and the foreign currency risk. To cover from these risks the company disposes of derivatives (swaps, collars and others). As we can see in the chart below interest rate hedges and foreign currency hedges have been reduced in derivative liabilities from 2011 to 2012. This could be due to the quantitative reduction of those derivative liabilities or due to the reduction of risk that allows the company to invest less in hedging.

On the other hand, interest rate hedges on derivative assets have increased from 2011 to 2012, while foreign currency hedges have decreased in a huge amount. This can be because the company perceives more risk coming from the interest rate than from foreign currency. However the total hedging in derivative assets has been reduced from one year to the other.

To conclude, the total investment in hedging assets and liabilities has been reduced in an amount of 321.237 thousand euros. If we look at the balance sheet of the company we see that both derivative assets and liabilities have been reduced, so the company has shorten its hedging due to this fact.

| 2012 | Total derivative assets | Total derivative liabilities |
|-------------------------|-------------------------|------------------------------|
| Interest rate hedges | 114.857 | 204.123 |
| Foreign currency hedges | 272.183 | 233.489 |

| | | |
|--------------|----------------|----------------|
| TOTAL | 387.040 | 437.612 |
|--------------|----------------|----------------|

(thousands of euros)

| 2011 | Total derivative assets | Total derivative liabilities |
|-------------------------|-------------------------|------------------------------|
| Interest rate hedges | 80.339 | 302.011 |
| Foreign currency hedges | 466.173 | 297.402 |
| TOTAL | 546.512 | 599.413 |

(thousands of euros)

7. RATINGS

| | long term rating | short term rating |
|---|---|---|
| Moodys' Investors Services Limited | Baa1 (Subject to moderate credit risk). | P2 (Superior ability to repay short-term debt obligations). |
| Standard & Poor's Ratings Services | BBB (adequate protection parameters). | A2 (STRONG capacity to meet financial commitments). |
| Fitch Ratings Inc. | BBB+ (expectations of default risk are currently low). | F2 (Good credit quality. Indicates good intrinsic capacity for timely payment of financial commitments). |

At this time, the credit ratings granted by Moody's, Standard & Poor's and Fitch are Baa1, BBB and BBB+, respectively. Taking into account that this agencies rate the companies depending on where they mostly develop their business, that in the case of IBERDROLA is Europe, and that nowadays Europe is not highly valued, these are very good ratings. So we can say that according to the ratings of these agencies IBERDROLA has a low level of risk.



Profitability and productivity

Analysis of the profitability, the productivity and the leverage enhancement of the company. This analysis has been made using different ratios. In this part a comparison between the profitability and the risk is also made.

III. PROFITABILITY AND PRODUCTIVITY

PROFITABILITY

1. Return on equity (ROE)

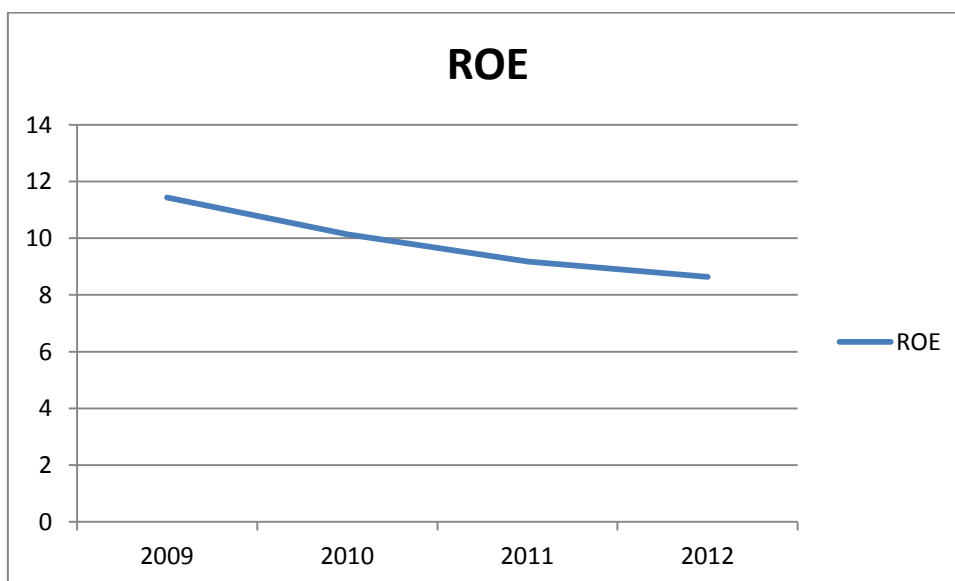
It measures the profitability of a corporation by revealing how much profit a company generates with the money shareholders have invested.

It is calculated by the following formula:

$$\text{ROE} = \text{Net income} / \text{Equity}$$

In the case of IBERDROLA the ROE have decreased from 11,43 % in 2009 to 8,63 % in 2012, which means a drop of 35% in the last 4 years. This result is due to the increase of 29% of the equities and the fall of over 2% of the net income. Considering both variations of the data commented few lines above we could ensure that the company have been facing a difficult period due to the firm had to increase nearly 30% of its equities, by capital increases or other vehicles, to keep up with the current activity.

Checking the graph of the evolution of ROE since 2009 we can see that although ROE have been decreasing during the whole period it has been dropping slower in the last 2 years.



1.1 Margin ratio

It measures how much out of every euro of sales a company actually keeps in earnings. A high Margin ratio indicates a more profitable company with a greater control over its costs compared to its competitors.

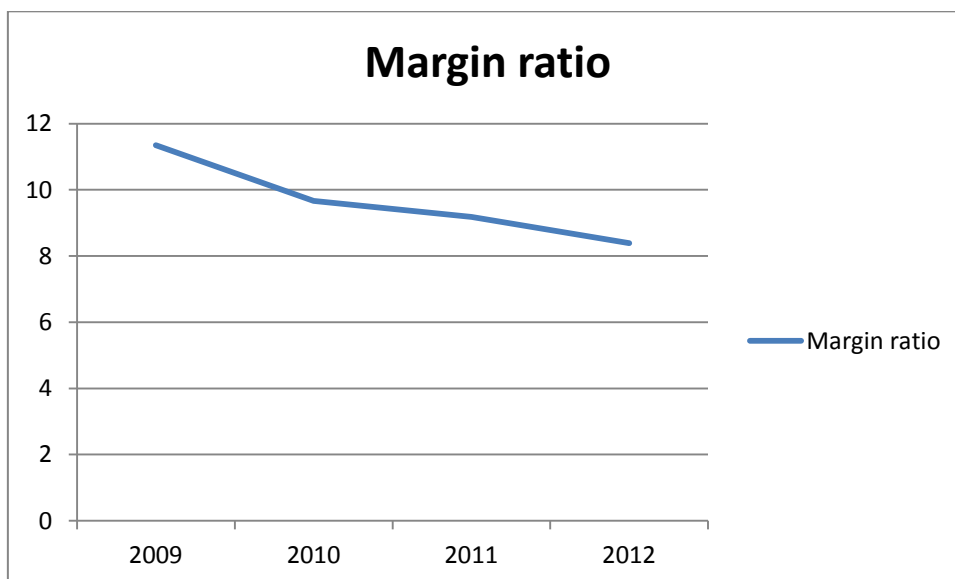
It is calculated by the following formula:

$$\text{Margin ratio} = \text{Net Income}/\text{Sales}$$

In the case of IBERDROLA the Margin ratio has decreased over the last 4 years in 26%, being in 2009 of 11,35% and in 2012 of 8,39%. As we can see in the graph, from 2009 to 2010 the ratio sharply decreased from 11,35% to 9,67%, then in the following years it has been stabilized showing only a soft decrease. This decline means that in 2009 the company kept in earnings 11 cents of each euro of sales and in the next years it just kept 8 cents.

The drop on the margin is due to a decrease in net income and an increase in sales, which means that the company is selling more but at a lower price than in previous years, because net income is more or less the same in the last 4 years while sales increase in 32%.

To sum up, IBERDROLA has decreased the margin it gets for every euro of product sold in the last 4 years.

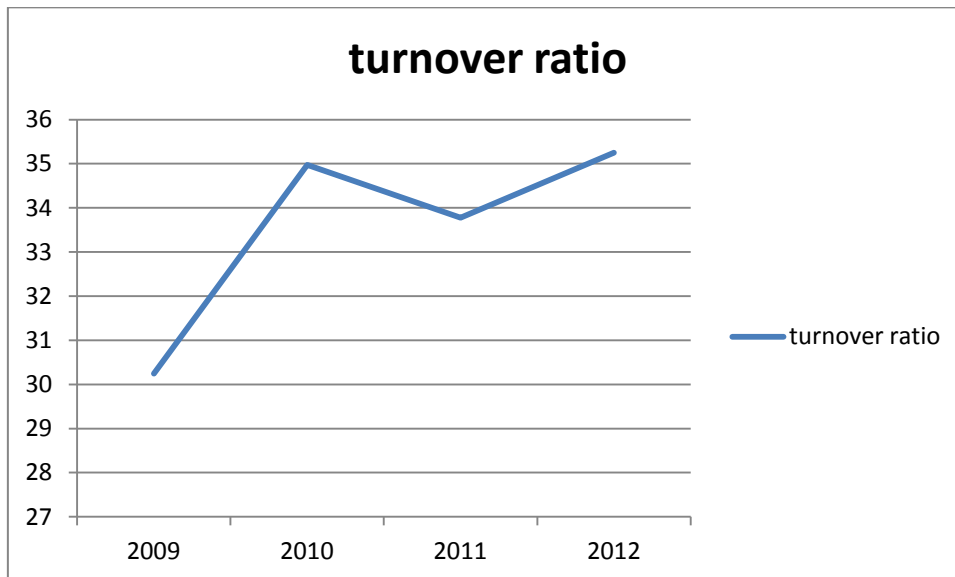


1.2 Turnover ratio

It measures a firm's efficiency at using its assets in generating sales or revenue, the higher the number the better.

Turnover ratio = Sales / Assets

As we can see in the graph, in the case of IBERDROLA the Turnover ratio has increased in the period 2009-2012 in 16, 55%, being the value in 2009 of 30,24% and in 2012 of 35,25%. These values mean that its assets were able to generate the 30% of sales in 2009 while in the last year they were able to generate 35% of sales. This growth is due to a higher increase in sales than in asset in the last 4 years, so it concerns the turnover ratio IBERDROLA is in a good situation.



1.3 Comparison Margin and Turnover ratio

Usually companies with low margin ratios tend to have high asset turnover ratios, while those with high margin ratios have low asset turnover ratios. The case of IBERDROLA might be hold in the first group; the company has quite a low margin ratios but it is compensated with a pretty high turnover ratios. This is quite logical because the profitability of an energetic company comes basically from selling large amounts of

energy (turnover ratio) instead of getting a huge margin for each unit sold (margin ratio).

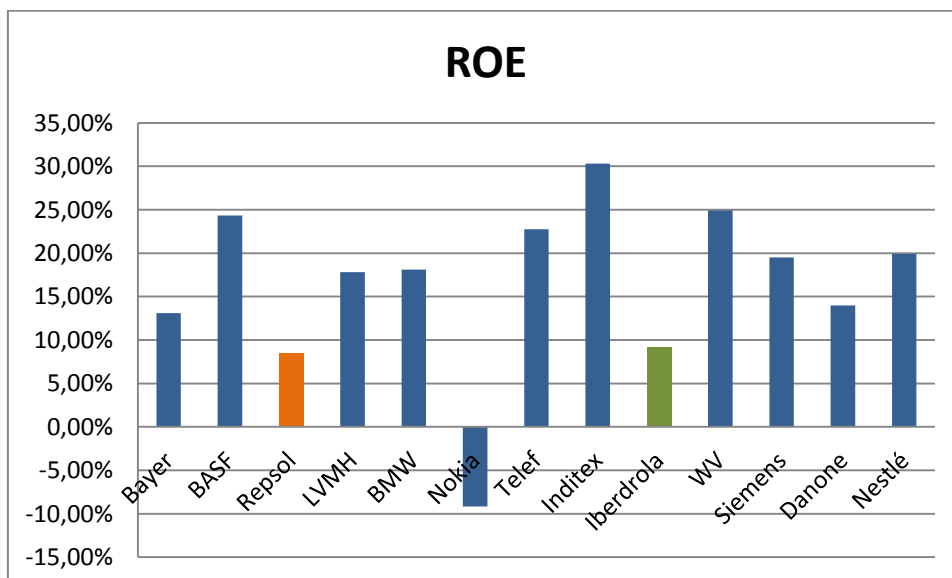
To sum up, the company will be located between the massive production and the brand champions, although it would be much closer to the massive production point.

2. Comparison with other companies (data from 2011)

In this part we are going to compare some variables already analyzed with other companies. Eventhough most of them are not from the same sector, it is good to see how attractive could be for investors in general terms.

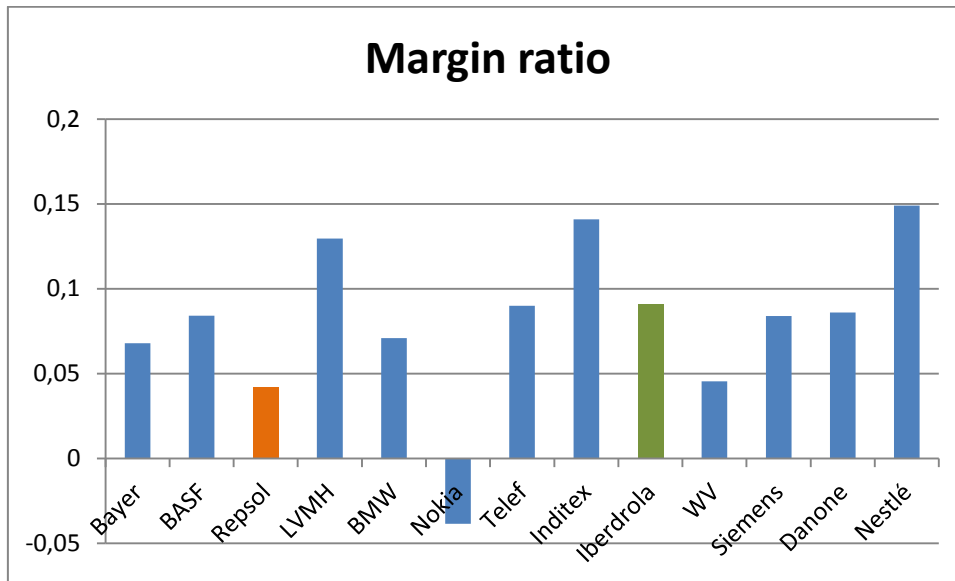
On the other hand, our closer competitor from the list of firms studied is REPSOL. Although its current activity is in the energetic business the services offered are not equally compared with the ones that IBERDROLA do.

2.1 ROE



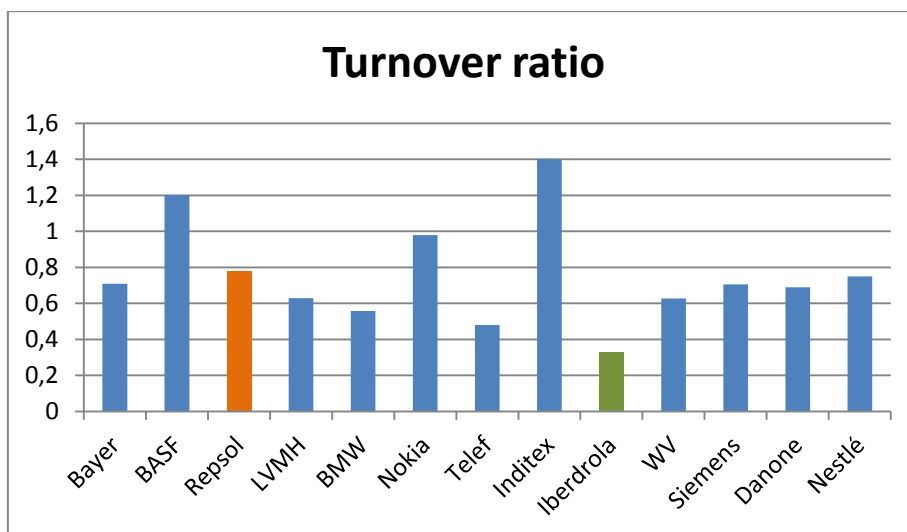
Comparing some companies of the EUROSTOXX 50, always taking into account data from 2011, we can see that IBERDROLA is one of the companies that get a lower ROE with a value of approximately 9%. Comparing it with REPSOL, that is a company of the same industry; we can see that they both have similar ROE.

2.2 Margin ratio



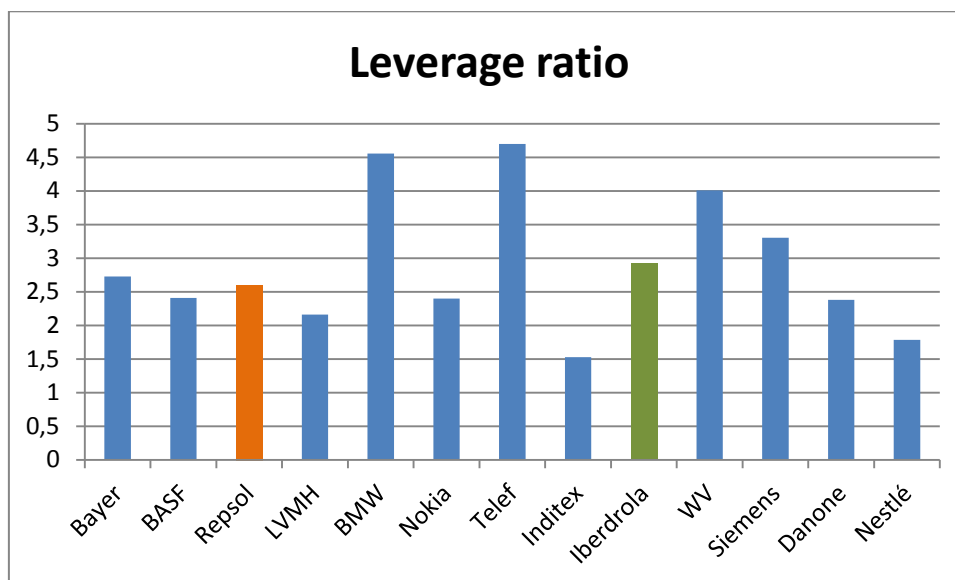
When focusing on the margin ratio, that is the part of the sales that remains on the net income of the company; on the one hand, IBERDROLA doesn't have a very high ratio compared to the other companies of EUROSTOXX 50. But on the other hand it's higher than the one from REPSOL, it's most direct competitor. The firm might not be the most profitability due to its low risk or even because the business is not a very revolutionary one.

2.3 Turnover ratio



In the case of the turnover ratio, that is the amount of sales generated by every euro of assets, IBERDROLA is the company which has the lowest value, being this 0,33. Compared to REPSOL the difference is quite high, approximately 0,4 points.

2.4 Leverage ratio



Analyzing the leverage ratio we can see that IBERDROLA has a ratio neither too high nor too low compared to the other companies of the EROSTOXX 50. The highest leverage corresponds to BMW and the lowest to INDITEX. Compared to its most direct competitor, REPSOL, the ratio is very similar although is a bit higher in the case of IBERDROLA.

To sum up, if we directly compare IBERDROLA with REPSOL we could affirm that the ROE of IBERDROLA is higher than the one of REPSOL. On the one hand IBERDROLA has a higher margin. On the other hand REPSOL has a higher turnover but the difference is lower than the one from Margin.

3. ROE before taxes

ROE before taxes is the perfect tool to compare ROE's from different countries. It is that useful because it takes out the effect of taxes on the ROE, so as not every country apply the same policy on taxes it is been used to compare.

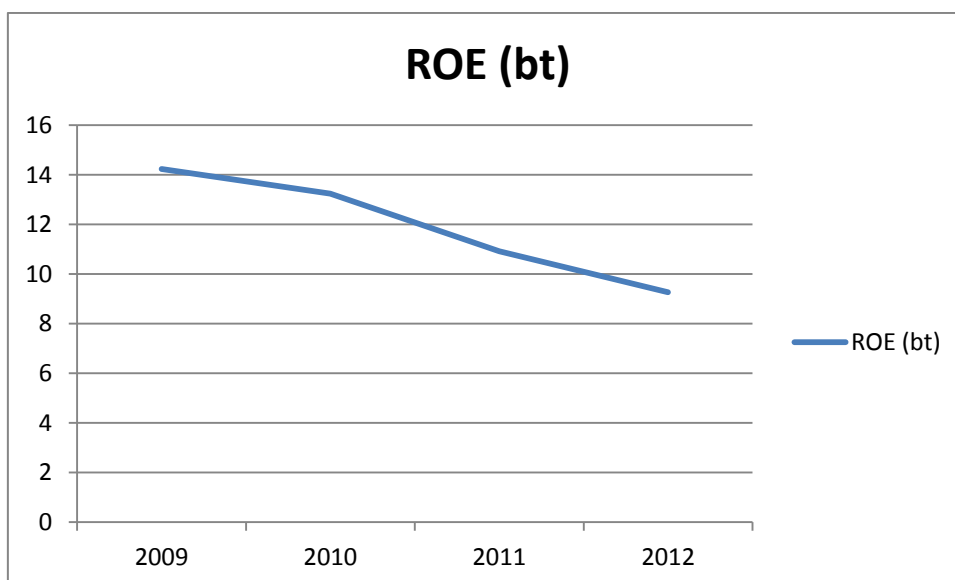
It is also worked out in order to know the impact of corporate tax in the Return on equity. By this way, we could evaluate how effective is the fiscal engineering in the firm.

The formula is the following one:

$$\text{ROE bt} = \text{EBIT} / \text{Equity}$$

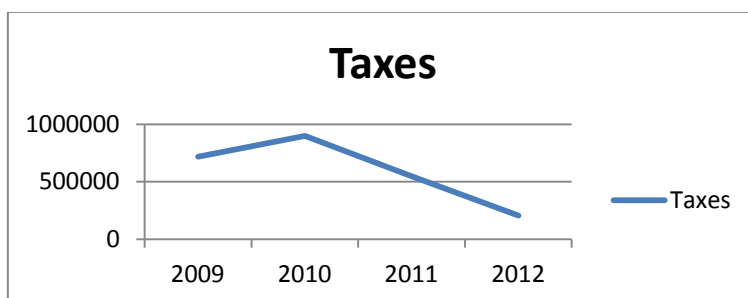
At first we can see that the evolution is similar to ROE. However, the difference between ROE (bt) and ROE widen from 2009 to 2010 due to IBERDROLA paid much more taxes in 2010 than 2009 and this means a decrease in net income. Then, since 2011, taxes in our company's case started to radically drop and the ROE and ROE (bt) became similarly.

To sum up, taxes in IBERDROLA ROE had a notorious impact but in the last two years it has reduced its significance. So, we can affirm that the fiscal department is doing a great job.



3.1 Taxes

Taxes are the amount of money that the firm has to compulsory pay to the public sector. We have extracted them from the memory of the consolidated results and we want to highlight them because of its enhancement. The following graph shows the evolution of the taxes for the last 4 years:



Observing the graph we can simply conclude that the taxes have dropped from the levels of 2009 to 2012. Although it is easily seen in the graph what it is not that appreciable and it is also relevant is that this fall is of 71%.

4. Return on assets (ROA)

An indicator of how profitable a company is relative to its total assets. ROA gives an idea of how efficient management is at using its assets to generate earnings. With this ratio we analyze the profitability of the company independently of how is it financed.

The formula is the following one:

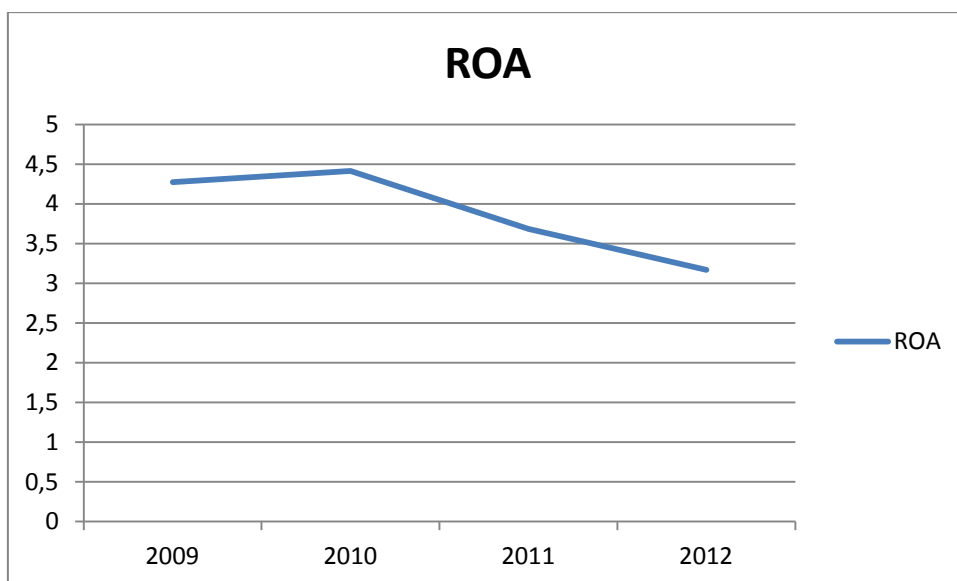
$$\text{ROA} = \text{EBIT} / \text{Assets}$$

In the case of IBERDROLA, as we can see in the graph, ROA softly increases from 2009 to 2010 due to an increase in EBIT and in sales. Then, in the period 2010-2012 return on assets decrease from 4, 41% to 3, 16%. This decline is because although assets are still increasing in these 3 years, EBIT decreases.

The reason why EBIT decreases year after year could be, on the one hand the reduction of EBITDA and in the other hand the increase in the depreciation of our assets. Looking the annual reports we can see that EBITDA is not reduced but all the

opposite, it has been increasing for the last 10 years. This way, if EBITDA increases and EBIT decreases we can assume that this decline is due to an increase of the depreciation of our assets. We have to take into account that the more the company uses its assets the more revenues it has, but also the more depreciation. So the company has to find the equilibrium when using its assets.

So, in the last years the company has become a bit less efficient at using its assets to generate earnings.



PRODUCTIVITY

5. Salary Ratio

Salary ratio could be understood as the value that a unit of wage adds to the final value. The formula is the next one:

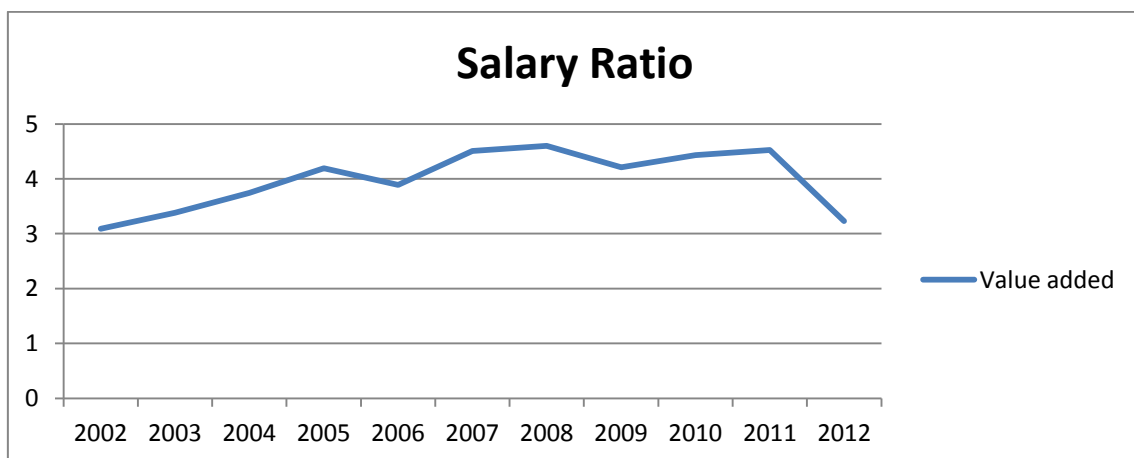
$$\text{Salary ratio} = \text{EBITDA} / \text{Salaries}$$

In our firm, IBERDROLA, the value that a unit of workforce adds to the final product is nearly 3 at 2012. This result could be interpreted as the employees of the company create a wide amount of value to the service. As IBERDROLA is an energetic company

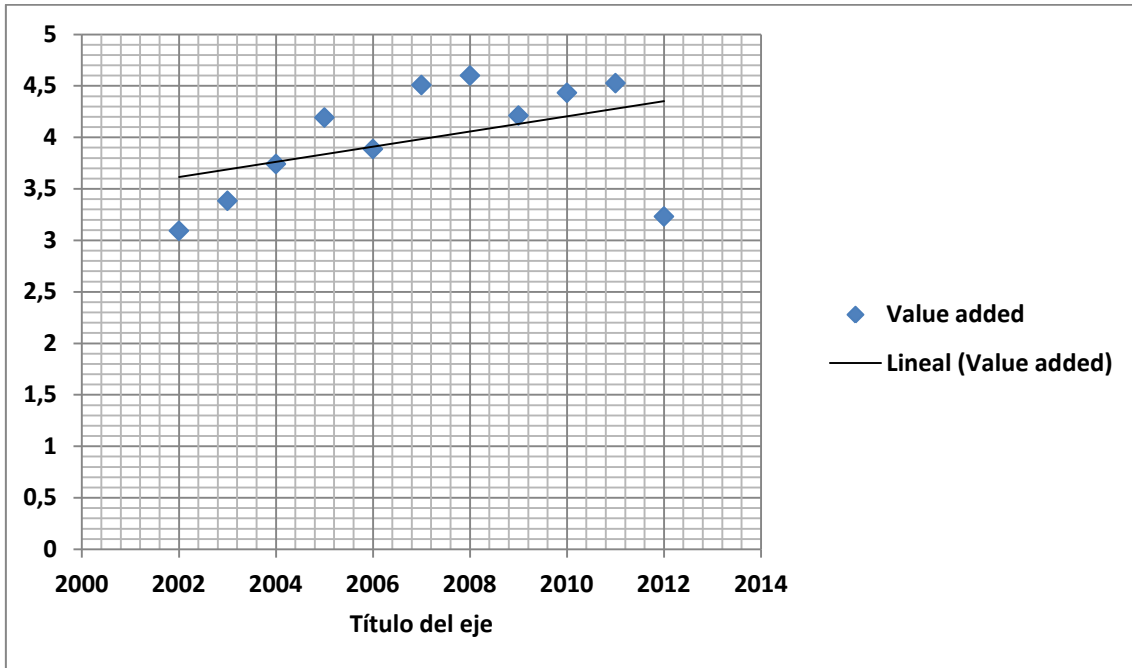
the presence of qualified employees is essential to its current activity and they are the main input of the company.

On the other hand, a firm is most valued if it does not depend much in low salaries. Deeply analyzing the data from excel document we could affirm that the increasing in gains of the company is being really expensive for the company nowadays. Since 2009 the cost of employees has been risen up to 40% while EBITDA have just grown 7,8%. Having said that and double checking the graph we could affirm that the productivity of its workforce has been widely reduced the last year, when the company had face an increasing of 45% of wages cost in order to keep growing its EBITDA.

Summarizing, IBERDROLA has a great dependence to workforce due to its main activity needs a wide base of tech and administrative knowledge. Indeed, although the average productivity has been growing since 2009, the last year this productivity has been reduced.



Average of growing for the last decade:



6. Value Added

In order to understand this product it could be easily compared with the GDP of a country. Not only it considers the produced money that comes from the product of margin and turnover, but also the fact that the wages that the firm is paying to its employees is increasing the richness (or the value) of the whole firm.

The formula used to work out value added is the following one:

$$\text{Value added} = \text{EBITDA} + \text{Wages}$$

In the case of our firm, IBERDROLA, the value added has been sharply growing in the last 10 years from 3119104 to 10117527 which means an increase of 224,37%. This high up is the result of an incredible increase of EBITDA but also Wages. To sum up, the firm is increasing its value added year by year.

LEVERAGE ENHANCEMENT

To work out this part of the analysis we have to take into account different data and variables which are relevant in the leverage aspect of IBERDROLA.

In order to finally get the optimal point of leverage for our company situation, we had to calculate the following variables:

Firstly, it has been indispensable to know how much confidence the banks have in IBERDROLA. It could be explained as the sensibility that banks have when lending money to the firm in question. As we can see in the formula – just few lines below – it indirectly depends on the ROA of the company and it is directly linked with the *Euribor rate* and the quotient Liabilities/Equities.

$$ROE_{bt} = ROA + (ROA - e) * \left(\frac{Liabilities}{Equities} * 100\right) - j * \left(\frac{Liabilities}{Equities} * 100\right)^2$$

When we isolate the “j”, we obtain the numerical number that refers to the sensibility commented before.

Taking a look to the results, we can observe that the evolution that this variable has followed is the next one:

From 2009 to 2010 “j” grew a 5% until achieving its highest value in the whole period. This amount, 0’2, means that the financial institutions did not have much confidence with the firm itself. Or, at least, that his confidence in comparison with the previous year has been reduced.

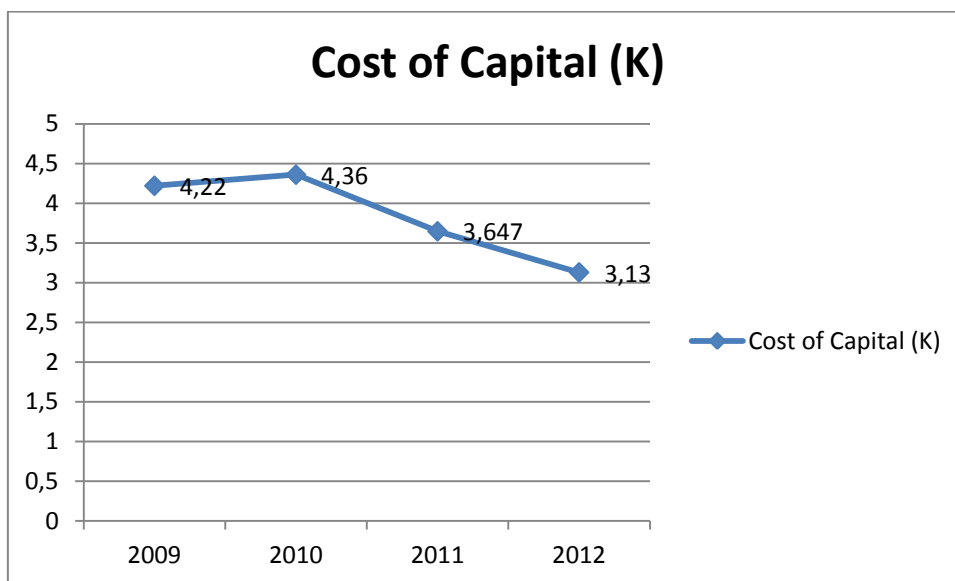
After 2010 the value started to decrease until levels of nowadays. This fall was of 17% from 2010 to 2011, relaxing the tensions between the company and its creditors. Then, it keeps on decreasing progressively and at the end the “j” went down 27% since 2010.

Summarizing, we could affirm that the confidence between financial institution and the firm were degraded for a few period of time, probably because of the worldwide economic situation. Although this black point in the history of the economy, IBERDROLA has been able to turn up the situation until a preferable one.

Once we have reached the “j” what we have to evaluate is the cost of capital for the company itself (K). It is been worked out by the next formula:

$$K = e + (\text{Liabilities/Equities}) * J$$

With the results of the variable K we have done a graph in order to be able to see the evolution in a better way.



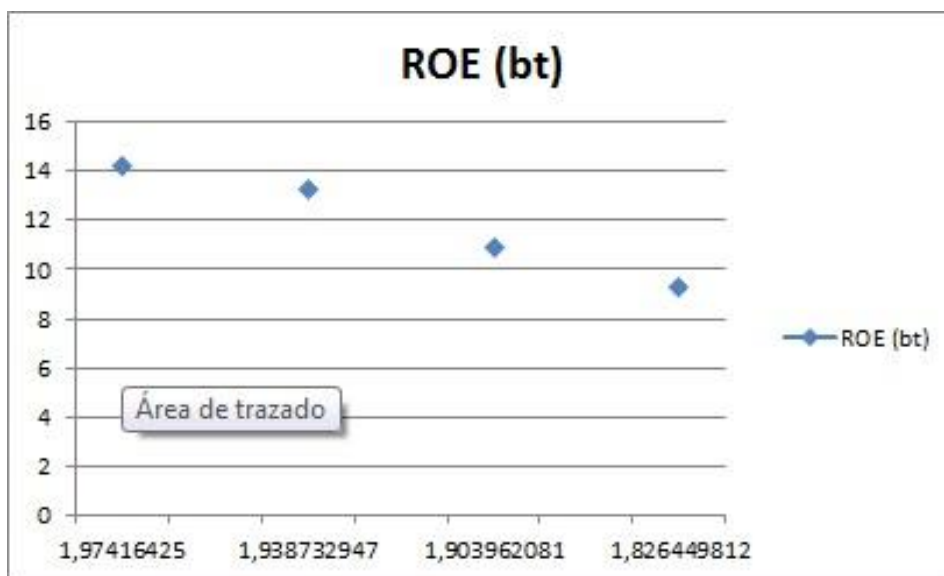
Deeply analyzing the graph, we can see that in 2010 the firm had some problems to finance itself due to the cost of capital were costly. However, with time the global situation has been relaxed and the company has been performing well all this time. Both facts have been favorable for the acquisition of debt for IBERDROLA, and it has observed a decrease on the cost of its external financing.

1. Comparison ROA and Cost of Capital

ROA - K 0,0525232 0,0543675 0,0396338 0,0396434 -24,52209

This comparison is done in order to see how financial profitability increases or decreases without enhancing the margin and the turnover. As we well know the company could obtain a higher ROE bt leveraging up the company, so, upper the leverage higher the ROE bt. Contrarily, as we can see in the following graph, as low is

the leverage of the firm lower is its ROE bt. This graph shows the level of leverage from 2009 until 2012.

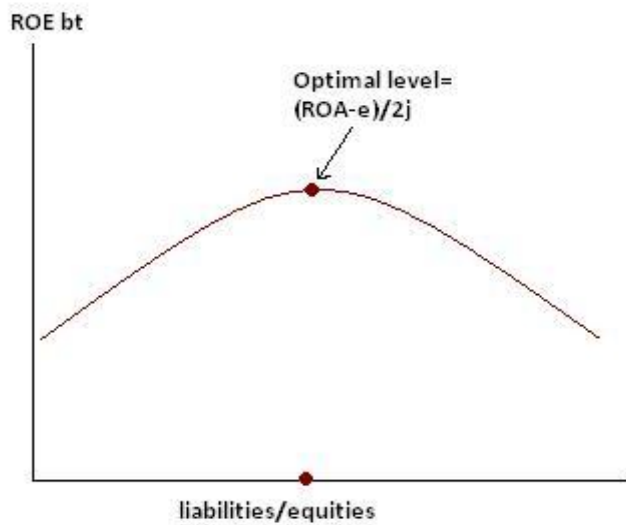


What is relevant in this graph is that if we did a regression line which considers all the point of the draw, the angle between this regression line and the horizontal axis will mean the gain in financial profitability due to the leverage. Checking the data from above (ROA – K) we can affirm that this profitability coming from the leverage has been decreasing because of the decrease of leverage.

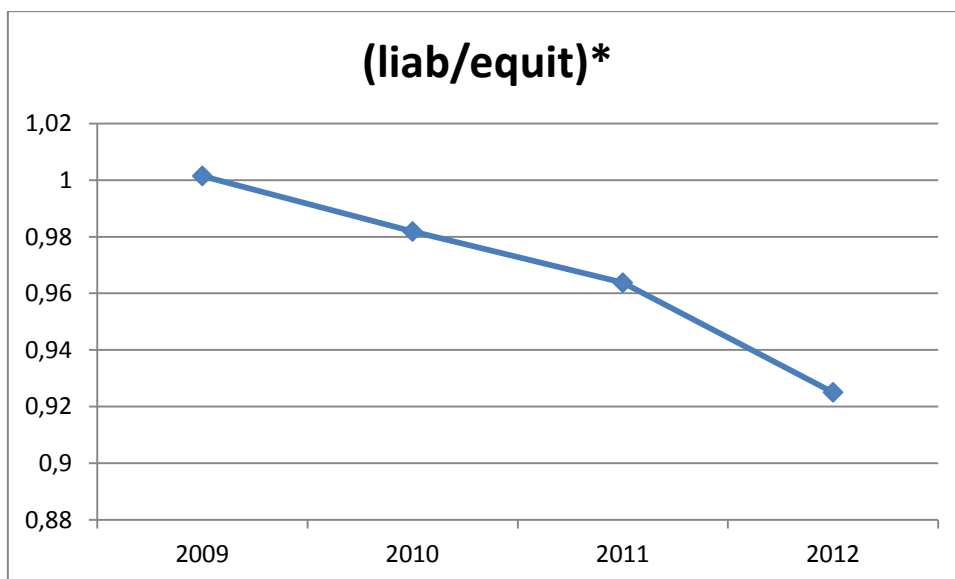
In the whole period the leverage ratio has been reduced a 7,5%. This decrease is because although the liabilities have grown 9% in the last 4 years the equity has risen a 17%. This evolution of the leverage ratio caused the reduction of the ROE before taxes up to 35%. Referring to this results and including the table of the (ROA – K) attached some lines above we can affirm that the company has reduced its financial profitability due to its liabilities has also been decreased.

2. Level of leverage

One important thing we have to take into account when analysing the profitability of a company is the level of leverage. As we can see in the graph below, ROE before taxes increases while leverage level increases until one point. Then, after achieving this point, ROE before taxes starts decreasing. This point, where the trend changes, is the optimal level of leverage for a company to have the maximum ROE before tax.

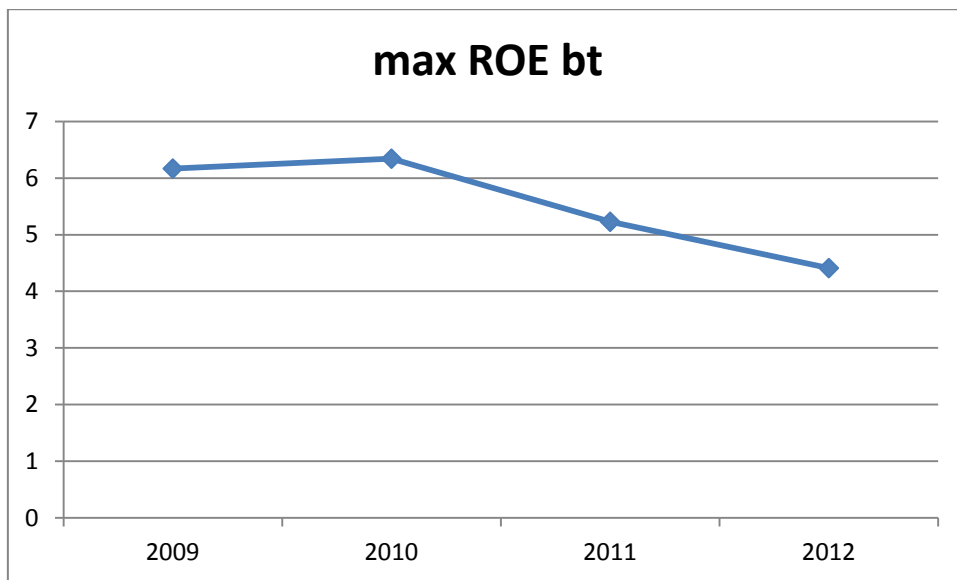


In the case of our company, as we can see in the graph below, in the period 2009-2012 the level of leverage needed for getting the maximum ROE before tax decreases. Year after year we need less debt to maximize the financial profitability. This drop is because a reduction of ROA during this period and also, a decrease on “j”, which means that the sensibility of the banks regarding the indebtedness situation of the company is reduced during this period.



With this optimal level of leverage we obtain a theoretical maximum level of ROE before tax, as we can see in the graph below.

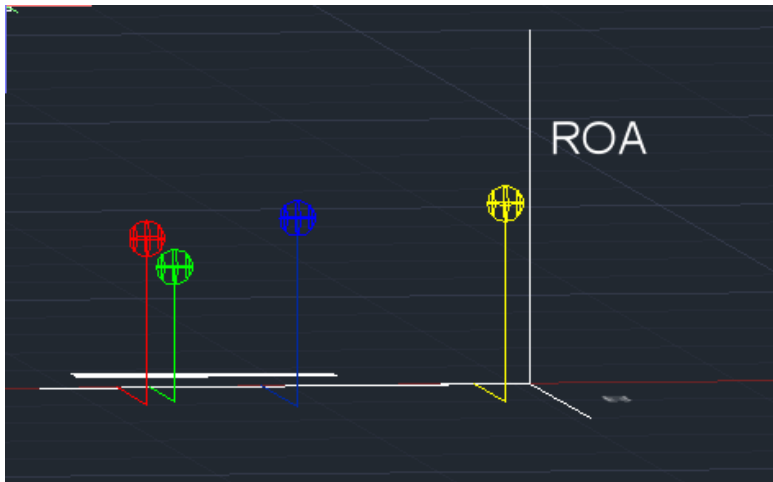
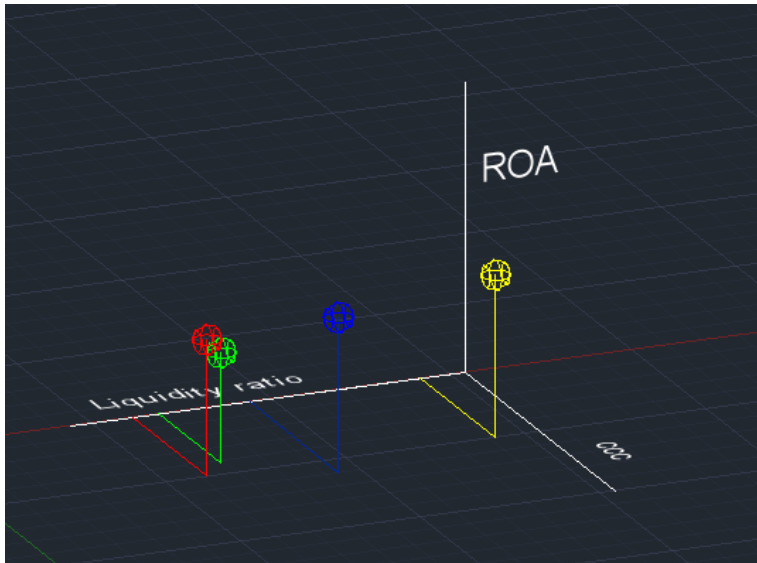
It is necessary to point out that the real ROE before tax the company gets during the period 2009-2012 is higher than the theoretical maximum, that is because this is a theoretical exercise and we are not considering many variables that influence in reality



RISK – PROFITABILITY

In this part we have ensemble the results obtained in both parts of the project: the risk and the profitability.

The aspects considered in the graph (both pictures are the same graph from different points of view) are the Liquidity ratio and Cash cycle, which took part in the risk analysis, and ROA, which has been studied lastly.



Legend:

2009 2010 2011 2012

Observing both pictures, we could see that there has been an irregular moving of the variables. What means that it has not follow a trend and the firm has changed its strategy in the middle of the period studies. Let's take a deeply look on that.

In 2009, the liquidity ratio as well as the cash cycle was quite good so the company was not holding much risk and its ROA was also pretty high. Then, they took the strategy of obtain more profitability even if they had to hold a bit more risk. So, they considerably reduced IBERDROLA's liquidity ratio and also the cash cycle to get a higher ROA.

When the company took this way stakeholders started to worry because of the increasing risk that the company was holding. An example of this preoccupation is that

the J, which is the willingness of the banks of lending money to a determinate company, grew up to its maximum value of the last four years.

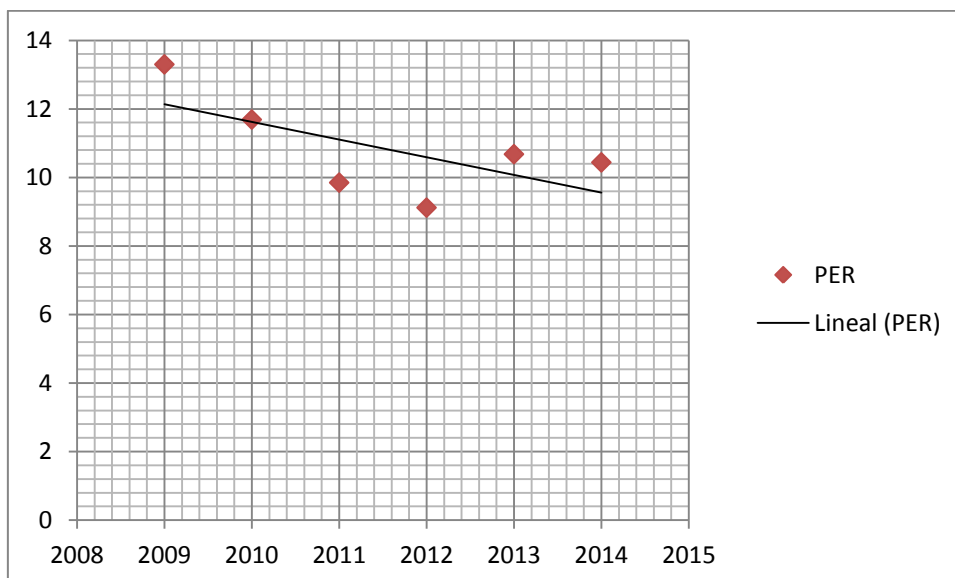
However, when the board of directors realized that I might not be the best maneuver they drastically change its strategy. So, IBERDROLA worked hard to recover its low riskiness, which is observable in the increased liquidity ratio and cash cycle. On the other hand, its ROA were obviously affected and was reduced a bit. The new direction of the firm's strategy and the enhancement of the global economic situation has been tranquilized its stakeholders. This fact was seeable when the bank sensibility when lending money began to decrease.

1. Price to earnings ratio (PER)

Price to earnings ratio is an indicator which helps investor to measure its investment. From the business side it can be seen to know how well the company's payout is performing comparing with other companies. The formula used is the following one:

2. Market Value per Share Earnings per Share (EPS)

In the case of IBERDROLA the results has been the ones drawn in the graph.



What we can see is, on the whole, this value have been decreasing for the last four years. This could be interpreted as the investors are not willing to pay the current price of the share for the dividend received. However, the forecast for the next years is

positive in comparison with the 2012 one. What does this mean is that the shares are undervalued and they the predictable trend is that its price might go up.

On the one hand, PER for 2009 and 2010 was in a range that may be considered fair value. Since 2011, the Price to Earning ratio has been under 10 which means that either the stock is undervalued or the company's earnings are thought to be in decline. Alternatively, current earnings may be substantially above historic trends or the company may have profited from selling assets.

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