2016 Annual Report

Italgas

2016
Annual Report

Corporate mission and values

Skill, efficiency, innovation, reliability, safety and closeness to the people.
The work of the Italgas men and women has been inspired by these values every day for the past 180 years.
As always, Italgas continues to support the economic and social development of the country by promoting sustainable growth. Today, it is the largest natural gas distributor in Italy, and the third largest in Europe.
Built on these solid foundations, the group is now looking ahead and is aiming to strengthen its presence on the market. Investment, development, continuous improvement and quality of service are the main strategic lines it has established to achieve its various goals and to continue to create value.
Italgas, 180 years of history and a future success story yet to be written.

Italgas, the Italgas Group or the Group means Italgas S.p.A. and the companies within its scope of consolidation.

Corporate bodies

BOARD OF DIRECTORS[a]

Chairman
Lorenzo Bini Smaghi

Chief Executive Officer and General Manager
Paolo Gallo

Directors
Nicola Bedin
Barbara Borra
Maurizio Dainelli
Cinzia Farisè
Yunpeng He
Paolo Mosa
Paola Annamaria Petrone

BOARD OF STATUTORY AUDITORS[a]

Chairman
Gian Piero Balducci

Statutory Auditors
Giandomenico Genta
Laura Zanetti

Alternate Auditors
Marilena Cederna
Walter Visco

CONTROL, RISK AND RELATED-PARTY TRANSACTIONS COMMITTEE[b]

Paola Annamaria Petrone (Chairman)
Barbara Borra
Cinzia Farisè

APPOINTMENTS COMMITTEE[b]

Cinzia Farisè (Chairman)
Nicola Bedin
Maurizio Dainelli

FINANCE AND SERVICES GENERAL MANAGER[c]

Antonio Paccioretti

REMUNERATION COMMITTEE[b]

Barbara Borra (Chairman)
Maurizio Dainelli
Paola Annamaria Petrone

SUSTAINABILITY COMMITTEE[b]

Nicola Bedin (Chairman)
Yunpeng He
Paolo Mosa

SUPERVISORY BODY[d]

Carlo Piergallini (Chairman)
Eliana La Ferrara
Francesco Profumo

INDEPENDENT AUDITORS[e]

EY S.p.A.

(a) Appointed by the Shareholders' Meeting of 04 August 2016. In office until the date of the ordinary Shareholders' Meeting convened to approve the year ended financial statements as at 31 December 2018.
(b) Committee established by the Board of Directors on 4 August 2016. Members appointed by the Board of Directors on 5 September 2016.
(c) Appointed by the Board of Directors on 26 September 2016, with effect from 7 November 2016.
(d) Appointed by the Board of Directors on 20 December 2016.
(e) Position conferred by the Shareholders' Meeting on 4 August 2016 for the 2016 to 2018 period.

Contents

Disclaimer
The Annual Report contains forward-looking statements, specifically in the "Outlook" section, relating to: investment plans, future management performance and the execution of projects. Such statements are, by their very nature, subject to risk and uncertainty as they depend on whether future events and developments take place. The actual results may therefore differ from those forecast as a result of several factors: actual operating performance, general macroeconomic conditions, geopolitical factors such as international tensions, the effect of new energy and environmental legislation, the successful development and implementation of new technologies, changes in stakeholders' expectations and other changes in business conditions.

Report and consolidated financial statements


COZZO
RIGIOLI
868,0
850,9
872,6
806,5
816,8
803,3
COMUNALE
STRADA
1:5000

Methodology and definitions

In order to provide a representation as comprehensive and meaningful as possible, this report divides the various financial data into the following three categories:

- "Consolidated", which refers to the consolidated financial data of Italgas S.p.A., which includes Italgas S.p.A. since its incorporation (1 June 2016), and the consolidated companies Italgas Reti S.p.A., Napoletanagas S.p.A. and ACAM Gas S.p.A. since the date of separation of the equity holding of Italgas Reti in Snam and, therefore, in the establishment of the Italgas Group (7 November 2016);
- "Consolidated Pro-forma ", prepared for the sole purposes of providing a suitable representation of Italgas Group's financial position for the full year, which includes the financial data of the conglomerate comprising Italgas S.p.A. since its incorporation (1 June 2016), and the companies Italgas Reti S.p.A., Napoletanagas S.p.A. and ACAM Gas S.p.A. from 1 January 2016;
- "Consolidated Gas Distribution", prepared in order to better illustrate and facilitate comparison over time of the performance of the gas distribution and metering operations, and which represents both the financial and the consolidated operational data of Italgas Reti S.p.A., Napoletanagas S.p.A. and ACAM Gas S.p.A., allowing a like-for-like comparison of the financial year 2016 with 2015;
- The "Consolidated Pro-forma" and "Consolidated Gas Distribution" present data that do not necessarily correspond to the actual final data of Italgas' consolidated financial statements for 2016. They have been prepared in order to comment on the operating performance of the Italgas Group and, in the case of the "Consolidated Gas Distribution", also to review the trend of the operational activities compared to the previous year. The final data of the Italgas Group and Italgas S.p.A. are provided in the "Consolidated financial statement" and "Financial statement of Italgas S.p.A" sections of this Annual Report respectively, and comprise the data generated (i) during the period from 1 June to 31 December 2016 for the financial statement of Italgas S.p.A. and (ii) from 1 June to 31 December 2016 for Italgas S.p.A. and 7 November to 31 December for the consolidated companies Italgas Reti S.p.A., Napoletanagas S.p.A. and ACAM Gas S.p.A. The "Consolidated Pro-forma" and "Consolidated Gas Distribution" provide data that precede Italgas' demerger from Snam.

Letter to Shareholders and Stakeholders

To our Shareholders and Stakeholders,

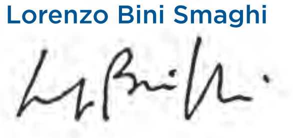
2016 was a very important year for Italgas. On 7 November 2016, after 13 years of absence, Italgas marked its return to the Italian stock market and was quoted on the FTSE MIB of the Italian stock exchange.
The new listing process followed a complex path that led to equity investments in operating companies focused on the gas distribution business being transferred from the previous parent company Snam to a new autonomous entity incorporated under the name Italgas S.p.A.
Considering the specific nature of their business and the various opportunities for development that presented themselves in their respective market environments, Snam and Italgas opted for a spin-off solution to strengthen both companies and create more value for its shareholders and stakeholders.
The group that was formed as a result now includes Italgas Reti (formerly Italgas), controlled directly by Italgas S.p.A., Napoletanagas and ACAM Gas, controlled through Italgas Reti. Among the companies not included in the scope of consolidation, it is worth mentioning the 48.08% equity stake in Toscana Energia, a leading company in gas distribution in Tuscany, as well as the 50% stake in Metano Sant'Angelo Lodigiano and 45% in Umbria Distribuzione Gas.
The Italgas Group, including its subsidiaries, manages a network spanning more than 65 thousand km and over 7.4 million gas delivery points across 1,582 concessions, and has a market share of about 34% in gas distribution in terms of delivery points.
With its renewed structure and increased focus on the objectives of its development strategy, Italgas sees industry tenders as an opportunity to grow and consolidate the market, operating efficiency as the key to maintaining leadership in terms of profitability, significant investment as the means to continue to modernise the network and introduce important technological innovations, and the injection of new resources and the internal reorganisation of its people as the strength and expertise necessary to carry out the ambitious project.

Italgas plans to carry out some of the largest investments in the Italian industrial landscape with around €2 billion by the end of 2020, based on the current management perimeter. In addition to staff growth, Italgas also anticipates net investments of €1.3 billion for the acquisition of new concessions.
The last few months of 2016 have seen significant changes and developments on the Italian and international, economic, political and social landscape. Since its fresh start on 7 November 2016, re-entering the market, Italgas immediately confronted complex and changing situations that affect the context in which it operates and the perception and response in the markets.
In November, the Fitch rating agency assigned a "BBB+", stable outlook, to Italgas S.p.A., while Moody's Investors Service assigned the final rating of "Baa1" for long-term credit, also with a stable outlook.
Following the approval of medium/long term bond issues (EMTN), voted in by the Board of Directors in October 2016, Italgas marked its debut on the bond market by issuing bonds totalling €2,150 million on 19 January 2017, broken down as follows: (i) €1,500 million, divided into two tranches, the first 5 years and the second 10 years, both at a fixed rate, amounting to 750 million euro each of 0.50% and 1.625% of the annual coupon respectively; (ii) 650 million issued on 14 March 2017, with a maturity of 14 March 2024 and an annual fixed-rate coupon of 1.125%.
Moreover, in December 2016, Italgas achieved financing from the European Investment Bank (EIB) for €300 million for a term of 16 years. The transaction, earmarked to finance the installation of new smart meters in particular, is the largest secured by the utilities segment in Italy from the EIB this year.
The consolidated profit and loss sheet for the year ended (from 7 November 2016 to 31 December 2016), had an effect on the non-recurrent additional costs. Excluding these costs, the "Consolidated"[1] economic performance of the last two months of 2016 show an adjusted operating profit and adjusted net income of 52 and 30 million respectively.
The "Pro-forma Consolidated"[2] economic performance, on the other hand, posted an adjusted operating profit of €359 million and an adjusted net profit of €221 million.
The Board of Directors intends to propose a dividend payout of 0.20 euro per share to the Shareholders' Meeting.
We have a good deal of important history behind us and at the same time we are a start-up 180 years old with almost 4,000 people. In our many years of operation we have experienced significant changes, hardships, successes and continuous rebirth marked by a common factor: the ongoing desire to always look forward and take on new challenges. This is the guiding principle for the daily work of our people. It is to them, and to you all who believe in Italgas, that we direct our gratitude for our achievements. And it is in them and in you that we place our trust to tackle our next objectives.

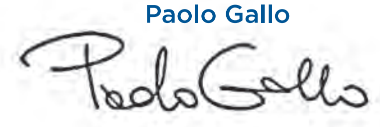
23 March 2017

for the Board of Directors

The Chairman
Lorenzo Bini Smaghi



The Chief Executive Officer
Paolo Gallo



[1] Refer to the introduction of this report for the definition of "Consolidated".
[2] Refer to the introduction of this report for the definition of "Pro-forma Consolidated".

Highlights of 2016

- Completion of the **separation from Snam** and the **admission to listing of Italgas shares** on the Milan Stock Exchange on 7 November 2016 (with a share closing value of €3.731 in 2016);
- **Full financial autonomy** achieved as a result of the repayment of the entire financial exposure to Snam thanks to the availability of a package of bank loans totalling €3.9 billion with a pool of leading banks, both Italian and international, and the funding provided by the EIB for a total face value of €424 million;
- Approval, on 18 November 2016, of the **Euro Medium Term Notes Programme** for a total amount up to €2.8 billion;
- Conclusion, on 12 December 2016, of an **EIB loan for €300 million** (EIB Italgas Gas Smart Metering) earmarked for projects designed to make the gas distribution system even more efficient;
- The **adjusted "Consolidated Pro-forma" net profit** for the full year 2016 amounted to €221 million;
- Proposal by the Board of Directors to award our shareholders a **dividend** of €0.20 per share.

Italgas and the financial markets

As at 7 November 2016, Italgas is back to being quoted on the FTSE MIB index of the Italian Stock Exchange, after an absence of 13 years. With respect to the reference price at the close of 04 November at €3.998, the stock at year end recorded an official price of €3.731, that it, a fall of 6.7%[3]. The stock performance was essentially affected by rising sovereign yields that occurred after the outcome of the U.S. presidential election, mainly caused by expectations of a more expansive fiscal policy by the new US administration. Utilities, particularly those regulated, due to their defensive profile and predictability of their business, are treated as bonds, and tend to underperform in periods of rising bond yields.

In November and December 2016, the average daily trading volume of the Italgas stock on the electronic market of the Italian Stock exchange was 8.5 million shares, with greater volumes recorded in the early days of the listing.

More generally, the European stock markets recorded widespread declines in the first half of 2016, affected by fears of the Fed raising interest rates in an economic environment characterized by signs of a slowdown, as well as the outcome of the referendum on the European Union held in the United Kingdom. In the second half of the year, however, the improvement in the economic indicators and the new historic highs achieved on Wall Street, also supported by the rise in oil prices and by those expectations of higher US tax leverage, enabled a substantial recovery in European stock prices.

The Stoxx Europe 600 index for 2016 ended down 1.2% from the values recorded at the end of 2015, while national indices showed a 10.2% decline of FTSE Mib, greatly weighed down during the first half of the year by the performance of bank stocks, contrasts with the positive performance recorded by both the DAX in Frankfurt that the CAC 40 in Paris (respectively + 6.9% and +4.9%), which benefited from better macroeconomic figures and less exposure to the banking sector. The London FTSE 100 Index recorded an increase of 14.4% supported predominantly by the depreciation of the pound against other major currencies after the United Kingdom's decision to leave the European Union (Euro/British pound +16% in 2016).

The European utilities sector also closed down in 2016 compared to year end 2015; the Stoxx Europe 600 index utilities depreciated 8.9%, the performance determined also by the trend in the securities of regulated companies, which in the second half of the year were adversely affected by rising sovereign yields.

After hitting new lows in the middle part of the year, the eurozone sovereign bond yields showed an upward movement consequent to the rising inflationary expectations, supported by a strengthening economic outlook and the recovery in the price of energy commodities.

[3] The percentage change was calculated by taking as a reference the year-end official price per share, rounded off to three decimal places.

The extension at the end of 2017 of the Quantitative Easing programme by the European Central Bank has kept the eurozone's sovereign yield values very low, especially for the major countries of the region; at the end of 2016 the yield of ten-year government bond [BTP] stood at 1.82% from 1.60% at the end of 2015, while the spread compared to the German Bund stood at 161 bps compared to 97 bps at the end of 2015. The different monetary policy undertaken by the ECB compared to the Fed (QE extension vs. expectations of rising interest rates) has fostered the depreciation of the EUR/USD exchange, which at the end of 2016 stood at €1.052, down 3 per cent compared with the end of 2015, the least in 14 years.

SHAREHOLDERS

The share capital as at 31 December 2016 consisted of 809,135,502 shares with no indication of nominal value, compared to a total value of €1,001,231,518.44.

At the end of 2016, on the basis of the results of the shareholders' list, the information available and the notices received pursuant to Article 120 of the Consolidated Finance Act, the owners of significant shareholdings (shares exceeding 3%) are represented below.

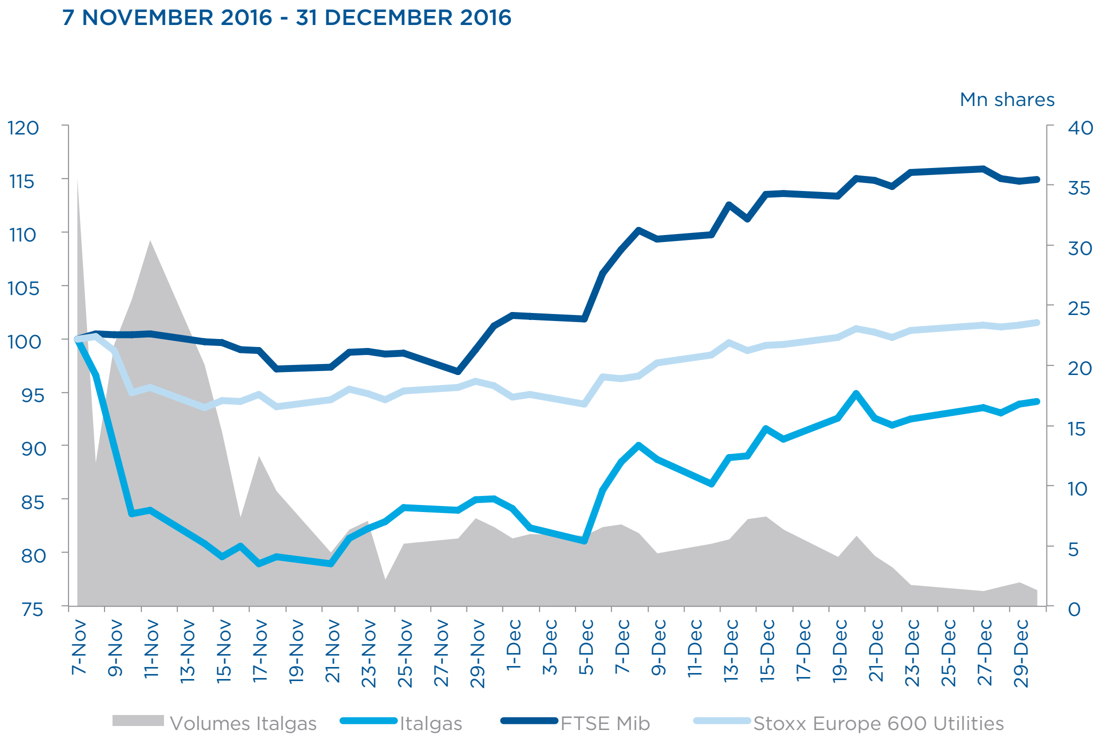
CONSOLIDATED COMPANY	REGISTRANTS(*)	% OWNERSHIP
Italgas S.p.A.	CDP Group [4]	26.05
	Snam S.p.A. [4,5]	13.50
	Romano Minozzi	3.85
	Other shareholders	56.60

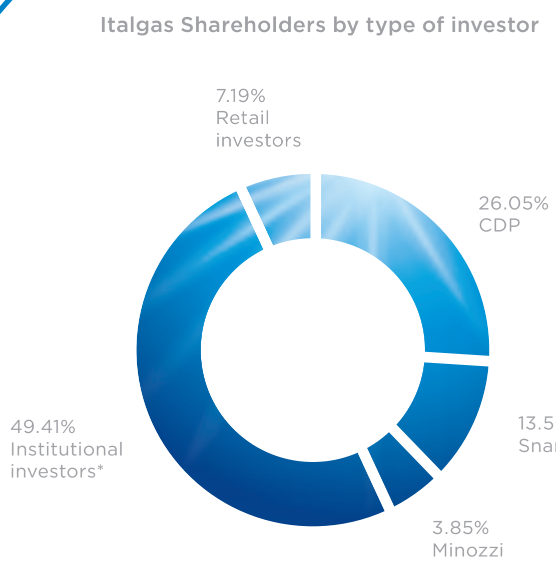
(*) On 30 January 2017, Lazard Asset Management Llc claimed to hold a 5.04 percent stake in the share capital of Italgas S.p.A.

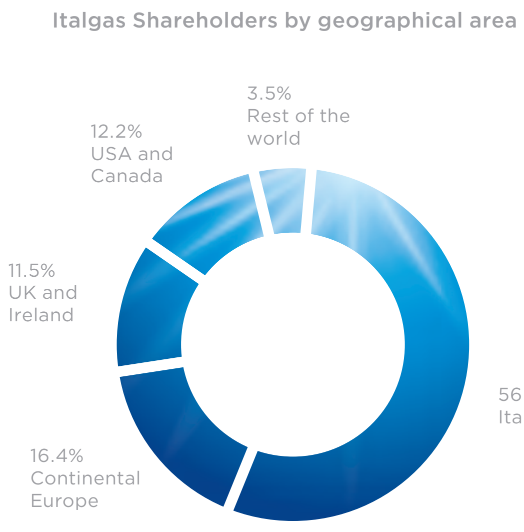
[4] On 20 October 2016 a shareholders' agreement was concluded between Snam, CDP Reti and CDP Gas, with effect from the effective date of the demerger, in relation to Italgas S.p.A..

[5] 13.47% of this stake comes from the placement of 8.23% of the Snam holdings in Italgas Reti for Italgas, and the remaining 0.03%, from the allocation of Italgas shares in proportion to the treasury shares in the portfolio prior to the demerger's effective date.

COMPARISON OF THE QUOTES ITALGAS, FTSE MIB AND EURO STOXX 600 UTILITIES (7 NOVEMBER 2016 - 31 DECEMBER 2016)







The Italgas Group

HISTORY

1837 - The founding

The history of Italgas is identified with that of the gas industry in Italy that began in Turin in 1837 with the establishment of the Public Gas Lighting Company in the city of Turin. In 1851, when the Turin Stock Exchange opened, the Company's stock was one of the 7 "Private funds" allowed to be listed. In 1863, immediately after the unification of Italy, the company changed its name and took the name of Società Italiana per il Gaz.

1900 - The expansion

1900 marked its entrance into the Milan Stock Exchange. The spread of electricity instead of gas for public lighting impelled the company to seek new business opportunities in homecare applications, beginning with cooking and then heating and hot water. In the 1920s, a large acquisition programme was launched for majority packets of gas companies operating in some Italian cities, including Venice (1924), Rome (1929) and Florence (1929), with the goal of creating a large industrial group.

1967 - Entrance into Eni

The stock packet that ensured the control of Italgas was acquired by Eni, even then one of the largest energy groups in the world. With the progressive confirmation of natural gas and the development, starting from the 1970s, of import pipeline networks, the company has focussed on delivering new city networks and the modernization of existing ones, taking a leading role in developing the country's natural gas supply. In 2003, as part of a reorganization process, Eni delisted the Italgas stock from the stock market.

2009 - Italgas was acquired by Snam

SNAM collected Eni's entire stake in Italgas as part of an operation aimed at creating an integrated group to safeguard all the regulated activities of the natural gas sector, from transport to storage, from urban distribution to regasification.

2016 - Separation from Snam and return to the Stock Exchange

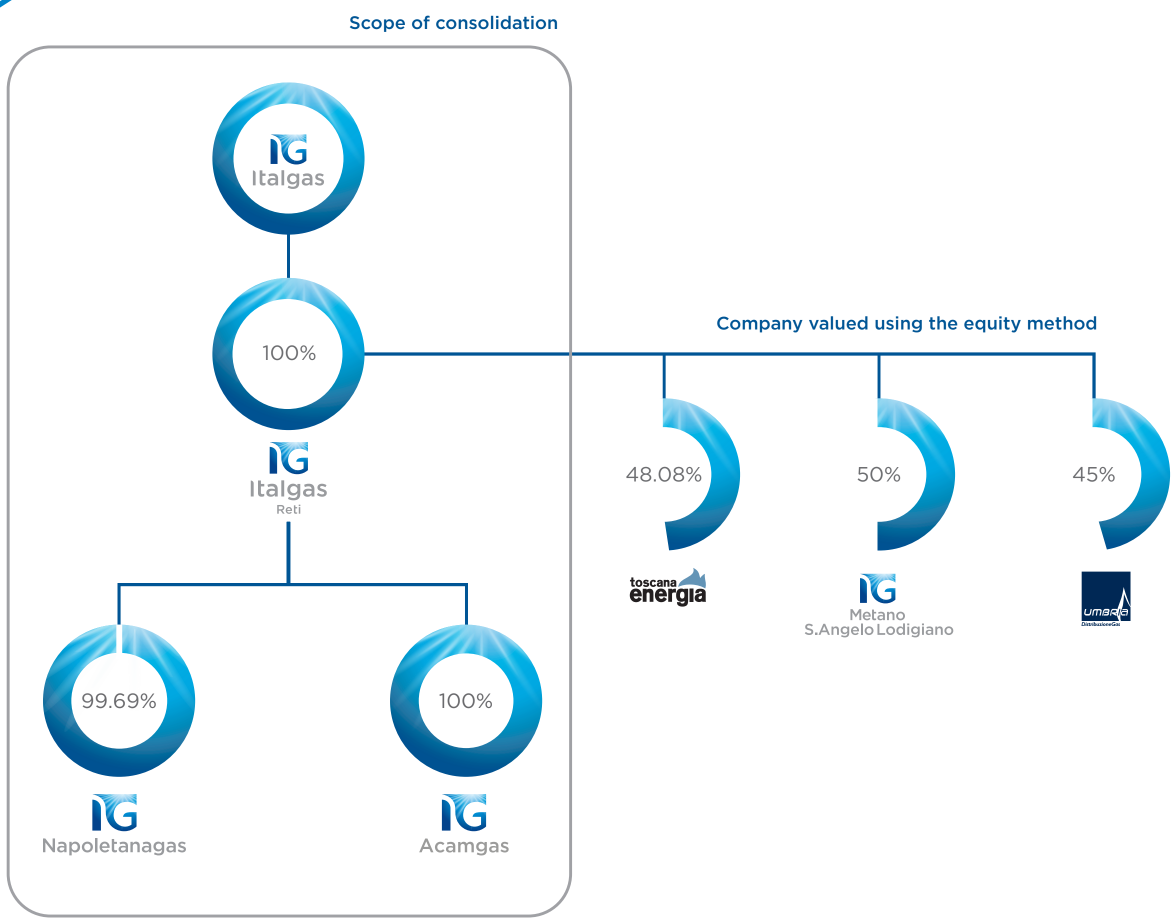
On 7 November 2016, with the completion of the operation of the Snam Group's industrial reorganisation, the Italgas stock went back to being listed on the FTSE MIB index of the Italian Stock Exchange.

NEW BRAND IDENTITY

With the listing on the Milan Stock Exchange and separation from Snam, Italgas adopted a new brand based on the IG monogram, recalling and renewing the historic identification code of the Stock Exchange, with which the company had been identified. The symbol recalls the shape of a cornucopia in which energy, represented symbolically by a light source, moves and expands. The open form of the brand identity expresses dynamism and nearness, in line with the aspiration of Italgas to be a connecting element between energy and people.
The colours recall the traditional company colours, with the modern connotation of a company striving to be technologically advanced and ready to address a new chapter of its history.
IG is also the sign that enables identifying Italgas and its affiliates and making them recognisable throughout time.
.

GROUP STRUCTURE AT 31 DECEMBER 2016

The structure of the Italgas Group at 31 December 2016 is shown below:



Summary data and information

MAIN EVENTS

Separation of Italgas Reti from Snam

7 November 2016 marked the date on which Italgas Reti effectively separated from Snam, at the same time that Italgas (formerly ITG Holding) was listed on the Mercato Telematico Azionario (screen-based market) organised and operated by Borsa Italiana S.p.A.

The reorganisation was implemented through the following three concurrent steps:

- the transfer in kind by Snam to Italgas of an interest amounting to 8.23% of the share capital of Italgas Reti against the assignment to Snam of 108,957,843 newly issued Italgas shares, to allow Snam to own, post-demerger, a stake of 13.5% in Italgas;
- the sale by Snam to Italgas S.p.A. of 98,054,833 Italgas Reti shares, equal to 38.87% of the share capital, for a price of €1,503 million, against the assumption of a debt for the same amount held by Italgas;
- the partial and proportional demerger with allocation to Italgas S.p.A. of 52.9% of the stake held by Snam in Italgas Reti and consequent allocation to Snam shareholders of 86.5% of the Italgas capital. As a result of Italgas demerger, Snam shareholders were issued and assigned one Italgas share for every five Snam shares held.

The demerger instrument was recorded with the Business Register on 3 November 2016 following the Italian Stock Exchange's issue of the order to list Italgas shares on the Screen-based Stock Market, which was issued on 2 November 2016, and CONSOB's issue of the equivalence assessment, pursuant to Article 57, paragraph 1, section (d) of the Issuers' Regulation, regarding the Demerger Prospectus, which was issued on 3 November 2016.

As a result of the operation, the entire stake held by Snam in Italgas Reti, equal to 100% of the share capital of Italgas Reti, was transferred to Italgas.

Debt structure and EMTN programme

In order to achieve an autonomous financial structure and reimburse the entire exposure to Snam, in October 2016, Italgas signed a financing package for a total of €4.3 billion with a pool of leading credit institutions, both Italian and international. In particular, the financing package comprised:

- a variable-rate, Bridge-to-Bond loan, provided by a pool of 11 banks for a committed amount of €2.3 billion for a duration of 12 months (with the option for Italgas to renew for an additional 12 months);
- two variable-rate revolving credit lines, supplied by the same pool of banks for a total committed amount of €600 million and €500 million and a duration of 3 and 5 years respectively;
- three variable-rate type Term loans of up to 3 years for a total of €500 million, provided by three of the 11 participating banks in the pool;

- in addition to these, there is the funding made available by the European Investment Bank (EIB) following: the conclusion of a finance release agreement between Snam and Italgas for the two EIB loans for Italgas (EIB Distribution II and III) for a total of €424 million.

On 11 November 2016 the debt to the former parent company Snam was repaid by Italgas Reti and its subsidiaries totalling €3,211 million[6].

Subsequently, on 12 December 2016, a new EIB loan was agreed for €300 million (EIB Italgas Gas Smart Metering), allocated to projects designed to make the gas distribution system even more efficient and to improve the quality of information available to consumers through the "smart meter" system. In addition, in December 2016, two of the three Term Loans totalling €300 million were repaid.
On 7 and 8 November 2016, Italgas obtained a credit rating from Moody's (Baa1 with stable outlook) and from Fitch (BBB+ with stable outlook). On 12 December 2016, Moody's, after a change of the long-term rating outlook from stable to negative of the Italy's creditworthiness, confirmed Italgas' Baa1 rating, but assigned it a negative outlook.
In implementation of the decision of the Board of Directors of 18 October 2016, on 18 November 2016 Italgas concluded, with the approval of the relevant Luxembourg supervisory authority, the first Euro Medium Term Notes Programme of the company, for a total of up to €2.8 billion.
The program, valid until 31 October 2017, provides for the issue of one or more bond issues, to be placed with institutional investors operating in Europe in one or more tranches, which will enable the company to establish a solid and efficient financial structure with the aim of diversifying sources of supply and to strike an appropriate balance between fixed and variable rates at competitive costs.
To implement the EMTN programme, Italgas issued bonds for a total of €2,150 million, broken down as follows: (i) €1,500 million, issued on 19 January 2017 divided into two tranches, the first 5 years and the second 10 years, both at a fixed rate, amounting to €750 million each and 0.50% and 1.625% of the annual coupon respectively; (ii) €650 million issued on 14 March 2017, with a maturity of 14 March 2024 and an annual fixed-rate coupon of 1.125%.

[6] This amount does not include the €424 million related to the EIB financing for which a finance agreement was signed.

KEY FIGURES

The Italgas Group's main "Consolidated"[7] figures

Key financial indicators		2016
Group shareholders' equity per share (a)	(€)	1.40
Price/Book value (Average official price per share/Group shareholders' equity per share)	(€)	2.48

(a) Calculated based on the average number of shares in issue during the period 07/11 - 31/12/2016.

Key share figures		2016
Number of shares of share capital	(million)	809.0
Number of shares outstanding at 31 December	(million)	809.0
Average number of issued shares in the period 7/11 - 31/12 2016	(million)	809.0
Year-end official share price	(€)	3.73
Official average price per share in the period 7/11 - 31/12 2016	(€)	3.47
Market capitalisation (a)	(million)	3,019

(a) The product of the number of shares outstanding (exact number) multiplied by the year-end official share price.

The Italgas Group's main "Consolidated" and "Consolidated Pro-forma"[8] figures

(€ million)	2016
Total pro-forma revenues	1,079
Adjusted pro-forma EBITDA (*)	685
Adjusted Pro-forma operating profit (*)	359
Adjusted pro-forma net profit (*)	221
Net invested capital at 31 December	4,682
Shareholders' equity including minority interests as at 31 December	1,064
Group shareholders' equity as at 31 December	1,063
Net financial debt at 31 December	3,618

(*) The gross operating margin, operating profit and net profit on an adjusted basis are not income measures required by the IFRS. These Non GAAP performance measures are determined in exclusion of the special items, consisting of income items that result from (i) non-recurring events or transactions or from transactions or events which do not occur frequently in the ordinary course of business; or (ii) from events or transactions which are not representative of the normal course of business. These performance metrics allow for analysis of the business trends, making it easier to compare results. For further details, please refer to the chapter entitled "financial review".

[7] Refer to the introduction of this report for the definition of "Consolidated".

[8] Refer to the introduction of this report for the definition of " Consolidated Pro-forma".

Main “Consolidated Gas Distribution”[9] figures

Key financial and balance sheet indicators		2015	2016
Adjusted EBIT (*)	(€)	509	**362**
Adjusted net profit (*)	(€)	345	**226**
Shareholders’ equity	(€)	2,724	**2,388**
Technical investments	(€)	393	**378**
Net invested capital at 31 December	(€)	4,572	**4,671**

(*) Non GAAP - measures (please see table above).

Key operating figures	2015	2016	Change	% change
Active meters (millions)	6,526	**6,536**	0.01	
Gas distribution concessions (number)	1,472	**1,472**		
Distribution network (kilometres) (a)	56,798	**56,717**	81	0.1

(a) The data refers to kilometres of Italgas operating networks.

[9] Refer to the introduction of this report for the definition of “Consolidated Gas Distribution”.

Operating performance of the “Consolidated Gas Distribution”

INFRASTRUCTURE

Italgas is a leader in Italy in the field of natural gas distribution and is the third largest operator in Europe.
The distribution service consists of transporting gas through local pipeline networks, from the delivery points at the metering and reduction stations interconnected with the transport networks (“city-gates”) up to the delivery points with the end customers (households, enterprises, etc.). Furthermore, Italgas is engaged in metering activities, which consist of determining, gathering, making available and storing metering data on the natural gas picked up in the distribution networks.
Withdrawal stations are the systems that connect local networks to the national pipeline network. These are complex systems that serve multiple functions, including measuring the quantity of gas collected and an initial reduction of the pressure to allow routing to the city network. Currently Italgas has stations with advanced remote control withdrawal and remote reading systems. The remote control permits maximum timeliness for an intervention in the event of a fault; remote metering allows the continuous detection of a number of parameters related to the management of gas flows as well as detecting the amount of incoming gas in the networks.
Pressure reduction systems are devices placed along the distribution network and are designed to bring the gas pressure to the right level in relation to the type of use.

REGULATION

Italgas is subject to regulation by the electricity, Gas and water system authority (hereinafter the Authority or AEEGSI), which defines both how to conduct the service and the distribution and metering rates.
Gas distribution activity has traditionally been conducted in a system of concession by award of the service on a municipal basis. In 2011, four Ministerial Decrees were adopted for reforming the legislation governing the sector. Specifically, a special decree established 177 minimum territory areas (ATEM) based on which new licences will be assigned.
The gas distribution service is performed by transporting the gas on behalf of authorised sales companies for marketing to end customers.
The relationship between the distribution companies and sales companies is governed by a special document called the “Network Code,” which specifies the services performed by the distributor broken down into main services (gas distribution service and distribution plant technical management) and ancillary services (start-up of new plants; activation, deactivation, suspension and reactivation of supply to end customers; checking the metering unit at the request of end customers, etc.).

MAIN OPERATING INFORMATION ON "CONSOLIDATED GAS DISTRIBUTION"

In order to provide comprehensive information on management performance and ensure comparability over time, below are the most important investment and operating data of 2016 for the "Consolidated Gas Distribution", including the companies Italgas Reti, Napoletanagas and ACAM Gas, which are comparable to data for the previous year.

Investments

In 2016 technical investments were made for €378 million, a decrease of 3.8% compared to 2015 (€393 million).

(€ million)	2015	2016	Change	Change %
Distribution	**199**	**210**	**11**	**5.5**
Network maintenance and development	161	**172**	11	6.8
Replacement of cast-iron pipes	38	**38**		
Metering	**134**	**112**	**(22)**	**(16.4)**
Other investments	**60**	**56**	**(4)**	**(6.7)**
	393	**378**	**(15)**	**(3.8)**

Investments in distribution (€210 million) were mainly related to development projects (extensions and new networks) and the renovation of old sections of pipe, including the replacement of cast-iron pipes.

Investments in metering (€112 million) primarily concerned the meter replacement programme and the launch of the smart meter project.

Throughout 2016, the Company continued to implement its remote gas meter reading plan, which was launched in late 2010 for meters for large-scale users (calibres higher than G6), and subsequently extended in 2014 to include the mass market area (G4 and G6 calibre meters), with point-to-point communication.

Other investments (€56 million) mainly involved investments in IT, property and vehicles.

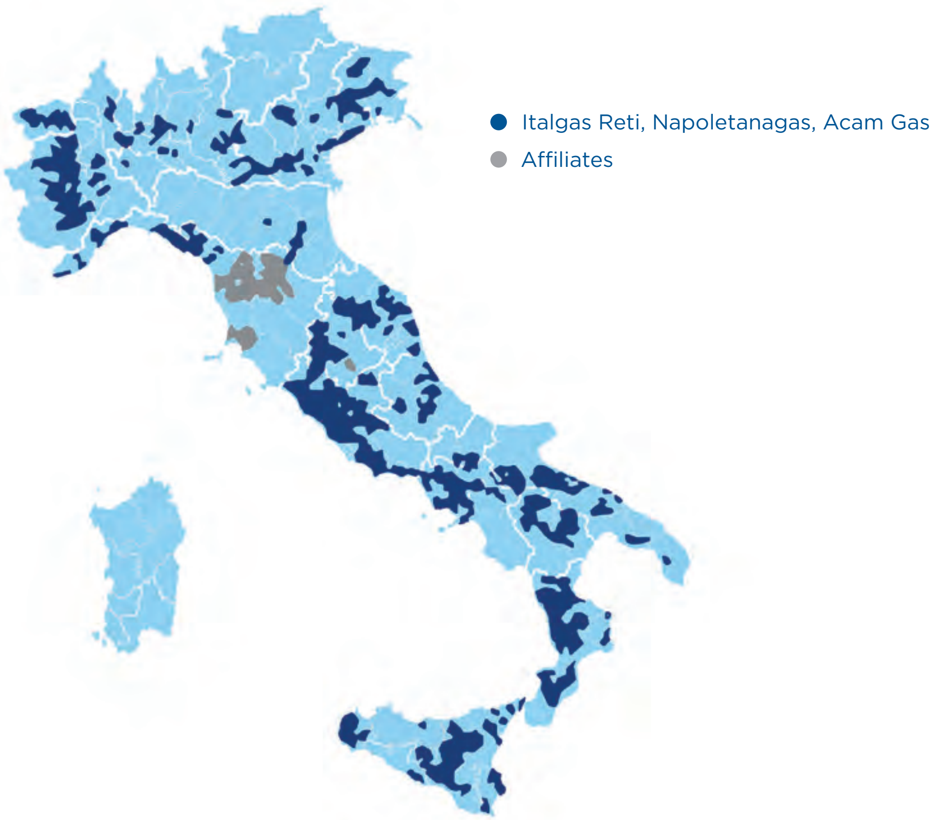
Municipalities in concession and local area tenders[10]

At 31 December 2016 Italgas was the gas distribution service concessionaire in 1,472 Municipalities (similar to 31 December 2015), of which 1,422 are operative (1,401 at 31 December 2015).

The map shows the presence of the Italgas Group in Italy.

During 2016 Italgas, currently present in 113 ATEM, continued activities of preparation and transmission to the Local Authorities and/or Contractors of the information and documentation provided by law, preparatory to offering tenders (Arts. 4 and 5 of Min. Decree 226/11). In this context, the activities were continued to achieve the approval of the repayment shares owed to Group companies.
Within the regulatory framework that provides for the assigning gas distribution service by tenders of territory (and not per individual municipality) at 31 December 2016, 19 territory tender notices were published (of which 5 were suspended by the contracting Stations, 8 extended over the initial terms and one revoked for the incomplete documentation attached).

[10] For more information on the regulation concerning the assignment of gas distribution service and the related call for proposals, please see the specific paragraph in the chapter "Legislative framework and regulatory framework".



Gas distributed

At 31 December 2016 Italgas had distributed 7,470 million cubic metres of gas in 2016 through 282 marketing companies.

Distribution network

The gas distribution network at 31 December 2015, covered 56,798 km (56,717 km as at 31 December 2015), with an increase of 81 km compared with 31 December 2015.

Meters

At 31 December 2016 the number of active meters at redelivery points (PdR) amounted to 6.536 million (6.526 at 31 December 2015).
The legislation on remote meter reading (Resolution No. 631/2013/R/gas as amended) defines the objectives of electronic meters differentiated by calibre and commissioning. These objectives were changed multiple times during the period (from Resolution ARG/gas 155/08 to Resolution 554/2015/R/gas). To comply with this requirement the Italgas Group foresees replacement of approximately 3.7 million meters by 2018, of which 1.1 million are already replaced and 2.6 million are still to be replaced.

Regulation

The natural gas distribution business is regulated by the Electricity, Gas and Water Authority Among its functions are the calculation and updating of the tariffs, and the provision of rules for access to infrastructure and for the delivery of the relative services. The tariff systems provide, in particular, that the revenue used to formulate tariffs is determined in such a way as to ensure that operators' costs are covered and that return on invested capital is fair. There are three categories of recognised cost:

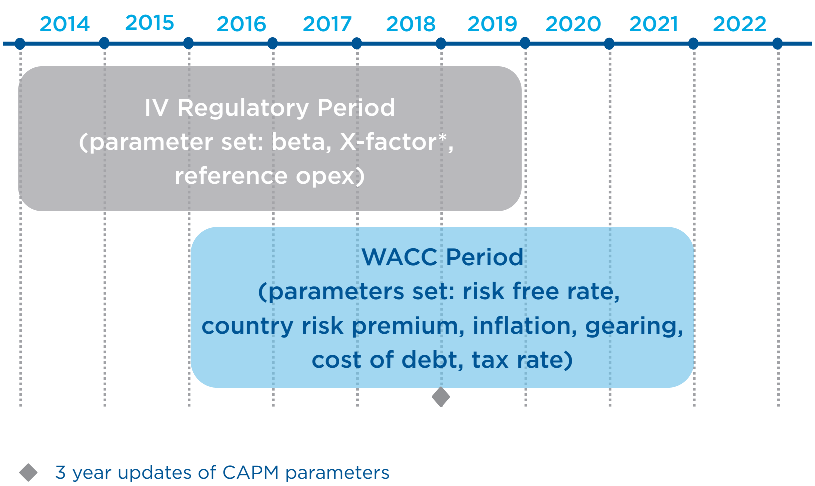
- the cost of net capital invested for regulatory purposes (Regulatory Asset Base, RAB) through the application of a rate of return for the same;
- amortisation and depreciation, covering capital expenditure;
- operating costs for the year.

The main tariff components based on the regulatory framework in force (Resolution No 573/2013/R/gas as amended) are set out below.

Highlights from the fourth regulation period (from 01/01/2014 to 31/12/2019)

End of regulatory period (TARIFFS)	31 December 2019
Calculation of net invested capital recognised for regulatory purposes (RAB) (*)	Revalued historical cost Parametric method for centralised assets
Return on net invested capital recognised for regulatory purposes (pre-tax WACC)	Distribution: 6.1% for years 2016-2018 Metering: 6.6% for years 2016-2018
Incentives on new investments	Return on investments t-1 to offset the regulatory time lag (from 2013)
Efficiency factor (x factor)	1.7%- on distribution operating costs 0.0%- on metering operating costs

(*) The RAB of the companies included in the scope of the consolidation, resulting from the application of the criteria adopted by the AEEGSI in defining the reference tariffs for 2016, is equal to about €5.7 billion.



With **Resolution No. 573/2013/R/gas** the Authority defined the tariff criteria for the distribution and metering services for the third regulatory period, from 1 January 2014 to 31 December 2019.
The capital invested (RAB) of distributing companies is broken down into two categories: capital invested locally and on a centralised level. For the first three years of the regulatory period (2014-2016):

- the criterion for evaluating capital invested is based on the revalued historical cost method, while for investments relating to electronic smart metering, the standard cost method applies;
- the parametric method was again applied to assess centralised capital invested in relation to industrial buildings and property and to other fixed tangible and intangible assets.
- with regard to centralised assets relating to the remote management systems, smart metering/remote management costs and the concentrator-related costs incurred by companies will be recognised in tariffs for the first two years of the fourth regulatory period.

The revenue components which are related to remuneration and depreciation are determined on the basis of the annual update of net capital invested (RAB), with inclusion of the assets of year t-1.
The method for updating the price cap tariffs is applied only to revenue relating to operating costs, which are indexed to inflation and reduced by a fixed annual productivity return coefficient set at 1.7% for operating costs relating to distribution and 0% for operating costs relating to metering and sales.

With **Resolution No. 583/2015/R/com** the Authority defined procedures for determining and updating the rate of return on invested capital (WACC) for the infrastructure services regulated by the electricity and gas sectors, unifying all parameters except those specific to individual services, such as the beta parameter that expresses the specific level of the non-diversifiable risk of each service and the weight of equity and debt capital used for the weighting (D/E ratio).
The duration of the remuneration rate regulatory period of capital invested for infrastructure regulations in the gas and electricity sector is set at six years (2016-2021), and a mechanism is provided for updating the rate at mid-period according to the prevailing situation.
The WACC value for the distribution service for the 2016-18 period has been set by the Authority at 6.1% (a reduction from the 6.9% applied in 2014-2015) in real terms before tax, while for the metering service this value, for the same period 2016-18, was fixed by the Authority at 6.6% (also a reduction from the 7.2% applied in 2014-2015) in real terms before tax.

With **Resolution No. 645/2015/R/gas**, the Authority approved the mandatory tariffs and bi-monthly equalisation prepayment amounts for natural gas distribution and metering services for 2016.

With **Resolution No. 647/2015/R/gas**, the Authority recalculated the reference rates for gas distribution and metering services for the 2009-2014 period, based on some of the corrections made by the distribution companies and received by 15 September 2015.

With **Resolution No. 98/2016/R/gas**, the Authority redefined the reference tariffs for gas distribution and metering services for the 2009-2014 period.

With **Resolution No. 99/2016/R/gas**, the Authority set the definitive reference tariffs for gas metering and distribution services for 2015, calculated based on the preliminary balance sheet data for 2014.

With **Resolution No. 173/2016/R/gas**, the Authority determined the provisional reference tariffs for the gas distribution and metering services for 2016, based on the preliminary balance sheet data for 2015, pursuant to Article 3, paragraph 2, section (a) of the RTDG (Regulation of Tariffs for Gas Distribution and Metering Services).

With **Resolution No. 500/2016/R/gas**, the Authority integrated and clarified certain provisions of the RTDG for calculating operating costs for localities with expiry of the contract award following the call for tenders.

With **Resolution No. 704/2016/R/gas**, the Authority adopted provisions for the recognition of investment costs in natural gas distribution networks. In particular, the Authority confirmed the introduction of standard costs in the mechanism for recognising costs relating to investment in natural gas distribution networks starting from the 2018 investments, which will be reflected in the 2019 tariffs.

With **Resolution No. 733/2016/R/gas**, the Authority recalculated the reference rates for gas distribution and metering services for the 2009-2015 period, based on some of the corrections made by the distribution companies and received by 15 September 2016.

With **Resolution No. 774/2016/R/gas**, the Authority approved the mandatory tariffs and bi-monthly equalisation prepayment amounts for natural gas distribution and metering services for 2017.

With **Resolution No. 775/2016/R/gas**, the Authority defined the criteria for the infra-period update of the tariff regulation for gas distribution and metering services, applicable to the 2017-2019 three-year period. The update applies to the annual reduction rates from 1 January 2017 for the approved unit costs covering the operating costs of the distribution, metering and marketing (X-factor) services, the component covering the costs arising from the obligation to carry out periodical metrological checks of the converters (DCVER), the components covering the centralised costs for the smart metering/remote management system and the costs of the concentrators (t(tel) and t(con) respectively) and the standard costs applicable to electronic smart metering equipment for the purposes of recognising the capital costs. In particular:

- with regard to the operating costs of the distribution and metering service, the Authority confirmed the productivity recovery targets of 1.7% and 0% respectively;

- with regard to the operating costs of the marketing service, the Authority increased the recognised unit cost for 2017, fixing it as €2.0/pdp and confirming the X-factor at 0%;

- with regard to the costs related to the metrological verification component (DCVER), pending further investigation, the Authority has forecast a provisional reduction of the unit value of the component for the 2017, fixing it at €50 per delivery point;

- with regard to the centralised costs associated with smart meter/remote management t(tel) system and the costs of the concentrators t(con), the Authority has set the recognition of the final costs for 2017 (with a cap on tariff awards for costs incurred of €5.74 per delivery point at which a smart meter has been installed);

- with regard to the recognition of investments in G6-calibre or lower metering equipment for 2016, the Authority confirmed the current system, recognising the actual costs incurred by enterprises up to the limit of 150% of the standard cost;

- with regard to the standard investments costs in G6-calibre or higher metering equipment for 2017, the Authority has set a level of 135 €/meter for G4-calibre meters and 170 €/meter for G6-calibre meters.

At its meeting on 16 March 2017, the Authority approved the following resolutions:

- **Resolution No. 145/2017/R/gas** – “Determination of definitive reference tariffs for gas distribution and metering services for 2016”.

- **Resolution No. 146/2017/R/gas** – “Redetermination of reference tariffs for gas distribution and metering services for 2009-2015”.

Financial review

7 November 2016 marked the completion of the separation of 100% of the equity stake in Italgas Reti, which was transferred from Snam to Italgas, incorporated on 1 June 2016.
As of that date, Italgas therefore gained direct control of Italgas Reti (100%) and indirect control of Napoletanagas (99.69%) and ACAM Gas (100%).
In accordance with paragraph 20 of IFRS 10, as of 7 November, these companies operating in the gas distribution sector were subject to consolidation[11] by the parent company Italgas.

"CONSOLIDATED"[12] INCOME STATEMENT

Italgas' "Consolidated" income statement, represented by the results achieved by Italgas S.p.A. (from the date of its incorporation on 1 June 2016 to 31 December 2016) and the operating companies (from 7 November to 31 December 2016) is provided below:

(€ million)	01/06 - 31/12/2016
Regulated Gas Distribution Revenues	184
Other revenue	12
Total revenue (*)	**196**
Operating costs (*)	(90)
of which special items	*23*
Operating costs net of special items (*)	(67)
EBITDA	**106**
Amortisation, depreciation and impairment	(77)
EBIT	**29**
Adjusted EBIT	**52**
Net financial expenses	(123)
Net income from equity investments	3
Pre-tax profit	**(91)**
Income tax	19
Net loss (**)	(72)
Adjusted net profit (**)	**30**

(*) Net of the effects of IFRIC 12 "Service concession arrangements" (€62 million) which defines the recognition and measurement criteria to be adopted for the agreements between the public and private sectors related to the development, financing, operation and maintenance of infrastructure under a concession which have given rise to, in equal measure, the revenues and costs related to the construction and strengthening of the distribution infrastructure.
(**) The result is attributable to Italgas.

11 "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".
12 Refer to the introduction of this report for the definition of "Consolidated".

The **net result** achieved in relation to the portion of the year of consolidation is a loss of €72 million. This position has resulted, in particular, from the net financial costs incurred following the closure of the financial position with the former parent company Snam with the inclusion of non-recurring financial costs amounting to €119 million (€86 million net of tax) together with the costs associated with the demerger and listing transaction of €8 million (€5 million net of tax) and voluntary redundancy incentives for €15 million (10 million net of tax).

Excluding these non-recurring items, which can be classified as special items, as defined below, the adjusted net profit amounted to €30 million.

NON-GAAP MEASURES

Reconciliation of EBIT and the reported net profit with adjusted EBIT and adjusted net profit

Italgas' management assesses Group performance on the basis of adjusted EBIT and adjusted net profit, which exclude special items from EBIT and net profit respectively. The income components are classified under special items, if significant, when: (i) they result from non-recurring events or transactions or from transactions or events which do not occur frequently in the ordinary course of business; or (ii) they result from events or transactions which are not representative of the normal course of business. The tax rate applied to the items excluded from the calculation of adjusted net profit is determined on the basis of the nature of each revenue item subject to exclusion. Adjusted EBIT and adjusted net profit are not provided for by either IFRS or other standard setters. These performance metrics allow for analysis of the business trends, making it easier to compare results.

The items excluded from the calculation of the adjusted results are described below.

The income items for the 2016 fiscal year, classified as special items included: (i) non-recurrent voluntary redundancy incentives (€15 million; €10 million net of tax); (ii) non-recurring costs related to the demerger and listing transaction (€8 million; €5 million net of tax); (iii) financial expenses resulting from the early repayment of the passive loan contracts in effect with the former parent company Snam (€119 million euro; €86 million net of tax).

(€ million)	01/06 - 31/12/2016
EBIT	**29**
Excluding special items	*23*
Adjusted EBIT	**52**
Net financial expenses	(123)
- *of which special items*	*119*
Net income from equity investments	3
Income tax	19
- *of which special items*	*(40)*
Net loss	**(72)**
Excluding special items	
- financial expenses from early extinguishment of loans (*)	87
- charges for voluntary redundancy incentives (*)	10
- spin-off and listing costs (*)	5
Adjusted net profit	**30**

(*) Net of the related tax effect.

"CONSOLIDATED GAS DISTRIBUTION" INCOME STATEMENT AND "CONSOLIDATED PRO-FORMA" INCOME STATEMENT[13]

Given that the "Consolidated" values represent the results of an interim period and that there is no basis for comparison with equivalent balance sheets from the previous year, the "Consolidated Gas Distribution" income statement has been presented, which, in 2016, is comparable with the balance sheets from the previous year. The "Consolidated Pro-forma" income statement for the Italgas Group in 2016 also includes the "Consolidated Gas Distribution", as defined above, and the income statement (profit and loss accounts) of Italgas S.p.A. since its incorporation (1 June 2016).
It should be noted that the information contained in these income statements are provided for the sole purpose of offering a clearer illustration of the gas distribution activities. They do not represent the Italgas Group's financial position as at 31 December 2016. For this, please refer to the "Consolidated" section of this chapter. The information is therefore only useful for commenting on the trends of the financial results under the terms set out above.

[13] Refer to the introduction of this report for the definition of "Consolidated Gas Distribution" and "Consolidated Pro-forma".

(€ million)	2015 "Consolidated Gas Distribution"	2016 "Consolidated Gas Distribution"	Change	% change	2016 "Consolidated Pro-forma"
Regulated Gas Distribution Revenues	1,071	**1,052**	(19)	(1.8)	**1,052**
Other revenue	27	**28**	1	3.7	**27**
Total revenue (*)	**1,098**	**1,080**	**(18)**	**(1.6)**	**1,079**
Operating costs (*)	(356)	**(407)**	(51)	14.3	**(417)**
- of which special items	*40*	***15***	*(25)*	*(62.5)*	***23***
Operating costs net of special items (*)	**(316)**	**(392)**	(76)	24.1	**(394)**
Adjusted Gross Operating Margin (adjusted EBITDA)	**782**	**688**	**(94)**	**(12.0)**	**685**
Amortisation, depreciation and impairment	(273)	**(326)**	(53)	19.4	**(326)**
Adjusted EBIT	**509**	**362**	**(147)**	**(28.9)**	**359**
Net financial expenses	(48)	**(165)**	(117)		**(167)**
- of which special items		***119***	*119*		***119***
Net financial costs net of special items	**(48)**	**(46)**	**2**	**4.2**	**(48)**
Net income from equity investments	29	**20**	(9)	(31.0)	**20**
Adjusted pre-tax profit	**490**	**336**	**(154)**	**(31.4)**	**331**
Income tax	(110)	**(73)**	37	(33.6)	**(70)**
- of which special items	*35*	***37***	*2*	*5.7*	***40***
Net income tax net of special items	(145)	**(110)**	35	(24.1)	**(110)**
Adjusted net profit	**345**	**226**	**(119)**	**(34.5)**	**221**

(*) Net of the effects of IFRIC 12 "Service concession arrangements" (€316 and €321 million in 2015 and 2016 respectively).

With regard to the 2015 fiscal year, the income items classified as special items included (i) the actuarial assumption of costs in 2015 for the employer resulting from the abolishment of the Gas Fund as of 1 December 2015 pursuant to Law 125 of 6 August 2015 (€40 million, €27 million net of tax)[14].

[14] In particular, Articles 9-decies and 9-undecies of the Law stipulate that the employer must cover: (i) an extraordinary contribution to cover expenses related to supplementary pension benefits in place at the time of the elimination of the Gas Fund for the years 2015 to 2020; and (ii) a contribution or a voluntary continuation of the contribution for members who, as at 30 November 2015, had not accrued the right to the supplementary pension benefits from the eliminated Gas Fund, of 1% for each year of registration in the supplementary fund, multiplied by the social insurance tax base relating to the same supplementary fund for 2014, to be allocated to the employer or the supplementary pension plan. At present, the criteria, procedures and time periods for payment of the extraordinary contribution have not yet been announced. Employee decisions about the allocation of the amounts (supplementary insurance or to the employer) were made as required by the Law, on 14 February 2016.

These costs are related to work previously carried out, and therefore are entered in full in the income statement at the time of valuation; (ii) the income resulting from the adjustment in deferred tax as a result of the reduction in IRES from 27.5% at 24% (€22 million) as of 1 January 2017 pursuant to Law 208/2015 (2016 Financial Stability Law) implementing the "Provisions for preparation of the annual and multi-annual financial statements of the State", published in the Official Gazette of 30 December 2015 and in force as of 1 January 2016.
The income items for the 2016 fiscal year classified as "Consolidated Gas Distribution" special items included voluntary redundancy incentives (€15 million; 10 million net of tax) and financial expenses resulting from the early repayment of the passive loan contracts in effect with the former parent company Snam (€119 million euro; €86 million net of tax). In "Consolidated Pro-forma ", the special items also included, in addition to the previous components, the non-recurring costs related to the demerger and listing operation (€8 million; €5 million net of tax).

The **adjusted operating profit of the "Consolidated Gas Distribution"**[15] in 2016, amounted to €362 million, down €147 million compared with 2015. The decrease is mainly due to (i) lower revenues from regulated Gas Distribution (€-19 million); (ii) increased operating costs net of special items (€76 million) arising mainly from the movement of risk funds and future cost provisions and (iii) higher depreciation (€53 million) resulting from the reduction in the service life of traditional meters, subject to the smart meter replacement plan, required by the AEEGSI Resolutions under the smart meter installation plan.

The **adjusted net income of "Consolidated Gas Distribution"** amounted to €226 million in 2016, representing a reduction of €119 million compared with the previous year, due to the aforementioned reduction in operating profit and net income from investments (€-9 million), partially offset by lower income taxes (€+35 million).

[15] Refer to the introduction of this report for the definition of "Consolidated Gas Distribution".

The Adjusted net income of "Consolidated Pro-forma", amounting to €221 million, was mainly affected by, in addition to the "Consolidated Gas Distribution", a €2 million increase in operating costs net of special items and €2 million higher net financial expenses accrued by Italgas S.p.A. from 7 November 31 December 2016.

Total revenue

(€ million)	2015 "Consolidated Gas Distribution"	2016 "Consolidated Gas Distribution"	Change	% change	2016 "Consolidated Pro-forma"
Distribution revenues	1,027	**1,004**	(23)	(2.2)	**1,004**
Other gas distribution regulated revenues	44	**48**	4	9.1	**48**
Total gas distribution regulated revenues	**1,071**	**1,052**	**(19)**	**(1.8)**	**1,052**
Other revenues	27	**28**	1	3.7	**27**
	1,098	**1,080**	**(18.0)**	**(1.6)**	**1,079**

The **revenues of the "Consolidated Gas Distribution"** amounted to €1,080 million, down by €18 million compared with 2015.

Excluding the items that are offset in the costs[16], the €19 million reduction is mainly due to lower through-transmission revenues (€-23 million) partially offset by the increase of other regulated Gas Distribution revenue (€4 million).

The decrease in through-transmission revenues (€-23 million) is attributable mainly to: (i) the reduction in the return on net invested capital recognised for regulatory purposes[17] (€-45 million), (ii) the non-recognition on the part of the Authority of the investment incentives for the replacement of cast iron pipelines for previous years (€-6 million), partially offset (iii) by the increase in the contribution pursuant to Art. 57 of Resolution No 367/14[18] (€25 million) arising from the smart meter replacement investment plan provided under the smart meter project pursuant to AEEGSI Resolution N. 631/13 and 554/15[19] and (v) the increased revenues related to the change in the scope of consolidation (ACAM Gas, €5 million).

The increase of other regulated gas income (€4 million) is mainly due to higher AEEGSI incentives and rebates (€5 million), partly offset by the decrease in other income items.

[16] These items refer to the revenue resulting from the repayment by the Electricity Equalisation Fund of charges relating to the interruptions to the supply at redelivery points requested by retail companies pursuant to Article 12-bis, Appendix A of the Consolidated Gas Arrears Act (TIMG) and amount to €9 million in 2016 (compared with €8 million in 2015).

[17] Return on the net capital invested recognised for regulatory purposes (pre-tax WACC) for distribution 6.1% compared to 6.9% in 2015, for metering 6.6% compared to 7.2% in 2015.

[18] Measures relating to the disposal of metering equipment in implementing the directives for commissioning the gas metering equipment.

[19] With regard to the meter replacement plan, during the course of 2016 Italgas has:
- identified the volume of meters to be replaced in accordance with the regulatory obligations in 2016, 2017 and 2018;
- adjusted the service life of these meters in order to finalise the depreciation process to coincide with the replacement plans;
- reproportioned the estimated tariff recognition for the 2017-2018 period, in accordance with and in partial coverage of any higher depreciation.

The **other "Consolidated Gas Distribution" revenues** (€28 million) saw an increase of €1 million mainly due to the higher revenues from water sales (€2 million), partially offset by lower other revenues (€1 million).

Operating costs

(€ million)	2015 "Consolidated Gas Distribution"	2016 "Consolidated Gas Distribution"	Change	% Change	2016 "Consolidated Pro-forma"
Controllable fixed costs	223	**243**	20	9.0	**245**
Variable costs	7	**8**	1	14.3	**8**
Other costs	108	**132**	24	22.2	**140**
- of which special items	*40*	***15***	(25)	(62.5)	***23***
Total adjusted gas distribution regulated costs	**298**	**368**	**70**	**23.5**	**370**
Other costs	18	**24**	6	33.3	24
Adjusted operating costs	**316**	**392**	**76**	**24.1**	**394**

Adjusted operating expenses of the "Consolidated Gas Distribution"

The **controllable fixed costs** amounted to €243 million, an increase of €20 million compared to 2015 (€223 million) and are calculated by totalling all recurrent payroll and external costs.
The €20 million increase is due to the higher work cost (€10 million), mainly associated with the fact that adopting the operating functions as part of the new organisational model has strengthened and internalised the engineering and design activities, and the higher external costs (€10 million) relating specifically to maintenance work (€8 million) and increased meter reading costs (€2 million).

Variable costs (€8 million) increased by €1 million due to the combined effects of higher costs incurred for purchasing Energy Efficiency Certificates (€3 million), partially offset by the lower consumption costs in the gas pick-up stations (€2 million).

The **other costs** amounted to €132 million, an increase of €24 million. Excluding the items that are offset in the revenue and special items, the other costs amounted to €108 million (€60 million in 2015). The increase of €48 million derives mainly from: (i) higher network verification costs (€10 million); (ii) higher appropriations, net of use, for funds to purchase Energy Efficiency Certificates (€18 million); (iii) surplus use of the risk fund for litigation in 2015 (€11 million); (iv) use of the provision for impairment receivables in 2015 (€5 million); (v) higher levels of risk provisioning that occurred due to tax disputes that arose after the demerger (€2 million).

The various costs (€24 million) increased by €6 million mainly as a result of higher provisions for environmental liabilities.

The " Consolidated Pro-forma" adjusted operating costs

Compared to the "Consolidated Gas Distribution", **the *adjusted* operating costs** (€394 million), including €2 million of fixed costs which, net of any chargebacks for services rendered to subsidiaries, are the costs that continue to be held by Italgas S.p.A..

Amortisation, depreciation and impairment losses

(€ million)	2015 "Consolidated Gas Distribution"	2016 "Consolidated Gas Distribution"	Change	% Change	2016 "Consolidated Pro-forma"
IFRIC12 intangible assets	232	283	51	22.0	**283**
Intangible assets	27	29	2	7.4	**29**
Property, plant and equipment	14	14			**14**
	273	**326**	**53**	**19.4**	**326**

Amortization, Depreciation and **Impairment Losses** (€326 million) increased by €53 million, equal to 19.4% with respect to the 2015 fiscal year. The increase is mainly due to higher depreciation resulting from the reduction in the service life of traditional meters[20], subject to the smart meter replacement plan, required by the AEEGSI Resolutions under the smart meter installation plan.

[20] As discussed earlier, the service life of the meters included in the replacement plan pursuant to AEEGSI Resolution Number 631/13 and 554/15 has been adjusted in order to complete the depreciation process in line with the replacement plan scheduled to be completed by 2018.

Net financial expenses

(€ million)	2015 "Consolidated Gas Distribution"	2016 "Consolidated Gas Distribution"	Change	% Change	2016 "Consolidated Pro-forma"
Expense (income) on financial debt	**49**	**159**	**110**		**161**
- Interest and other expense on short- and long-term financial debt	49	159	110		161
- of which special items		*119*	*119*		*119*
Expenses (income) on adjusted financial debt	**49**	**40**	**(9)**	**(18.4)**	**42**
Other net financial expense (income)		**7**	**7**		**7**
- Expenses (income) related to the discounting of environmental provisions and provisions for employee benefits	(2)	7	9		7
- Other net financial expense (income)	2		(2)		
Financial expense capitalised	**(1)**	**(1)**			**(1)**
	48	**46**	**(2)**	**(4.2)**	**48**

The adjusted net financial costs of the "Consolidated Gas Distribution" (€46 million) saw a €2 million reduction compared to 2015 due to: (i) lower borrowing costs due essentially to the lower average loan costs (€9 million), (ii) lower other net financial costs (€2 million), partially offset by (iii) increased borrowing costs related to the planned reduction in discounts on the rates applied for calculating environmental funds and employee benefits (€9 million).

Financial costs for €1 million were capitalised in 2016, unchanged from the previous year.

The **adjusted net financial expenses** of **"Consolidated Pro-forma"** amounted to €48 million and include, compared to the corresponding total of the "Consolidated Gas Distribution" at the end of 2016, an increase of €2 million connected to greater financial interests of Italgas S.p.A., essentially as a result of the €1,503 million increase in debt due to the acquisition of Italgas Reti, which took place as part of the corporate transaction explained in the chapter titled "Summary Data and Information - The separation of Italgas Reti from Snam" of this report.

Net income from equity investments

(€ million)	2015 "Consolidated Gas Distribution"	2016 "Consolidated Gas Distribution"	Change	% Change	2016 "Consolidated Pro-forma"
Equity method valuation effect	20	20			**20**
Other net income (expense)	9		(9)		
	29	**20**	**(9)**	**(31)**	**20**

Income from equity investments (€20 million) includes the share of net profit for the period of companies valued using the equity method, with particular reference to Toscana Energia. The €9 million reduction compared with the previous year stems from the assessment, made in 2015, of the proportion of ACAM Gas determined on a fair value basis at the date of acquiring control[21].

Income taxes

(€ million)	2015 "Consolidated Gas Distribution"	2016 "Consolidated Gas Distribution"	Change	% Change	2016 "Consolidated Pro-forma"
Current taxes					
Current taxes	169	122	(47)	(27.8)	119
- of which special items	*(13)*	*(37)*	*(24)*		*(40)*
	182	**159**	**(23)**	**(12.6)**	**159**
Deferred (prepaid) taxes					
Deferred taxes	(57)	(33)	24	(42.1)	(33)
- of which special items	*(22)*		*22*		
Prepaid taxes	(2)	(16)	(14)		(16)
	(37)	**(49)**	**(12)**	**32.4**	**(49)**
Adjusted tax rate (%)	**29.6%**	**32.8%**	**3.2**	**11.0**	**33.3%**
Adjusted income tax	**145**	**110**	**(35)**	**(24.1)**	**110**

[21] Under the IFRS 3 accounting standard, the purchase of 51% of ACAM Gas from ACAM S.p.A. by Italgas Reti, which already held 49% of ACAM Gas, falls under the so-called "Step acquisition" definition. In accordance with the aforementioned principle, the value of the investment previously held in ACAM Gas was subject to revaluation at fair value at the date of acquisition of control (1 April 2015).

The **adjusted income taxes of the "Consolidated Gas Distribution"** (€110 million) fell €35 million from the previous year as a result of the lower adjusted gross operating profit for 2016 (€-155 million).

The **adjusted tax rate** was 32.8% (29.6% in 2015). The reconciliation of the theoretical tax rate with the effective tax rate is described in the note - "Income taxes" of the Notes to the consolidated financial statements.

RECLASSIFIED STATEMENT OF FINANCIAL POSITION

The reclassified statement of financial position combines the assets and liabilities of the mandatory format included in the Annual Report of the year ended based on the criterion of how the business operates, conventionally split into the three basic functions of investment, operations and financing.
This format presents useful information for investors as it allows the identification of the sources of financing (equity and third-party funds) and the investment of financial resources in fixed and working capital.

"CONSOLIDATED" RECLASSIFIED STATEMENT OF FINANCIAL POSITION

The "Consolidated" reclassified financial position of Italgas as at 31 December 2016, compared[22] with that on 7 November 2016, the date of the demerger and consolidation of Italgas Reti and its subsidiary Napoletanagas and ACAM Gas, is summarised below:

(€ million)	"Consolidated" 07.11.2016	"Consolidated" 31.12.2016	Change
Fixed capital	4,802	4,793	(9)
Property, plant and equipment	225	227	2
Intangible assets	4,487	4,487	
Equity investments	173	176	3
Net payables for investments	(83)	(97)	(14)
Net working capital	(52)	(9)	43
Provisions for employee benefits	(125)	(121)	4
Assets held for sale and directly related liabilities	18	19	1
NET INVESTED CAPITAL	4,643	4,682	39
Shareholders' equity (including minority interests)			
- attributable to the Group	1,131	1,063	(68)
- attributable to minority interests	1	1	
	1,132	1,064	(68)
Net financial debt (cash)	3,511	3,618	107
COVERAGE	4,643	4,682	39

The **net invested capital** as at 31 December 2016 amounts to €4,682 million and consists of the items discussed below.

The **tangible and intangible assets** amounting to €4,714 million. Intangible assets include the IFRIC 12 service concession arrangements accounted for under the heading of intangible assets (€4,359 million). Tangible fixed assets mainly include buildings (€178 million) and industrial and commercial equipment (€33 million).

The item **Equity investments** (€176 million) includes the valuation of equity investments using the equity method and refers in particular to Toscana Energia (€174 million), Umbria Distribuzione Gas e Metano (€1 million) and Metano Sant'Angelo Lodigiano (€1 million).

[22] The similar opening situation compared to 1 June 2016 shows shareholders' equity and net financial debt of €50,000.00.

The consolidated **Net working capital** amounted to €-9 million as at 31.12.2016 and is composed of the following:

(€ million)	"Consolidated" 31.12.2016
Trade receivables	418
Inventories	33
Tax receivables	54
Accruals and deferrals from regulated activities	35
Other assets	146
Trade payables	(174)
Provisions for risks and charges	(230)
Liabilities for deferred tax	(106)
Net tax payables	(14)
Other liabilities	(171)
	(9)

Assets held for sale and directly related liabilities relate to a property complex owned by Italgas (€19 million, net of environmental provisions for charges relating to reclamation work on the property), for which sales negotiations are in progress[23].

The **net financial debt** as at 31 December 2016 amounts to €3,618 million and consists of short-term loans (€2,696 million), long-term financial liabilities (€923 million) and cash and cash equivalents (€1 million), wholly denominated in euro.

Short-term loans (€2,696 million) essentially refer to: (i) net use of short-term bank credit lines for €396 million; (ii) a pooled (Bridge to Bond) Bank financing, for a nominal value of €2,300 million. This funding, despite having a contract duration of 12 months extendible to 24 months upon request by Italgas, under IAS 39, has been reclassified as short term liabilities as Italgas plans to replace it with bond issues in 2017.

[23] It is worth pointing out that, together with the Snam demerger, the rights and obligations in relation to the Property Complex located in Roma Ostiense were transferred to Italgas Reti S.p.A. as a result of specific contractual agreements made during the sale by Eni to Snam of 100% of the former's share capital in Italgas Reti, which occurred in 2009. However, the rights and obligations concerning the price adjustment were transferred by Snam S.p.A. to Italgas S.p.A.

Long-term financial liabilities (€923 million) relates to: (i) debts with the European Investment Bank (EIB) for a nominal total amount of €724 million and (ii) a Term Loan for a nominal value of €200 million.

The net financial debt as at 31 December 2016 is entirely subject to variable interest rates.

At 31 December 2016, Italgas had unused committed long-term credit lines worth €1.1 billion.

As at 31 December 2016 there were no financial covenants and unsecured bilateral and syndicated loan agreements in place with banks and other financial institutions. Some of these contracts provide, inter alia, for the following: (i) negative pledge commitments pursuant to which Italgas and its subsidiaries are subject to limitations concerning the pledging of real property rights or other restrictions on all or part of the respective assets, shares or merchandise; (ii) *pari passu* and change-of-control clauses; and (iii) limitations on certain extraordinary transactions that the Company and its subsidiaries may carry out.

"CONSOLIDATED GAS DISTRIBUTION" RECLASSIFIED STATEMENT OF FINANCIAL POSITION

In an approach similar to that made earlier for the items on the reclassified income statement with the aim of providing information on the developments in the main items in the balance sheet, in addition to those on the Italgas "Consolidated" balance sheet, we have provided and commented on the main "Consolidated Gas Distribution" balance sheet items as at 31 December 2016 and 31 December 2015.

(€ million)	"Consolidated Gas Distribution" 31.12.2015	"Consolidated Gas Distribution" 31.12.2016	Change
Fixed capital	4,761	**4,793**	**32**
Property, plant and equipment	230	**227**	(3)
Intangible assets	4,472	**4,487**	15
Equity investments	169	**176**	7
Net payables for investments	(110)	**(97)**	13
Net working capital	(91)	**(25)**	66
Provisions for employee benefits	**(116)**	**(116)**	
Assets held for sale and directly related liabilities	**18**	**19**	**1**
NET INVESTED CAPITAL	**4,572**	**4,671**	**99**
Shareholders' equity	**2,724**	**2,388**	**(336)**
Net financial debt (cash)	**1,848**	**2,283**	**435**
COVERAGE	**4,572**	**4,671**	**99**

Changes in **Property, plant and equipment** and **intangible assets** of the "Consolidated Gas Distribution" are analysed below:

(€ million)	Property, plant and equipment	IFRIC 12 assets	Intangible assets	Total
Balance at 31 December 2015 "Consolidated Gas Distribution"	**230**	**4,360**	**112**	**4,702**
Investments	11	322	45	**378**
Amortisation, depreciation and impairment	(14)	(283)	(29)	**(326)**
Transfers, eliminations and divestments		(12)		**(12)**
Grants		(28)		**(28)**
Balance at 31 December 2016 "Consolidated Gas Distribution"	**227**	**4,359**	**128**	**4,714**

The "Consolidated Gas Distribution" investments for 2016 amounted to €378 million include the replacement of meters and the installation/replacement of gas networks.

Net working capital

(€ million)	2015 "Consolidated Gas Distribution"	2016 "Consolidated Gas Distribution"	Change
Trade receivables	456	**421**	(35)
Inventories	19	**33**	14
Tax receivables	30	**42**	12
Accruals and deferrals from regulated activities	2	**33**	31
Other assets	100	**136**	36
Trade payables	(133)	**(171)**	(38)
Provisions for risks and charges	(192)	**(229)**	(37)
Liabilities for deferred tax	(160)	**(109)**	51
Tax liabilities	(37)	**(14)**	23
Other liabilities	(176)	**(167)**	9
	(91)	**(25)**	**66**

Compared to 31/12/2015, an increase of €66 million in working capital is mainly due to: (i) the decrease in deferred tax liabilities (€+51 million), due to the use of risk fund movements; (ii) an increase in other assets (€+36 million) in connection with loans with Energy and Environmental Services Fund – CSEA[24] (particularly in relation to Energy Efficiency Certificates, partly offset by additional tariff items) and advances for tender-associated costs; (iii) higher accruals from regulated activities (€+31 million) relating to contributions under Resolution No. 367/14, Art. 57 (iv) higher trade payables (€-38 million) in particular to suppliers; (v) increased other liabilities (€+9 million) resulting from municipal fees and liabilities to employees; (vi) lower tax liabilities (€+23 million); (vii) reduced trade receivables (€-35 million) in particular from sales companies and from CSEA for equalisation[25]; (viii) increased provisions for liabilities and charges attributable essentially to Energy Efficiency Certificates, reclamation and voluntary redundancy incentives.

[24] Law 208/15 (Stability Law for 2016) provides, in Art. 1, paragraph 670, for the transformation of the Equalisation Fund for the Electricity Sector - CCSE into a public financial institution, under the name Cash for Energy and Environmental Services - CSEA, starting from 1 January 2016. The transformation of CCSE into a public financial institution and the change in name does not alter in any way nor give rise to any discontinuity in the functional relationships of CSEA (formerly CCSE) with the regulated entities and suppliers.

[25] The mechanism by which the debit/credit is recorded with CSEA is the difference between the turnover of the sales companies and the revenue limit defined by AEEGSI.

RECONCILIATION BETWEEN THE SEPARATE AND CONSOLIDATED NET INCOME AND SHAREHOLDERS' EQUITY OF ITALGAS S.P.A.

(€ million)	Net income (Jun-Dec 2016)	Shareholders' equity 31.12.2016
Financial Statements of Italgas S.p.A.	**177**	**1,640**
Net income of companies included in the scope of consolidation*	(65)	
Difference between the carrying value of investments in consolidated companies and the shareholders' equity of the financial statements, including the net result for the period.		(598)
Consolidation adjustments for:		
Dividends net of the tax effect	(187)	
Income from valuation of equity investments using the equity method and other income from investments	3	21
	(249)	**(577)**
Minority interests		**1**
Consolidated Financial Statement	**(72)**	**1,064**

(*) effect relating to the period 07/11 - 31/12 based on IFRS 10

RECLASSIFIED STATEMENT OF CASH FLOWS

The reclassified statement of cash flows below summarises the legally required financial reporting format. It shows the connection between opening and closing cash and cash equivalents and the change in net financial debt during the period. The two statements are reconciled through the free cash flow[26], i.e. the cash surplus or deficit left over after servicing capital expenditure.

[26] The free cash flow closes either: (i) with the change in cash for the period, after adding/deducting all cash flows related to financial liabilities/assets (taking out/repaying financial receivables/payables) and equity (payment of dividends/capital injections); or (ii) with the change in net financial debt for the period, after adding/deducting the debt flows related to equity (payment of dividends/capital injections).

“Consolidated” reclassified statement of cash flows

(€ million)	01.06.2016- 31.12.2016
Net loss	**(72)**
Adjusted for:	
- Amortisation, depreciation and other non-monetary components	**70**
- Net capital losses (capital gains) on asset sales and eliminations	**1**
- Interest and income taxes	**104**
Change in working capital due to operating activities	**38**
Dividends, interest and income taxes collected (paid)	**(186)**
Net cash flow from operating activities	**(45)**
Adjusted net cash flow from operating activities	***82***
Technical investments	**(79)**
Change in scope of consolidation and business units	**(1,503)**
Other changes relating to investment activities	**14**
Free cash flow	**(1,613)**
Adjusted free cash flow	***(1,511)***
Assumption of long-term financial debt	**927**
Repayment of long-term financial debt	**(1,442)**
Increase in short-term financial debt	**2,128**
Net cash flow for the period	**0**

Change of net financial debt

Change in net financial debt	**01.06.2016- 31.12.2016**
Free cash flow	**1,613**
Change in the scope of consolidation and business unit (non-monetary)	**2,005**
Change in net financial debt	**3,618**

Net cash flow from adjusted operating activities and the adjusted Free cash flow are determined from the results of the period that takes into account the special items above.

The change in net financial debt of €3,618 million comes from the combined effect of: (i) net cash flow from operating activities (€-45 million), (ii) negative cash flow (€1,503 million) due to the purchase of shareholdings (Italgas Reti) entered in the scope of consolidation and net investments for €65 million, (iii) assumption of debts of the company entered in the scope of consolidation as a result of the aforementioned transfer and demerger operation (€2,005 million).

Reclassified cash flow of the “Consolidated Gas Distribution” and “ Consolidated Pro-forma”

(€ million)	2015 “Consolidated Gas Distribution”	2016 “Consolidated Gas Distribution”	2016 “Consolidated Pro-forma”
Net profit	**340**	**129**	**119**
Adjusted for:			
- Amortisation, depreciation and other non-monetary components	275	**303**	**305**
- Net capital losses (capital gains) on asset sales and eliminations	12	**11**	**11**
- Interest and income taxes	158	**231**	**228**
Change in working capital due to operating activities	(88)	**10**	**(5)**
Dividends, interest and income taxes collected (paid)	(180)	**(291)**	**(287)**
Net cash flow from operating activities	**517**	**393**	**371**
Adjusted net cash flow from operating activities	**517**	**512**	**499**
Technical investments	(360)	**(350)**	**(350)**
Change in scope of consolidation and business units	(46)		**(1,503)**
Other changes relating to investment activities	27	**(13)**	**(13)**
Free cash flow	**138**	**30**	**(1,495)**
Change in short- and long-term financial debt	31	**435**	**1,770**
Equity cash flow	(214)	**(465)**	**(275)**
Net cash flow for the period	**(45)**	**0**	**0**

RECONCILIATION OF THE RECLASSIFIED FINANCIAL STATEMENT WITH THE COMPULSORY FORMATS

Reclassified income statement

(€ million) **01/06 - 31/12/2016**

Items of the reclassified income statement	Reference to the notes to the consolidated financial statements	Legally required amounts	Partial amounts from legally required format	Amount from reclassified format
Total revenue		**274**		**196**
- Revenue from the construction and upgrading of distribution infrastructure IFRIC 12.	(note 24)		*62*	
- AEEGSI Penalties	(note 24)		*16*	
Operating costs		**(168)**		**(90)**
- Costs for the construction and upgrading of distribution infrastructure IFRIC 12.			*(62)*	
- AEEGSI Penalties			*(16)*	
Total operating costs		**(168)**		**(90)**
EBITDA		**106**		**106**
Amortisation, depreciation and impairment		**(77)**		**(77)**
EBIT		**29**		**29**
Net financial expenses		**(123)**		**(123)**
Of which special item		***119***		***119***
Pre-tax profit		**(91)**		**(91)**
Income tax		**19**		**19**
Net loss		**(72)**		**(72)**

Reclassified statement of financial position

(€ million)

Reclassified balance sheet items (Where not expressly stated, the component is taken directly from the legally required format)	Reference to the notes to the consolidated financial statements	31.12.2016 Partial amount from legally required format	Amount from reclassified format
Fixed capital			
Property, plant and equipment			**227**
Intangible assets			**4,487**
Equity-accounted investments			**176**
Net payables for investments, consisting of:			***(97)***
- Payables for investment activities	(note 17)	**(103)**	
- Receivables from investment/divestment activities	(note 8)	**6**	
Total fixed capital			**4,793**
Net working capital			
Trade receivables	(note 8)		**418**
Inventories			**33**
Tax receivables, consisting of:			***54***
- Current income tax assets and other current tax assets	(note 10)	**38**	
- IRES receivables for the national tax consolidation scheme	(note 8)	**16**	
Trade payables	(note 17)		**(174)**
Tax liabilities, consisting of:			***(14)***
- Current income tax liabilities and other current tax liabilities	(note 10)	**(14)**	
Deferred tax liabilities			**(106)**
Provisions for risks and charges			**(230)**
Other assets, consisting of:			***146***
- Other receivables	(note 8)	**139**	
- Other current and non-current assets	(note 11)	**7**	
Assets and liabilities from regulated activities, consisting of:			***35***
- Regulated assets	(note 11)	**35**	
- Regulated liabilities	(note 18)		
Other liabilities, consisting of:			***(171)***
- Other payables	(note 17)	**(166)**	
- Other current and non-current liabilities	(note 18)	**(5)**	
Total net working capital			**(9)**

Provisions for employee benefits			**(121)**
Assets held for sale and directly related liabilities, consisting of:			***19***
- Assets held for sale		**25**	
- Liabilities directly associated with assets held for sale		**(6)**	
NET INVESTED CAPITAL			**4,682**
Shareholders' equity including minority interests			**1,064**
Net financial debt			
Financial liabilities, consisting of:			***3,619***
- Long-term financial liabilities		**923**	
- Short-term financial liabilities		**2,696**	
Financial receivables and cash and cash equivalents, consisting of:			***(1)***
- Cash and cash equivalents	(note 7)	**(1)**	
Total net financial debt			**3,618**
COVERAGE			**4,682**

Reclassified statement of cash flows

(€ million)		01.06.2016 - 31.12.2016
Items from the reclassified statement of cash flows and reconciliation with the legally required format	**Partial amount from legally required format**	**Amount from reclassified format**
Net profit		**(72)**
Adjusted for:		
Amortisation, depreciation and other non-monetary components:		70
- Amortisation and depreciation	77	
- Equity method valuation effect	(3)	
- Change in provisions for employee benefits	(4)	
Net capital losses (capital gains) on asset sales and eliminations		1
Interest, income taxes and other changes:		104
- Interest expense	123	
- Income taxes	(19)	
Change in working capital due to operating activities:		38
- Inventories	(8)	
- Trade receivables	(34)	
- Trade payables	51	
- Change in provisions for risks and charges	21	
- Other assets and liabilities	8	
Dividends, interest and income taxes collected (paid):		(186)
- Interest paid	(123)	
- Income taxes (paid) received	(63)	
Net cash flow from operating activities		**(45)**
Technical investments:		(1,582)
- Property, plant and equipment	(4)	
- Intangible assets	(75)	
Investments in companies joining the scope of consolidation and business units:	(1,503)	
Other changes relating to investment activities:		14
- Change in payables and receivables relating to investments	14	
Free cash flow		**(1,613)**
Change in financial payables:		1,613
- Taking on long-term financial debt	927	
- Repaying long-term financial debt	(1,442)	
- Net increase (decrease) in short-term financial debt	2,128	
Net cash flow for the period		**0**

Italgas S.p.A. financial review

Italgas S.p.A., incorporated on 1 June 2016 and listed on the Milan Stock Exchange since 7 November 2016, holds, as at that date, 100% of the share capital of the operating companies Italgas Reti S.p.A. and ACAM Gas S.p.A. and 99.69% of the share capital of Napoletanagas S.p.A. Italgas S.p.A. is also responsible for the strategic planning, management, coordination and control of its subsidiaries.
It should be noted that the shareholder CDP S.p.A. consolidates Italgas S.p.A. under the international accounting principle IFRS 10 - Consolidated financial statements.

RECLASSIFIED INCOME STATEMENT

In view of the industrial type stakeholding nature that Italgas S.p.A. has, the following reclassified Income Statement has been prepared, which inverts the order of the income statement items under Leg. Decree 127/91, presenting first those which relate to the financial operations, as this is the most significant income component for those companies[27].

(€ million)	01.06.2016 - 31.12.2016
Financial income and expense	
Income from equity investments	190
Interest income	2
Interest expense and other financial expense	(5)
Total financial income and expense	187
Income from services rendered	8
Other operating income	8
Other operating expenses	
For personnel	(6)
For non-financial services and other costs	(13)
Total other operating expenses	(19)
Pre-tax profit	176
Income tax	1
Net profit	177

The **net profit** earned in the period between the incorporation date of the company and 31 December 2016 amounted to €177 million, attributable mainly to income from investments (€190 million), partly offset by: (i) costs for non-financial services and other costs (€13 million), related primarily to the listing costs of Italgas (€-8 million); (ii) staffing costs (€-6 million); and (iii) interest liability and other financial expenses (€-5 million).

[27] See Consob Communication 94001437 of 23 February 1994.

Financial income and expense

(€ million)	01.06.2016 - 31.12.2016
Income from equity investments	190
Interest income	2
Interest expense and other financial expense	(5)
	187

Income from equity investments (€190 million) consists of the dividends paid by the subsidiary Italgas Reti in December 2016.
Interest income and other financial income (€2 million) essentially relates to interest income from the intragroup loans granted by Italgas to its subsidiaries.
Interest expense and other financial expense (€5 million) refers primarily to the costs relating to short- and long-term financial debt, and concerns costs associated loans from banks and other financial institutions.

Other operating income

Other operating income (€8 million), refer to chargebacks to subsidiaries of costs incurred for the provision of services centrally managed by Italgas S.p.A.. These services are governed by contracts stipulated between Italgas Reti and Napoletanagas and concern the following areas: ICT, personnel and organisation, planning, administration, finance and control, general services, property and security services, legal and corporate affairs and compliance, health, safety and environment, regulation, external relations and communication, internal audit and Enterprise Risk Management (ERM). The pricing model for contracts is based on the chargeback from costs incurred to provide the services on a full-cost basis.

Other operating expenses

(€ million)	01.06.2016 - 31.12.2016
For personnel	*(6)*
For non-financial services and other costs	*(13)*
Total other operating expenses	**(19)**

Costs for non-financial services and other costs (€13 million) consist mainly of costs incurred for listing Italgas S.p.A. on the stock market (€8 million).

The staffing costs amount to €6 million as at 31 December 2016. The number of employees at 31 December 2016 (337 people) is broken down below by professional status.

(number)	31.12.2016
Professional status	
Executives	**33**
Managers	**77**
Office workers	**227**
	337

RECLASSIFIED STATEMENT OF FINANCIAL POSITION[28]

(€ million)	31.12.2016
Fixed capital	**3,690**
Equity investments	2,967
Financial receivables held for operating activities	723
Net working capital	**13**
Provisions for employee benefits	**(5)**
NET INVESTED CAPITAL	**3,698**
Shareholders' equity	**1,640**
Net financial debt	**2,058**
COVERAGE	**3,698**

The **net capital invested** amounted to €3,698 million.

The **Fixed capital** amounted to €3,690 million as at 31 December 2016 principally as a result of equity investments (€2,967 million) and financial credits in operating activities (€723 million).

The €2,967 million in **Investments** relate to the equity held in Italgas Reti following the separation operation[29] of Italgas Reti[30] from Snam.

[28] Please see the "Financial review" section of the consolidated financial statements for a closer examination of the reclassified financial statements.

[29] For more information on this operation please refer to the corresponding paragraph in the chapter "Summary data and information" of this report.

[30] With effect from 12 September 2016 the operating company formerly named Società Italiana per il Gas S.p.A. (Italgas S.p.A. for short) took the name of Italgas Reti S.p.A..

The reorganisation was implemented through the following three concurrent steps:

- the legal instrument for Snam's in-kind contribution to Italgas of an 8.23% equity investment in the share capital of Italgas Reti in exchange for the allocation to Snam of 108,957,843 newly issued Italgas shares, to enable Snam to hold, after the demerger, a 13.5% equity investment in Italgas;
- a sale agreement between Snam and Italgas for 98,054,833 Italgas Reti shares representing 38.87% of the share capital for €1,503 million, in exchange for assuming debt in the same amount owed by Italgas;
- the legal instrument for the partial and proportional demerger through the allocation to Italgas S.p.A. of 52.9% of the equity investment that Snam held in Italgas Reti, along with the allocation to Snam shareholders of 86.5% of the Italgas share capital. As a result of the Italgas demerger, on one Italgas share was issued and allocated to Snam shareholders for every five Snam shares that they held;

The **financial receivables held for operating activities** relate to long-term financial receivables for loans granted to the subsidiary Italgas Reti by the European Investment Bank worth €723 million.

Net working capital

(€ million)	31.12.2016
Tax receivables	28
Trade receivables	9
Other assets	14
Trade payables	(16)
Tax liabilities	(17)
Provisions for risks and charges	(1)
Other liabilities	(4)
	13

The **net working capital** amounted to €13 million at 31 December 2016, and consists of the following items: (i) tax receivables worth €28 million, related to the company's current taxes (€12 million) and credits (€16 million) with its subsidiaries following their participation in the domestic tax consolidation, against which tax liabilities were accounted for in the same amount; (ii) other activities for €14 million, made up mainly of up-front Fees on revolving credit lines (+ €6 million).

The **Shareholders' equity** at 31 December 2016 amounted to €1,640 million.

Net financial debt

(€ million)	31.12.2016
Financial payables	**3,619**
Short-term financial debt	2,696
Long-term financial debt	923
Financial receivables not held for operations	**(1,561)**
	2,058

Italgas S.p.A.'s net financial debt as at 31 December 2016 amounts to €2,058 million and consists of short-term loans (€2,695 million), long-term financial liabilities (€924 million) and non-operatiing financing receivables (€-1,561 million), wholly denominated in euro.

Short-term loans (€2,696 million) essentially refer to: (i) net use of short-term bank credit lines for €396 million; (ii) a pooled (Bridge to Bond) Bank financing, for a nominal value of €2,300 million. This funding, despite having a contract duration of 12 months extendible to 24 months upon request by Italgas, under IAS 39, has been reclassified as short term liabilities as Italgas plans to replace it with bond issues in 2017.

Long-term financial liabilities (€923 million) relates to: (i) debts with the European Investment Bank (EIB) for a nominal total amount of €724 million and (ii) a Term Loan for a nominal value of €200 million.

Non-operational financing receivables (€1,561 million) relate to financial receivables from subsidiaries, arising mainly as a result of repayments by Italgas, on behalf of its subsidiaries, of existing loan agreements on 7 November 2016 to Snam amounting to €1,708 million. The separation of Italgas Reti from Snam in effect brought about the acceleration of the abovementioned loan agreements.

The net financial debt as at 31 December 2016 is entirely subject to variable interest rates.

At 31 December 2016, Italgas had unused committed long-term credit lines worth €1.1 billion.

As at 31 December 2016 there were no financial covenants and unsecured bilateral and syndicated loan agreements in place with banks and other financial institutions. Some of these contracts provide, inter alia, for the following: (i) negative pledge commitments pursuant to which Italgas is subject to limitations concerning the pledging of real property rights or other restrictions on all or part of the respective assets, shares or merchandise; (ii) *pari passu* and change -of-control clauses; and (iii) limitations on certain extraordinary transactions that the Company may carry out.

RECLASSIFIED STATEMENT OF CASH FLOWS

(€ million)	01.06.2016 - 31.12.2016
Net profit	**177**
Adjusted for:	
- Amortisation, depreciation and other non-monetary components	1
- Dividends, interest and income taxes	(190)
Change in working capital due to operating activities	3
Dividends, interest and income taxes collected (paid)	177
Net cash flow from operating activities	**168**
Equity investments	(1,503)
Financial investments for operations	(723)
Free cash flow	**(2,058)**
Change in financial receivables not held for operating activities	(1,561)
Change in current and non-current financial debt	3,619
Net cash flow for the period	**0**

RECONCILIATION OF THE RECLASSIFIED FINANCIAL STATEMENT WITH THE COMPULSORY FORMATS

Reclassified statement of financial position

(€ million)

Reclassified balance sheet items			31.12.2016
(Where not expressly stated, the component is taken directly from the legally required format)	Reference to the notes to the consolidated financial statements	Partial amount from legally required format	Amount from reclassified format
Fixed capital			
Equity-accounted investments			2,967
Financial receivables held for operating activities	(note 6)		723
Total fixed capital			3,690
Net working capital			
Trade receivables	(note 8)		9
Tax receivables, consisting of:			28
- Current income tax assets and other current tax assets	(note 7)	28	
Trade payables	(note 11)		(16)
Tax liabilities, consisting of:			(17)
- Other current tax liabilities	(note 7)	(1)	
- IRES payables for the national tax consolidation scheme	(note 11)	(16)	
Provisions for risks and charges			(1)
Other assets, consisting of:			14
- Other receivables	(note 6)	8	
- Other current and non-current assets	(note 8)	6	
Other liabilities, consisting of:			(4)
- Other payables	(note 11)	(4)	
Total net working capital			13
Provisions for employee benefits			(5)
NET INVESTED CAPITAL			3,698
Shareholders' equity including minority interests			1,640
Net financial debt			
Financial liabilities, consisting of:			3,619
- Long-term financial liabilities		923	
- Short-term financial liabilities		2,696	
Financial receivables and cash and cash equivalents, consisting of:			(1,561)
- Financial receivables not held for operations	(note 8)	(1,561)	
Total net financial debt			2,058
COVERAGE			3,698

Reclassified statement of cash flows

(€ million)		01.06.2016 - 31.12.2016
Items from the reclassified statement of cash flows and reconciliation with the legally required format	**Partial amount from legally required format**	**Amount from reclassified format**
Net profit		**177**
Adjusted for:		
Amortisation, depreciation and other non-monetary components:		1
- Change in provisions for employee benefits	1	
Interest, income taxes and other changes:		(190)
- Dividends	(190)	
- Interest income	(2)	
- Interest expense	3	
- Income taxes	(1)	
Change in working capital due to operating activities:		3
- Inventories		
- Trade receivables	(9)	
- Trade payables	16	
- Change in provisions for risks and charges	1	
- Other assets and liabilities	(5)	
Dividends, interest and income taxes collected (paid):		177
- Dividends collected	190	
- Interest collected	2	
- Interest paid	(3)	
- Income taxes (paid) received	(12)	
Net cash flow from operating activities		**168**
Equity investments		(1,503)
- Financial receivables held for operating activities		(723)
Free cash flow		**(2,058)**
Change in financial receivables not held for operating activities		
Change in financial payables:		2,058
- Taking on long-term financial debt	923	
- Repaying long-term financial debt	2,696	
Change in financial receivables not held for operating activities	(1,561)	
Net cash flow for the period		**0**

Elements of risk and uncertainty

Italgas has established, under authority of the General Director of Finance and services, the Enterprise Risk Management (ERM) unit to supervise the process of integrated risk management for all group companies. The main objectives of ERM are to define a homogeneous and transversal risk assessment model, identification of priority risks, and ensuring the consolidation of mitigation actions and the development of a reporting system.

The ERM methodology adopted by Italgas is in line with the existing international best practice reference models (COSO Framework and ISO 31000).

The ERM unit operates as part of the broader internal control and risk management system of Italgas.

ITALGAS' ENTERPRISE RISK MANAGEMENT PROCESS

Italgas chose to adopt a model of risk identification, evaluation, management and control that is structured and homogeneous for all the Group companies through the ERM. The model provides an integrated, transversal and dynamic risk assessment that enhances existing management systems in individual business processes.
The findings, in terms of the main risks and the plans devised to manage them, are presented to the Control and Risk Committee so that an assessment can be carried out on the effectiveness of the Internal Control and Risk Management System in relation to Italgas' specific characteristics and the risk profile it has taken on.

Italgas's dedicated ERM department manages and oversees the following main activities:

- risk identification and measurement;
- enterprise valuation and risk prioritisation;
- risk management strategy definition;
- monitoring and reporting;
- model maintenance and development.

The objective of the risk identification phase is to identify any risky events relating to the Italgas Group's corporate processes and external processes that could affect the achievement of the corporate objectives.

Integrated and transversal risk measurement is carried out using scales for classifying probabilities and impacts concerning both quantitative aspects (e.g., economic and financial impacts) and more qualitative and intangible aspects (e.g., impacts relating to reputation, health, safety and environment).

Each event is assigned an "enterprise measurement". For each risk, this score summarises the different evaluations performed by the risk Owners and by the centralised units with specialist areas of expertise. The prioritisation of risks is defined by combining the measurements of impact and probability.

Management actions and any specific measures to be taken are identified for all risks, together with the relevant implementation schedule, and each risk is allocated one of the codified risk management types. The risk map is dynamic. The periodicity of the reverification depends on the enterprise evaluation and is in any case at least once a year.

Periodic reporting guarantees, at the various corporate levels, the availability and representation of information relating to the management and monitoring of the relevant risks.

Below are the main risks analysed and monitored by the Italgas Group.

FINANCIAL RISKS

Interest rate risk

Fluctuations in interest rates affect the market value of Italgas' financial assets and liabilities and its net financial expense. The Italgas Group has adopted a centralised organisational model. In accordance with this model, Italgas' various departments access the financial markets (capital markets and banking channels) and use funds to cover financial requirements, in compliance with approved objectives, ensuring that the risk profile stays within the defined limits.
As at 31 December 2016 the loans are entirely at a floating rate.
At 31 December 2016, the Italgas Group used external financial resources in the form of bonds and bilateral and syndicated loans with banks and other financial institutions, in the form of medium- to long-term loans and bank credit lines at interest rates indexed to benchmark market rates, in particular the Europe Interbank Offered Rate (Euribor). Therefore an increase in interest rates could have negative effects on the assets and on the economic and financial situation of the Italgas Group. However, given the current market environment characterised by negative Euribor rates, any impacts on the net equity and the net result of the year from a hypothetical positive and negative variation of 10% in the interest rates are negligible or insignificant anyway.
Italgas aims at maintaining, at steady-state, a debt ratio between fixed rate and variable rate to minimise the risk of rising interest rates, with a goal for a fixed-rate and variable-rate debt composition of approximately 2/3 fixed-rate and 1/3 variable-rate . We note in this regard that in early 2017 the company issued bonds for a total of €2,150 million, broken down as follows: (i) €1,500 million, issued on 19 January 2017 divided into two tranches, the first 5 years and the second 10 years, both at a fixed rate, amounting to €750 million each and 0.50% and 1.625% of the annual coupon respectively; (ii) €650 million issued on 14 March 2017, with a maturity of 14 March 2024 and an annual fixed-rate coupon of 1.125%.

Credit risk

Credit risk is the exposure to potential losses arising from counterparties failing to fulfil their obligations. Default or delayed payment of fees may have a negative impact on the financial results and financial situation of Italgas.
The rules for client access to the gas distribution service are established by the AEEGSI and set out in the Network Codes, namely, in documents that establish for each type of service, the rules regulating the rights and obligations of the parties involved in the process of providing said services and contain contractual conditions, which reduce the risk of non-compliance by the clients, such as the release of bank or insurance guarantees on first request.
At 31 December 2016 there were no significant credit risks. It should be noted, however, that around 58% of trade receivables refer to extremely reliable clients, including Eni, which represents 47% of the total trade receivables.
It cannot be ruled out, however, that Italgas could incur liabilities and/or losses due to its customers' failure to perform payment obligations.

Liquidity risk

Liquidity risk is the risk that new financial resources may not be available (funding liquidity risk) or that the Company may be unable to convert assets into cash on the market (asset liquidity risk), meaning that it cannot meet its payment commitments. This may affect profit or loss should the Company be obliged to incur extra costs to meet its commitments or, in extreme cases, lead to insolvency and threaten the Company's future as a going concern.
In order to mitigate this risk and to maintain a level of liquidity consistent with maintaining the requirements of the rating, Italgas signed finance contracts in excess of its financial needs at 31 December 2016. This surplus (€1.1 billion) will be used for any potential liquidity needs, where required, if the actual borrowing requirement is higher than estimated.
Italgas aims, in financial terms, at establishing a financial structure that, in line with its business objectives, ensures a level of liquidity adequate for the group in terms of the duration and composition of the debt. The achievement of this financial structure will be ensured by monitoring certain key variables, such as the debt/RAB ratio, the short/medium-long term debt ratio, the fixed-rate/variable-rate debt ratio and the ratio of bank credit granted to bank credit used. To this end, it should be noted that on 18 November 2016, the relevant Luxembourg financial authorities approves a Euro Medium Term Notes (EMTN) programme for Italgas that permits the issue, by 31 October 2017, of one or more bonds for up to a maximum amount of €2.8 billion, to be placed with institutional investors.

Rating risk

With reference to the long-term debt of Italgas, respectively on 7 and 8 November 2016, Fitch and Moody's assigned Italgas S.p.A. the final rating of BBB + (stable outlook) and Baa1 (stable outlook, later changed to negative outlook on 12 December 2016, following the previous change from stable to negative outlook of the long-term rating of the Italian Republic).
Based on the methodologies adopted by the rating agencies, a downgrade of one notch in Italy's current rating could trigger a downward adjustment in Italgas's current rating.

Debt covenant and default risk

As at 31 December 2016, Italgas has unsecured bilateral and syndicated loan agreements in place with banks and other financial institutions not backed by collateral. Some of these contracts provide, inter alia, for the following: (i) negative pledge commitments pursuant to which Italgas and its subsidiaries are subject to limitations concerning the pledging of real property rights or other restrictions on all or part of the respective assets, shares or merchandise; (ii) *pari passu* and change-of-control clauses; and (iii) limitations on certain extraordinary transactions that the Company and its subsidiaries may carry out.
Failure to comply with these covenants, and the occurrence of other events, some of which are subject to specific threshold values such as cross-default events can determine default cases for Italgas and possibly cause the acceleration of the related loan.

OPERATING RISKS

The Italgas Group uses specific, certified management systems with the objective of overseeing the processes and business activities in accordance with the health and safety of workers, environmental protection and the energy effectiveness of services offered.

Risks associated with failures and unforeseen interruption of distribution service

Managing regulated gas activities involves a number of risks of malfunctioning and unforeseeable distribution service disruptions from unintended events, such as accidents, breakdowns or malfunctioning of equipment or control systems; the underperformance of plants; and extraordinary events such as explosions, fires, earthquakes, landslides or other similar events beyond Italgas's control. These related events could cause a decrease in revenue and involve substantial damage to persons, property or the environment. Although Italgas has taken out specific insurance policies in line with best practices to cover some of these risks, the related insurance coverage could be insufficient to meet all the losses incurred, the compensation obligations or cost increases.

Risks associated with environmental, health and safety protection

Italgas' activities are subject to Italian and European Union legislation on environmental protection.
Italgas conducts its business in compliance with laws and environmental and safety regulations. Under those circumstances, it cannot be excluded with certainty that the Group may incur significant costs or liabilities. It is, in fact, difficult to foresee the economic-financial consequences of any existing environmental damage given the possible effects of new environmental protection laws and regulations, the impact of technological innovations for environmental rehabilitation, the possibility of litigation and difficulties in determining the possible consequences in relation to the liability of other parties.
Italgas is engaged in the business of remediation of sites contaminated essentially due to manufactured gas production performed in the past, removal and disposal of waste (mainly for demolition of obsolete plant facilities) and disposal of materials containing asbestos.
To cover the liabilities estimated in relation to the formalities required by the law in effect, a special fund has been set up, amounting to 136 million.

Risks related to Energy Efficiency Certificates

Legislative Decree 164/00 concerning the liberalisation of the gas market, with Art. 16.4 provides that distributors of natural gas for civil use pursue energy savings for the end users and the development of renewable energy; for achieving this, distributors are assigned the so-called Energy Efficiency Certificates, whose annulment initiates a refund from the Energy and Environmental Services Fund on the basis of funds constituted through the RE (Energy Saving) components in the distribution fees.
With the national savings amount per year to be pursued through the mechanism of the white certificates, the Authority determines its specific energy saving targets for electricity and natural gas distributors.

There is a potential risk of economic loss due to any negative difference between the mean purchase value of the certificates and the recognised tariff-based fee and the failure to achieve the targets set.

Risks associated with the expiration and renewal of gas distribution concessions

The gas distribution activity in which the Group Italgas operates is performed by virtue of concessions made by individual municipalities. As at 31 December 2016, Italgas managed 1,472 natural gas distribution concessions throughout Italy.
Interministerial Decree 226/11 ruled that gas distribution service can only be made on the performed of the basis of tendering procedures exclusively for ATEM, mainly provincial in dimension.
Under the tender processes initiated, Italgas may not be awarded concessions in the planned areas, or may be awarded said concessions under conditions that are less favourable than the current conditions, with a possible negative impact on its operating assets and on the balance sheet, the economic and financial situation. However, it must be noted that, in the event of failure to award the concessions with regard to municipalities previously managed, Italgas would be entitled to the payment amount provided for reimbursement to the outgoing operator (see next section).
With reference to the EIB, its contracts contain a clause whereby, in the event of a significant reduction in EBITDA resulting from the loss of concessions, there is a disclosure obligation to the EIB and a subsequent consultation period, after which the early repayment of the loan may be required.

Also it should be noted that, in the context of procedures for the tenders initiated, Italgas may be awarded concessions in ATEM previously managed entirely or partially by other operators; therefore, it cannot be ruled out that such awards could lead, at least initially, to higher operating for the Group than their standard operations.

Given the complexity of the regulations governing the expiration of the concessions held by Italgas, this could give rise to judicial and/or arbitral disputes between concession-holders, with possible negative effects on the operating assets and on the economic and financial situation of the Italgas Group.

Risks associated with the reimbursement amount paid by the new operator

With reference to the gas distribution concessions for which Italgas also owns the networks and facilities, Leg. Decree 164/00, as subsequently supplemented and amended, provides that the reimbursement amount paid to the outgoing service managers, and owners of existing assignments and concessions is calculated in accordance with the provisions in the agreements or contracts, provided that they were concluded before the date of the regulation entering into force under Min. Decree 226 dated 12 November 2011 (i.e., before 11 February 2012), and, to the extent not attributable to the will of the parties, as well as for aspects not governed by those conventions or contracts, based on the Guidelines on criteria and procedures for assessing the reimbursement value subsequently prepared by the Ministry of Economic Development with the document dated 7 April 2014 and approved by Ministerial Decree dated 22 May 2014[31] .
Where there is a disagreement between the local authority and the outgoing operator with regard to the reimbursement amount, the public notice contains a reference amount to be used for the purpose of the tender. This reference amount is the estimate of the contracting local authority or the RAB, whichever is greater. Ministerial Decree 226 of 12 November 2011, on tender process criteria and bid evaluation, states that the incoming operator acquires ownership of the plant with the payment of the reimbursement to the outgoing operator, with the exception of any portions of the plant that are already municipally owned.

Eventually, i.e., in subsequent periods, the reimbursement to the outgoing operator shall be the value of local net fixed assets, net of government grants for capital expenditure and private contributions relating to local assets, calculated on the basis of criteria used by the Authority to determine distribution tariffs (RAB).

In light of the new legal framework introduced, it cannot be ruled out that the reimbursement value of the concessions, which is a third party beneficiary to the outcome of the tenders, would be less than the value of the RAB. In that case, it may have negative effects on Italgas’ financial position, results and cash flows.

[31] In other words, the specific methods provided for in the individual concession agreements entered into and effective prior to 11 February 2012 take precedence over the guidelines, albeit subject to the limitations set forth in the guidelines and in the tender criteria regulation mentioned in Ministerial Decree No. 226/11.

Regulatory risk

Italgas carries out its activities in a gas sector subject to regulation. The relevant directives and legal provisions issued by the European Union and the Italian government and the resolutions of the AEEGSI and, more generally, changes to the regulatory framework, may have a significant impact on the operating activities, the economic results and financial equilibrium of the Group.

Considering the specific nature of its business and the context in which Italgas operates, developments in the regulatory context with regard to criteria for determining reference tariffs are particularly significant.

Future changes to European Union policies or at the national level, which may have unforeseeable effects on the relevant legislative framework and, therefore, on Italgas's operating activities and results, cannot be ruled out.

Legal and non-compliance risk

Legal and non-compliance risk concerns the failure to comply, in full or in part, with rules and regulations at the European, national, regional and local levels with which Italgas must comply in relation to the activities it performs. The violation of such rules and regulations may result in criminal, civil and/or administrative penalties, as well as damage to the balance sheet, financial position and/or reputation. As regards specific cases, among other things, the infringement of regulations on the protection of workers' health and safety and of the environment, and the infringement of anti-corruption rules, may also result in (possibly significant) penalties for the Company based on the administrative responsibility of entities (Leg.Decree 231/01).

Business Outlook

Italgas will continue pursuing the strategic objectives envisaged in 2016-2020 Plan with focus on the realisating investments, streamlining processes and operating costs and optimising the financial structure, equally maintaining constant attention to development opportunities.

With specific reference to **technical investments** in tangible and intangible assets, in 2017, Italgas envisions an increase in expenses compared to the previous year due to the maintenance and development of networks and metering activities designed to implement the relevant installation programme of the electronic meters (smart meters), in line with the decisions of the Authorities and completing the construction of new networks.

Italgas intends to increase its **operating efficiency** by implementing a programme of cost reduction and quality improvement in processes and services that will be launched early in the year.

During 2017 Italgas will also continue actions aimed at **financial structure optimisation** of the group by extending the average maturity of the debt and increasing the fixed-rate debt component, in line with its financial goal.

Finally, Italgas **will participate in tenders for the renewal of concessions** of strategic interest in order to achieve development objectives designed to maintain and increase its market share in the gas distribution business in Italy.

Other information

TREASURY SHARES

In compliance with Art. 2428, fourth paragraph of the Italian Civil Code, it is noted that the company does not hold treasury bonds as at 31 December 2016.

COMPENSATION PAID TO DIRECTORS AND STATUTORY AUDITORS, GENERAL MANAGERS AND MANAGERS WITH STRATEGIC RESPONSIBILITIES, AND INVESTMENTS HELD BY EACH OF THESE

Information on the compensation paid to directors and statutory auditors, general managers and managers with strategic responsibilities, and the equity investments held by each of these, can be found in the Remuneration Report, which is prepared in accordance with Article 123-ter of Legislative Decree 58/1998 (TUF). The Remuneration Report is available on the Italgas website (www.italgas.it) under Governance, which is referenced.

RELATIONSHIPS WITH RELATED PARTIES

Based on the current Italgas ownership structure, the related Italgas parties are represented by the affiliated companies and joint ventures as well as the subsidiaries (directly or indirectly) controlled by CDP, including the shareholder Snam and the Ministry of Economy and Finance (MEF). Transactions with these parties concerning the exchange of goods, the provision of services and, in relation to the CDP, the provision of financial resources.

These transactions are part of ordinary business operations and are generally settled at market conditions, i.e., the conditions which would be applied for two independent parties. All transactions conducted are performed in the interest of the Italgas Group companies.

Pursuant to the provisions of the applicable legislation, the Company has adopted internal procedures to ensure that transactions with related parties carried out by the group or its subsidiaries are transparent and correct in their substance and procedure.

Directors and statutory auditors declare potential interests that they have in relation to the Company and the Group every six months, and/or when changes in said interests occur; they also inform the Chief Executive Officer (or the Chairman, in the case of the Chief Executive Officer's interests), who in turns informs the other directors and the Board of Statutory Auditors, of individual transactions that the Company intends to carry out and in which they have an interest.

Italgas is not subject to management and coordination activities although the CDP and CDP Reti consolidate it within the International Financial Reporting Standard (IFRS) 10. As at 31 December 2016, Italgas handles the management and coordination activities in relation to its subsidiaries pursuant to Art. 2497 et seq. of the Civil Code.

The various commercial and financial amounts with the related parties, the description of the most relevant types of operations and their impact on the financial position, the economic performance and the cash flows are noted under

"Relations with Related Parties" in the Explanatory notes to the consolidated financial statements.
Relations with strategic managers (so-called "Key Managers") are described under "Operating Expenses" in the Notes to the consolidated financial statements.

PERFORMANCE OF SUBSIDIARIES

For information on the outlook of the areas where Italgas operates in whole or in part through subsidiaries, please refer to "Operating Outlook" and "Comments on the Economic and Financial Results" of this Report.

BRANCH OFFICES

In compliance with Art. 2428, fourth paragraph of the Italian Civil Code, it is noted that the company does not have secondary offices.

RESEARCH AND DEVELOPMENT

Italgas' research and development activities are described by sector under "Sustainable Development Commitment".

POST-BALANCE SHEET EVENTS

In addition to those listed below, the significant events subsequent to the close of the year are described in the relevant chapters in this Report.

Share Consolidation

On 13 March 2017, the Napoletanagas Shareholders' Meeting resolved to proceed with the consolidation of the company shares at the ratio of one new share with a nominal value of €100,000 each for every 100,000 shares with a nominal value of €1. The Company Registry is currently fulfilling the necessary requirements.

At the end of the share splitting, Italgas Networks will acquire the entire share capital of Napoletanagas.

The transaction is aimed at a more flexible equity management and the more rapid and less costly implementation of extraordinary transactions.

Tariff Regulation

On 16 March 2017, the Authority approved Resolution No. 145/2017/R/gas "Determination of definitive reference tariffs for the distribution and gas metering services for 2016" in which it established the final tariffs for 2016.

In addition, the Authority, in the same session, also approved Resolution No. 146/2017/R/gas "Reassessment of reference tariffs for distribution services and gas metering for 2009-2015", with which it restated the definitive reference rates from 457 Italgas network locations for 2015 and a location for 2014.

The Company assessed that the impact of both the aforementioned Resolutions on bond revenues is marginal and insignificant.

Report on corporate governance and ownership structure

INTRODUCTION

The complete picture of the Italgas corporate governance system is analytically described in the "Report on Corporate Governance and the 2016 Ownership Structure" (hereinafter the "2016 Governance Report") prepared pursuant to Art. 123-bis of Legislative Decree No. 58/1998 (hereinafter the "Consolidated Finance Act" or "TUF"), subject to approval of the Board of Directors on 23 March 2017.

The "2016 Report on Corporate Governance and Ownership" is published on www.italgas.it along with the Annual Report.

CORPORATE GOVERNANCE SYSTEM

Italgas is an issuer with shares listed on the Electronic Stock Market managed by Borsa Italian SpA, and therefore fulfils the legal and regulatory obligations for the listing.

The Italgas corporate governance system is the set of planning, management and control rules and methods necessary for the operation of the Company and has been outlined by the Board of Directors:

- in compliance with applicable law, also taking into account its qualification as a listed Issuer and its characteristic activity (such as the laws on so-called unbundling),
- in accordance with the Code of Corporate Governance,
- having as a reference the national and international best practices.

This system is founded on certain basic principles, such as fair and transparent management of business choice also ensured by identifying the information flows between corporate bodies and the efficient definition of the internal control and risk management system. A system of Enterprise Risk Management was implemented, composed of rules, procedures and organisational structures aimed at identifying, measuring, management and monitoring the main risks that might affect the achievement of the strategic objectives.

The Bylaws define the Company's governance model and the main rules for the functioning of corporate bodies. Italgas adopted a traditional administration and control system, characterised by the presence of the following bodies:

- Stockholders' Meeting;
- Board of Directors;
- Board of Statutory Auditors.

Stockholders' meeting

The Stockholders' Meeting is a decision-making body of the shareholders and appoints the Board of Directors and the Board of Statutory Auditors.
The validity of the Meeting's quorum and its deliberations is established in accordance with the law.

According to the Statute, the Meeting deliberates on the matters covered by the law. However, as permitted by law, the Bylaws assign the Board jurisdiction to decide on the following matters:

- the merger in the cases set forth by Art. 2505 and 2505-bis of the Italian Civil Code, which also call for a de-merger;
- establishment, modification and elimination of secondary offices;
- the reduction in share capital when a shareholder withdraws;
- compliance of the Bylaws with regulatory provisions;
- the transfer of the registered office within Italy.

In accordance with the provisions of the Code of Corporate Governance, the Shareholders' Meeting approved its own dedicated meeting regulations that regulate the order and functions of the General Meeting and guarantee that each shareholder is entitled to express his/her opinion about the issues being discussed.

The corporate Bylaws provide for a combined notice of meeting for both the Ordinary and Extraordinary Shareholders' Meetings. The right to attend Shareholders' Meetings is governed by law, the Bylaws and the provisions contained in the notice of meeting. Those with voting rights may be represented by written proxy within the legal limits and notice of this proxy must be delivered to the Company by certified email. Shareholders may ask questions about agenda items even prior to a meeting. Questions arriving before the Shareholders' Meeting will be answered during the Meeting, at the latest. The information is provided in observance of the rules for price-sensitive information.

Board of Directors

The Board of Directors is vested with full powers of ordinary and extraordinary administration and can perform all acts deemed appropriate to achieve the corporate purpose, in line with the Corporate Governance Code and the applicable rules and regulations, with the exception of those actions which the law and the Articles of Association reserves to the Shareholders' Meeting. The Board of Directors appoints the Chairman, if the Shareholders' Meeting has not already done so, delegates its powers to one or more of its members and may set up Committees. Specifically, the Board of Directors has created the following Committees, in compliance with the Code of Corporate Governance and the Bylaws: The Compensation Committee, Nomination Committee, Committee for Control and Risk and Related Party Transactions and Sustainability Committee.
On 4 August 2016 the Meeting set nine as the number of members of the Board of Directors of Italgas S.p.A. and the term of Office as three years, expiring on the date of the General Meeting to be convened in 2019 to approve the financial statements at 31 December 2018, and appointed as Directors Lorenzo Bini Smaghi (Chairman) Paolo Gallo, Nicola Bedin, Barbara Borra, Maurizio Dainelli, Cinzia Farisè, Yunpeng He, Paolo Mosa and Paola Annamaria Petrone. The Board of directors of Italgas S.p.A. appointed by the Shareholders' Meeting has determined that for the 9 Directors, of which 4 are independent, there are no grounds for their ineligibility or inappropriateness, that each

one possesses the integrity requirements established by law and that Directors Barbara Borra, Nicola Bedin, Cinzia Farisè and Paola Annamaria Petrone hold the requisites of independence established by the law and the Corporate Governance Code. The feminine gender is represented on the Board of Directors with three of nine members, in compliance with current regulations regarding gender balance (one third of the members).

Director	Position
Lorenzo Bini Smaghi	Non-executive director and Chairman
Paolo Gallo	Chief Executive Officer
Nicola Bedin	Non-executive director (1)
Barbara Borra	Non-executive director (1)
Maurizio Dainelli	Non-executive director
Yunpeng He	Non-executive director
Cinzia Farisè	Non-executive director (1)
Paolo Mosa	Non-executive director
Paola Annamaria Petrone	Non-executive director (1)

(1) Independent director pursuant to TUF and the Corporate Governance Code.
(2) Institutional investors.

The meeting of the Board of Directors on 4 August 2016 appointed Paolo Gallo as Managing Director, attributing the functions of Chief Executive Officer and granting him all the powers and authority, excluding those otherwise provided for by law and the Bylaws and which are not reserved to the Board of Directors or the Chairman.

On 28 November 2016, the Board of Directors appointed Alessio Minutoli, the Head of Legal and Corporate Affairs and Compliance, as Secretary to the Board of Directors.

The Board, at the time of its appointment and periodically thereafter, evaluates the independence and integrity of the directors, as well as the lack of grounds for ineligibility or incompatibility.

With effect starting upon completion of the separation of Italgas Gas from the Snam Group, Paolo Gallo also assumed the position of General Manager of Italgas, while on the same date Antonio Paccioretti took over as General Director of Finance and Services.

Committees established by the Board of Directors

The Board of Directors of Italgas established four internal committees, appointing the members:

- Compensation Committee;
- Appointments Committee;
- Control, Risk and Related-Party Transactions Committee;
- Sustainability Committee.

The composition, duties, and operation of the committees are being governed by the Board with appropriate regulations. The Board appoints the members.

The committees are composed of three non-executive directors in the majority independent except for the Committee for Control and Risks and Transactions with Related Parties which is composed of only independent directors, and the Sustainability Committee which is composed of non-executive directors. The term of Office of each member corresponds to the tenure of the Director's office.

In the performance of their functions, the Committees may access information and company departments. They have sufficient financial resources and may use external consultants within the terms set from time to time by the Board of Directors. Committee meetings may be attended, upon invitation, also by parties that are not members.

The Control, Risk and Related-Party Transactions Committee is composed as follows:

Member	Position
Paola Annamaria Petrone	Independent, non-executive(*) - Chairman
Barbara Borra	Independent, non-executive(*)
Cinzia Farisè	Independent, non-executive(*)

(*) Independent pursuant to the independence requirements set out by the TUF and the Code of Corporate Governance.

The Board of Directors has determined that at least one Member of Committee of Control, Risk and Related-Party Transactions has the specific expertise in financial matters or compensation required by the Corporate Governance Code.

The composition of the Compensation Committee is as follows:

Member	Position
Barbara Borra	Independent, non-executive(*) - Chairman
Maurizio Dainelli	Non-executive
Paola Annamaria Petrone	Independent, non-executive(*)

(*) Independent pursuant to the independence requirements set out by the TUF and the Code of Corporate Governance.

The Board of Directors has determined that at least one Member of Committee of Control, Risk and Related-Party Transactions has the specific expertise in financial matters or compensation required by the Corporate Governance Code.

The Appointments Committee is composed as follows:

Member	Position
Cinzia Farisè	Independent, non-executive(*) - Chairman
Maurizio Dainelli	Non-executive
Nicola Bedin	Independent, non-executive(*)

(*) Independent pursuant to the independence requirements set out by the TUF and the Code of Corporate Governance.

The Sustainability Committee is composed as follows:

Member	Position
Nicola Bedin	Independent, non-executive(*) - Chairman
Yunpeng He	Non-executive
Paolo Mosa	Non-executive

(*) Independent pursuant to the independence requirements set out by the TUF and the Code of Corporate Governance.

Board of Statutory Auditors

The Board of Statutory Auditors supervises compliance with the law and the Articles of Association, respect for the principles of correct administration in carrying out corporate activities, the adequacy of the organisational structure for aspects of responsibility, of the system of internal control and accounting system as well as the reliability of the latter in correctly representing transactions, and how to implement the corporate governance rules provided under the Corporate Governance Code. Pursuant to Legislative Decree No. 39 of 27 January 2010, the Board of Statutory Auditors also performs supervisory functions in its capacity as "Committee for internal control and account auditing".

Italgas's Board of Statutory Auditors is made up of three standing auditors and two alternates appointed by the Shareholders' Meeting for three financial years and can be re-elected for the term of office. Statutory auditors are chosen from among those who meet the professionalism and integrity requirements indicated in Decree No. 162 of the Ministry of Justice of 30 March 2000. For the purposes of the decree and as provided by the Bylaws, the matters strictly pertaining to the company activities are: business law, economics and corporate finance. Likewise, the sector pertaining strictly to the Company's business is the engineering and geology sector.

Upon prior notice to the Chairman of the Board of Directors, the Board of Statutory Auditors may call Shareholders' Meetings and Board of Directors' meetings. The power to call Board of Directors' meetings may be exercised individually by each member of the Board of Statutory Auditors; the power to call Shareholders' Meetings must be exercised by at least two members of the Board. The Board of Statutory Auditors is asked to attend the meetings of the Committee of Control and Risk and Related Party Transactions.

Pursuant to the procedure “Transactions in which directors and statutory auditors have an interest and related-party transactions”, members of the Board of Statutory Auditors must declare any interest on their own behalf or that of third parties in specific transactions submitted to the Board of Directors.

The current Board of Statutory Auditors was appointed by the Shareholders’ Meeting of 4 August 2016 for a term of three financial years and in any event until the date of the Shareholders’ Meeting called to approve the financial statements for 2018:

Member	Position
Gian Piero Balducci	Standing auditor and Chairman
Giandomenico Genta	Statutory auditor
Laura Zanetti	Statutory auditor
Marilena Cederna	Alternate auditor
Walter Visco	Alternate auditor

The Board has reviewed and confirmed that its members have the requirements of professionalism and integrity set forth in Ministerial Decree 162 of 30 March 2000 as specified by Art. 20.1 of the Bylaws and the independence requirements set forth by law and the Code of Conduct, sending the Board the results of this analysis in accordance with Application Criterion 8.C.1. of the Code of Conduct approved by the Committee for Corporate Governance (July 2015 edition).

Independent auditors

As required by law, auditing activities are assigned to an independent auditing firm included in the relevant register and appointed by the Shareholders’ Meeting based on a reasoned proposal from the Board of Statutory Auditors.
On 4 August 2016 the Shareholders’ Meeting assigned the task of the statutory audit of Italgas S.p.A. to EY S.p.A. for the years 2016-2024.

INFORMATION ON OWNERSHIP STRUCTURE

Share capital and key shareholders

The share capital of Italgas is composed of registered ordinary shares, which are indivisible and confer the right to one vote. As at the date of 31 December 2016 (unchanged at 23 March 2017) the share capital of Italgas amounts to € 1,001,231,518.44 and is divided into 809,135,502 ordinary shares, with no par value indicated.

The Italgas stock is quoted in the FTSE MIB index of the Milan Stock Exchange.

Based on the information available and communications received pursuant to Article 120 of the Consolidated Law on Finance and Consob Resolution No. 11971/1999 (Consob Issuer Regulations), as of 31 December 2016, shareholders holding shares worth more than 3% of the Italgas share capital are:

Significant shareholdings [1]

Registrant	Direct Shareholder	Proportion of ordinary share capital (%)	Share of voting capital %
CDP S.p.A.	CDP Reti S.p.A.[2]	25.076	25.076
	CDP Gas S.p.A.[3]	0.969	0.969
	Total	**26.045**	**26.465[4]**
Snam S.p.A.	**Snam S.p.A.**	**13.50**	**13.50**
Romano Minozzi	Granitifiandre S.p.A.	0.482	0.482
	Finanziaria Ceramica Castellarano S.p.A.	0.225	0.225
	Iris Ceramica Group S.p.A.	1.471	1.471
	Romano Minozzi	1.669	1.669
	Total	**3.847**	**3.847**

(1) On 23 March 2017, Lazard Asset Management Llc claimed to hold a 5.038% percent stake in the share and voting capital of Italgas S.p.A.
(2) CDP Reti is owned 59.1% by CDP, 35% by State Grid Europe Limited – SGEL, a subsidiary of State Grid Corporation of China, and 5.9% by some institutional investors.
(3) CDP Gas is owned 100% by CDP. Based on the information available to the company, on 25 January 2017 the competent corporate bodies of CDP and CDP Gas endorsed a proposed merger of CDP Gas into CDP. As of the date of this report the merger has not yet become effective.
(4) Considering the stake held by CDP in Snam, accounting for 30.1% (respectively, 28.98% held by CDP Reti and 1.12% held by CDP Gas), CDP owns indirectly an additional share of 4%, resulting in a total CDP stake in Italgas of 30.1%.

Further information, as required pursuant to Article 123- bis, paragraph 1 of the TUF, can be found in the 2016 governance report.

Shareholder agreements between shareholders

The agreements between shareholders pursuant to Art. 122 of the TUF of which Italgas is aware are as follows.
On 20 October 2016 Snam S.p.A. ("Snam"), CDP Reti S.p.A. ("CDP Reti") and CDP Gas S.p.A. ("CDP") signed a shareholders' agreement (the "Italgas Shareholders Agreement") covering all the shares that the respective parties held in Italgas of consequence and with effect starting on the effective date of the partial and proportional demerger from Snam in favour of Italgas and the simultaneous listing of the Italgas shares, namely 7 November 2016. The Italgas Shareholders Agreement governs, among other things: (i) the exercise of voting rights attached to the syndicated shares; (ii) the establishment of a consultation committee; (iii) the obligations and procedures for submitting a joint list for the appointment of members of the company's Board of Directors; and (iv) certain restrictions on the sale and purchase of Italgas shares. The Italgas Shareholders' Agreement was filed in copy at the Milan Business Registry on 11 November 2016 and can be retrieved in extract from the company's website at: http://www.italgas.it/investitori/azionariato/patti-parasociali/.

On 27 November 2014, CDP S.p.A. ("CDP"), on the one hand, and State Grid Europe Limited ("SGEL") and State Grid International Development Limited ("SGID"), on the other, entered into a shareholders' agreement (the "SGEL Shareholders' Agreement'") in the context of the sales contract concluded between the same parties on 31 July

2014 in accordance with which on 27 November 2014 SGEL acquired from CDP a stake equal to 35% of the share capital of CDP Reti. In conjunction with the effectiveness of the partial and proportional demerger from Snam in favour of Italgas and the simultaneous listing of the Italgas shares on 7 November 2016, SGEL, SGID and CDP have amended and supplemented the SGEL Shareholders' Agreement, effective on the same date, extending its application to the stake held by CDP Reti in Italgas. The Italgas Shareholders' Agreement was filed in copy at the Milan Business Registry on 11 November 2016 and can be retrieved in extract from the company's website at: http://www.italgas.it/investitori/azionariato/patti-parasociali/.

ITALGAS REGULATORY SYSTEM

In accordance with the evolving process aimed at continually improving the effectiveness and efficiency of its internal control and risk management system, Italgas has adopted its own regulatory system comprising the following regulatory levels: (i) Corporate System Framework (first level regulation), (ii) Procedures (second level regulation), and (iii) Operating Instructions (third level regulation). The regulatory system also includes as an integral part thereof, the documents belonging to the certified management systems for health, safety, environment and quality in accordance with international ISO standard (Policies, Manuals, Procedures and Operating Instructions). Lastly, there are regulatory circulars to govern specific issues (sometimes with temporary validity). The Bylaws, the Ethics Code, the Corporate Governance Code, Model 231 and the Internal Control System on Corporate Information are placed in the general framework of the Regulatory System, as, although specific tools, the principles that inspire them are recognised as the founding principles of the conduct of the Italgas Group and, therefore, part of the general framework of the entire regulatory system.

These regulatory tools are part of the efficient handling of the Management and Coordination activities performed by Italgas concerning Subsidiaries, and they are subject to regular delivery to, and/or formal adoption by, the Boards of Directors of the Subsidiaries.

Principles of the system of risk management and internal control in relation to the financial reporting process

The internal control and risk management system and the corporate reporting process of the Italgas Group are elements of the same "System"(the Corporate Reporting Internal Control System), which aims to ensure the reliability[32], accuracy[33], dependability[34] and timeliness of corporate disclosure with regard to financial reporting and the ability of the relevant business processes to produce this information in keeping with generally accepted accounting standards.

32 Reliability of information: reporting that is correct, complies with generally accepted accounting standards and fulfils the requirements of the applicable laws and regulations.

33 Accuracy of information: information free of errors.

34 Dependability of information: information that is clear and comprehensive, enabling investors to make informed investment decisions.

The reporting in question consists of all the data and information contained in the periodic accounting documents required by law – the separate and consolidated Annual Financial Report, half-year financial report and interim report on operations – as well as in any other accounting document or external communication – such as press releases and prospectuses prepared for specific transactions – covered by the statements provided for by Article 154-bis of the TUF. This reporting includes both financial and non-financial information, where the latter aims to describe significant aspects of the business, comment on the financial results for the year and/or describe future prospects.

The internal control and risk management model adopted by Italgas and its subsidiaries with regard to corporate reporting was defined in accordance with the provisions of the above-mentioned Article 154-bis of the TUF that Italgas is required to ensure compliance with, and is based in methodological terms on the "COSO Framework"("Internal Control - Integrated Framework", issued by the Committee of Sponsoring Organisations of the Treadway Commission), the international reference model for the establishment, updating, analysis and assessment of the internal control system. Its update was published in May 2013.

The planning, institution and maintenance of the Corporate Reporting Internal Control System are achieved through the activities of scoping, identifying and assessing the risks and controls (at the business level and process level through the activities of risk assessment and monitoring) and the related information flows (reporting).

The structure of the control system features entity-level controls (Company entity-level controls) which operate transversely across the entity in question (group/individual company) and process-level controls.

The controls, both at the entity level and process level, are subject to regular evaluation (monitoring) to verify the adequacy of the design and actual operability over time. For that purpose, there is provision for ongoing monitoring activities, assigned to the management responsible for the relevant procedures/activities, as well as independent monitoring (separate evaluations), assigned to the Internal Audit, which operates according to a plan agreed with the Director responsible for preparing the company's financial reports (DP) which aims to define the scope and objectives of its operation through concerted audit procedures.

In addition, the Board of Directors of Italgas appointed independent auditors EY to examine the adequacy of the internal control system in relation to the preparation of financial information for the production of the separate and consolidated financial statements of Italgas S.p.A., by conducting independent checks on the effectiveness of the design and functionality of the control system.

The results of the monitoring activities, the checks made on the controls and any other information or situations relevant to the Corporate Reporting Internal Control System are subject to periodic reporting on the state of the control system, which involves all levels of the organisational structure of Italgas and its major subsidiaries, including operational business managers, heads of department, administrative managers and chief executive officers.

The assessments of all controls instituted within by Italgas and its subsidiaries are brought to the attention of the Chief Financial Officer, who, on the basis of this information, draws up half-yearly and annual reports on the adequacy and effective application of the Corporate Reporting Internal Control System. These are shared with the Chief Executive Officer and communicated to the Board of Directors, after informing the Control and Risk Committee and the Board of Statutory Auditors, when the separate and consolidated financial statements, and the consolidated half-year report, are approved, to allow the Board of Directors to perform its supervisory functions and to conduct the assessments that fall to its responsibility with regard to the Corporate Reporting Internal Control System.

MODEL 231 AND THE SUPERVISORY BOARD

The Board of Directors of Italgas S.p.A. on 18 October 2016 approved its "Model 231", of which the Corporate Governance Code is an integral part, indicating the principles of organisation, management and control to prevent crimes from being committed in the interest or to the advantage of the Company as per the regulations on the administrative liability of companies (Legislative Decree 231 dated 8 June 2001).
In 2017 the company will launch a Risk Assessment process used to prepare the "Processes, sensitive activities and specific control standards of Model 231" document, which will integrate Model 231 with the mechanisms adopted for each specific type of crime falling within the scope of Legislative Decree 231 dated 8 June 2001.
On 20 December 2016 Italgas S.p.A.'s Board of Directors appointed the Supervisory Board, composed of Prof. Carlo Piergallini as Chairman and Professors Eliana La Ferrara and Francesco Profumo.
The Supervisory Board is guarantor of the Ethics Code and is equipped with autonomous powers of initiative and control in accordance with the regulation of law. The Board may be submitted requests for clarifications and interpretations on the principles and contents of the Ethics Code, suggestions regarding its application and notices of code violations, also anonymously.

Ethics Code

The Ethics Code defines a shared value system, expresses Italgas's business ethics culture and forms the basis for the Company's strategic thinking and the conduct of its corporate activities.
The Ethics Code is a compulsory general principle of "Model 231", containing the fundamental principles that must guide Italgas, such as respect for the law, fair competition, honesty, integrity, fairness and good faith towards all parties who keep relationships with it. It also contains the general principles of sustainability and corporate responsibility, in addition to recalling the principles that must be respected in matters of the workplace, relations with stakeholders and suppliers and for the protection of personal data.

Legislative and regulatory framework

ASSIGNMENT OF GAS DISTRIBUTION SERVICE AND THE RELATED LOCAL TENDER NOTICES

Italgas operates in a regulatory environment characterised by subsequent legislative acts aimed at implementing the provisions of Article 46-bis of Decree-Law 159/07. With this Decree the legislature entrusted the Minister for Economic Development the task of defining the new criteria to notify the tenders for awarding distribution service, no longer for individual municipalities, but for minimum territorial areas, according to the identification of optimal user pools, based on the criteria of efficiency and cost savings.

In 2011 the Ministry of Economic Development adopted four measures of reorganisation of the matter, described below.
The Local Decree of 19 January 2011 established multi-municipality minimum geographical areas (ATEM) for which new gas distribution concessions must be assigned. The subsequent Decree of 18 October 2011 identified the municipalities that are part of the 177 ATEM.

Then on 12 November 2011 the Ministerial Decree was adopted that outlines the criteria for the tender and evaluation of the bids for the award of natural gas distribution service. The measure was subsequently amended by Decree of the Ministry of Economic Development 106, in consultation with the Ministry for Regional Affairs and Autonomy, on 20 May 2015, published in the Official Gazette No. 161 on 14 July 2015. The measure contains instructions on preliminary aspects of the tender (including the participation requirements, the criteria for assessing bids, the value of the compensation to be paid to the outgoing operator, etc.), as well as the invitation to tender and the tender regulations "type". The reimbursement value for holders of defunct contracts and concessions upon expiry is calculated in accordance with the provisions in the agreements or contracts, provided that they were concluded before the date of the entry into force of the regulation as per Min. Decree 226 dated 12 November 2011 (i.e., before 11 February 2012), and, although not obvious from the will of the parties, as well as for the areas not covered by those agreements or contracts according to the Guidelines on operational criteria and procedures for the assessment of the reimbursement value , prepared by the Ministry of Economic Development and approved by Ministerial Decree of 22 May 2014. In any case, private contributions relating to local assets, as valued according to the current tariff regulation methodology, shall be subtracted from the amount to be reimbursed. Where there is a disagreement between the Local Authority and the outgoing operator with regard to the reimbursement amount, the tender notice states a reference amount to be used for the purpose of the tender, determined as the greater amount between the estimate of the contracting Local Authority and the value of net fixed assets of localities recognised by the Authority (RAB). Once the dispute has been resolved, any difference will be settled between the incoming operator and the outgoing operator. Eventually, i.e., in subsequent periods, the reimbursement to the outgoing operator shall be the value of local net fixed assets, net of government grants for capital expenditure and private contributions relating to local assets, calculated on the basis of criteria used by the Authority to determine distribution tariffs (RAB).

The tenders will be awarded on the basis of the most economically advantageous bid, in accordance with criteria of safety, quality of service and development plans for the systems.

On 5 February 2013 finally the Ministerial Decree was adopted approving the format for the service type contract to perform distribution tasks.

Main provisions 2016 concerning tenders

With **Resolution No. 10/2016/R/gas** the Authority updated the interest rate to 3.53%, valid for three years from 2016 to 2018, to be applied to determine the one-off reimbursement owed to the outgoing operators of the distribution service covering the gas expenses set forth in Ministerial Decree 226/11.

The **Official Gazette No. 47 on 26 February 2016**, published Law 21/16, the conversion into law, with amendments, of Decree Law 210/15, the so-called "one thousand extensions". Among the other provisions, the measure further amended the deadlines, repeatedly extended, for holding tenders to award gas distribution service; specifically:

- the deadlines related to failure to publish the notice are extended to 12 months for the first grouping of local territories, 14 months for the second, 13 months for the third, fourth and fifth, 9 months for the sixth and seventh, and 5 months for the eighth, in addition to the extensions in effect at the date of the Law entering into force that converts Decree-Law 210/2015;
- article 4, paragraph 5 of Decree-Law 69/2013 was deleted, which provided for a penalty to be paid by the Local Authorities in a case of non-compliance with the conditions for holding tenders;
- after six months from the expiry of said new deadlines without the tender being published, the region responsible for each area starts the bidding process through the appointment of an acting commissioner;
- after a further two months from the expiry of that period without the relevant Region having proceeded with the appointment of the Commissioner, the Ministry of Economic Development, in consultation with the Region, intervenes to initiate the tender by appointing another acting commissioner.

With **the notices of 19 May 2016 and 3-4 August 2016**, the Authority and the Ministry of Economic Development provided some clarifications concerning the operator's obligation for paying the concession fee, also with an expired concession, pending the completion of the local tender, consistent with the continuity of managing the gas distribution service.
The Authority expressed the principle, shared by the Ministry, whereby the concessionaire that continues operating a gas distribution service, also at the expiry of the concession, continuing to receive the related tariff, must continue to provide the municipality the rate stated under the original conditions at the origin of the relationship, as it an agreement between the entrusting Authority and the distribution enterprise or another entitling.
This applies both in relation to assignments made reaching expiry, and for those expired ope legis.

The Ministry also clarifies that reference to Article 5 of the service type contract (approved by Min. Decree on 5/2/2013), in accordance with which, when the period of 12 years of the new assignments has passed, payment of the fee is excluded for the municipality until the new tender, is neither relevant nor applicable to the present situation, but only to a situation already underway as the assumptions and purposes are different.
With **Resolution No. 16/2016 – DIUC of 28 June 2016**, the Authority updated the reference values at the time defined by resolution No. 414/2014/R/gas, acting to determine the unit costs to be used in the analysis for the indices relating to verifying the variances between RIV and RAB, to calculate the reimbursement value of gas distribution networks. The update was performed by applying the deflator for gross fixed investments, respectively, at 0.10% for the year 2015 and 0.20% for 2016.
Law 232 dated 11 December 2016, in force since 1 January 2017, then intervened on the same matter, with primary legislative rank. Paragraph 453 of Art. 1, in fact , interprets the provision in article 14, paragraph 7, of Leg. Decree 164/00, specifying that the outgoing operator of the gas distribution service, which continues in the ordinary management of the service also at the expiry of the contract relationship and up to the effective date of the new assignment, remains obligated to pay the concession contract to the Local Authority.

OBLIGATIONS FOR INSTALLATION AND COMMISSIONING SMART GAS METERS

With **Resolution No. 631/2013/R/gas**, the Authority updated the deadlines for installing and commissioning the gauges that support smart metering and remote management functions (called smart meters), falling specifically in classes G4, G6 and G10.

By effect of the provisions of that Resolution, the companies that provide metering service were required to satisfy the following schedule:

- with reference to the delivery points with class measuring unit greater than G40, 100% in the service delivery points existing as at the date of 29 February 2012;
- with reference to the active redelivery points with measurement unit class equal to G40 (i) 95% in service by 31 December 2013; (ii) 100% in service by 31 December 2014;
- with reference to the active redelivery points with measurement unit class equal to G25 and G16 (i) 25% in service by 31 December 2013; (ii) 60% in service by 31 December 2014; (iii) 100% in service by 31 December 2015;
- with reference to the active redelivery points with measurement unit class equal to G10 (i) 15% in service by 31 December 2014; (ii) 30% in service by 31 December 2015;
- with reference to the active redelivery points with measurement unit class less than or equal to G6 (i) for the distribution companies with more than 200,000 end customers at 31 December 2013, 3% installed by 31 December 2014, 3% in service by 31 December 2015, 10% by 31 December 2015, and 60% in service by 31 December 2018; (ii) for distribution companies with a number of end

customers between 100,000 and 200,000 at 31 December 2014, 3% installed by 31 December 2015.

To allow a smooth transition from traditional technology to innovative technologies, the companies, however, had the option to install, up to 31 December 2014, G4 and G6 class measuring units that do not meet the functional requirements as per the relevant Directives. After that date, the entity in charge of the metering service was required to install metering units in accordance with the functional requirements referred to the relevant Directives when replacing a metering unit or with the creation of a new redelivery point.
With Resolution No. 554/2015/R/gas, the Authority updated the deadlines to 2018 for commissioning the smart meter gas service, specifically for class G4, G6 and G10, making some changes and additions to the Directives in Annex A to Resolution No. 631/2013/R/gas, and establishing penalties that the distribution companies must pay for non-compliance with the installation and commissioning obligations for the year 2014.
As a result of new provisions, without prejudice to the obligations established by Resolution No. 631/2013/R/gas for other classes of metering units, the entity in charge of the metering service is required to install and operate the smart gas meter class G4, G6 and G10, at least in compliance with the following schedule:

	by 31/12/2014	by 31/12/2015	by 31/12/2016	by 31/12/2017	by 31/12/2018
Existing class G10 delivery points	15% in service	30% in service	50% in service	85% in service	100% in service
Existing delivery points less than or equal to G6 (distribution companies with more than 200,000 end users as at 31 December 2013)	3% installed	3% in service 10% installed	15% in service	33% in service	50% in service

With **Resolution No. 821/2016/R/gas** , the Authority established that, pending the necessary technical and regulatory clarifications, gas distribution companies can defer the use of tele-management of the electro-valve inserted in the smart gas meter in service in class G4 and G6 up to 1 January 2018, notifying the Authority by January 31, 2017, along with the detailed reasons for the need for postponement and providing all the available evidence and data on the use of the electro-valve in the field, collected at least until the year 2016.

ENERGY EFFICIENCY

The system of Energy Efficiency Certificates [TEE], also known as White Certificates, was introduced into Italian law with Min. Decree dated 20 July 2004 as amended, and provides that distributors of electricity and natural gas with a client base exceeding 50,000 units annually reach certain quantitative targets for primary energy savings, expressed in Tonnes of Oil Equivalent saved.
The obligated businesses are paid a tariff-based fee for the TEEs obtained, as defined by the Authority. More precisely, starting from 2013, the Authority determines a

preliminary tariff-based fee scale and a final tariff-based fee calculated, respectively, at the beginning and end of the same year of obligation, where:

- the preliminary fee is defined on the basis of the final fee for the previous year and the percentage of change in average energy prices to residential customers;
- the final fee is determined on the basis of the preliminary fee set for the same year and the average value of the stock's trading prices occurring on the organised market.

In 2016 the main energy efficiency measures were as follows.

With **Resolution No. 1/2016 of 15 January 2016**, the Authority sent the Ministry of Economic Development and the Energy Services Manager the list of obligated entities and the data necessary for determining the specific objectives for primary energy savings in the year 2016 for gas and electricity distributors.
The total amount of natural gas in distributed nationwide in the year 2014 by distributors subject to the obligation for the year 2016 is 986,134,068.18 GJ.

With **Decision DMEG/EFR/11/2016 dated 16 June 2016**, the Authority established the values of the final tariff-based fee for the year of the 2015 obligation and the preliminary tariff-based fee for the 2016 obligation, for the Energy Efficiency Certificates respectively at 114.83 EUR/TEE and 118.37 EUR/TEE.
On 27 July 2016 GSE communicated the amount payable to each distributor of electricity and natural gas subject to the obligation to cover the costs incurred in relation to 2015; the fees recognised are respectively EUR 61,376,290.51 for Italgas Reti, EUR 7,416,180.72 for Napoletanagas and EUR 1,415,050.09 for ACAM Gas.

With **Resolution No. 710/2016/E/EFR**, the Authority began an investigation into the market trends in energy efficiency certificates to evaluate the opportunity to revise the method for determining the tariff basis in order to increase the mechanism's efficiency.

In the context of the investigation, the evolution of prices and volumes of trade in energy efficiency certificates will be analysed as found in the organised market from the month of June 2016; the Authority notes that in November 2016, particularly high trades took place in securities on the stock exchange compared to historical prices.

The Authority expects to conclude the investigation by 31 March 2017.

SAFETY OF GAS DISTRIBUTION AND METERING SERVICE

With **Resolution No. 20/2016/R/gas**, the Authority determined the bonuses and penalties relating to safety improvements in the gas distribution service for the year 2013, for the distribution companies. Total bonuses pertaining to Italgas for odorisation dispersion components totalled EUR 5.2 million.

With **Resolution No. 686/2016/R/gas**, the Authority determined the bonuses and penalties relating to safety improvements in the gas distribution service for the year 2014, for the distribution companies. Total bonuses pertaining to Italgas for odorisation dispersion components totalled EUR 12.4 million.

COMMERCIAL REGULATION OF GAS DISTRIBUTION AND METERING SERVICE

With **Decision DMEG/MRT/10/2016**, the Authority established the disclosure obligations for natural gas distribution companies concerning the quality of measurement data.

To this end all the distribution companies must provide every six months, within 45 days of the end of each half-year, information relating to the provision of measurement data necessary for terminating the supply.

GAS CUSTOMERS' INSURANCE

With **Resolution No. 223/2016/R/gas**, the Authority defined the criteria that must regulate insurance against risks in using the gas downstream of the point of delivery, which benefits the consumers of gas distributed through the local pipelines and transportation networks for the period 1 January 2017 – 31 December 2020, and has regulated the arrangements for concluding the insurance contract.

Sustainability and corporate responsibility

Italgas believes that sustainability forms an integral part of its business model. It is in fact a leading factor in defining the Company's strategic and operational decisions and a lever for long-term sustainable growth, ensuring at the same time delivery of the shareholders' expected results and sharing the value generated with all of its stakeholders including in terms of environmental and social issues.

Italgas founded its business' daily practices on the principles of transparency, honesty, fairness, good faith and in full compliance with regulations to protect competition. These principles are listed in the Code of Ethics adopted by all the companies, which are fundamental tools for orientating the conduct of personnel and for responsible management of relationships with the stakeholders.

The Italgas Group uses specific, certified management systems with the objective of overseeing the processes and business activities in accordance with the health and safety of workers, environmental protection and the quality of services offered.

Ever since its establishment, Italgas has taken steps to prepare its Sustainability Report drawn up in accordance with the guidelines (GRI-G4) published by the Global Reporting Initiative. The financial statements approved by the Board of Directors together with the Annual Report examines the activities carried out in accordance with the logic of economic efficiency, environmental protection and social responsibility, handling all subjects on which the company measures and compares itself publicly.

The Sustainability Report also constitutes the reference document to meet the requirements of Legislative Decree 254 of 30 December 2016 issued in implementation of Directive 2014/95 / EU on the disclosure of non-financial information by companies and large groups.

As regards, however, this report, the following provides some information related to personnel management, the environment, the fight against bribery and corruption, and the main social impacts relating to the business activities conducted by Italgas. In order to provide complete disclosure on the outlook of this management and to ensure comparability over time, the key data for the "Pro-forma Consolidation" are provided below for 2016.

For further information with respect to the topics represented, see the Sustainability Report.

PEOPLE AND ORGANISATION

The work of Italgas is based on the growth and development of its employees as well as their health and safety, the creation of a positive work environment that offers all development possibilities based on merit, the growth of professional skills and management and the involvement of employees so that they feel like an active part of the development and improvement processes.

Employment

The active staff at the Italgas Group as of 31 December 2016 includes 3,570 people with a total increase of 272 staff compared to the previous year's data. The analysis by contractual category and company included in the scope of consolidation is shown in the following tables:

Staff by Company (number) (*)	**2015**	**2016**	**Change**
Italgas S.p.A		**337**	337
Italgas Reti S.p.A. (*)	2,768	**2,704**	(64)
Napoletanagas S.p.A	438	**437**	(1)
Acam Gas S.p.A.	92	**92**	
	3,298	**3,570**	**272**

(*) The figure for 2015 for Italgas Reti includes 179 persons from A.E.S. Torino.

The change in the number of employees is due to Snam separating from the operating distribution companies and the establishment of Italgas, resulting in reimbursement activities previously outsourced by the former parent company Snam based on service contracts.

Staff by position (number)	**2015**	**2016**	**Change**
Executives	30	**56**	26
Managers	180	**237**	57
Office workers	1,699	**1,896**	197
Manual workers	1,389	**1,381**	(8)
	3,298	**3,570**	**272**

More specifically, the employment figures recorded during 2016 were as follows:

- an increase of 355 people, 112 of which are market hires (46% of which are college graduates and 50% have institute or technical degrees) and 59 incoming come from the Snam Group;
- a reduction of 83 people, of whom 45 due to termination of employment and 38 for other departures from service (for example leave from work).

The CCNL (Gas-Water Agreement for Distribution) was applied to all Italgas employees.
About 97% of people at Italgas have an open-period employment contract; the remaining 3% is divided between temporary contracts, apprenticeships and access-to-work contracts.
With respect to the Group's national distribution, 1,489 people are employed in the northern regions of Italy, 995 in the central regions and 1,086 in the south.
University graduates account for 9.8% of the total while the staff with high school diplomas totals 49.5%; the average age of Group employees remained stable compared

to previous years, reaching a value of just over 52 years, while the average length of service is about 26.4 years, up from the previous year.
Overall in the Italgas Group, females make up 10.7% of the entire company workforce, which has been constantly growing over the last three-years. In particular, the presence of women in management (executives and managers) is 12.3%, with an increasing trend because the new entries from university graduates see the number of women to rise to about 27%.

Organisation

The establishment of the new Italgas SpA was accompanied by designing a new organisational and management structure and required finding skilled and qualified staff from the external market, added into the main central staff units: Legal, corporate and compliance affairs, external relations and communication, institutional relations and regulatory affairs, finance and services, business development, security, human resources and organisation.
Italgas Reti has added a consistent number of new staff to strengthen the technical area and commercial area.
In particular, in the area Operations area, Engineering has been significantly strengthened (for design and network verification) with the inclusion of young engineers and with the completion of the work team of directors hired by a variety of external engineering companies with experience and specific and diversified expertise in their management and control of construction sites.
Strengthening Operations has also involved the network management area, the Coordination activities, districts and operational centres through the targeted inclusion of engineering graduates into the engineering and control units in addition to the technical graduates for operational technician operators at the centres.
Also the Commercial Development area has been involved in a managerial and operational strengthening, with the inclusion of managers from the market with experience and young graduates in economics and engineering.
The significant number of hires in 2016 thus enabled the Group's enrichment with a new team of young people who will be involved in critical activities for the business and essential to the development of Italgas strategy: preserving the technical know-how, planning and innovation, knowledge of the distribution market, logic and activities aimed at the participating and managing the local tenders.
New hires are trained and gain experience over the first few years with time in the classroom, job shadowing and on-the-job training and participation in work groups.

Training

Italgas training is aimed primarily at ensuring the growth of required skills while performing business activities. Altogether in 2016, over 113 thousand hours of training were provided to 3,266 participants for a total of 14,122 participations.

Hours of training supplied by position (number)	2015	2016	Change
Executives	1,199	**792**	(407)
Managers	7,672	**7,563**	(109)
Office workers	44,248	**79,052**	34,804
Manual workers	19,668	**25,708**	6,040
	72,787	**113,115**	**40,328**

The most significant activities carried out in 2016 include the following:

- training on energy and energy saving management issues aimed at all Group employees in the scope of activities planned for the achievement and maintenance of ISO 50001 standard;
- dissemination of educational initiatives aimed at promoting the culture of ethics, corporate legality and anti-corruption;
- the continuation of training activities aimed at technicians and employees in relation to the organisational and operational model;
- the continuation of training for technicians and employees in the use of new IT tools (tablets) in support of the operational activity with particular reference to the evolution of the Work Force Management systems;
- the implementation of training initiatives in the engineering area with specific modules focused on regulatory issues, sites visits, mapping, company integration and relations with suppliers;
- the activation of "Security Coaching" initiatives intended for managers and executives for managing threats from the cyber universe and enterprise data protection;
- conducting integration programs for young graduates characterised by meetings and field experience, in direct contact with the operative realities to facilitate integration in the organisation.

In continuing with previous years, the commitment to training required by the applicable law on particular health issues, safety, environment and quality have been maintained. All training courses in the field of "health and safety" have been organised and delivered in accordance with the provisions of the State - Regions Agreement of 21 December 2011.

Initiatives in favour of employees

The Italgas welfare system includes:

- Initiatives for families, reserved for employees' children, with recreational, sports and training activities for the youngest, English-language study and sports/adventures for teens;

- Health and wellness programs with early detection programs, check-ups, nutrition education programs and physical activities for employees;
- "Work-life balance" initiatives, the goal of which is to offer ancillary services to the employee's work life so as to enhance their private life;
- Benefits and economic benefits to employees.

HEALTH, SAFETY AND ENVIRONMENT

Through the Health Safety and Environment Policy, Italgas, in its prevention and protection principles, recognises the inalienable values and assumes a specific commitment for injury prevention, the protection of health and mitigation of the environmental impacts from its activities.

Health and safety

In 2016, a total of 23 accidents were recorded, of which 14 were related to accidents at work and in transport and 9 were while commuting. The total number of accidents corresponds to 1,316 days of total absence (of which 872 are non-commuting) with a frequency index of 4.09 and a severity index of 0.23; excluding the commuting accidents, the indices are as follows: 2.49 for frequency and 0.16 for severity.

Accidents at work (*)

	2015	2016
Total employee accidents	18	**14**

(*) Number of non-commuting accidents

Accident indices

Employees	2015	2016
Frequency index (*)	3.34	**2.49**
Severity index (**)	0.16	**0.16**

(*) Number of non-commuting accidents, with incapacity of at least one day, per million hours worked.
(**) Number of working days lost (calendar days) in relation to accidents at work resulting in absence of at least one day, per million hours worked. Data do not reflect fatal accidents.

The inner perimeter of Italgas pays particular attention to raising staff awareness and training on the risks arising from operating activities and in implementing the safety requirements to be adopted to safeguard their own and others' safety. The growth of the "safety culture" is fuelled by many standard initiatives such as the "Italgas Safety Trophy" and the "Zero Accidents Award", which is assigned to homogeneous groups that have operated for 365 consecutive days without injury.
Externally, accident prevention involves, especially, contractors working at Italgas construction sites, and the granting Municipalities that, in the process of examining and approving subsurface projects, are sensitised to every possible interference within the existing gas distribution networks.
For staff exposed to specific risk factors Italgas implements periodic health surveillance, which recorded 2,424 medical visits in the year.

Environmental Protection

Environmental protection is of paramount importance at all Italgas business stages. The most significant Italgas environmental aspects are atmospheric emissions deriving from combustion processes (carbon dioxide, carbon monoxide, nitrogen oxides, etc.), both by the distribution (natural gas releases into the atmosphere from networks) and the production of waste from the ordinary construction and maintenance of networks and the recovery of industrial areas.

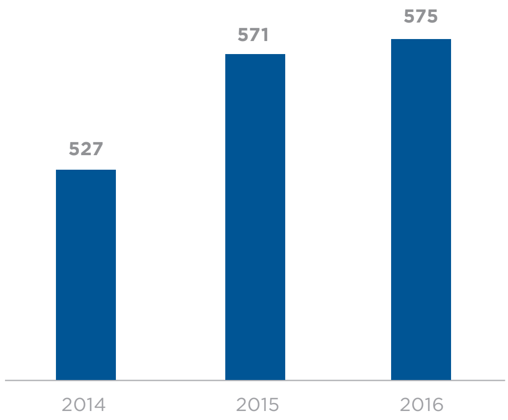
The Italgas commitment is oriented to promote activities aimed at reducing the environmental impact of its production processes and the improvement of plant safety conditions as well as environmental restoration and site remediation for contamination by past industrial activities involving manufactured gas production.

For the reduction of methane emissions into the atmosphere, interventions to replace the cast iron pipes with sections of hemp/lead is of particular importance, using the same material for mechanical joints. This activity also allows for increased levels of security and the reducing the loss of raw materials.

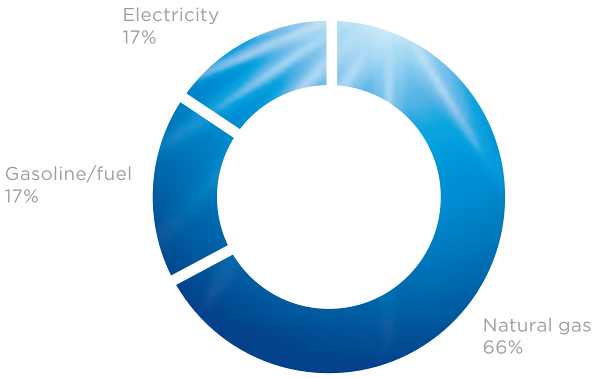
With reference to reduction targets for acoustic emissions, Italgas has continued the activities under the gas reduction systems insulation plan with particularly high noise emission values. Further action aimed at saving energy resources have been implemented, such as the construction of smaller photovoltaic plants for the local production of electricity, the use of local led lighting or recovery through turbo-expanders, the energy resulting from the gas pressure reduction process for the distribution in the local area.

The following is the main environmental impact data:

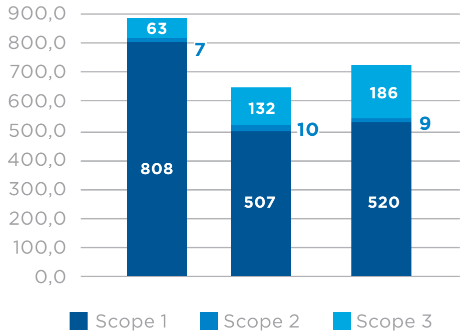
Energy consumption (TJ)



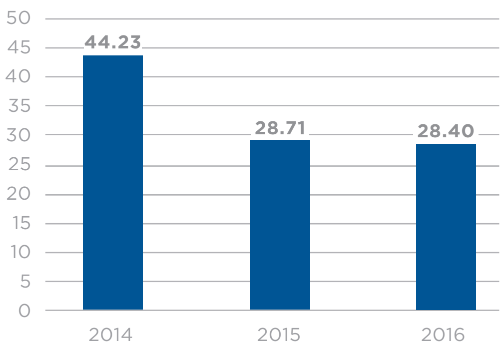
Consumption by source 2016 (energy mix)



CO_2 Emissions eq. (Kt)



Natural gas emissions (10^6 m^3)



Scope 1 - direct GHG emissions from sources owned and controllo by the organisation and for the supply of transport vehicles.
Scope 2 - indirect emissions from the use of energy sources outside of the corporale scope and not directly controllo (e.g. purchased electricity, steam, etc.).

Scope 3 - other indirect GHG emission, such as, for example, those related to staff journeys, the transport of products, materials, people, aste, external activies, etc.

Technological innovation and research

The innovation and technological development activities carried out by Italgas aim to improve the quality and safety standards of the service, to reduce the environmental impact of distribution and to increase overall efficiency of the distribution system.

The main projects launched by Italgas in 2016 have allowed:

- the development of innovative ideas within the company to strengthen its competitive position;
- the application of IT services and infrastructure for the community;
- the continuous improvement of the mobile service and optimal management of technical interventions;
- the optimisation of odourising volume, with experimental evidence relating to an innovative system for the odourising levels to vary the gas delivery conditions or the network's fluid-dynamic structure;
- the improvement of the buildings' seismic protection measures through experimentation in the field on a valve system that allows the timely interruption of the gas flow in sensitive buildings;
- the study and analysis of the methods used to estimate the natural gas emissions by the distribution networks in order to arrive at a shared European approach.

STAKEHOLDER RELATIONS

The Italgas Engagement system is present at all levels of the company.
Italgas maintains extensive relationships with investors, institutions and companies with the intention of offering a consistent service for the national and local needs and growth plans and encourage the continuous improvement of the reliability of the plant and the quality of services offered.

Internal Communications and *change management*
Communication sent to Italgas staff strives to be a "change agent" acting on values, stimulating new views, contributing to the change of the corporate culture and inspiring new behaviours.
The Group's intranet portal was immediately created and updated, right away becoming the preferred channel to disperse a new means of communicating: the home page has become the space where there is an alternation between news "in the foreground", "highlighted" topics, the launch of corporate initiatives and pop-ups; innovations were introduced on the portal such as the gallery with videos and photos, as a tool to share, with the directness of pictures, experiences and company events.
Italgas has also decided to support the innovations in its organisation, systems and procedures with an articulated and consistent staff Training and Change Management Plan.
The plan was initiated with the *workshop* called "Leaders of Our Future", which involved all managers.

Industrial relations
Italgas guarantees all workers the right to freely express their opinions, to join associations and engage in union activities. At the end of 2016, 57% of employees joined a trade union.

Union activities can be held in appropriate meeting places, and employees are given special time off in accordance with the provisions of the legislation in force and the applicable sector trade union agreement.
In 2016, the relationship between Italgas and the trade unions was characterised by the discussion of issues pertaining to the split from the Snam Group and the subsequent listing of Italgas SpA on the Stock Exchange. The path has been paved by many meetings, necessary both to illustrate the operation and for establishing favourable conditions for the passage of personnel between the companies involved in this extraordinary operation. In total, during the year, they were 72 meetings with the trade unions (27 national and 45 local).
In 2016, there was an election for the Unitary Union Representative (RSU), confirming the importance of the position vested in this individual, identified as a partner for the second-level bargaining - as enshrined in the Protocol on Industrial Relations of 17 October 2013 and the agreement of 18 April 2016 that reformulated its composition.
The negotiating process, in line with the provisions of the aforementioned agreements, led to the Parties establishing the productivity and profitability indicators of the Participation Bonus for 2016 for all Italgas Group Companies.
Negotiations are now proceeding to renew the national labour contract applied to the Group.

Investor Relations

Italgas, since its listing on the stock market, has placed transparency in its relationships with investors and the entire financial community among its top priorities, explaining their plans and goals to shareholders and the financial market in order to allow for an evaluation of the Company's value creation levers.
Italgas is a company with a limited industrial and financial risk profile, subject to a stable and transparent regulatory system that can ensure visibility in terms of results and future cash flows.
Company priorities are the initiatives that allow shareholders and the financial community to be updated on the business plans. In the last quarter of 2016, a roadshow was conducted, reaching the major European and North America markets, aimed to illustrate the demerger from Snam and the subsequent listing of the Company for investors.
At the beginning of 2017, at the launch of the first bond issue, major promotional activity was carried out for the Bond investors and credit analysts through a dedicated roadshow in major European financial centres.
In November 2016, the Company obtained a creditworthiness rating of "Baa1" with a stable Outlook from Moody's rating agency, which thereafter became negative in December following a similar change in the Outlook for the Italian Republic, and it also obtained a creditworthiness rating of "BBB+" from the Fitch rating agency with a stable outlook; these ratings reflect the structure and the financial soundness of the Company.
The information of interest to shareholders and investors, including the quarterly/semi-annual reports, both in Italian and in English, will be available in the Investor Relations section of the corporate website www.italgas.it.

Communities and local areas

Italgas, consistent with its role as the provider of gas distribution services, with the principles of sustainable development and its growth plans, is constantly engaged in a continuous and effective dialogue with the communities in which it operates.
In relations to the European, national and local authorities, Italgas operates on the principles of sincere cooperation and transparency by providing its skills and abilities, conscious of the social utility of its role. The commitment to openness has resulted in joining Registries for formal transparency as formally instituted by the European Parliament, the Chamber of Deputies, the Ministry of Economic Development and the Region of Lombardy.
Italgas also attaches great importance to cooperation in the field associated with the other operators in the energy sector, on an equal and fair field of comparison. Finally, the construction of cooperative relationships with the associations representing consumers helps people understand and respond as best as possible to the needs and expectations of the users of its services.

Customers and the Electricity, Gas and Water Authority

Italgas pays special attention to the relationship with the sales company, constantly updating the tools and procedures that allow access to services.
The operating and commercial activities are carried out with an increasingly sophisticated computer systems that allow for a rapid flow of information in contract management. These systems are constantly updated on the basis of regulations issued by AEEGSI, which are constantly regulating the services of the Italgas Group.
Relations with the AEEGSI are of key importance for companies operating in the energy business. Since its establishment, Italgas has presented the Authority, continuously as in the past, a constructive and purposeful relationship, which translates for example into ensuring the Group's contribution to the consultation processes for preparing resolutions and illustrating specific issues in the sector and supplying the information required by the regulator.

Suppliers

Italgas adopts purchasing practices based on the principles of transparency, fairness and responsibility, respect for free competition and pursuing the achievement of economic objectives and performance also in the long run.
Italgas requires suppliers to adopt Form 231 and the principles of the Ethics Code in compliance with the law on safety at the workplace, health protection, environmental protection and respect for the international standards concerning the right to work.
Suppliers are also involved in a process of improving and optimising the procedures that regulate subcontracting, which leads to greater empowerment of the subcontractor ensuring growth of the supplier and a better quality of work carried out for the Company.
During the course of the year, various sections of the suppliers' portal - a tool intended to become a point of reference and a preferred channel of contact between suppliers and the Company - were supplemented in order to improve and optimise the day-to-day operations of everyone involved in the management of the entire supply chain.

Glossary

A glossary of financial, commercial and technical terms, as well as units of measurement, is available online at www.Italgas.it.

ALTERNATIVE PERFORMANCE INDICATORS

Net working capital
Represents the capital that is invested in short-term assets and is an indicator of a company's short-term financial position. This is defined as the sum of the values relating to trade Receivables and Payables, Inventories, Receivables and Payables, Provisions for risks and expenses, Deferred tax liabilities and Other assets and liabilities.

Fixed capital
Fixed capitals defined as the sum of the values relating to items of property, plant and equipment, intangible assets, equity investments and payables net of investment.

Net invested capital
Net investments of an operating nature, represented by the sum of the values related to Non-current assets, Net working capital, Funds for employee benefits and Assets held for sale and the directly associated liabilities.

Cash flow
Net cash flow from operating activities (cash flow) is represented by the cash generated by a company over a certain period of time. Specifically, the difference between current inflows (mainly cash revenue) and current cash outflows (costs in the period that generated cash outflows).

Controllable fixed costs
Fixed operating costs of regulated activities, represented by the sum of "Total recurring personnel expense" and "Recurring external operating costs".

EBIT (Operating profit)
Result of the operating performance, calculated as the sum of the values related to Net income, Income taxes, and Net finance costs excluding Net income from financial investments.

Adjusted EBIT (adjusted operating profit)
EBIT that components of the total income classified as special item will be subtracted from (as defined in the chapter "Comment on the economic and financial results" of this report).

EBITDA (Gross operating profit)
EBITDA, calculated as the sum of values relating to the Operating profit and Depreciation and amortisation.

Free cash flow

The free cash flow represents the free cash flow of the company and is the difference between the cash flow from operating activities and the cash flow for investments in fixed assets.

Net financial debt

Indicator of capacity to cope with financial obligations, determined as the sum of the values relating to Short and long-term loans, net of Cash and cash equivalents.

R.O.E. (Return on equity)

Relationship between net income and shareholders' equity at the end of the period, able to express the profitability of equity.

R.O.I. (Return on investment)

Ratio between operating income and net invested capital at the end of the period, net of investments, able to express operating profitability, expressing the enterprise's ability to remunerate the capital invested with the result of its core business.

OTHER ECONOMIC AND FINANCIAL TERMS

Non-current assets

Asset on the balance sheet which shows long-lasting assets, net of amortisation, depreciation and impairment losses. These are divided into the following categories: "Property, plant and equipment", "Compulsory inventories", "Intangible assets", "Equity investments", "Financial assets" and "Other non-current assets".

Covenant

A covenant is a commitment contained within a loan contract under which certain activities may or may not be performed by the borrower. Specifically, a covenant is defined as "financial" when it imposes a limit on the possibility of acquiring additional debt; while, in the "economic" covenant, the clauses are aimed, inter alia, at limiting the use of leverage by the company, requiring the maintenance of a certain debt to budget cap ratio.
These commitments are imposed by lenders to prevent the borrower's financial conditions from deteriorating and, where it does, to require early loan repayment.

Credit rating

Represents the opinion of the rating Agency with respect to a debtor's general credit or the debtor's creditworthiness with specific reference to a particular debt instrument or another form of financial obligation, based on the relevant risk factors; the classification of various risk levels is made using letters of the alphabet and with essentially the same procedures by the various agencies.

Dividend payout

Ratio between the dividend and net profit for the period, and equal to the percentage of profits paid out to shareholders in the form of dividends.

Outlook
The outlook indicates the future rating prospects and a view over a long period of time, usually two years. When it is "negative" it means that the rating is weak and that the rating agency detected some critical elements. If the weakness factors persist or worsen the rating may be downgraded.

Notch
Risk level assigned by the rating agency, as part of the process of assigning the credit rating, which corresponds to the default probability, i.e. of the issuer's default.

Consolidated Finance Act (TUF)
Leg. Decree No. 58 of 24 February 1998, as amended.

Comprehensive income
Includes both net income for the period and changes in equity, which are recognised in equity in accordance with international accounting standards (Other components of comprehensive income).

COMMERCIAL AND TECHNICAL TERMS

Thermal year
Time period into which the regulatory period is divided. Starting from the third regulatory period, the thermal year coincides with the calendar year.

ATEM
Minimum Geographical Areas for conducting tenders and assigning the gas distribution service calculated as 177 pursuant to the definition of Article 1 of the Ministerial Decree of 19 January 2011. The Municipalities belonging to each area are listed in the Ministerial Decree of 18 October 2011.

Energy and Environmental Services Fund - CSEA
Public economic institution that operates in the fields of electricity, gas and water. Its primary mission is the collection of certain tariff components by operators; these components are collected in dedicated management accounts and subsequently disbursed to businesses according to the rules issued by the Authority. The CSEA is supervised by the authority and the Ministry of Economy and Finance. The CSEA also, in relation to the entities administered, performs inspection activities aimed at administrative, technical, accounting and management assessments, consisting in hearing and comparing the entities involved, with recognition of locations and systems, research, testing and comparison of documents.

End user
The consumer who buys gas for their own use.

Network code
The document governing the rights and obligations of the parties involved in providing the gas distribution service.

Gas distribution concession
The deed by which a Local authority entrusts a company to the management of a service which falls within the scope of the prerogatives of this Authority, and for which said company assumes the operating risk.

Local Tender
The local tender is the only tender for the concession of the gas distribution service carried out in each of the 177 ATEM identified by Decree of the Ministry of Economic Development on 19 January 2011, pursuant to Arts. 1 and 2 of the Decree of the Ministry of Economic Development on 19 January 2011.

Gas distributed or circulated
Amount of gas redelivered to users of the distribution network at the redelivery points.

Equalisation
Difference between revenues for the period (annual TRL) and those invoiced to retail companies. The net position with the CSEA is established at the end of the thermal year and settled over the course of the year on the basis of advance payments.

Regulatory period
This is the time period (usually four years) for which criteria are defined for setting tariffs for gas distribution services. The third regulation period ended on 31 December 2013. We are currently in the fourth regulatory period, which runs from 1 January 2014 to 31 December 2019.

Redelivery point
This is the point of demarcation between the gas distribution plant and the plant owned or managed by the end user at which the distribution company redelivers gas transported for supply to the end user, and at which metering occurs.

Gas distribution service
Service of transporting natural gas through networks of local methane pipelines from one or more delivery points to redelivery points, generally at low pressure and in urban areas, for delivery to end users.

Retail Company or RelCo (Retail Company)
Company which, by way of a contract giving it access to the networks managed by a distributor, sells the gas.

Regulatory Asset Base (RAB)
The term RAB (Regulatory Asset Base) refers to the value of net invested capital for regulatory purposes, calculated on the basis of the rules defined by the Electricity, Gas and Water Authority (AEEGSI) for determining the reference tariff.

Centralised RAB
The Centralised Net Invested Capital is made up of tangible fixed assets other than those included under local tangible fixed assets and intangible fixed assets (in other words non-industrial buildings and property, other tangible fixed assets and intangible fixed assets, such as, for example, remote management and remote control systems, equipment, vehicles, IT systems, furniture and furnishings, software licenses).

Local RAB
The Local Net Invested Capital for the distribution service consists of the following types of tangible fixed assets: land on which sit industrial buildings, manufacturing buildings, major and minor plants, road and pipeline installations (connections). Local Net Invested Capital relating to the metering service is made up of the following types of tangible fixed assets: traditional metering equipment and electronic metering equipment.

Reimbursement Value
The Reimbursement Value is the amount owed to outgoing operators on the termination of the service pursuant to Article 5 of Decree of the Ministry of Economic Development No. 226 of 12 November 2011 in the absence of specific different calculation method forecasts contained in the documents of the individual concessions stipulated before 11 February 2012 (the date when Min. Decree 226/2011 came into force).

RIV or Residual Industrial Value
The residual industrial value of the part of the plant owned by the outgoing operator is equal to the cost that should be incurred for its new reconstruction, reduced by the value of the physical degradation and also including non-current assets under construction as shown in the accounting records (Article 5, paragraph 5 of Min. Decree 226/2011).

TRL (Total Revenue Limit)
Total revenue allowed for distribution companies by the regulatory body to cover costs for providing distribution and metering services.

WACC
Weighted Average Cost of Capital. Rate of return on net invested capital.

Consolidated Financial Statements

Consolidated Financial Statements

Balance sheet

(€ million)		31.12.2016	
	Notes	Total	*of which with related parties*
ASSETS			
Current assets			
Cash and cash equivalents	(7)	1	
Trade and other receivables	(8)	579	*256*
Inventories	(9)	33	
Current income tax assets	(10)	35	
Other current tax assets	(10)	3	
Other current assets	(11)	4	
		655	
Non-current assets			
Property, plant and equipment	(12)	227	
Intangible assets	(13)	4,487	
Investments valued using the equity method	(14)	176	
Other receivables	(8)		
Other non-current assets	(11)	38	
		4,928	
Non-current assets held for sale	(15)	25	
TOTAL ASSETS		5,608	
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Short-term financial liabilities	(16)	2,696	
Short-term portion of long-term financial liabilities	(16)		
Trade and other payable	(17)	443	*73*
Current income tax liabilities	(10)	1	
Other current tax liabilities	(10)	13	
Other current liabilities	(18)		
		3,153	
Non-current liabilities			
Long-term financial liabilities	(16)	923	
Provisions for risks and charges	(19)	230	
Provisions for employee benefits	(20)	121	
Deferred tax liabilities	(21)	106	
Other non-current liabilities	(18)	5	
		1,385	

Liabilities directly associated with assets held for sale	(15)	**6**
TOTAL LIABILITIES		**4,544**
SHAREHOLDERS' EQUITY	(22)	
Italgas shareholders' equity		
Share capital		**1,001**
Reserves		**134**
Profit (loss) for the period		**(72)**
Treasury shares		
Total Italgas shareholders' equity		**1,063**
Minority interests		**1**
TOTAL SHAREHOLDERS' EQUITY		**1,064**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**5,608**

INCOME STATEMENT[35]

(€ million)			Jun-Dec 2016
	Notes	Total	*of which with related parties*
REVENUE	(24)		
Core business revenue		**248**	***202***
Other revenue and income		**26**	***6***
		274	
OPERATING COSTS	(25)		
Purchases, services and other costs		**(111)**	***(15)***
Personnel cost		**(57)**	***1***
		(168)	
AMORTISATION, DEPRECIATION AND IMPAIRMENT	(26)	**(77)**	
EBIT		**29**	
FINANCIAL INCOME (EXPENSES)	(27)		
Financial expenses		**(123)**	***(121)***
Financial income			
		(123)	
INCOME (EXPENSE) ON EQUITY INVESTMENTS	(28)		
Equity method valuation effect		**3**	***3***
Other income (expense) from equity investments			
		3	
PRE-TAX PROFIT		**(91)**	
Income tax paid	(29)	**19**	
Profit (loss) for the period		**(72)**	
Applicable to:			
- Italgas		**(72)**	
- Minority interests			
Net profit per share (€ per share)			
- basic		**(0.09)**	
- diluted		**(0.09)**	

[35] The consolidated Income Statement is prepared on the basis of the figures for Italgas S.p.A. from the date of establishment (1 June 2016) and the subsidiaries from the date of acquisition of control (7 November 2016).

STATEMENT OF COMPREHENSIVE INCOME

(€ million)	Notes	Jun-Dec 2016
Net profit		**(72)**
Other components of comprehensive income		
Components that can be reclassified to the income statement:		
Components that cannot be reclassified to the income statement:		
Actuarial profit (loss) from remeasurement of defined-benefit plans for employees		**2**
Tax effect		
		2
Total other components of comprehensive income, net of tax effect		**2**
Total comprehensive income for the period	(22)	**(70)**
Applicable to:		
- Italgas		**(70)**
- Minority interests		
		(70)

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(€ million)	Equity pertaining to shareholders of the parent company									
	Share capital	Consolidation reserve	Share premium reserve	Legal reserve	Reserve for defined-benefit plans for employees net of tax effect	Other reserves	Net profit for the year	Total	Minority interests	Total shareholders' equity
Balance as at 1 June 2016 (a) (Note 22)										
Profit for 2016							(72)	(72)		(72)
Other components of comprehensive income:										
Components that can be reclassified to the income statement:										
Components that cannot be reclassified to the income statement:										
Actuarial gains on remeasurement of defined-benefit plans for employees					2					
Total comprehensive income for 2016 (b)					2		(72)	(70)		(70)
Transactions with shareholders:										
- Reclassification to legal reserve										
- Capital increase										
- Effect of the acquisition of Italgas Reti by Snam S.p.A.	1,001		620	192		(350)		1,463	1	1,464
- Change in scope of consolidation		(316)			(14)			(330)		(330)
Total transactions with shareholders (c)	1,001	(316)	620	192	(14)	(350)		1,133	1	1,134
Other changes in shareholders' equity (d)										
Balance as at 31 December 2016 (e=a+b+c+d) (Note 22)	1,001	(316)	620	192	(12)	(350)	(72)	1,063	1	1,064

CASH FLOW STATEMENT

(€ million)	Notes	Jun-Dec 2016
Profit (loss) for the period		**(72)**
Adjustments for reconciling net profit with cash flows from operating activities:		
Total amortisation and depreciation		**77**
Net impairments of tangible and intangible assets		
Equity method valuation effect	(14)	**(3)**
Net capital losses (capital gains) on asset sales, cancellations and eliminations		**1**
Interest income		
Interest expense		**123**
Income tax paid	(29)	**(19)**
Other changes		
Changes in working capital:		
- Inventories		**(8)**
- Trade receivables		**(34)**
- Trade payables		**51**
- Provisions for risks and charges		**21**
- Other assets and liabilities		**8**
Working capital cash flow		***38***
Change in provisions for employee benefits		**(4)**
Dividends collected		
Interest collected		
Interest paid		**(123)**
Income taxes paid net of reimbursed tax credits		**(63)**
Net cash flow from operating activities		**(45)**
- of which with related parties	(30)	***(110)***
Investments:		
- Property, plant and equipment	(12)	**(4)**
- Intangible assets	(13)	**(75)**
- Companies joining the scope of consolidation and business units		**(1,503)**
- Equity investments		
- Financial receivables held for operations		
- Change in payables and receivables relating to investments		**14**
Cash flow from investments		***(1,568)***

Divestments:		
- Property, plant and equipment		
- Intangible assets		
- Equity investments		
- Change in receivables relating to divestment activities		
Cash flow from divestments		
Net cash flow from investment activities		**(1,568)**
- of which with related parties	(30)	
Assumption of long-term financial debt		**927**
Repayment of long-term financial debt		**(1,442)**
Increase (decrease) in short-term financial debt		**2,128**
Financial receivables not held for operations		
Sale of treasury shares		
Dividends paid to Italgas shareholders		
Net cash flow from financing activities		**1,613**
- of which with related parties	(30)	
Changes in scope of consolidation and other changes		
Net cash flow for the period		***0***
Cash and cash equivalents at the beginning of the period	(7)	
Cash and cash equivalents at the end of the period	(7)	**1**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Company information

On 7 November 2016 the transaction of acquiring the gas distribution sector from Snam was brought to a conclusion following the transfer of the 100% stakeholding of Italgas Reti S.p.A. (previously called Italgas S.p.A.) from Snam S.p.A. to Italgas S.p.A., a company that was incorporated on 1 June 2016 and which took that name on 12 September 2016.

Specifically, the transaction as a whole, which will occur in a unitary and substantially simultaneous manner, includes:

a) the transfer in kind by Snam to Italgas of a stake equal to 8.23% of the share capital of Italgas Reti, in exchange for the allocation to Snam of 108,957,843 newly issued shares of Italgas, in order to enable it to hold, post-demerger (as per point c), a stake of 13.50% in the Beneficiary Company (0.03% deriving from the treasury shares held by Snam);
b) the sale by Snam to Italgas of 98,054,833 Italgas Reti shares, equal to 38.87% of the share capital of Italgas Reti, for a consideration of €1,503 million, following the assumption of a debt of the same amount pertaining to the Beneficiary Company (Vendor Loan); and
c) the partial and proportional Demerger of Snam, with the allocation to Italgas of an equity investment equal to the 52.90% held by the Demerged Company in Italgas Reti, and consequent allocation to Snam shareholders of the remaining 86.50% of the Beneficiary Company's share capital.

The reorganisation of the shareholding structure of Italgas Reti through the transfer and the sale, simultaneous to the demerger, is closely connected to the realisation of the actual demerger and creates a situation whereby, on the one side, Snam can own, post-demerger, an equity investment of 13.50% in the Beneficiary Company after the conclusion of the transaction (coming almost entirely from the transfer) and, on the other side, a consequent level of debt pertaining to the issuer deemed consistent and sustainable, in the judgement of the issuer, in relation to its operations, risk profile and generation of cash flows (through the sale and consequent provision of the Vendor Loan).

Business combinations involving companies that are definitively controlled by the same company or companies before and after the transaction, and where such control is not temporary, are classed as "business combinations of entities under common control". Such transactions do not fall within the scope of application of IFRS 3, and are not governed by any other IFRS. In the absence of a reference accounting standard, the selection of an accounting standard for such transactions, for which a significant influence on future cash flows cannot be established, is guided by the principle of prudence, which dictates that the principle of continuity be applied to the values of the net assets acquired. The assets are measured at the book values from the financial statements of the companies being acquired predating the transaction or, where available, at the values from the consolidated financial statements of the common ultimate parent. With regard to business transfers under common control, the transferee entity should record the business transferred at its historical book value

increasing its shareholders' equity by this amount; the transferring entity will record the investment in the transferee entity for the same amount as the increase in the shareholders' equity of the latter.
This accounting treatment is based on the Preliminary Guidelines on IFRS (OPI 1 Revised) - "Accounting treatment of business combinations of entities under common control in the separate and consolidated financial statements" issued by Assirevi in October 2016[36].

As set out in the provisions of IFRS 10 "Consolidated financial statements", the assets and liabilities of the above-mentioned gas distribution business were subject to consolidation on the same date (7/11/2016), corresponding to the acquisition of control of Italgas Reti S.p.A., Napoletanagas S.p.A. and ACAM Gas S.p.A. by Italgas S.p.A..

In this regard it should be noted that the acquisition of the natural gas distribution business took place through three simultaneous transactions (transfer, sale and demerger) involving the stake held by Snam S.p.A. in Italgas Reti S.p.A. in favour of Italgas S.p.A.. This transaction resulted in the deconsolidation by Snam of the natural gas distribution sector, and by Italgas S.p.A. of the acquisition of the stakeholding in Italgas Reti and, at a consolidated level, the net assets of the gas distribution sector. Note that the Snam main shareholder, CDP, is also, at the same time, the main shareholder of Italgas. The exposure described above reflects an approach based on the continuity of book values (with regard to Snam) because, under the scope of the wider group that Italgas is a part of, the transaction represents a "business combination under common control". The companies participating in the business combination (Snam, Italgas and Italgas Reti) have remained, as a result of the transaction, subject to control, and therefore wholly-consolidated by the same party (CDP), pursuant to IFRS 10, as represented by Snam in the information document pursuant to Article 70 and by Italgas in the information document pursuant to Article 57.

The Italgas Group, consisting of Italgas S.p.A., the consolidating company, and its subsidiaries (hereinafter referred to as "Italgas", the "Italgas Group" or the "Group"), is an integrated group at the forefront of the regulated natural gas sector and a major player in terms of its regulatory asset base (RAB[37]) in the sector.

Italgas S.p.A. is a joint-stock company incorporated under Italian law and listed on the Milan Stock Exchange, with registered offices in Milan at 11 via Carlo Bo.

[36] For further information, see the note "Business combinations".
[37] The term RAB (Regulatory Asset Base) refers to the value of net invested capital for regulatory purposes, calculated on the basis of the rules defined by the Italian Electricity, Gas and Water Authority (AEEGSI) for determining base revenues for the regulated businesses.

CDP S.p.A. exercises *de facto* control over Italgas S.p.A. pursuant to IFRS 10 "Consolidated financial statements".

As at 31 December 2016, CDP S.p.A., via CDP Reti S.p.A.[38] and CDP GAS S.r.l.[39] owns, respectively 25.08% and 0.97% of the share capital of Italgas S.p.A..

On 20 October 2016, Snam, CDP Reti and CDP Gas signed a shareholders' agreement involving all the shares that the respective parties held in Italgas as a result of the partial and proportional demerger of Snam in favour of Italgas and the simultaneous admission to listing of Italgas shares on 7 November 2016.

1) Basis of presentation

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and adopted by the European Commission according to the procedure pursuant to Article 6 of (EC) Regulation No. 1606/2002 of the European Parliament and Council of 19 July 2002 and pursuant to Article 9 of Legislative Decree 38/2005. The IFRS also include the International Accounting Standards (IAS) as well as the interpretation documents currently in force issued by the IFRS Interpretation Committee (IFRS IC), including those previously issued by the International Financial Reporting Interpretations Committee (IFRIC) and, even earlier, by the Standing Interpretations Committee (SIC). For simplicity, all of the aforementioned standards and interpretations will hereinafter be referred to as "IFRS" or "International Accounting Standards".

The consolidated financial statements are prepared in consideration of future continuing business using the historical cost method, taking into account value adjustments where appropriate, with the exception of the items which, according to IFRS, must be measured at fair value, as described in the measurement criteria.

The consolidated financial statements as at 31 December 2016, approved by the Board of Directors of Italgas S.p.A. at the meeting of 23 March 2017 were subjected to an audit by EY S.p.A., as the main auditor, is entirely responsible for the auditing of the Italgas Group consolidated financial statements.

The consolidated financial statements are presented in Euro. Given their size, amounts in the financial statements and respective notes are expressed in millions of Euro, unless otherwise specified.

[38] CDP S.p.A. holds 59.10%.

[39] Company wholly owned by CDP S.p.A. Based on the information available to the company, note that on 25 January 2017 the members of the corporate bodies of CDP and CDP Gas approved a merger by incorporation of CDP Gas into CDP. At the date of this Report this merger is not yet effective.

Accounting principles and interpretations applicable from 2016

The accounting principles and interpretations, issued by the IASB/IFRIC, endorsed by the European Commission and which came into force from 2016 are listed below.

The amendments to IAS 19 - Defined benefit plans: employee contributions were adopted through (EU) Regulation 29/2015 of the European Commission of 17 December 2014, published in the Official Journal L. 5 of 9 January 2015. The amendment was necessary to facilitate the accounting of the defined benefit plans which involve contributions from employees or third-parties in compliance with certain conditions. In this regard, in the presence of all the following conditions:

(I) formalisation of the conditions in the plan;
(II) connection of the employee to the service;
(III) lack of correlation to the number of years of service of the employee;

there is the right to account for the contribution as a direct reduction of the cost relating to the provision of the work as an alternative to recording it with the allocation of the contribution to the individual periods of the plan (actuarial calculation).

Improvements were made through (EU) homologation Regulation 28/2015 to the international accounting principles in the 2010-2012 cycle. The objective of the annual improvements is to deal with subjects relating to inconsistencies discovered in the IFRS or clarifications of a terminology nature, which are not urgent, but which have been discussed by the IASB during the project cycle begun in 2011. In some cases the amendments involve clarifications or corrections of the principles in question (IFRS 8, IAS 16, IAS 24 and IAS 38), in other cases the amendments involve changes to the provisions in force or provide further instructions with regard to their application (IFRS 2 and 3). In particular:

(i) for IFRS 2, the definition of "vesting condition" was specified and definitions were introduced of service conditions and vesting conditions; (ii) for IFRS 3, it was clarified that the obligations to pay contingent considerations, other than those defined as equity instruments, are measured at fair value through profit or loss at each reporting date; (iii) for IFRS 8 disclosure of the judgements made by management was required, describing the segments that have been aggregated and the economic indicators that have been assessed in determining the existence of the economic characteristics that are similar in the aggregated segments; (iv) for IAS 16 and IAS 38, the ways in which the gross carrying amount is calculated when revaluation takes place was highlighted; and (v) for IAS 24, the information to be provided when a third party that provides key management personnel services to the reporting entity (or the parent company) was defined.

(EU) Regulation 2015/2173 of the European Commission of 24 November 2015, published in Official Journal L. 307 of 25 November, which adopts amendments to IFRS 11 Joint Arrangements, provides guidance on the accounting of the acquisition of interests in joint operations which come under the definitions contained in IFRS 3.

(EU) Regulation 2015/2231 of the European Commission of 2 December 2015, published in Official Journal L. 317 of 3 December, which adopts the amendments to IAS 16 - Property, Plant and Equipment and to IAS 38 Intangible Assets, clarifies that an amortisation method based on revenues generated by assets (so-called revenue-based method) is not deemed appropriate because it is based exclusively on the flow of revenues by this asset and not, on the other hand, the way in which the economic benefits embodied in said asset are consumed. With reference to intangible assets, this assumption can be overtaken if: (i) the right to use the asset is related to the achievement of a predetermined revenue threshold to be produced or (ii) it can be shown that the achievement of revenue and use of the economic benefits generated by the assets are closely correlated.

(EU) Regulation 2015/2343 of the European Commission of 15 December 2015, published in Official Journal L. 330 of 16 December, adopts the annual cycle of improvements for IFRS 2012-2014. This document (i) for IFRS 5, defines the guidance if an entity reclassifies an asset from the held-for-sale category to the held-for-distribution category (or vice versa), or the classification requirements of an asset held-for-distribution, specifying that these reclassifications do not constitute a change to a (sale or disposal) plan and therefore the original classification and valuation criteria remain valid; (ii) for IFRS 7, introduces further guidance to clarify whether a servicing contract constitutes a residual involvement in an asset transferred for information purposes required in relation to the assets transferred and the information on the compensation of financial assets and liabilities under the scope of interim financial statements; (iii) for IAS 19, it provides clarification with regard to calculating the discount rate of post-employment benefits specifying that for these cases it is necessary to refer to high quality corporate bonds issued in the same currency used for the payment of the benefits; (iv) for IAS 34 - Interim financial statements, it involves the alternative inclusion of certain information required by the principle in the Interim financial statements or in another part of the documents, such as, for example, the Interim financial report, but with the warning of inserting explicit reference to this other section in the Interim financial statements (in the last case the Report should be available in the same ways to those reading the financial statements and at the same times that the Interim financial statements are available).

(EU) Regulation 2015/2406 of the European Commission of 18 December 2015, published in Official Journal L. 333 of 19 December, adopts amendments to IAS 1 - Presentation of financial statements: Information initiative. In the broadest sense of improving the disclosure of the financial statements, the amendment in question makes some changes to IAS 1 aimed at providing clarifications with regard to elements which could be perceived as impediments to the clear and intelligible preparation of the financial statements.

(EU) Regulation 2015/2441 of the European Commission of 18 December 2015, published in Official Journal L. 336 of 23 December, which adopts amendments to IAS 27 Separate financial statements "Equity method in separate financial statements", introduces the possibility, in the separate financial statements of the investor, of valuing the investments in subsidiaries, companies subject to joint control or subject to considerable influence using the shareholders' equity method. The selected accounting option must be applied for each category of equity investment. As a result said document has revised the definition of separate financial statements specifying that it means the financial statements "that are presented in addition to the consolidated financial statements or in addition to the financial statements of the investor which does not have investments in subsidiaries but does have them in associate companies or joint ventures, on account of which IAS 28 imposes the accounting of equity investments in associate companies or joint ventures using the equity method.

(EU) Regulation 2016/1703 of the European Commission of 22 September 2016, published in Official Journal L. 257 of 23 September, amends (EC) Regulation 1126/2008 which adopts certain international accounting principles in conformity with (EC) Regulation 1606/2002 of the European Parliament and Council as far as International Financial Reporting Standards (IFRS) 10 and 12 and International Accounting Principle (IAS) 28 are concerned. The main changes involved (i) IFRS 10 - Consolidated financial statements with regard to cases of exemption in the presentation of consolidated financial statements, the requirements for determining an investment entity and cases of exemption from the consolidation of equity investments held by investment entities; (iii) IFRS 12 - Disclosure of interests in other entities, with regard to the disclosure obligation on investment entities which prepare financial statements in which their subsidiaries are valued pursuant to IFRS 10; (iii) IAS 28 - Investments in associates and joint ventures, with reference to the application of the equity methods, and related exemptions.

The provisions contained in the aforementioned documents will take effect for financial years from 1 January 2016.

The above changes did not have an impact on the Group's operations, results, balance sheet and cash flow.

2) Consolidation principles

The consolidated financial statements comprise the financial statements of Italgas S.p.A. and of the companies over which the Company has the right to exercise direct or indirect control, as defined by IFRS 10 – "Consolidated Financial Statements". Specifically, control exists where the controlling entity simultaneously:

- has the power to make decisions concerning the investee entity;
- is entitled to receive a share of or is exposed to the variable profits and losses of the investee entity;
- is able to exercise power over the investee entity in such a way as to affect the amount of its economic returns.

The proof of control must be verified on an ongoing basis by the Company, with a view to identifying all the facts or circumstances that may imply a change in one or more of the elements on which the existence of control over an investee entity depends.
Consolidated companies, joint ventures, associates and other significant equity investments are indicated separately in the Appendix "Subsidiaries, associates and equity investments of Italgas S.p.A. at 31 December 2016", which is an integral part of these notes.
All financial statements of consolidated companies close at 31 December and are presented in Euro.

Companies included in the scope of consolidation

Figures relating to subsidiaries are included in the consolidated financial statements from the date on which the Company assumes direct or indirect control over them until the date on which said control ceases to exist.
The assets, liabilities, income and expenses of the consolidated companies are consolidated line-by-line in the consolidated financial statements (full consolidation); the book value of the equity investments in each of the subsidiaries is derecognised against the corresponding portion of shareholders' equity of each of the investee entities, inclusive of any adjustments to the fair value of the assets and liabilities on the date of acquisition of control.
The portions of equity and profit or loss attributable to minority interests are recorded separately in the appropriate items of shareholders' equity, the income statement and the statement of comprehensive income.
Changes in the equity investments held directly or indirectly by the Company in subsidiaries that do not result in a change in the qualification of the investment as a subsidiary are recorded as equity transactions. The book value of the shareholders' equity pertaining to shareholders of the parent company and minority interests are adjusted to reflect the change in the equity investment. The difference between the book value of minority interests and the fair value of the consideration paid or received is recorded directly under equity pertaining to shareholders of the parent company.
Otherwise, the selling of interests entailing loss of control requires the posting to the income statement of: (i) any capital gains or losses calculated as the difference between the consideration received and the corresponding portion of consolidated shareholders' equity transferred; (ii) the effect of the revaluation of any residual equity investment maintained, to align it with the relative fair value; and (iii) any amounts posted to other components of comprehensive income relating to the former subsidiary which will be reversed to the income statement. The fair value of any equity investment maintained at the date of loss of control represents the new book value of the equity investment, and therefore the reference value for the successive valuation of the equity investment according to the applicable valuation criteria.

Equity investments in associates and joint ventures

An associate is an investee company in relation to which the investor holds significant influence or the power to participate in determining financial and operating policies, but does not have control or joint control[40]. It is assumed that the investor has significant influence (unless there is proof to the contrary) if it holds, directly or indirectly through subsidiaries, at least 20% of the exercisable voting rights.
A joint venture is a joint arrangement in which the parties that hold joint control have rights to the net assets subject to the arrangement and, therefore, have an interest in the jointly controlled corporate vehicle.
Equity investments in associates and joint ventures are measured using the equity method, as described under "Equity-accounted investments".

Business combinations

Business combinations are recorded using the acquisition method in accordance with IFRS 3 - "Business Combinations". Based on this standard, the consideration transferred in a business combination is determined at the date on which control is assumed, and equals the fair value of the assets transferred, the liabilities incurred or assumed, and any equity instruments issued by the acquirer. Costs directly attributable to the transaction are posted to the income statement when they are incurred.
The shareholders' equity of these investee companies is determined by attributing to each asset and liability its fair value at the date of acquisition of control. If positive, any difference from the acquisition or transfer cost is posted to the asset item "Goodwill"; if negative, it is posted to the income statement.
Where total control is not acquired, the share of equity attributable to minority interests is determined based on the share of the current values attributed to assets and liabilities at the date of acquisition of control, net of any goodwill (the "partial goodwill method"). Alternatively, the full amount of the goodwill generated by the acquisition is recognised, therefore also taking into account the portion attributable to minority interests (the "full goodwill method"). In this case, minority interests are expressed at their total fair value, including the attributable share of goodwill. The choice of how to determine goodwill (partial goodwill method or full goodwill method) is made based on each individual business combination transaction.
If control is assumed in successive stages, the acquisition cost is determined by adding together the fair value of the equity investment previously held in the acquired company and the amount paid for the remaining portion. The difference between the fair value of the previously held equity investment (redetermined at the time of acquisition of control) and the relative book value is posted to the income statement. Upon acquisition of control, any components previously recorded under other components of comprehensive income are posted to the income statement or to another item of shareholders' equity, if no provisions are made for reversal to the income statement.
When the values of the assets and liabilities of the acquired entity are determined provisionally in the financial year in which the business combination is concluded, the

[40] Joint control is the contractual sharing of control pursuant to an agreement, which exists only where the unanimous consent of all the parties that share power is required for decisions relating to significant activities.

figures recorded are adjusted, with retroactive effect, no later than 12 months after the acquisition date, to take into account new information about facts and circumstances in existence at the acquisition date.

Business combinations involving entities under joint control

Business combinations involving companies that are definitively controlled by the same company or companies before and after the transaction, and where such control is not temporary, are classed as "business combinations of entities under common control". Such transactions do not fall within the scope of application of IFRS 3, and are not governed by any other IFRS. In the absence of a reference accounting standard, the selection of an accounting standard for such transactions, for which a significant influence on future cash flows cannot be established, is guided by the principle of prudence, which dictates that the principle of continuity be applied to the values of the net assets acquired. The assets are measured at the book values from the financial statements of the companies being acquired predating the transaction or, where available, at the values from the consolidated financial statements of the common ultimate parent. With regard to business transfers under common control, the transferee entity should record the business transferred at its historical book value increasing its shareholders' equity by this amount; the transferring entity will record the investment in the transferee entity for the same amount as the increase in the shareholders' equity of the latter.
This accounting treatment is based on the Preliminary Guidelines on IFRS (OPI 1 Revised) - "Accounting treatment of business combinations of entities under common control in the separate and consolidated financial statements" issued by Assirevi in October 2016.

Intragroup transactions that are eliminated in the consolidation process

Unrealised gains from transactions between consolidated companies are derecognised, as are receivables, payables, income, expenses, guarantees, commitments and risks between consolidated companies. The portion pertaining to the Group of unrealised gains with companies valued using the equity method is derecognised. In both cases, intragroup losses are not derecognised because they effectively represent impairment of the asset transferred.

3) Measurement criteria

The most significant measurement criteria adopted when preparing the consolidated financial statements are described below.

Property, plant and equipmenti

Property, plant and equipment is recognised at cost and recorded at the purchase, transfer or production cost, including directly allocable ancillary costs needed to make the assets available for use. When a significant period of time is needed to make the asset ready for use, the purchase, transfer or production cost includes the financial expense which theoretically would have been saved during the period needed to make the asset ready for use if the investment had not been made.
Property, plant and equipment may not be revalued, even through the application of specific laws.
The costs of incremental improvements, upgrades and transformations to/value of property, plant and equipment are posted to assets when it is likely that they will increase the future economic benefits expected. The costs of replacing identifiable components of complex assets are allocated to balance sheet assets and depreciated over their useful life. The remaining book value of the component being replaced is allocated to the income statement. Ordinary maintenance and repair expenses are posted to the income statement in the period when they are incurred.

Depreciation of property, plant and equipment

Starting when the asset is available and ready for use, property, plant and equipment is systematically depreciated on a straight-line basis over its useful life, defined as the period of time in which it is expected that the company may use the asset.
The amount to be depreciated is the book value, reduced by the projected net realisable value at the end of the asset's useful life, if this is significant and can be reasonably determined.
The table below shows the annual depreciation rates used for the year in question, broken down into homogeneous categories, together with the relevant period of application:

	Annual depreciation rate (%)
Land and buildings	
- Industrial buildings	2%
- Civil buildings	3%
Plant and equipment	
- Other plant and equipment	4%
Industrial and commercial equipment	
- Office furniture and machinery	12% - 33.3%
- Transportation vehicles	20% - 25%

When an item recorded under property, plant and equipment consists of several significant components with different useful lives, a component approach is adopted, whereby each individual component depreciates separately.
Land is not depreciated, even if purchased in conjunction with a building; neither is property, plant and equipment held for sale (see the "Non-current assets held for sale and discontinued operations" section).
Depreciation rates are reviewed each year and are altered if the current estimated useful life of an asset differs from the previous estimate. Any changes to the depreciation plan arising from revision of the useful life of an asset, its residual value or ways of obtaining economic benefit from it are recognised prospectively.
Freely transferable assets are depreciated during the period of the concession or of the useful life of the asset, if lower.

Assets under finance leases

Assets under finance leases, or under agreements which may not take the specific form of a finance lease, but call for the essential transfer of the benefits and risks of ownership, are recorded at the lower of fair value less fees payable by the lessee and the present value of minimum lease payments, including any sum payable to exercise a call option, under property, plant and equipment as a contra-entry to the financial debt to the lessor. The assets are depreciated using the criteria and rates adopted for owned property, plant and equipment. When there is no reasonable certainty that the right of redemption can be exercised, depreciation takes place during the shorter of the term of the lease and the useful life of the asset.
Leases under which the lessee maintains nearly all of the risks and benefits associated with ownership of the assets are classified as operating leases. In this case, the lessee incurs only costs for the period in the amount of the lease expenses set out in the contract, and does not record fixed assets.

Intangible assets

Intangible assets are those assets without identifiable physical form which are controlled by the company and capable of producing future economic benefits, as well as goodwill, when purchased for consideration. The ability to identify these assets rests in the ability to distinguish intangible assets purchased from goodwill. Normally this requirement is satisfied when: (i) the intangible assets are related to a legal or contractual right, or (ii) the asset is separable, i.e. it can be sold, transferred, leased or exchanged independently, or as an integral part of other assets. The company's control consists of the power to utilise future economic benefits deriving from the asset and the ability to limit access to it by others. Intangible assets are recorded at cost, which is determined using the criteria indicated for property, plant and equipment. They may not be revalued, even through the application of specific laws.
Technical development costs are allocated to the balance sheet assets when: (i) the cost attributable to the intangible asset can be reliably determined; (ii) there is the intent, availability of financial resources and technical capability to make the asset available for use or sale; and (iii) it can be shown that the asset is capable of producing future economic benefits.

Alternatively, costs for the acquisition of new knowledge or discoveries, investigations into products or alternative processes, new techniques or models, or the design and construction of prototypes, or incurred for other scientific research or technological developments, which do not meet the conditions for disclosure under balance sheet assets are considered current costs and charged to the income statement for the period in which they are incurred.
Intangible fixed assets are eliminated at the time they are decommissioned, or when no future economic benefit is expected from their use; the related profit or loss is posted in the income statement.

Service concession agreements

Intangible assets include service concession agreements between the public and private sectors for the development, financing, management and maintenance of infrastructures under concession in which: (i) the grantor controls or regulates the services provided by the operator through the infrastructure and the related price to be applied; and (ii) the grantor controls any significant remaining interest in the infrastructure at the end of the concession by owning or holding benefits, or in some other way. The provisions relating to the service concession agreements are applicable for Italgas in its role as a public service natural gas distributor, i.e. applicable to the agreements under which the operator is committed to providing the public natural gas distribution service at the tariff established by the AEEGSI, holding the right to use the infrastructure, which is controlled by the grantor, for the purposes of providing the public service.

Amortisation of intangible assets

Intangible assets with a finite useful life are amortised systematically over their useful life, which is understood to be the period of time in which it is expected that the company may use the asset.
The amount to be depreciated is the book value, reduced by the projected net realisable value at the end of the asset's useful life, if this is significant and can be reasonably determined.

The table below shows the annual depreciation rates used for the year in question, broken down into homogeneous categories, together with the relevant period of application:

	Annual depreciation rate (%)
Patent rights and intellectual property rights	20% - 33.3%
Concession expenses	Depending on the duration of the agreement
Land and buildings (concession agreements)	
- Industrial buildings	2.5% - 5%
- Light constructions	9% - 10%
Plant and equipment (concession agreements)	
- Gas distribution network	2% - 5%
- Principal and secondary facilities	5% - 6%
- Gas derivation plants	2.5% - 5.4%
Industrial and commercial equipment (concession agreements)	
-Metering and control equipment	6.7% - 20%

Goodwill and other intangible assets with an indefinite useful life are not subject to amortisation.

Grants

Capital grants given by public authorities are recognised when there is reasonable certainty that the conditions imposed by the granting government agencies for their allocation will be met, and they are recognised as a reduction to the purchase, transfer or production cost of their related assets. Similarly, capital grants received from private entities are recognised in accordance with the same regulatory provisions.
Operating grants are recognised in the income statement on an accruals basis, consistent with the relative costs incurred.

Impairment of non-financial fixed assets

Impairment of property, plant and equipment and intangible assets with a finite useful life

When events occur leading to the assumption of impairment of property, plant and equipment or intangible assets with a finite useful life, their recoverability is tested by comparing the book value with the related recoverable value, which is the fair value adjusted for disposal costs (see "Measurement at fair value") or the value in use, whichever is greater.
Value in use is determined by discounting projected cash flows resulting from the use of the asset and, if they are significant and can be reasonably determined, from its sale at the end of its useful life, net of any disposal costs. Cash flows are determined based on reasonable, documentable assumptions representing the best estimate of future economic conditions which will occur during the remaining useful life of the asset, with a greater emphasis on outside information. Discounting is done at a rate reflecting current market conditions for the time value of money and

specific risks of the asset not reflected in the estimated cash flows. The valuation is done for individual assets or for the smallest identifiable group of assets which, through ongoing use, generates incoming cash flow that is largely independent of those of other assets or groups of assets ("cash-generating units" or CGUs).
The value of property, plant and equipment classed under regulated assets is determined by taking into consideration: (i) the amount quantified by the Authority based on the rules used to define the tariffs for provision of the services for which they are intended; and (ii) any value that the group expects to recover from their sale or at the end of the concession governing the service for which they are intended. As with the quantification of tariffs, the quantification of the recoverable value of property, plant and equipment classed under regulated assets is done on the basis of the regulatory provisions in force.
If the reasons for impairment losses no longer apply, the assets are revalued and the adjustment is posted to the income statement as a revaluation (recovery of value). The recovery of value is applied to the lower of the recoverable value and the book value before any impairment losses previously carried out, less any depreciation that would have been recorded if an impairment loss had not been recorded for the asset.

Impairment of goodwill, intangible assets with an indefinite useful life and intangible assets not yet available for use
The recoverability of the book value of goodwill, intangible assets with an indefinite useful life and intangible assets not yet available for use is tested at least annually, and in any case when events occur leading to an assumption of impairment. Goodwill is tested at the level of the smallest aggregate, on the basis of which the Company's management directly or indirectly assesses the return on investment, including goodwill. When the book value of the CGU, including the goodwill attributed to it, exceeds the recoverable value, the difference is subject to impairment, which is attributed by priority to the goodwill up to its amount; any surplus in the impairment with respect to the goodwill is attributed pro rata to the book value of the assets which constitute the CGU. Goodwill impairment losses cannot be reversed.

Investments valued using the equity method

Equity investments in joint ventures and associates are valued using the equity method. In applying the equity method, investments are initially recognised at cost and subsequently adjusted to take into account: (i) the participant's share of the results of operations of the investee after the date of acquisition, and (ii) the share of the other components of comprehensive income of the investee. Dividends paid out by the investee are recognised net of the book value of the equity investment. For the purposes of applying the equity method, the adjustments provided for the consolidation process are taken into account (see also the "Consolidation principles" section).
In the case of assumption of an association (joint control) in successive phases, the cost of the equity investment is measured as the sum of the fair value of the interests previously held and the fair value of the consideration transferred on the date on which the investment is classed as associated (or under joint control). The effect of revaluing the book value of the investments previously held at assumption of association is

posted to the income statement, including any components recognised under other components of comprehensive income. When the transferral of equity investments entails loss of joint control or significant influence over the investee company, the following are recognised in the income statement: (i) any capital gains or losses calculated as the difference between the consideration received and the corresponding portion of the booked amount transferred; (ii) the effect of the revaluation of any residual equity investment maintained, to align it with the relative fair value; and (iii) any amounts posted to other components of comprehensive income relating to the investee company that will be taken to the income statement. The value of any equity investment maintained, aligned with the relative fair value at the date of loss of joint control or significant influence, represents the new book value, and therefore the reference value for the successive valuation according to the applicable valuation criteria.
If there is objective evidence of impairment, the recoverability of the amount recognised is tested by comparing the book value with the related recoverable value determined using the criteria indicated in the section "Impairment of non-financial fixed assets".
When the reasons for the impairment losses entered no longer apply, equity investments are revalued up to the amount of the impairment losses entered with the effect posted to the income statement under "Income (expense) from equity investments".
The parent company's share of any losses of the investee company, greater than the investment's book value, is recognised in a special provision to the extent that the parent company is committed to fulfilling its legal or implied obligations to the subsidiary/associate, or, in any event, to covering its losses.

Inventories

Inventories, including compulsory inventories, are recorded at the lower of purchase or production cost and net realisation value, which is the amount that the company expects to receive from their sale in the normal course of business.
The cost of natural gas inventories is determined using the weighted average cost method.

Financial instruments

The financial instruments held by Italgas are included in the following balance sheet items:

Cash and cash equivalents

Cash and cash equivalents include cash amounts, on demand deposits, and other short-term financial investments with a term of less than three months, which are readily convertible into cash and for which the risk of a change in value is negligible. They are recorded at their nominal value, which corresponds to the fair value.

Trade and other receivables and other assets

Trade and other receivables and other assets are valued when the comprehensive fair value of the costs of the transaction (e.g. commission, consultancy fees, etc.) are first recognised. The initial book value is then adjusted to account for repayments of principal, any impairment losses and the amortisation of the difference between the repayment amount and the initial book value.

Amortisation is carried out using the effective internal interest rate, which represents the rate that would make the present value of projected cash flows and the initial book value equal at the time of the initial recording (the amortised cost method).

Where there is actual evidence of impairment, the impairment loss is calculated by comparing the book value with the current value of anticipated cash flows discounted at the effective interest rate defined at the time of the initial recognition, or at the time of its updating to reflect the contractually defined repricing. There is objective evidence of impairment when, among other things, there are significant breaches of contract, major financial difficulties or the risk of the counterparty's insolvency.

Receivables are shown net of provisions for impairment losses; this provision, which is previously created, may be used if there is an assessed reduction in the asset's value or due to a surplus. If the reasons for a previous write-down cease to be valid, the value of the asset is restored up to the value of applying the amortised cost if the write-down had not been made.

The economic effects of measuring at amortised cost are recorded in the "Financial income (expense)" item.

Financial assets that are disposed of are derecognised in the balance sheet when the contractual rights connected to obtaining the cash flows associated with the financial instrument are realised, expire or are transferred to third parties.

Financial liabilities

Financial liabilities, including financial debt, trade payables, other payables and other liabilities, are initially recorded at fair value less any transaction-related costs; they are subsequently recognised at amortised cost using the effective interest rate for discounting, as demonstrated in "Trade and other receivables and other assets" above.

Financial liabilities are derecognised upon extinguishment or upon fulfilment, cancellation or maturity of the contractual obligation.

Non-current assets held for sale and discontinued operations

Non-current assets and current and non-current assets of disposal groups are classified as held for sale if the relative book value will be recovered mainly by their sale rather than through their continued use. This condition is regarded as fulfilled when the sale is highly probable and the asset or discontinued operations are available for immediate sale in their current condition.

Non-current assets held for sale, current and non-current assets related to disposal groups and directly related liabilities are recognised in the balance sheet separately from the Company's other assets and liabilities.

Non-current assets held for sale and non-current assets in disposal groups are not amortised or depreciated, and are measured at the lower between the book value and the related fair value, less any sales costs.

The fair value is the amount that may be received for the sale of an asset or that may be paid for the transfer of a liability in a regular transaction between market operators as at the valuation date (i.e. exit price).
The fair value of an asset or liability is determined by adopting the valuations that market operators would use to determine the price of the asset or liability. A fair value measurement also assumes that the asset or liability would be traded on the main market or, failing that, on the most advantageous market to which the Company has access.
The fair value of a non-financial asset is determined by considering the capacity of market operators to generate economic benefits by putting the asset to its maximum and best use or by selling it to another market participant capable of using it in such a way as to maximise its value. The maximum and best use of an asset is determined from the perspective of market operators, also hypothesising that the company intends to put it to a different use; the current use by the company of a non-financial asset is assumed to be the maximum and best use of this asset, unless the market or other factors suggest that a different use by market operators would maximise its value.
The fair-value measurement of a financial or non-financial liability, or of an equity instrument, takes into account the quoted price for the transfer of an identical or similar liability or equity instrument; if this quoted price is not available, the valuation of a corresponding asset held by a market operator as at the valuation date is taken into account. The determination of the fair value of a liability takes into account the risk that the company may not be able to honour its obligations ("Debit Valuation Adjustment" (DVA)).
When determining fair value, a hierarchy is set out consisting of criteria based on the origin, type and quality of the information used in the calculation. This classification aims to establish a hierarchy in terms of the reliability of the fair value, giving precedence to the use of parameters that can be observed on the market and that reflect the assumptions that market participants would use when valuing the asset/liability. The fair value hierarchy includes the following levels:

- level 1: inputs represented by (unmodified) quoted prices on active markets for assets or liabilities identical to those that can be accessed as at the valuation date;
- level 2: inputs, other than the quoted prices included in Level 1, that can be directly or indirectly observed for the assets or liabilities to be valued;
- level 3: inputs that cannot be observed for the asset or liability.

In the absence of available market quotations, the fair value is determined by using valuation techniques suitable for each individual case that maximise the use of significant observable inputs, whilst minimising the use of non-observable inputs.

The classification as "held for sale" of equity investments valued using the equity method implies suspended application of this measurement criterion. Therefore, in this case, the book value is equal to the value resulting from the application of the equity method at the date of reclassification.

Any negative difference between the book value and the fair value less selling costs is posted to the income statement as an impairment loss; any subsequent recoveries in value are recognised up to the amount of the previously recognised impairment losses, including those recognised prior to the asset being classified as held for sale.

Non-current assets and current and non-current assets (and any related liabilities) of disposal groups, classified as held for sale, constitute discontinued operations if, alternatively: (i) they represent a significant independent business unit or a significant geographical area of business; (ii) they are part of a programme to dispose of a significant independent business unit or a significant geographical area of business; or (iii) they pertain to a subsidiary acquired exclusively for the purpose of resale. The results of discontinued operations, as well as any capital gains/losses realised on the disposal, are disclosed separately in the income statement as a separate item, net of related tax effects, including for the periods under comparison.
In the case of a programme for the sale of a subsidiary that results in loss of control, all assets and liabilities of that subsidiary are classified as held for sale, regardless of whether an investment is maintained following the sale.

Provisions for risks and charges

Provisions for risks and charges concern costs and charges of a certain nature which are certain or likely to be incurred, but for which the amount or date of occurrence cannot be determined at the end of the year.
Provisions are recognised when: (i) the existence of a current legal or implied obligation arising from a past event is probable; (ii) it is probable that the fulfilment of the obligation will involve a cost; and (iii) the amount of the obligation can be reliably determined.
Provisions are recorded at a value representing the best estimate of the amount that the company would reasonably pay to fulfil the obligation or to transfer it to third parties at the end of the reporting period. Provisions related to contracts with valuable consideration are recorded at the lower of the cost necessary to fulfil the obligation, less the expected economic benefits deriving from the contract, and the cost to terminate the contract.
When the financial impact of time is significant, and the payment dates of the obligations can be reliably estimated, the provision is calculated by discounting the anticipated cash flows in consideration of the risks associated with the obligation at the Company's average debt rate; the increase in the provision due to the passing of time is posted to the income statement under "Financial income (expense)".
When the liability is related to items of property, plant and equipment (e.g. site dismantlement and restoration), the provision is recognised as a counter-entry to the related asset, and posting to the income statement is accomplished through amortisation. The costs that the Company expects to incur to initiate restructuring programmes are recorded in the period in which the programme is formally defined, and the parties concerned have a valid expectation that the restructuring will take place.
Provisions are periodically updated to reflect changes in cost estimates, selling periods and the discount rate; revisions in provision estimates are allocated to the same item of the income statement where the provision was previously reported or, when the liability is related to property, plant and equipment (e.g. site dismantling and restoration), as a contra-entry to the related asset, up to the book value; any surplus is posted to the income statement.

The notes to the financial statements describe contingent liabilities represented by: (i) possible (but not probable) obligations resulting from past events, the existence of which will be confirmed only if one or more future uncertain events occur which are partially or fully outside the Company's control; and (ii) current obligations resulting from past events, the amount of which cannot be reliably estimated, or the fulfilment of which is not likely to involve costs.

Provisions for employee benefits

Post-employment benefits

Post-employment benefits are defined according to programmes, including non-formalised programmes, which, depending on their characteristics, are classed as "defined-benefit" or "defined-contribution" plans.

- **Defined-benefit plans**
  The liability associated with defined-benefit plans is determined by estimating the present value of the future benefits accrued by the employees during the current year and in previous years, and by calculating the fair value of any assets servicing the plan. The present value of the obligations is determined based on actuarial assumptions and is recognised on an accruals basis consistent with the employment period necessary to obtain the benefits.
  Actuarial gains and losses relating to defined-benefit plans arising from changes in actuarial assumptions or experience adjustments are recognised in other comprehensive income in the period in which they occur, and are not subsequently recognised in the income statement. When a plan is changed, reduced or extinguished, the relative effects are recognised in the income statement.
  Net financial expense represents the change that the net liability undergoes during the year due to the passing of time. Net interest is determined by applying the discount rate to the liabilities, net of any assets servicing the plan. The net financial expense of defined-benefit plans is recognised in "Financial Income (Expense").

- **Defined-contribution plans**
  In defined-contribution plans, the Company's obligation is calculated, limited to the payment of state contributions or to equity or a legally separate entity (fund), based on contributions due.
  The costs associated with defined-benefit contributions are recognised in the income statement as and when they are incurred.

Other long-term plans

Obligations relating to other long-term benefits are calculated using actuarial assumptions; the effects arising from the amendments to the actuarial assumptions or the characteristics of the benefits are recognised entirely in the income statement.

Distribution of dividends

The distribution of dividends to the Company's Shareholders entails the recording of a payable in the financial statements for the period in which distribution was approved by the Company's Shareholders or, in the case of interim dividends, by the Board of Directors.

Revenue

Revenue from sales and the provision of services is recognised upon the effective transfer of the risks and benefits typically relating to ownership or on the fulfilment of the service when it is likely that the financial benefits deriving from the transaction will be realised by the vendor or the provider of the service.
Revenue is recognised at the fair value of the payment received or to be received.
As regards the activities carried out by the Italgas Group, revenue is recognised when the service is provided. The largest share of core revenue relates to regulated revenue, which is governed by the regulatory framework established by the AEEGSI. Therefore, the economic terms and conditions of services provided are defined in accordance with regulations rather than negotiations. With regard to the natural gas distribution segment, the difference between the revenue recognised by the regulator (so-called revenue cap) and the effectively accrued revenue is recognised in the balance sheet item "Trade and other receivables", if positive, and in the item "Trade and other payables", if negative, inasmuch as it will be subject to cash settlement with the Energy and Environmental Services Fund (CSEA)[41].
Allocations of revenue relating to services partially rendered are recognised by the fee accrued, as long as it is possible to reliably determine the stage of completion and there are no significant uncertainties over the amount and the existence of the revenue and the relative costs; otherwise they are recognised within the limits of the actual recoverable costs.
Items of property, plant and equipment not used in concession services, transferred from customers (or realised with the cash transferred from customers) and depending on their connection to a network for the provision of supply, are recognised at fair value as a contra-entry to revenue in the income statement. When the agreement stipulates the provision of multiple services (e.g. connection and supply of goods), the service for which the asset was transferred from the customer is checked and, accordingly, the disclosure of the revenue is recognised on connection or for the shorter of the term of the supply and the useful life of the asset.
Revenue is recorded net of returns, discounts, allowances and bonuses, as well as directly related taxes.

[41] Law No. 208 of 28 December 2015 (2016 Stability Law) makes provision, in Article 1, paragraph 670, for the transformation of the Electricity Equalisation Fund (CCSE) into a state-controlled company called the Energy and Environmental Services Fund (CSEA) as of 1 January 2016. The transformation of the CCSE into a state-controlled company and the change of name does not in any way, either cause discontinuity in the functional relations of the CSEA (formerly the CCSE) with regulated parties or with suppliers.

Revenue is reported net of items involving tariff components, in addition to the tariff, applied to cover gas system expenses of a general nature. Amounts received from Italgas are paid in full to the Energy and Environmental Services Fund. Gross and net presentation of revenue is described in more detail in the Notes to the consolidated financial statements (see “Revenue” note).
Since they do not represent sales transactions, exchanges between goods or services of a similar nature and value are not recognised in revenue and costs.

Dividends received

Dividends are recognised at the date of the resolution passed by the Shareholders' Meeting, unless it is not reasonably certain that the shares will be sold before the ex-dividend date.

Costs

Costs are recognised in the period when they relate to goods and services sold or consumed during the same period or when it is not possible to identify their future use. Fees relating to operating leases are charged to the income statement for the duration of the contract.
Costs sustained for share capital increases are recorded as a reduction of shareholders' equity, net of taxes.

Income taxes

Current income taxes are calculated by estimating the taxable income. Receivables and payables for current income taxes are recognised based on the amount which is expected to be paid/ recovered to/ from the tax authorities under the prevailing tax regulations and rates or those essentially approved at the reporting date.
Regarding corporation tax (IRES), Italgas has exercised the option to join the national tax consolidation scheme, to which all the consolidated companies have officially signed up. The projected payable is recognised under “Current income tax liabilities”.

The regulations governing Italgas Group companies' participation in the national tax consolidation scheme stipulates that:

- subsidiaries with positive taxable income pay the amount due to Italgas. The taxable income of the subsidiary, used to determine the tax, is adjusted to account for the recovery of negative components that would have been non-deductible without the consolidation scheme (e.g. interest expense), the so-called ACE (help for economic growth) effect and any negative taxable income relating to the subsidiary's equity investments in consolidated companies;
- subsidiaries with negative taxable income, if and insofar as they have prospective profitability which, without the national tax consolidation scheme, would have enabled them to recognise deferred tax assets related to the negative taxable income on the separate financial statements, receive from their shareholders – in the event that these are companies with a positive taxable income or a negative taxable income with prospective profitability – or from Italgas in other cases, compensation amounting to the lower of the tax saving realised by the Group and the aforementioned deferred tax assets.

Regional production tax (IRAP) is recognised under the item "Current income tax liabilities"/"Current income tax assets".

Deferred and prepaid income taxes are calculated on the timing differences between the values of the assets and liabilities entered in the balance sheet and the corresponding values recognised for tax purposes, based on the prevailing tax regulations and rates or those essentially approved for future years. Prepaid tax assets are recognised when their recovery is considered probable; specifically, the recoverability of prepaid tax assets is considered probable when taxable income is expected to be available in the period in which the temporary difference is cancelled, allowing the activation of the tax deduction. Similarly, unused tax receivables and prepaid taxes on tax losses are recognised up to the limit of recoverability.

Prepaid tax assets and deferred tax liabilities are classified under non-current assets and liabilities and are offset at individual company level if they refer to taxes which can be offset. The balance of the offsetting, if it results in an asset, is recognised under the item "Prepaid tax assets"; if it results in a liability, it is recognised under the item "Deferred tax liabilities". When the results of transactions are recognised directly in equity, prepaid and deferred current taxes are also posted to equity.

Income tax assets with elements of uncertainty are recognised when they are regarded as likely to be obtained.

4) Financial statements

The formats adopted for the preparation of the financial statements are consistent with the provisions of IAS 1 - "Presentation of financial statements" (hereinafter "IAS 1"). In particular:

- the balance sheet items are broken down into assets and liabilities, and then further into current or non-current items[42];
- the income statement classifies costs by type, since this is deemed to be the best way of representing the Group's operations and is in line with international best practice;
- the statement of comprehensive income shows the profit or loss in addition to the income and expense recognised directly in shareholders' equity as expressly provided for by the IFRS;

[42] The assets and liabilities are classified as current if: (i) their realisation is expected in the normal corporate operating cycle or in the twelve months after the financial year-end; (ii) they are composed of cash or cash equivalents which do not have restrictions on their use over the twelve months following the year-end date; or (iii) they are mainly held for trading purposes.

- the statement of changes in shareholders' equity reports the total income (expense) for the financial year, Shareholder transactions and the other changes in shareholders' equity;
- the cash flow statement is prepared using the "indirect" method, adjusting the profit for the year of non-monetary components.

It is believed that these statements adequately represent the Group's situation with regard to its balance sheet, income statement and financial position.

Moreover, pursuant to Consob Resolution No. 15519 of 28 July 2006, any income and expense from non-recurring operations is shown separately in the income statement. With regard to the same Consob Resolution, the balances of receivables/payables and transactions with related parties, described in more detail in the note – "Related-party transactions", are shown separately in the financial statements.
The Italgas Group is configured as such following the transaction of separating from Snam which took place on 7 November 2016. There is therefore no information available from the previous year for comparison purposes. 2016 is the first that these financial statements have been published.

5) Use of estimates

The application of generally accepted accounting principles for the preparation of financial statements involves management making accounting estimates based on complex and/or subjective judgements, estimates based on past experience and assumptions regarded as reasonable and realistic on the basis of the information known at the time of the estimate. The use of these accounting estimates has an influence on the book value of the assets and liabilities and on the information about potential assets and liabilities at the reporting date, as well as the amount of revenue and costs in the reference period. The actual results may differ from the estimated results owing to the uncertainty that characterises the assumptions and the conditions on which the estimates are based.
Details are given below about the critical accounting estimates involved in the process of preparing the financial statements and interim reports, since they involve a high degree of recourse to subjective judgements, assumptions and estimates regarding matters that are by nature uncertain. Any change in the conditions forming the basis of the judgements, assumptions and estimates used could have a significant impact on subsequent results.

Impairment of assets

Assets are impaired when events or changes in circumstances give cause to believe that the book value is not recoverable. The events which may give rise to an impairment of assets include changes in business plans, changes in market prices or reduced use of plants. The decision on whether to apply an impairment and the quantification of any such impairment depend on the Company's management assessment of complex and highly uncertain factors, such as future price trends, the impact of inflation and technological improvements on production costs, production profiles and conditions of supply and demand.

The impairment is determined by comparing the book value with the related recoverable value, represented by the greater of the fair value, net of disposal costs, and the value in use, determined by discounting the expected cash flows deriving from the use of the asset. The expected cash flows are quantified in the light of the information available at the time of the estimate, on the basis of subjective judgements regarding future trends in variables – such as prices, costs, the rate of growth of demand and production profiles – and are updated using a rate that takes account of the risk inherent to the asset concerned.

More information on the impairment test carried out by the Company's management on property, plant and equipment and on intangible assets can be found in the "Impairment of non-financial fixed assets" section.

Business combinations

The reporting of business combination transactions involves the allocation to the assets and liabilities of the acquired company of the difference between the acquisition cost and the net book value. For the majority of assets and liabilities, the allocation of the difference is carried out by recognising the assets and liabilities at their fair value. The unallocated portion, if positive, is recognised as goodwill; if negative, it is allocated to the income statement. In the allocation process, the Italgas Group draws on the available information and, for the most significant business combinations, on external valuations.

Environmental liabilities

The Italgas Group is subject, in relation to its activities, to numerous laws and regulations on environmental protection at European, national, regional and local level, including the laws which implement international conventions and protocols relating to the activities carried out. With reference to this legislation, when it is probable that the existence and amount of a large liability can be reliably estimated, provisions are made for the associated costs.

The group currently does not believe there will be particularly negative impacts on the financial statements due to failure to comply with environmental regulations, also taking into account the measures already undertaken. However, it cannot be definitely ruled out that further costs or responsibilities may be incurred, including quite significant ones because, as far as we are currently aware, it is impossible to predict the effects of future developments also taking into account, among other things, the following aspects: (i) the possible emergence of contamination; (ii) the results of current and future refurbishment and the other possible effects arising from the application of the laws in force; (iii) the possible effects of new laws and regulations for environmental protection; (iv) the effects of any technological innovations for environmental cleansing; and (v) the possibility of disputes and the difficulty of determining the possible consequences, including in relation to the liability of other parties and to possible compensation payments.

Provisions for employee benefits

Defined-benefit plans are valued on the basis of uncertain events and actuarial assumptions which include, inter alia, the discount rates, the expected returns on the assets servicing the plans (where they exist), the level of future remuneration, mortality rates, the retirement age and future trends in the healthcare expenses covered.
The main assumptions used to quantify defined-benefit plans are determined as follows: (i) the discount and inflation rates representing the base rates at which the obligation to employees might actually be fulfilled are based on the rates which mature on high-quality bonds and on inflation expectations; (ii) the level of future remuneration is determined on the basis of elements such as inflation expectations, productivity, career advancement and seniority; (iii) the future cost of healthcare services is determined on the basis of elements such as present and past trends in healthcare costs, including assumptions regarding the inflationary growth of costs, and changes in the health of the participating employees; and (iv) the demographic assumptions reflect the best estimates of trends in variables such as mortality, turnover, invalidity and others in relation to the population of the participating employees.
Differences in the value of net liabilities (assets) in employee benefit plans, arising due to changes in the actuarial assumptions used and the difference between the actuarial assumptions previously adopted and actual events, occur routinely and are called actuarial gains and losses. Actuarial gains and losses relating to defined-benefit plans are recognised in the statement of comprehensive income. Actuarial assumptions are also used to determine obligations relating to other long-term benefits; to this end, the effects arising from changes to the actuarial assumptions or the characteristics of the benefit are fully recognised in the income statement.

Provisions for risks and charges

In addition to recognising environmental liabilities and obligations to remove property, plant and equipment and restore sites, and liabilities relating to employee benefits, Italgas makes provisions relating mainly to legal and tax disputes and to the expenses related to reaching the Energy Efficiency Certificates targets indicated by the Authority (TEE). The estimate of the provisions for these purposes is the result of a complex process involving subjective judgements on the part of the Company's management.

6) Recently issued accounting standards

Accounting standards and interpretations issued by the IASB/IFRIC and approved by the European Commission, but not yet in force

(EU) Regulation 2016/1905 of the European Commission of 22 September 2016, published in Official Journal L. 295 of 29 October 2016, adopted IFRS 15 Revenues from contracts with customers, aimed at improving the accounting of revenues and therefore the comparability of revenues in financial statements. Specifically, the objective of the principle is to create a complete and standardised reference framework to measure revenue, that can apply to all commercial agreements (with the exception of lease agreements, insurance contracts and those for financial instruments). The essential points for the recognition of revenues are the identification of contracts with customers, the clarification of the obligations in the contract, the calculation of the price of the transactions underlying the contracts, the allocation of the contractual obligations of the components of the sales price or the payment of the revenue when an obligation is satisfied. The application of the standard is required, at the latest, from the start date of the first financial year which will commence on 1 January 2018 or later. Italgas launched an analysis in 2016 of the impacts of !FRS 15. In this regard it is necessary to consider that almost all Group revenues result from services subject to the regulatory activities of the AEEGSI which establishes the price levels paid, the underlying obligations covered in the tariffs and the frequency. The relationship between Italgas and its customers (retail companies) is governed by the network code in which the customer access methods to distribution networks and related services are described. The revenues subject to regulation include those connected to the gas distribution service, ancillary services included in the network code, refunds paid by the regulator following the attainment of technical and commercial standards. The remaining revenues essentially stem from property income and third-party services. Based on the preliminary analysis it is believed that the adoption of the principle in question will not have significant impacts on the consolidated financial statements of the Group.

For the full implementation of IFRS 15, the Group expects its analyses to be completed by the end of 2017, in time for the evaluation of any quantitative aspects of the adoption of the new principle, to be presented in the financial statements at 31 December 2017.

The provisions in IFRS 15 will be in effect starting from the periods beginning on or after 1 January 2018.

Regulation 2016/2067, issued by the European Commission on 22 November 2016 adopted the provisions of IFRS 9 which include (i) the change of the classification of financial assets on contractual financial flows of the actual assets as well as on the business model of the company; (ii) the removal of the obligation to separate the embedded derivatives in the financial assets; (iii) the definition of a new impairment model that uses a new expected loss model applied to financial assets measured at amortised cost, financial assets measured at fair value in the other comprehensive income statement components receivables from lease agreements, as well as assets from contracts and certain loan supply and financial guarantee commitments,

which replaces the incurred loss model according to which the recognition of losses on receivables required the demonstration of a loss event (iv) the review of the qualification of hedging transactions in order to guarantee alignment with company risk management strategies. As a result IFRS 9 has also amended IFRS 7 “Financial instruments: disclosures”.
The provisions in IFRS 9, replacing those contained in IAS 39, are effective from the financial years after 1 January 2018.
The impact of the adoption of this principle on the Group is currently being analysed, however, the Group does not expect significant impacts from the application on recurring transactions.

Accounting standards and interpretations issued by the IASB/IFRIC and not yet approved by the European Commission
Listed and described below are the newly issued amendments, principles and interpretations in 2016 which, as at the preparation date of these financial statements, have not yet been approved by the European Commission but which cover subjects that are relevant to the Group’s financial statements.

On 11 September 2014, the IASB issued the document “Sale or Contribution of Assets between an Investor and its Associate or Joint Venture - Amendments to IFRS 10 and IAS 28”. In particular, the aim of the amendments is to provide a more detailed definition of the accounting treatment and the recognition of related effects in the income statement of the loss of control of an investee company due to its transferral to an associate or joint venture. The accounting treatment used in the investor’s financial statements depends on whether or not the object of the transaction is a business as defined by IFRS 3. On 17 December 2015, the IASB indefinitely deferred the adoption date for the regulatory provisions in this document.

On 13 January 2016, the IASB issued the document “IFRS 16 – Leases”. In considering that all leases from a purely substantive point of view consist of attributing to an entity the right to use an asset for a specified period of time in exchange for a consideration, and the fact that, if the payment of this consideration takes place throughout the contractual period, the entity is implicitly obtaining a loan, IFRS 16 eliminates the distinction between finance leases and operating leases, and introduces, for lessees, a single accounting model for recognising leases. By applying this model the entity recognises: (i) assets and liabilities for all leases longer than 12 months, unless the good in question is of insignificant value; (ii) separately in the income statement, the amortisation of the asset recognised and the interest on the payable entered. The measures contained in IFRS 16 will take effect from financial years starting on or after 1 January 2019, notwithstanding any subsequent deferrals established upon approval by the European Commission.

On 19 January 2016 the IASB issued the document "Recognition of Deferred Tax Assets for Unrealised Losses - Amendments to IAS 12", which clarifies that unrealised losses on debt financial instruments recorded at fair value and whose tax base on the other hand refers to the cost, give rise to temporary deductible tax differences, independently of the fact that the owner of the instrument expects to recover the actual value through ownership until expiry or alternatively through the sale of the actual instrument. The changes introduced also clarify that the estimate of future taxable income, whose valuation is necessary in order to record assets for deferred tax income: (i) includes income arising from the realisation of assets for amounts higher than the relative book value; (ii) excludes the reversal of deductible temporary tax differences; (iii) should take into consideration any limits imposed by tax regulations on the types of taxable income in response to which the tax deductions operate. These provisions are effective from the years starting on or after 1 January 2017, notwithstanding any subsequent deferrals established upon approval by the European Commission. On 29 January 2016 the IASB issued the document "Disclosure initiative - Amendments to IAS 7", which requires users of financial statements to be provided with information that allows them to assess what changes have taken place to the liabilities and assets originating from financing activities (effectively, in loans payable and, for example assets for long-term loan hedging derivative instruments), both as a result of monetary movements and otherwise (by way of example, following changes in exchange rates, fair value or after the acquisition or loss of control of a subsidiary or business). These measures will take effect from financial years starting on or after 1 January 2017, notwithstanding any subsequent deferrals established upon approval by the European Commission.

On 12 April 2016 the IASB issued "Clarifications to IFRS 15 Revenue from Contracts with Customers". The changes to the principle introduce clarifications as well as new examples in order to facilitate the application of the principle and specifically with regard to: (i) the identification of individual contract obligations; (ii) the qualification of the entity as principal or agent; (iii) when to measure revenue from the concession to a customer of the use of or access to intellectual property. The changes also introduce additional practical devices which can make the transition to the new principle less onerous and specifically with regard to: (i) contracts concluded prior to the start of the first comparison period presented, also under the scope of the full retrospective approach; (ii) the aggregate representation of the contractual changes that took place before the start of the comparison period (full retrospective approach) or the first application period (modified retrospective approach). These measures will take effect from financial years starting on or after 1 January 2018, notwithstanding any subsequent deferrals established upon approval by the European Commission.

Currently, Italgas does not expect to exercise the right of early adoption granted by the principle. The standard requires mandatory retroactive application and transition can take place in two possible ways: through a full retrospective approach in conformity with IAS 8 or through a modified retrospective approach. If the second approach is chosen, IFRS 15 is only applied retroactively to contracts which have not been concluded at the initial application date (1 January 2018). Italgas is evaluating which of the two retroactive options to apply.

On 20 June 2016 the IASB issued the document "Classification and Measurement of Share-based Payment Transactions - Amendments to IFRS 2", with the objective of clarifying the classification and accounting of several types of share-based payment transactions, specifically with regard to: (i) the accounting of the effects of the vesting conditions on cash-regulated transactions; (ii) the classification of transactions regulated on a net basis in connection with withholdings at source; (iii) the accounting of changes to the terms and conditions which alter the qualification of the transaction from cash-regulated to regulated through the provisions of equity instruments. These measures will take effect from financial years starting on or after 01 January 2018, notwithstanding any subsequent deferrals established upon approval by the European Commission.

On 12 September 2016 the IASB issued the document "Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts-Amendments to IFRS 4" aimed at solving the problems resulting from the application of IFRS 9 before the implementation of the standard which will replace IFRS 4 which is being developed by the IASB. The changes introduced involve the adoption of two alternatives: (i) the possibility of reclassifying costs and revenues from certain financial assets in the comprehensive income statement; (ii) the possibility of not temporarily applying IFRS 9 for entities where the main activity is to issue insurance contracts coming under the scope of the application of IFRS 4. The first option is effective retroactively when IFRS 9 is first applied, while the second option is effective from financial years starting on or after 1 January 2018, notwithstanding any subsequent deferrals established upon approval by the European Commission.

On 8 December 2016 the IASB published the document "Annual Improvements to IFRS Standards 2014-2016 Cycle" which includes changes to several principles under the scope of the annual improvement process (including: IFRS 1 First-time Adoption of International Financial Reporting Standards, IFRS 12 Disclosure of Interest in Other Entities, IAS 28 Investments in Associates and Joint Venture). The changes to IFRS 1 and to IAS 28 apply from financial years starting on or after 1 January 2018, while the changes to IFRS 12 apply from financial years starting on or after 1 January 2017, notwithstanding any subsequent deferrals established upon approval by the European Commission.

On 8 December 2016 the IASB issued "Transfers of Investment property - Amendments to IAS 40", which clarifies that an entity should reclassify a property to, or from, the category of property investments if and only if there is a change in use of the property; a change in management's intended use with regard to a property does not, in itself, constitute evidence of a change in use. These measures will take effect from financial years starting on or after 01 January 2018, notwithstanding any subsequent deferrals established upon approval by the European Commission.

On the same date the IASB issued "IFRIC 22 Foreign Currency Transaction and Advance Consideration", which establishes that when foreign currency transactions take place whereby payment is made or received in advance, the exchange rate to apply for the initial recording of the asset, costs or revenue generated from the transaction for which advance payment/collection took place, corresponds to the exchange rate in force on the advance payment date.

These measures will take effect from financial years starting on or after 1 January 2018, notwithstanding any subsequent deferrals established upon approval by the European Commission.
Italgas is analysing the standards in question, where applicable, to assess whether their adoption will have a significant impact on the financial statements.

7) Cash and cash equivalents

Cash and cash equivalents equal to €1 million refer to current account deposits held at banks.
Cash and cash equivalents are not subject to any usage restrictions.
A comprehensive analysis of the financial situation and major cash commitments during the year can be found in the cash flow statement.

8) Trade receivables and other current and non-current receivables

Trade receivables and other current and non-current receivables, amounting to €579 million break down as follows:

(€ million)	1.6.2016			31.12.2016		
	Current	Non-Current	Total	Current	Non-Current	Total
Trade receivables				418		418
Receivables from investment/disinvestment activities				6		6
Other receivables				155		155
				579		579

Trade receivables (€418 million as at 31 December 2016), which mainly relate to the gas distribution service and ancillary services, mainly involve receivables from Eni S.p.A. (€196 million), third-parties (€174 million) and the Energy and Environmental Services Fund (CSEA) relating to the equalisation[43] (€48 million).

These are reported net of the provision for impairment losses of €21 million at 31 December 2016. Changes in the provision for impairment losses on receivables during the year are shown below:

(€ million)	Provision for impairment as at 01.06.2016	Change Scope of Consolidation	Provision	Utilisations	Other changes	Provision for impairment as at 31.12.2016
Trade receivables		20				**20**
Other receivables		1				**1**
		21				**21**

Receivables for investment/disinvestment activities (€6 million as at 31 December 2016) involve receivables for sales of tangible and intangible assets.

Other receivables (€155 million as at 31 December 2016) break down as follows:

(€ million)	1.6.2016	31.12.2016
IRES receivables for the national tax consolidation scheme		**16**
Other receivables:		**139**
- Energy and Environmental Services Fund (CSEA)		**82**
- Public administration		**27**
- Advances to suppliers		**13**
- to staff		**4**
- Other		**13**
		155

IRES receivables for the national tax consolidation scheme (€16 million, at 31 December 2016) concern receivables with the former parent company, Eni, relating to the IRES refund request (€13 million) resulting from the partial IRAP deduction relating to tax years 2004 to 2007 (pursuant to Article 6 of Decree-Law 185 of 28 November 2008, converted into Law 2 of 28 January 2009) and tax years 2007 to 2011 (pursuant to Decree-Law 201/2011).

[43] The mechanism based on which the differences between what is invoiced to sales companies and the revenue restrictions defined by the Authority are recorded as debits/credits from the CSEA.

Receivables from the CSEA (€82 million as at 31 December 2016) relate to the additional components of gas distribution tariffs for €38 million (UG2[44] and Gas Bonus[45]) and for €44 million to Energy Efficiency Certificates.

Receivables from public administrations (€27 million) relate to receivables from Municipalities.

The item "Others" (€13 million as at 31 December 2016) mainly relates to receivables from Snam S.p.A. following the transfer of personnel to Italgas S.p.A. and Italgas Reti S.p.A..

The market value of trade and other receivables is analysed in the Note - "Guarantees, commitments and risks - Other information about financial instruments". All receivables are in Euro.

The fair value measurement of trade and other receivables has no material impact considering the short period of time from when the receivable arises and its due date and contractual conditions.

The seniority of trade and other receivables is shown below:

(€ million)		1.6.2016			31.12.2016	
	Trade receivables	Other receivables (*)	Total	Trade receivables	Other receivables (*)	Total
Non-overdue and non-impaired receivables				389	155	544
Overdue and non-impaired receivables:				29		29
- 0-3 months overdue				9		9
- 3-6 months overdue				1		1
- 6-12 months overdue				4		4
- more than 12 months overdue				15		15
				418	155	573

(*) Including financial receivables, receivables from investment/divestment activities and other receivables.

Overdue and non-impaired receivables equal to €29 million mainly involve relations with gas marketing companies for the distribution service, covered by guarantee policies, and other receivables from the government.

44 Additional component of the distribution tariff for the purpose of containing the cost of the gas service for low consumption end users.

45 Component relating to requests for subsidies for natural gas provision by economically disadvantaged customers.

Receivables from related parties are described in the note "Related-party transactions". Specific information on credit risk can be found in the Note "Guarantees, commitments and risks – Financial risk management – Credit risk".

9) Inventories

Inventories, which amount to €33 million are analysed in the table below:

(€ million)	1.6.2016			31.12.2016		
	Gross amount	Impairment losses	Net value	Gross amount	Impairment losses	Net value
Inventories						
- Raw materials, consumables and supplies				33		33
				33		33

Inventories of raw materials, consumables and supplies (€33 million as at 31 December 2016) are mainly composed of gas meters in relation to the replacement plan. The provision for impairment is €0.3 million.

Inventories are not collateralised. Inventories do not secure liabilities, nor are they recognised at net realisation value.

10) Current income tax assets/liabilities and other current tax assets/liabilities

Current income tax assets/liabilities and other current tax assets/liabilities break down as follows:

(€ million)	1.6.2016	31.12.2016
Current income tax assets		**35**
IRES		32
IRAP		1
- Other assets		2
Other current tax assets		**3**
- VAT		1
- Other taxes		2
Current income tax liabilities		**1**
- IRES		1
- IRAP		
Other current tax liabilities		**13**
- VAT		5
- IRPEF withholdings for employees		7
- Other taxes		1
		24

Current income tax assets of €35 million mainly relate to IRES receivables involving the Group tax consolidation scheme.

Other current tax assets, amounting to €3 million refer to reimbursements from the tax authorities for registration tax (€2 million) and VAT receivables (€1 million).

Current income tax liabilities of €1 million refer to payables to the tax authorities for IRES.

Other current tax liabilities, amounting to €13 million mainly refer to payables to the tax authorities for VAT (€5 million) and IRPEF withholdings for employees (€7 million).

Taxes pertaining to the year under review are shown in the note - "Income taxes".

11) Other current and non-current assets

Other current assets, which amount to €4 million and *other non-current assets* of €38 million break down as follows:

(€ million)		1.6.2016			31.12.2016	
	Current	Non-current	Total	Current	Non-current	Total
Other regulated assets				3	32	35
Other assets				1	6	7
- Prepayments				1	5	6
- Security deposits					1	1
				4	38	42

Other regulated assets (€35 million as at 31 December 2016) essentially relate to the tariff recognition, by the Authority, following the plan to replace traditional meters with electronic meters.

The remaining item equal to €7 million mainly includes prepayments relating to the cost of taking out loans (€6 million of which €1 million is short-term).

12) Property, plant and equipment

Property, plant and equipment, which amounts to €227 million as at 31 December 2016 breaks down as follows:

(€ million)	31.12.2016						
	Land	Buildings	Plant and equipment	Industrial and commercial equipment	Other assets	Non-current assets under construction and payments on account	Total
Cost at 1.6.2016							
Investments						4	**4**
Disposals				(1)			**(1)**
Change in scope of consolidation	11	350	12	179		6	**558**
Other changes		1	(1)	7		(7)	
Cost at 31.12.2016	**11**	**351**	**11**	**185**		**3**	**561**
Provisions for amortisation and depreciation at 1.6.2016							
Total amortisation and depreciation		(1)		(1)			**(2)**
Disposals				1			**1**
Change in scope of consolidation		(172)	(5)	(152)			**(329)**
Other changes							
Provisions for amortisation and depreciation at 31.12.2016		**(173)**	**(5)**	**(152)**			**(330)**
Provision for impairment losses at 1.6.2016							
Change in scope of consolidation			(4)				**(4)**
Other changes							
Provision for impairment losses at 31.12.2016			**(4)**				**(4)**
Net balance at 1.6.2016							
Net balance at 31.12.2016	**11**	**178**	**2**	**33**		**3**	**227**

Investments (€4 million) mainly refer to fixed assets under construction.

Depreciation (€2 million) refers to economic and technical depreciation determined on the basis of the useful life of the assets or their remaining possible use by the Company.

During the year, there were no changes in the estimated useful life of assets or in the depreciation rates applied and explained by category in the Note - "Measurement criteria - Property, plant and equipment".

The provision for impairment of €4 million relates to the district heating plant and equipment of the municipality of Cologno Monzese (MB).

Contractual commitments to purchase property, plant and equipment, and to provide services related to the construction thereof, are reported in the Note "Guarantees, commitments and risks".

13) Intangible assets

Intangible assets, which amount to €4,487 million as at 31 December 2016 break down as follows:

(€ million)	Finite useful life				Indefinite useful life	
	Service concession agreements	Industrial patent rights and intellectual property rights	Non-current assets under construction and payments on account	Other intangible assets	Goodwill	Total
Cost at 1.6.2016						
Investments	59	1	14	1		**75**
Change in scope of consolidation	7,444	332	27	37	10	**7,850**
Disposals	(9)					**(9)**
Other changes	20	21	(20)	1		**22**
Cost at 31.12.2016	**7,514**	**354**	**21**	**39**	**10**	**7,938**
Provisions for amortisation and depreciation at 1.6.2016						
Total amortisation and depreciation	(69)	(5)		(1)		**(75)**
Change in scope of consolidation	(3,068)	(269)		(25)		**(3,362)**
Disposals	9					**9**
Other changes	(22)					**(22)**
Provisions for amortisation and depreciation at 31.12.2016	**(3,150)**	**(274)**		**(26)**		**(3,450)**
Provision for impairment losses at 1.6.2016						
Change in scope of consolidation	(1)					**(1)**
Provision for impairment losses at 31.12.2016	**(1)**					**(1)**
Net balance at 1.6.2016						
Net balance at 31.12.2016	**4,363**	**80**	**21**	**13**	**10**	**4,487**

Service concession agreements (€4,363 million as at 31 December 2016) refer to agreements between the public and private sectors on the development, financing, management and maintenance of infrastructure under concession by a contracting party. The provisions relating to the service concession agreements are applicable for Italgas in its role as a public service natural gas distributor, i.e. applicable to the agreements under which the operator is committed to providing the public natural gas distribution service at the tariff established by the AEEGSI, holding the right to use the infrastructure, which is controlled by the grantor, for the purposes of providing the public service.

Industrial patent rights and intellectual property rights (€80 million as at 31 December 2016) mainly concern information systems and applications in support of operating activities.

Intangible assets with an indefinite useful life (€10 million as at 31 December 2016) consist mainly of the goodwill recognised in 2008 following the acquisition by Italgas of 100% of the shares of Siciliana Gas. Goodwill was subjected to an impairment test which did not reveal losses in value compared with the recoverable amount and the carrying amount.

Investments for the year, equal to €75 million, mainly relate to service agreements awarded for the maintenance and development of the remote reading network (€55 million) and fixed assets under construction (€18 million).

Capital contributions from government authorities and other entities, €360 million and €427 million, respectively, are recorded as a deduction in the net value of service concession agreements.

Changes in the scope of consolidation (€4,487 million, net of the related provisions for depreciation, amortisation and impairment losses) relate to the acquisition of the stakeholding in Italgas Rete S.p.A. by Snam S.p.A.

Amortisation refers to economic and technical amortisation determined on the basis of the finite useful life of the intangible assets or their remaining possible use by the Company. The amount of €75 million includes greater amortisation as a result of the reduction in the useful life of traditional meters[46], subject to the plan to replace them with electronic meters, required by AEEGSI resolutions under the scope of the implementation of the remote metering reading plan (€43 million).

Contractual commitments to purchase intangible assets, and to provide services related to the development thereof, are reported in the Note - "Guarantees, commitments and risks".

[46] In order to complete the amortisation process in line with the meter replacement plan, to be completed by 2018, the useful life of the meters included in the project pursuant to AEEGSI resolutions 631/13 and 554/15 was adjusted.

14) Investments valued using the equity method

Investments valued using the equity method, amounting to €176 million break down as follows:

(€ million)	Investments in joint ventures
Initial value as at 01.06.2016	
Change in scope of consolidation	173
Acquisitions and subscriptions	
Capital gains (losses) from measurement using the equity method	3
Decrease owing to dividends	
Other changes	
Final value at 31.12.2016	**176**

Capital gains from measurement by the equity method (€3 million) refer to Toscana Energia S.p.A..

Equity investments are not collateralised.

With regard to the recoverable value of equity investments, for companies operating exclusively in regulated businesses, recoverable value is calculated using the adjusted RAB value of the net financial position.

In the light of the positive performance of those companies, the value estimated in this way is higher for all equity investments than the value recorded in the financial statements and therefore there are no losses in value.

Consolidated companies, joint ventures, associates and other significant equity investments are indicated separately in the Appendix "Significant shareholdings, associates and equity investments of Italgas S.p.A. at 31 December 2016", which is an integral part of these Notes.

Other information on equity investments

In accordance with the provisions of IFRS 12 - "Disclosure of interests in other entities", the economic and financial data for joint ventures and associates are provided below.

Investments in joint ventures

The IFRS-compliant economic and financial data for each significant joint venture[47], are reported below:

(€ million)	31.12.2016		
	Toscana Energia S.p.A.	Umbria Distribuzione Gas S.p.A.	Sant'Angelo Lodigiano S.p.A.
Current assets	74	3	1
- of which cash and cash equivalents			
Non-current assets	811	9	5
Total assets	**885**	**12**	**6**
Current liabilities	113	9	4
- of which current financial liabilities		3	1
Non-current liabilities	377		
- of which non-current financial liabilities			
Total liabilities	**490**	**9**	**4**
Shareholders´ equity	**395**	**3**	**2**
Equity interest held by the Group (%)	48.08%	45.00%	50.00%
Share attributable to the Group	190	1	1
Other adjustments	(16)		
Book value of the equity investment	**174**	**1**	**1**
Revenue	135	6	2
Operating costs	(39)	(6)	(2)
Amortisation, depreciation and impairment	(32)		
EBIT	**64**		
Financial income (expenses)	(4)		
Income (expense) from equity investments	1		
Income tax	(20)		
Net profit	**41**		
Other components of comprehensive income			
Total comprehensive income	**41**		

[47] Unless otherwise indicated, the financial statement figures for joint ventures, reported in full, have been updated to include adjustments made by the Parent Company pursuant to the equity-accounting method.

Information on investments in joint ventures

Toscana Energia S.p.A.
Toscana Energia S.p.A. operates in the natural gas distribution segment in Tuscany.

The share capital of Toscana Energia S.p.A. is owned by Italgas Reti S.p.A. (48.08%), the Municipality of Florence (20.61%), Publiservizi S.p.A. (10.38%)[48], other Local Authorities[49] (20.26%) and banking institutions (0.67%).

The corporate governance rules stipulate that decisions on significant activities must be taken with the unanimous consent of the private (Italgas Reti S.p.A.) and public (municipalities) shareholders.

Toscana Energia S.p.A.'s consolidated financial statements include Toscana Energia S.p.A. and Toscana Energia Green S.p.A.

Umbria Distribuzione Gas S.p.A.
Umbria Distribuzione Gas S.p.A. operates in the natural gas distribution segment in Umbria.

The share capital of Umbria Distribuzione Gas S.p.A. is owned by Italgas Reti S.p.A. (45%), by A.S.M. Terni S.p.A. (40%) and by Acea S.p.A. (15%).

Umbria Distribuzione Gas, as the holder of an 11-year mandate, manages the natural gas distribution service in the Terni municipality, making use of an integrated system of infrastructures, owned by Terni Reti S.r.l., a wholly-owned subsidiary of the Terni municipality, comprising stations for withdrawing gas from the transportation network, pressure reduction plants, the local transportation and distribution network, user derivation plants and redelivery points comprising technical equipment featuring meters at the end users.

Metano Sant'Angelo Lodigiano S.p.A.
Metano Sant'Angelo Lodigiano S.p.A. operates in the natural gas distribution sector in the municipalities of Sant'Angelo Lodigiano (LO), Villanova del Sillaro, Bargano (LO), Castiraga Vidardo (LO), Marudo (LO) and Villanterio (PV).

The corporate governance rules stipulate that decisions on significant activities must be taken with the unanimous consent of the private (Italgas Reti S.p.A.) and public (municipalities) shareholders.

48 A fully public, pure holding company. The company's shareholders are 35 Tuscan municipalities in the provinces of Florence, Pisa, Pistoia and Siena.

49 Data taken from the financial statements of Toscana Energia S.p.A for the year ended 31 December 2015.

15) Assets held for sale and directly related liabilities

Assets held for sale and liabilities directly associated with them, of respectively €25 and €6 million, mainly involve the property in Via Ostiense in Rome for which the sale to Eni S.p.A. was approved.
The table below summarises the breakdown of Assets and Liabilities classified as available for sale:

(€ million)	1.6.2016	31.12.2016
Non-current assets held for sale		**25**
Buildings		25
Directly associated liabilities		**6**
Provision for environmental risks and charges		6
		19

16) Short-term financial liabilities, long-term financial liabilities and short-term portions of long-term financial liabilities

Short-term financial liabilities, amounting to €2,696 million and *long-term financial liabilities*, including short-term portions of long-term liabilities totalling €923 million, break down as follows:

(€ million)	1.6.2016					31.12.2016				
	Short-term financial liabilities	long-term financial liabilities				Short-term financial liabilities	long-term financial liabilities			
		Short-term portion	Long-term portion maturing within 5 years	Long-term portion maturing in more than 5 years	Total long-term portion		Short-term portion	Long-term portion maturing within 5 years	Long-term portion maturing in more than 5 years	Total long-term portion
Bank loans						**2,696**		**293**	***630***	**923**
						2,696		**293**	***630***	**923**

Short-term financial liabilities

Short-term financial liabilities, amounting to €2,696 relate to a bridge to bond, signed with a group led by eleven leading national and international banks with the right of renewal for a further 12 months, for a nominal value of €2,300 and net utilisations of uncommitted lines of bank credit of €396 million.

There are no short-term financial liabilities denominated in currencies other than the Euro.

The weighted average interest rate on short-term financial liabilities was 0.25%.

Long-term financial liabilities and short-term portions of long-term financial liabilities
Long-term financial liabilities, including short-term portions of long-term liabilities, amounted to €923 million, net of amortised cost accruals and adjustments (€1 million).

Payables for bank loans (€924 million) refer to loan agreements, signed with:

- European Investment Bank (EIB):
  - discharge deed of assumption signed on 26 October 2016 by Snam and Italgas, for two loans for a total nominal amount of €424 million, previously stipulated by Snam and the EIB due on 30 October 2033 and 22 October 2035;
  - conclusion, on 12 December 2016, of a new loan for €300 million, due on 30 November 2032;
- Banca Nazionale del Lavoro (BNL) for a nominal value of €200 million due on 28 October 2019.

There are no other long-term bank loans denominated in currencies other than the euro.

There were no breaches of loan agreements as at the reporting date.

The weighted average interest rate on bank loans utilised was 0.65%.

The market value of short- and long-term financial liabilities is reported in the Note, "Guarantees, commitments and risks".

The Company had unused committed credit lines worth €1.1 billion.

Financial covenants and negative pledge commitments
As at 31 December 2016, there were no financial covenants and unsecured bilateral and syndicated loan agreements in place with banks and other financial institutions. Some of these contracts provide, inter alia, for the following: (i) negative pledge commitments pursuant to which Italgas and its subsidiaries are subject to limitations concerning the pledging of real property rights or other restrictions on all or part of the respective assets, shares or merchandise; (ii) pari passu and change-of-control clauses; and (iii) limitations on certain extraordinary transactions that the Company and its subsidiaries may carry out.

At 31 December 2016, Italgas also had medium/long-term loans taken out with the European Investment Bank (EIB), the contractual clauses of which are broadly in line with those described above. Exclusively for the EIB loans, the lender has the option to request additional guarantees if Italgas' credit rating is downgraded to BBB- (Standard & Poor's/Fitch Ratings Limited) or Baa3 (Moody's) for at least two of the three ratings agencies.

At 31 December 2016, the banking financial liabilities subject to these restrictive clauses amounted to approximately €3.2 billion.

Failure to comply with the commitments established for these loans - in some cases only when this non-compliance is not remedied within a set time period - and the occurrence of other events, such as cross-default events, some of which are subject to specific threshold values, may result in Italgas' failure to comply and could trigger the early repayment of the relative loan.

As at 31 December 2016, there were no identified events resulting in failure to comply with the aforementioned commitments.

Breakdown of net financial debt

The breakdown of net financial debt, showing related-party transactions, is provided in the following table:

(€ million)	1.6.2016			31.12.2016		
	Current	Non-current	Total	Current	Non-current	Total
A. Cash and cash equivalents				1		1
B. Securities available for sale and held to maturity						
C. Cash (A+B)				1		1
D. Financial receivables not held for operating activities						
E. Short-term financial liabilities to banks				2,696		**2,696**
F. Long-term financial liabilities to banks					923	**923**
G. Bonds						
H. Short-term financial liabilities to related parties						
I. Long-term financial liabilities to related parties						
L. Other short-term financial liabilities						
M. Other long-term financial liabilities						
N. Gross financial debt (E+F+G+H+I+L+M)				**2,696**	**923**	**3,619**
O. Net financial debt (N-C-D)				**2,695**	**923**	**3,618**

17) Trade and other payables

Trade payables and other payables, which amount to €433 million as at 31 December 2016 comprise the following:

(€ million)	1.6.2016	31.12.2016
Trade payables		174
Payables for investment activities		103
Other payables		166
		443

Trade payables (€174 million as at 31 December 2016) relate mainly to payables to suppliers.
Other payables of (€166 million as at 31 December 2016) break down as follows:

(€ million)	1.6.2016	31.12.2016
Payables to the government		49
Payables to the Energy and Environmental Services Fund (CSEA)		48
Payables to employees		39
Payables to pension and social security institutions		19
Payables to advisers and experts		4
Other payables		7
		166

Payables to the government (€49 million) primarily involve payables to municipalities for concession fees for the distribution business.

Payables to the CSEA (€48 million) relate to several ancillary components of tariffs for the gas distribution service to be paid to this Fund (RE, RS, UG1 and GS)[50].

Payables to personnel (€39 million) involve payables mainly for holidays accrued and not taken, the fourteenth months' pay and performance-related pay.

Payables to related parties are described in the note "Related-party transactions".

The book value of trade payables and other payables, considering the limited time interval between the occurrence of the payable and its maturity, is an approximation of the fair value. The market value of trade and other payables is provided in the Note - "Guarantees, commitments and risks - Other information on financial instruments".

[50] These components refer to: (i) RE - Variable portion to cover the expenses for calculating and implementing energy savings and the development of renewable energy sources in the natural gas sector; (ii) RS - Variable portion as coverage for expenses for gas services quality; (iii) UG1 - Variable portion to cover any imbalances in the equalisation system and to cover any adjustments; and (iv) GS - Variable portion to cover the tariff compensation system for economically disadvantaged customers.

18) Other current and non-current liabilities

Other current liabilities and *other non-current liabilities* are broken down below:

(€ million)	1.6.2016			31.12.2016		
	Current	Non-current	Total	Current	Non-current	Total
Other liabilities from regulated activities						
Other liabilities					**5**	**5**
- Liabilities for deposits					5	5
					5	**5**

Other liabilities (€5 million as at 31 December 2016) essentially include guarantee deposits paid.

19) Provisions for risks and charges

Provisions for risks and charges, which amount to €230 million, are analysed in the table below:

(€ million)	Opening balance	Changes in consolidation scope	Provisions	Increases due to passing of time	Utilisations		Other changes	Final balance
					against charges	for excess		
Provision for environmental risks and charges		136	3	(1)	(2)			**136**
Provision for litigation		22			(1)			**21**
Provision for other risks - energy efficiency certificates		9	4					**13**
Provision for plant upgrade risks		20						**20**
Provisions for retirement risks		5	15					**20**
Other provisions		17	3			(1)	1	**20**
		209	**25**	**(1)**	**(3)**	**(1)**	**1**	**230**

The provision for environmental risks and charges (€136 million as at 31 December 2016) mainly included costs for environmental soil reclamation, pursuant to Law 471/1999, as subsequently amended, primarily for the disposal of solid waste, in relation to the distribution business.

The provision for litigation (€21 million) included costs which the Company has estimated it will incur for existing lawsuits.

The Energy Efficiency Certificates risk provision (€13 million) is connected with reaching the Energy Efficiency Certificates targets (TEE) set by the Authority.

The adjustments to facilities risk provision (€20 million) includes the estimated costs of gas distribution plant upgrades in response to the results of the inspections conducted in 2014 as part of the asset protection measure imposed by the judicial authorities.

The risk provision for early retirement (€20 million) involves personnel incentive and mobility schemes.

In accordance with ESMA Recommendation 2015/1608 of 27 October 2015, the effects on provisions of risks and charges arising from a reasonably possible change to the discount rate used at year-end are shown below.

The sensitivity[51] of the discount rate represents the change in the value of the actuarial liability obtained using the end-of-year valuation data, changing the discount rate without any change in the other assumptions.

(€ million)		Change in discount rate
Effect on the net obligation as at 31.12.2016	**Reduction of 10%**	**Increase of 10%**
Provision for environmental risks and charges	1	(1)

20) Provisions for employee benefits

Provisions for employee benefits, amounting to €121 million, can be broken down as follows:

(€ million)	1.6.2016	31.12.2016
Employee severance pay (TFR)		73
Supplemental healthcare provision for company executives of Eni (FISDE)		6
Gas Fund		35
Other employee benefit provisions		7
		121

The provision for employee severance pay (TFR), governed by Article 2120 of the Italian Civil Code, represents the estimated liability determined on the basis of actuarial procedures for the amount to be paid to employees at the time that the employment is terminated. The principal amount of the benefit is equal to the sum of portions of the allocation calculated on compensation items paid during the employment and revalued until the time that such relationship is terminated. Due to the legislative changes introduced from 1 January 2007 for companies with more than 50 employees, a significant part of severance pay to be accrued is classified as a defined-contribution plan since the company's only obligation is to pay the contributions to the pension funds or to INPS. Liabilities related to severance pay pre-dating 1 January 2007 remain a defined-benefit plan to be valued using actuarial methods (€74 million as at 31 December 2016).

[51] For the purposes of sensitivity, only provisions for risks and charges showing a significant accretion discount were taken into account.

FISDE (€6 million as at 31 December 2016) includes the estimate of costs (determined on an actuarial basis) related to contributions benefiting current[52] and retired executives.

FISDE provides financial supplementary healthcare benefits to Eni Group[53] executives and retired executives whose most recent contract of employment was as an executive with the Eni Group. FISDE is funded through the payment of: (i) contributions from member companies; (ii) contributions from individual members for themselves and their immediate family; and (iii) ad hoc contributions for specific benefits. The amount of the liability and the healthcare cost are determined on the basis, as an approximation of the estimated healthcare expenses paid by the fund, of the contributions paid by the company in favour of pensioners.

The Gas Fund (€35 million) relates to the estimate, made on an actuarial basis, of the charges sustained by the employer due to the elimination, as of 1 December 2015, of the fund pursuant to Law 125 of 6 August 2015. In particular, Articles 9-*decies* and 9-*undecies* of the Law set forth that the employer must cover: (i) an extraordinary contribution to cover expenses related to supplementary pension benefits in place at the time of the elimination of the Gas Fund for the years 2015 to 2020[54]; and (ii) a contribution in favour of those registered or in voluntary prosecution of the contribution, that at 30 November 2015 were not entitled to supplementary pension benefits from the eliminated Gas Fund, of 1% for each year of registration to the supplementary fund, multiplied by the social security tax base relating to the same supplementary fund for 2014, to be allocated to the employer or the supplementary pension scheme.

At present, the criteria, procedures and time periods for payment of the extraordinary contribution have not yet been announced. Employee selection of where the amounts would be allocated (supplementary pension scheme or to the employer) were concluded, pursuant to the law, on 14 February 2016.

The other employee benefit provisions (€7 million as at 31 December 2016) relate to seniority bonuses and the deferred cash incentive plan (IMD).

Deferred cash incentive plans are allocated to executives who have met the goals set out in the year preceding the allocation year, and allocate a basic incentive that is disbursed after three years and varies according to the performance achieved by the Company during the course of the three-year period following the time of the allocation. The benefit is provisioned when Italgas' commitment to the employee arises. The estimate is subject to revision in future periods, based on the final accounting and updates to profit forecasts (above or below target).

[52] For executives in service, contributions are calculated from the year in which the employee retires and refer to the years of service provided.

[53] The fund provides the same benefits for Italgas Group executives.

[54] Article 9-*quinquiesdecies* also stipulates that *"... If monitoring shows that the extraordinary contribution pursuant to Article 9-decies is insufficient to cover the relative expenses, a decree issued by the Ministry of Labour and Social Policy, in concert with the Ministry of Economic Development and the Ministry of Economy and Finance, provides for the redetermination of the extraordinary contribution, the criteria for redistribution of the contribution between employers and the time periods and procedures for payment of the extraordinary INPS contribution".*

The long-term incentive plans, which replaced the preceding stock option allocations, involve the payment, three years after allocation, of a variable cash bonus tied to a measure of company performance. Obtaining the benefit depends on the achievement of certain future performance levels and is conditional on the beneficiary remaining with the Company for the three-year period following the allocation (the "vesting period"). This benefit is allocated pro rata over the three-year period depending on the final performance parameters.

Seniority bonuses are benefits paid upon reaching a minimum service period at the Company and are paid in kind.

Deferred cash incentive plans, long-term cash incentive plans and seniority bonuses are classified as other long-term benefits pursuant to IAS 19.
The composition of and changes in employee benefit provisions, determined by applying actuarial methods, are as follows[55]:

(€ million)	1.6.2016					31.12.2016				
	Provision for employee severance pay (TFR)	**FISDE**	**Gas Fund (*)**	**Other provisions**	**Total**	**Provision for employee severance pay (TFR)**	**FISDE**	**Gas Fund (*)**	**Other provisions**	**Total**
Current value of the obligation at the start of the year										
Change in scope of consolidation						74	6	36	7	**123**
Current cost										
Cost of past service										
Cost in interest										
Revaluations/(Impairment losses):						(2)		(1)		**(3)**
- Actuarial (gains)/losses resulting from changes in the financial assumptions						(2)		(1)		(3)
- Effect of past experience										
Benefits paid										
Effect of transfers						1				**1**
Current value of the obligation at the end of the year						**73**	**6**	**35**	**7**	**121**

(*) Relates to the valuation of the liability arising from: (i) the contribution in favour of those still in service or voluntarily continuing the contribution, of 1% for each year of registration to the Gas Fund, multiplied by the social security tax base relating to the same Gas Fund for 2014; and (ii) the extraordinary contribution to cover expenses related to supplementary pension benefits in place at the time of elimination of the Gas Fund for the years 2015 to 2020.

[55] The table also provides a reconciliation of liabilities recorded for employee benefit provisions.

Costs for defined-benefit plans recognised under other components of comprehensive income are broken down in the following table:

(€ million)			2016
	Provision TFR	FISDE	Total
(Impairment losses)/Revaluations:			
- Actuarial (gains)/losses resulting from changes in the financial assumptions	(2)		(2)
- Effect of past experience			
	(2)		(2)

The main actuarial assumptions used to determine liabilities at the end of the year and to calculate the cost for the following year are indicated in the table below:

	2016			
	Provision for employee severance pay (TFR)	FISDE	Gas Fund	Other provisions
Discount rate (%)	1.20	1.20	1.20	N/A
Inflation rate (%) (*)	1.20	1.20	N/A	N/A

(*) With regard to the other provisions, the rate relates only to seniority bonuses.

The discount rate adopted was determined by considering the yields on bonds issued by Eurozone companies with AA ratings.

The employee benefit plans recognised by Italgas are subject, in particular, to interest rate risk, in the sense that a change in the discount rate could result in a significant change in the liability.

The table below illustrates the effects of a reasonably possible[56] change in the discount rate at the end of the year.

The sensitivity of the discount rate represents the change in the value of the actuarial liability obtained using the end-of-year valuation data, changing the discount rate by a certain number of basis points, without any change in the other assumptions.

56 With regard to FISDE, any changes relating to mortality do not have a significant effect on the liability.

(€ million)	Discount rate	
Effect on the net obligation at 31.12.2016	**Reduction of 0.5%**	**Increase of 0.5%**
Employee severance pay (TFR)	3	(4)
FISDE		
Gas Fund (*)	3	(1)
Other employee benefit provisions		
	6	**(5)**

(*) The amount includes an estimate of the INPS solidarity surcharge of 10% applied to the amounts to be allocated to supplementary pension schemes.

The maturity profile of the obligations for employee benefit plans is shown in the following table:

(€ million)	1.6.2016					31.12.2016				
	Provision for employee severance pay (TFR)	**FISDE**	**Gas Fund (*)**	**Other provisions**	**Total**	**Provision for employee severance pay (TFR)**	**FISDE**	**Gas Fund (*)**	**Other provisions**	**Total**
Within the next year						2		4	3	**9**
Within five years						10	1	14	4	**29**
Between five and ten years						28	1	13		**42**
Beyond 10 years						33	4	4		**41**
						73	**6**	**35**	**7**	**121**

(*) The amount includes an estimate of the INPS solidarity surcharge of 10% applied to the amounts to be allocated to supplementary pension schemes.

The weighted average maturity of obligations for employee benefit plans is shown below:

	2016			
	Provision for employee severance pay (TFR)	**FISDE**	**Gas Fund**	**Other provisions**
Weighted average maturity (years)	10	15	6	2

21) Deferred tax liabilities

Deferred tax liabilities of €106 million are stated net of offsettable prepaid tax assets of €221 million.
There are no prepaid tax assets which cannot be offset.

(€ million)	**1.6.2016**	**Changes in consolidation scope**	**Provisions**	**Utilisations**	**Other changes**	**31.12.2016**
Deferred tax liabilities		330	1	(4)		**327**
Prepaid tax assets		(213)	(12)	4		**(221)**
		117	**(11)**			**106**

Deferred tax liabilities and prepaid tax assets break down as follows, based on the most significant temporary differences:

(€ million)									31.12.2016
	Opening balance	**Changes in consolidation scope**	**Provisions**	**Utilisations**	**Significant impacts on shareholders' equity**	**Other changes**	**Final balance 31.12.2016**	**of which: IRES**	**of which: IRAP**
Deferred tax liabilities		**330**	**1**	**(4)**			**327**	**296**	**31**
Depreciation and amortisation exclusively for tax purposes		201		(1)		(16)	184	174	10
Revaluation of property, plant and equipment		116				16	132	112	20
Capital gains subject to deferred taxation		4		(3)			1	1	
Employee benefits		3	1				4	3	1
Capitalisation of financial expenses		3					3	3	
Impairment losses on receivables in excess of tax deductibility		1					1	1	
Other temporary differences		2					2	2	
Prepaid tax assets		**(213)**	**(12)**	**4**			**(221)**	**(198)**	**(23)**
Site dismantling and restoration									
Provision for risks and charges and other non-deductible provisions		(69)	(1)				(70)	(61)	(9)
Non-repayable and contractual grants		(73)	(5)				(78)	(66)	(12)
Non-deductible amortisation and depreciation		(57)		4			(53)	(53)	
Employee benefits		(12)	(3)				(15)	(13)	(2)
Other temporary differences		(2)	(3)				(5)	(5)	
Net deferred tax liabilities		**117**	**(11)**				**106**	**98**	**8**

Prepaid tax assets and deferred tax liabilities are considered to be long term. The note "Income taxes" provides information about taxes for the year.

22) Shareholders' equity

Shareholders' equity, which amounts to €1,064 million as at 31 December 2016 breaks down as follows:

(€ million)	1.6.2016	31.12.2016
Net equity attributable to Italgas		**1,063**
Share capital		**1,001**
Legal reserve		**192**
Share premium reserve		**620**
Consolidation reserve		**(316)**
Other reserves		**(350)**
Retained earnings		
Reserve for remeasurement of defined benefit plans for employees		**(12)**
Net profit (loss)		**(72)**
Less:		
- Treasury shares		
Shareholders' equity attributable to third parties		**1**
Napoletanagas		**1**
		1,064

The effects on the shareholders' equity, resulting from the entire transaction (establishment of Italgas, transfer, purchase and demerger) are summarised below.

(€ million)	Establishment	Transfer	Purchases (*)	Demerger	Consolidation effect	Final shareholders' equity
Share capital	€50,000	40		961		**1,001**
Legal reserve				192		**192**
Share premium reserve		204		416		**620**
Reserve for remeasurement of defined benefit plans for employees					(14)	**(14)**
Consolidation reserve					(316)	**(316)**
Other reserves			(350)			**(350)**
		244	**(350)**	**1,569**	**(330)**	**1,133**

(*) The reserve relates to purchases and is equal to the difference between the purchase price and the corresponding portion of cost of the investment.

Share capital

The share capital as at 31 December 2016 consisted of 809,135,502 shares with no indication of par value, with a total value of €1,001,231,518.44.

Legal reserve

The legal reserve stood at €192 million as at 31 December 2016.

Share premium reserve

The share premium reserve stood at €620 million as at 31 December 2016.

Consolidation reserve

The consolidation reserve (negative by €316 million) was determined during the first consolidation due to the difference emerging between (i) the purchase cost of the Italgas Reti S.p.A. (€2,967 million) and (ii) the equity investments and the shareholders' equity attributable to the Group on the transaction completion date (€2,637 million) and the restoration in the consolidated statements of the negative reserve from the remeasurement of the defined benefit plans for employees equal to €-14 million.

Other reserves

Other reserves, €-350 million as at 31 December 2016, include the reserve for the business combination under common control recorded following the acquisition from Snam S.p.A of 38.87% of the equity investment in Italgas Reti S.p.A., equal to the difference between the purchase price (€1,503 million) and the book value of the equity investment (€1,153 million).

In this regard it should be noted that the acquisition of the natural gas distribution activities took place through three simultaneous transactions (transfer, sale and demerger) involving the stake held by Snam S.p.A. in Italgas Reti S.p.A. in favour of Italgas S.p.A.. This transaction resulted in the deconsolidation by Snam of the natural gas distribution sector, and by Italgas S.p.A. of the acquisition of the stakeholding in Italgas Reti and, at a consolidated level, the net assets of the gas distribution sector. Note that the Snam main shareholder, CDP, is also, at the same time, the main shareholder of Italgas. The exposure described above reflects an approach based on the continuity of book values (with regard to Snam) because, under the scope of the wider group that Italgas is a part of, the transaction represents a "business combination under common control". The companies participating in the business combination (Snam, Italgas and Italgas Reti) have remained, as a result of the transaction, subject to control, and therefore wholly-consolidated by the same party (CDP), pursuant to IFRS 10, as represented by Snam in the information document pursuant to Article 70 and by Italgas in the information document pursuant to Article 57.

Reserve for remeasurement of defined-benefit plans for employees

At 31 December 2016, the reserve for remeasurement of employee benefit plans (-€12 million) included actuarial losses, net of the relative tax effect, recognised under other components of comprehensive income pursuant to IAS 19.
The changes in the reserve during the course of the year are shown below:

(€ million)	Gross reserve	Tax effect	Net reserve
Reserve as at 1 January 2016			
Changes in consolidation scope	(19)	5	**(14)**
Changes in 2016	2		**2**
Reserve as at 31 December 2016	**(17)**	**5**	**(12)**

Treasury shares

As at 31 December 2016 Italgas did not have any treasury shares in its portfolio.

Dividends

In its meeting of 23 March 2017, the Board of Directors proposed to the Shareholders' Meeting convened for 28 April 2017 the distribution of an ordinary dividend of €0.20 per share. The dividend will be paid out as of 24 May 2017, with an ex-coupon date of 22 May 2017 and a record date of 23 May 2017.

Minority interests

Net profit and shareholders' equity attributable to minority interests relate to the following consolidated entities:

(€ million)	Shareholders' equity attributable to minority interests 1.6.2016	Shareholders' equity attributable to minority interests 31.12.2016	Net profit attributable to minority interests 1.6.2016	Net profit attributable to minority interests 31.12.2016
Napoletanagas		1		

23) Guarantees, commitments and risks

Guarantees, commitments and risks, amounting to €642 million as at 31 December 2016 comprise:

(€ million)	1.1.2016	31.12.2016
Guarantees given in the interest of:		**96**
- subsidiaries		96
Financial commitments and risks:		**546**
Commitments		**504**
Commitments for the purchase of goods and services		495
Other		9
Risks		**42**
- compensation and litigation		42
		642

Guarantees

Guarantees of €96 million mainly refer to waivers in favour of Snam S.p.A. with regard to sureties and other guarantees issued in the favour of subsidiaries (€92 million) and guarantees issued by Eni S.p.A. (€1 million), mainly performance bonds and to participate in tenders and concessions relating to natural gas distribution.

Commitments
At 31 December 2016, commitments with suppliers to purchase property, plant and equipment and provide services relating to investments in property, plant and equipment and intangible assets under construction totalled €495 million.
Other commitments refer to minimum future payments relating to non-cancellable operating lease transactions (€9 million, including €2 million expiring in the following year and €7 million between one and five years).

Risks
Risks concerning compensation and litigation (€42 million) relate to possible (but not probable) claims for compensation arising from ongoing litigation, with a low probability that the pertinent economic risk will arise.

FINANCIAL RISK MANAGEMENT

Introduction
Italgas has established the Enterprise Risk Management (ERM) unit, which reports directly to the General Manager of Finance and Services and oversees the integrated process of managing corporate risk for all Group companies. The main objectives of ERM are to define a standard and transverse risk assessment model that allows risks to be identified, as well as guaranteeing the consolidation of mitigation measures and drawing up a reporting system.

The ERM methodology adopted by the Italgas Group is in line with the reference models and existing international best practices (COSO Framework and ISO 31000).

The ERM unit operates as part of the wider Internal Control and Risk Management System of Italgas.

The main corporate financial risks identified, monitored and, where specified below, managed by Italgas are as follows:

- the risk arising from exposure to fluctuations in interest rates;
- credit risk arising from the possibility of counterparty default;
- liquidity risk arising from not having sufficient funds to meet short-term financial commitments;
- rating risk;
- debt covenant and default risk.

There follows a description of Italgas' policies and principles for the management and control of the risks arising from the financial instruments listed above. In accordance with IFRS 7 - "Financial instruments: additional information", there are also descriptions of the nature and size of the risks resulting from such instruments.

Information on other risks affecting the business (operational risk and risks specific to the segment in which Italgas operates) can be found in the "Elements of risk management and uncertainty" section of the Directors' Report.

Interest rate risk

Fluctuations in interest rates affect the market value of Snam's financial assets and liabilities and its net financial expense. The Italgas Group has adopted a centralised organisational model. In accordance with this model, Italgas' various departments access the financial markets (banking channel) and use funds to cover financial requirements, in compliance with approved objectives, ensuring that the risk profile stays within the defined limits.

At 31 December 2016 the financial debt was carried entirely at a floating rate.

At 31 December 2016, the Italgas Group used external financial resources in the form of bilateral and syndicated loans with banks and other financial institutions, in the form of medium- to long-term loans and bank credit lines at interest rates indexed to the reference market rates, in particular the Europe Interbank Offered Rate (Euribor).

Therefore a rise in interest rates could have negative effects on the operations, results, balance sheet and cash flow of the Italgas Group. However, taking into consideration the current market context which features negative Euribor rates, the impacts on shareholders' equity and the net profit for the year of a hypothetical positive or negative change of 10% in interest rate would be negligible or, in any event, insignificant.

The objective of Italgas is to maintain a debt ratio between fixed rate and floating rate that minimises risk if interest rates rise, with the goal of achieving debt where the ratio between the fixed rate and floating rate is in the order of 2/3 at fixed rate and 1/3 at floating rate. We note in this regard that in early 2017, the Company issued a total of €2,150 million in bonds with the following characteristics: (i) €1,500 million, issued on 19 January 2017 and divided into two tranches, the first with a term of 5 years and the second 10 years, both at a fixed rate, amounting to € 750 million each and an annual coupon respectively of 0.50% and 1.625%; (ii) € 650 million issued on 14 March 2017, maturing on 14 March 2024 with a fixed rate annual coupon of 1.125%.

Credit risk

Credit risk is the Company's exposure to potential losses arising from counterparties failing to fulfil their obligations. Default or delayed payment of fees may have a negative impact on the economic results and financial position of Italgas.

For the risk of non-compliance by the counterparty concerning contracts of a commercial nature, the credit management for credit recovery and any possible disputes is handled by the business units and the centralised Italgas departments.

The rules for user access to the gas distribution service are established by the AEEGSI and set out in the Network Codes. For each type of service, these documents explain the rules regulating the rights and obligations of the parties involved in providing said services and contain contractual conditions, which reduce the risk of non-compliance by the clients.

There were no material credit risks at 31 December 2016. It should be noted, however, that around 95% of trade receivables were with extremely reliable clients, including Eni, which represents 47% of total trade receivables.

It cannot be ruled out however, that Italgas may incur liabilities and/or losses from the failure of its clients to comply with payment obligations, particularly given the current economic and financial situation, which makes the collection of receivables more complex and critical.

Liquidity risk

Liquidity risk is the risk that new financial resources may not be available (funding liquidity risk) or that the Company may be unable to convert assets into cash on the market (asset liquidity risk), meaning that it cannot meet its payment commitments. This may affect profit or loss should the Company be obliged to incur extra costs to meet its commitments or, in extreme cases, lead to insolvency and threaten the Company's future as a going concern.

To mitigate this risk and keep a level of liquidity consistent with requirements to maintain the rating, Italgas signed loan agreements exceeding the amounts needed on 31 December 2016. This excess amount (€1.1 billion) could be used to deal with any temporary liquidity requirements if funding requirements were higher than estimated.

The objective of Italgas is to put in place a financial structure (in terms of debt to Regulatory Asset Base ratio, between short- and medium-to-long-term debt, fixed-rate and variable-rate debt, and bank credit granted and bank credit used) which, in line with the business objectives, would guarantee an adequate level of liquidity for the Group in terms of the duration and composition of the debt.

Note that as at 31 December 2016, Italgas launched the Euro Medium Term Notes (EMTN) programme which has allowed for the issuance, by 31 October 2017, of one or more additional bond loans worth up to €2.8 billion, to be placed with institutional investors.

Rating risk

With reference to Italgas' long-term debt, respectively on 8 November 2016, Fitch and Moody's assigned Italgas S.p.A. the definitive rating of BBB+ (stable outlook) and Baa1 (stable outlook, later changed to negative outlook on 12 December 2016 following the previous change of the outlook from stable to negative for the long-term rating of the Italian Republic).

Based on the methodologies adopted by the rating agencies, a downgrade of one notch in Italy's current rating could trigger a downward adjustment in Italgas' current rating.

Risk of default and debt covenant

As at 31 December 2016, there were no financial covenants and unsecured bilateral and syndicated loan agreements in place with banks and other financial institutions. Some of these contracts provide, inter alia, for the following: (i) negative pledge commitments pursuant to which Italgas and its subsidiaries are subject to limitations concerning the pledging of real property rights or other restrictions on all or part of the respective assets, shares or merchandise; (ii) pari passu and change-of-control clauses; and (iii) limitations on certain extraordinary transactions that the Company and its subsidiaries may carry out.
Failure to comply with the commitments established for these loans - in some cases only when this non-compliance is not remedied within a set time period - and the occurrence of other events, such as cross-default events, some of which are subject to specific threshold values, may result in Italgas' failure to comply and could trigger the early repayment of the relative loan.

Future payments for financial liabilities, trade and other payables

The table below shows the repayment plan contractually established in relation to the financial payables, including interest payments:

(€ million)

									Maturity
	Balance at 1.6.2016	Balance at 31.12.2016	Maturing within 12 months	Maturing beyond 12 months	2018	2019	2020	2021	Beyond
Financial liabilities									
Bank loans		**3,619**	**2,696**	**923**		220	20	53	630
Interest on loans		**124**	**8**	**58**	4	4	4	4	42
		3,743	**2,704**	**981**	**4**	**224**	**24**	**57**	**672**

With reference to the payment times with regard to trade and other payables, refer to the note "Short-term financial liabilities, long-term financial liabilities and short-term portions of long-term liabilities" in the consolidated financial statements.

Other information on financial instruments

In relation to the categories mentioned in IAS 39 “Financial instruments: recognition and measurement”, Italgas has no financial assets held to maturity, available for sale or held for trading. As a result, the financial assets and liabilities all fall within the classification of financial instruments measured at amortised cost.

The book value of financial instruments and the relative effects on results and the balance sheet can be seen below.

(€ million)	Book value		Financial/Income statement		Financial/Shareholders' equity [a]	
	Balance at 1.6.2016	Balance at 31.12.2016	Balance at 1.6.2016	Balance at 31.12.2016	Balance at 1.6.2016	Balance at 31.12.2016
Financial instruments measured at amortised cost						
- Financial receivables [b]						
- Financial payables [b]		3,619		(124)		

[a] Net of the tax effect.
[b] The effects on the income statement are recorded under “Financial income/(expense)”.

The table below provides a comparison between the book value of financial assets and liabilities and their respective fair value.

(€ million)	Balance at 1.6.2016		Balance at 31.12.2016	
	Amount market	Amount accounting	Amount market	Amount accounting
Financial instruments measured at amortised cost				
- Financial receivables				
- Financial payables			3,619	3,619

The book value of trade and other receivables is close to the related fair value measurement, given the short period of time between when the receivable arises and its due date.

Market value of financial instruments

Below is the classification of financial assets and liabilities measured at fair value in the statement of financial position in accordance with the fair value hierarchy defined on the basis of the significance of the inputs used in the measurement process. More specifically, in accordance with the characteristics of the inputs used for measurement, the fair value hierarchy comprises the following levels:

a) level 1: prices quoted (and not amended) on active markets for the same financial assets or liabilities;
b) level 2: measurements made on the basis of inputs differing from the quoted prices referred to in the previous point, which, for the assets/liabilities submitted for measurement, are directly (prices) or indirectly (price derivatives) observable;
c) level 3: inputs not based on observable market data.

Disputes and other measures

Italgas is involved in civil, administrative and criminal cases and legal actions related to its normal business activities. According to the information currently available and considering the existing risks, Italgas believes that these proceedings and actions will not have material adverse effects on its consolidated financial statements.
The following is a summary of the most significant proceedings; unless indicated otherwise, no allocation has been made for the litigation described below because the Company believes it improbable that these proceedings will have an unfavourable outcome or because the amount of the allocation cannot be reliably estimated.

Criminal cases

Italgas Reti S.p.A. - Barletta event

On 25 April 2015 an explosion occurred due to a gas leak. The event, which happened during an operation following the report of damage to the gas network by a third-party company killed one Italgas Reti worker and injured others. The competent public prosecutor has launched an investigation, with which the company is actively cooperating.

Italgas Reti S.p.A. - Rome/Via Parlatore event

The public prosecutor at the Court of Rome opened an investigation in relation to the incident that took place on 7 September 2015 during an ordinary intervention in the gas distribution network in the municipality of Rome. The incident, which took place due to causes that are still being investigated, caused a fire that involved three people. Two of them, workers for an Italgas Reti contractor, suffered mild injuries. The third person – an Italgas Reti employee – died after a few weeks despite medical treatment. The investigation, which currently involves several Italgas Reti managers, is ongoing and it is not possible to rule out charges of violations of workplace safety. The Company is actively cooperating with the relevant authorities.

Italgas Reti S.p.A. - Cerro Maggiore/Via Risorgimento event

The public prosecutor at the Court of Busto Arsizio opened criminal proceedings currently against Italgas Reti executives, technicians and manual workers in relation to

an incident that took place on 11 November 2015 during an emergency intervention. The incident was caused by a gas leak due to remote controlled horizontal drilling work for the placement of fibre-optic cables performed by a third party.
The explosion occurred while interception activities were being completed on the section involved in the damage, causing the collapse of a house at No. 39 and the death of the woman who lived there, a serious injury to an Italgas Reti employee and to two other people who suffered mild injuries. The area was closed off. On 15 November 2015 the Busto Arsizio public prosecutor served a one-time notice of technical investigation, and the public prosecutor appointed its own technical consultants, who filed their report on 22 April 2016. Italgas Reti also appointed its own technical consultants. The investigation is ongoing and it is not possible to rule out charges of violations of workplace safety. The Company is actively cooperating with the relevant authorities.

Italgas Reti S.p.A. - Rome/Via Magnaghi event

On 25 October 2016, while a meter was being replaced by employees of an Italgas Reti contractor, there was a fire which involved two workers as well as the owner of the property. The three people suffered injuries of varying degrees. The Public Prosecutor launched investigations with regard to unknown persons and the Company is actively cooperating.

Electricity, Gas and Water Authority (AEEGSI)

Italgas Reti S.p.A. - Gas distribution service quality violations

Through resolution 33/2012/S/gas of 9 February 2012, the AEEGSI arranged the *launch of four disciplinary proceedings for the issuance of monetary fines with regard to gas distribution service quality* to establish the violation of Articles 2, paragraphs 1 and 12, paragraph 7, letter b) of the ARG/gas 120/08 resolution by four natural gas distribution companies including Italgas Reti. In particular, the Authority claims that, with regard to its Venice plant, the company failed to comply with the obligation to recondition or replace, by 31 December 2010, at least 50% of the cast-iron pipes with hemp- and lead-sealed joints in operation as at 31 December 2003, set out in the aforementioned Article 12, paragraph 7, letter b). On 25 March 2016 the AEEGSI announced the findings of the preliminary investigation.

Italgas Reti S.p.A. - Gas distribution service violations relating to the billing of the "municipal fees" tariff component

By means of Resolution 104/2015/S/gas of 12 March 2015, the Authority began enforcement proceedings for violations relating to the billing of the "COLci" component. The Authority specifically alleges that the billing procedures for this component stipulated under current regulations have not been complied with. The duration of the investigation has been set at 180 days, while the deadline for the adoption of the provision is 90 days from the closing date of the investigation. On 23 April 2015, the AEEGSI requested the transmission of billing data for the COLci tariff component for the years 2009-2013, which the company provided on 7 May 2015. To date, the preliminary investigation has not been concluded. To date, the preliminary investigation has not been concluded.

Administrative dispute

Italgas Reti S.p.A. - Municipality of Venice - Veneto Regional Administrative Court

Italgas Reti appealed before the competent administrative court against the acts through which the Municipality of Venice had unlawfully deducted around €31,000,000 from the refund due to Italgas Reti as the outgoing operator of the gas distribution service. The Municipality of Venice claims that it acquired - through a free transfer - the ownership of a portion of the natural gas distribution network. Italgas Reti promptly argued that the Municipality of Venice had unlawfully omitted to consider the effects that, by virtue of the existing industry regulations on the free transfer of natural gas facilities, were produced by virtue of the extension of the natural expiry of the concession until 2025. The hearing is current set for 5 April 2017.

Other information

Actions promoted by Italgas Reti following the Judicial Administration phase

On 25 July 2016 the Palermo Court of Appeal issued a Decree revoking the Judicial Control measure with regard to Italgas Reti, declaring the implementation of the consequent provisions terminated. The Decree of the Court of Appeal of Palermo became final. From the time that the Public Prosecutor did not propose an appeal under the terms of the law at the Court of Cassation, the unfavourable ruling against Italgas Reti became definitive.
Italgas Reti, through an appeal filed on 24 October 2016, opposed the settlement order of the expert witnesses of the Court of Palermo, challenging its non-involvement and, alternatively, the excess compensation paid. On 16 January 2017 Italgas Reti also filed at the Court of Palermo: (i) a note challenging the statement submitted by the Judicial Administrators, highlighting the irregularities and incompleteness of the documentation; as well as (ii) a motion requesting the repayment of all costs unfairly incurred for payments and refunds made with regard to the Judicial Administrators and their assistants and consultants.

Tax cases

Italgas Reti S.p.A. – Direct and indirect taxes

The 2009 general tax audit performed by officials of the Revenue Agency (Piedmont branch, Audit and Collection Sector, Large Taxpayer Office), which ended on 7 December 2012 with the release of the official audit report, resulted in around €1 million of additional IRES, IRAP and VAT, plus penalties and interest. The proceedings closed with a negative result, and the Company, in consortium with Eni S.p.A. for the assessment notice concerning IRES, brought an appeal on 28 May 2015 before the provincial tax commission of Turin, thus contesting only the findings relating to the undue deduction of taxes on foreign regularisations and other unrelated taxes. The Company, according to the payments made, used a total of €777,204.78 from the risk provision fund. On 23 June 2016, the Turin Provincial Commission accepted Italgas' appeal made in May 2015. It was not deemed appropriate to make changes to the risk provision because the ruling is not yet definitive.

On 12 December 2016 a notice of investigation was served relating to greater IRES and IRAP, plus penalties and interest, totalling €240,600.00 as a result of the findings of the Audit Report of 17 November 2014 ending the general tax inspection that the Revenue Agency had conducted into the incorporated company AES S.p.A., for the 2011 tax period. Taking into account the possibility of getting the penalties reduced by one third, as well as offsetting the tax for the items for which a lack of jurisdiction is challenged, it is believed that the probable disbursement will be limited to €90,251.32. Therefore a new provision of €17,403.15 was added to the existing provision of €72,848.17.

Italgas Reti S.p.A. - Local duties

On 29.12.2016 Italgas Reti was notified by Ama, on behalf of the Municipality of Rome, of tariff assessment notices that had been rejected for the period from 1 January 2011 to 31 December 2013 and tax assessment notices that had been rejected for the period from 1 January 2014 to 30 June 2016 in relation to the properties owned by the Company at 47/53 Via Giuseppe Guicciardi. Documents are in the process of being acquired which are aimed at clarifying the situation with regard to various locations and different areas, in the years subject to investigation, in order to be able to challenge the provisions. Since, at the moment, there is no certainty of being able to incontrovertibly demonstrate *a posteriori* that there is no basis for the notices and therefore being able to rule out the liabilities, it was deemed necessary to make an allocation to the risk provision, equal to €1,572,117.10, corresponding to the Tariff/Tax calculation, the reduced penalties (if there is a settlement concession) and the interest as quantified in the notices.

Napoletanagas S.p.A. - Local duties

The allocation to the tax risk provision involves assessment notices, relating to waste disposal tax, being challenged by the Company. Specifically, the increase for 2016 includes:

- €25,185.00 (tax, penalties and interest) confirmed by Publiservizi S.r.l., on behalf of the Municipality of Caserta, with regard to uncovered areas of the Viale dei Bersaglieri premises for 2012. The notice was challenged before the Caserta Provincial Tax Commission;
- the amount of €72,404.53 (tax, penalties and interest), referring to the assessment notice received on 18/10/2016, from Equitalia Servizi di Riscossione S.p.A. for the Municipality of Naples, in relation to an alleged recovery of waste disposal tax, for the years 2010, 2011 and 2012 for the premises at 66/f via Galileo Ferraris. The notices were challenged before the Naples Provincial Tax Commission;
- the amount of €185,464.00 relates to two notices received on 29/12/2016, from Equitalia Servizi di Riscossione S.p.A, on behalf of the Municipality of Naples, which confirmed a greater solid urban waste disposal tax for the years 2010, 2011 and 2012, relating to the premises in Naples at Via Brin and via Leopardi. Investigations are in progress to determine the amounts effectively due in this regard. It was therefore deemed appropriate to allocate €185,464.00, including tax, reduced penalties (if there is a settlement concession) and interest.

Environmental regulations

With respect to environmental risk, while the Company believes that it operates in substantial compliance with the laws and regulations and considering the adjustments to environmental regulations and actions already taken, it cannot be ruled out that the Company may incur costs or liabilities, which could be significant.
It is difficult to foresee the repercussions of any environmental damage, partly due to new laws or regulations that may be introduced for environmental protection, the impact of any new technologies for environmental clean-ups, possible litigation and the difficulty in determining the possible consequences, also with respect to other parties' liability and any possible insurance compensation.

The following accounting items of the Consolidated Income Statement relate to Italgas S.p.A. as of the date of incorporation (1 June 2016) and its subsidiaries as of the date of acquiring control over them (7 November 2016).

24) Revenue

The breakdown of *revenue* for the period, amounting to €274 million, is shown in the following table.

(€ million)	Jun-Dec 2016
Core business revenue	248
Other revenue and income	26
	274

The Group's revenue was achieved exclusively in Italy as is detailed below.

Core business revenue

Core business revenue, amounting to €248 million, is broken down in the following table:

(€ million)	Jun-Dec 2016
Natural gas distribution	177
Revenue for infrastructure construction and improvements (IFRIC 12)	62
Technical assistance, engineering, IT and other services	5
Water distribution and sale	4
	248

Core business revenue (€248 million) mainly relates to fees for the natural gas distribution service (€177 million) and revenue resulting from the construction and upgrading of infrastructure associated with the concession agreements pursuant to the provisions of IFRIC 12 (€62 million).

Core business revenue is reported net of the following items involving tariff components, in addition to the tariff, applied to cover gas system expenses of a general nature. Amounts received from Italgas are paid, in an equal amount, to the Energy and Environmental Services Fund (CSEA).

(€ million)	Jun-Dec 2016
RE-RS-UG1 fees	27
UG3 fees	13
UG2 fees	5
Gas Bonus and GS fees	(1)
	44

Additional fees for the distribution service (€44 million) mainly relate to the following fees: (i) RE, to cover expenses for calculating and implementing energy savings and the development of renewable energy sources in the gas sector; (ii) RS, to cover gas services quality; (iii) UG1, to cover any imbalances in the equalisation system and any adjustments; (iv) UG2, to offset retail sales marketing costs; (v) UG3int, to cover expenses related to interruptions to the service; (vi) UG3ui, to cover expenses related to any imbalances in specific equalisation mechanism balances for the Default Distribution Service Provider, as well as any arrears expenses incurred by Suppliers of Last Resort, exclusively for end customers whose supplies cannot be suspended; (vii) UG3ft, to cover expenses relating to the service for temporary providers on the transportation network; and (viii) GS, to cover the tariff compensation system for economically disadvantaged customers.

Revenues from the distribution of gas (€177 million) relate to the transportation of natural gas on behalf of all commercial operators that require access to the network of distribution companies, based on the Network Code; the most significant annual transport volumes were those relating to the activities carried out by Eni S.p.A.. These revenues were determined based on Resolution no. 367/2014/R/gas and 173/2016/R/gas of the Authority.

Revenues from the sale of water (€4 million) relate to the distribution of water achieved by Napoletanagas.

Other revenue and income

Other revenue and income, amounting to €26 million, break down as follows:

(€ million)	Jun-Dec 2016
Income from gas distribution service safety recovery incentives	24
Income from property investments	1
Contractual penalties receivable	1
	26

* Net of costs incurred to purchase the certificates.

Income from security recovery incentives, amounting to €24 million, relate to amounts recognised by the Authority in connection with the achievement of quality and technical standards relating to the natural gas distribution service.

25) Operating costs

The breakdown of *operating costs*, amounting to €168 million, is shown in the following table:

(€ million)	Jun-Dec 2016
Purchases, services and other costs	111
Personnel cost	57
	168

Operating costs relating to the construction and upgrading of natural gas distribution infrastructure linked to concession agreements, recorded pursuant to IFRIC 12 amounted to €62 million and break down as follows:

(€ million)	Jun-Dec 2016
Purchase costs for raw materials, consumables, supplies and goods	8
Costs for services	37
Costs for the use of third-party assets	1
Personnel cost	16
	62

Purchases, services and other costs

The item *purchases, services and other costs*, amounting to €111 million, breaks down as follows:

(€ million)	Jun-Dec 2016
Purchase costs for raw materials, consumables, supplies and goods	15
Costs for services	70
Costs for the use of third-party assets	8
Changes in raw materials, consumables, supplies and goods	(7)
Net accrual to provisions for risks and charges	5
Other expenses	21
	112
Less:	
Increase on internal work	(1)
- of which costs for services	(1)
	111

Costs for raw materials, consumables, supplies and goods break down as follows:

(€ million)	Jun-Dec 2016
Inventory materials	15
	15

Warehouse materials specifically relate to the purchase of gas meters and pipes.

Costs for raw materials, consumables, supplies and goods include costs relating to the construction and upgrading of gas distribution infrastructures (€8 million), recorded due to the implementation of IFRIC 12 as of 1 January 2010.

Costs for services, amounting to €69 million, relate to:

(€ million)	Jun-Dec 2016
Project management and plant maintenance planning	33
Advisory and professional services	13
Centralised services	9
Staff-related service costs	3
Other sale costs	3
Telecommunications services	2
Electricity, water and other services (utilities)	1
Insurance	1
Other services	7
Utilisation of provisions for risks	(2)
	70
Less:	
Increase on internal work	(1)
	69

Costs for services include costs relating to the construction and upgrading of gas distribution infrastructures (€37 million), recorded due to the implementation of IFRIC 12 as of 1 January 2010.

Costs for project management and plant maintenance work (€33 million) mainly relate to activity involving the extension and maintenance of gas distribution plants.

Costs for the use of third-party assets, which amounted to €8 million, break down as follows:

(€ million)	Jun-Dec 2016
Fees for patents, licences and concessions	6
Leases and rentals	2
	8

Fees, patents and licences (€6 million) mainly concern fees paid to concessionary bodies for the operation of natural gas distribution concessions.

Leases and rentals (€2 million) mainly relate to charges for operating leases of properties for use as offices.

Costs for the use of third-party assets relating to the construction and upgrading of gas distribution infrastructures (€1 million), recorded due to the implementation of IFRIC 12 as of 1 January 2010.

The change in inventories of raw materials, consumables, supplies and goods (-€7 million) is mainly due to plan of replacing gas meters.

Net provisions for risks and charges, amounting to €5 million net of use, refer mainly to environmental risks and to the TEE risk fund. For more details about the change in provisions for risks and charges, please see the note "Provisions for risks and charges".

Other payables, amounting to €21 million, break down as follows:

(€ million)	Jun-Dec 2016
Gas distribution service safety recovery penalties	16
Direct and indirect taxes and local levies	3
Expenses for settlements, compensation and sanctions	1
Utilisation of provisions for risks	(1)
Other expenses	2
	21

Gas distribution service safety improvement penalties (€16 million) relate to repayments, paid to the Authority, related to awards for gas distribution safety improvements for 2016.

Personnel cost

Labour costs, amounting to €57 million, break down as follows:

(€ million)	Jun-Dec 2016
Wages and salaries	29
Social security contributions	10
Employee benefits	2
Income for personnel on secondment	(1)
Other expenses	18
	58
Less:	
Increase on internal work	(1)
	57

The item includes costs relating to the construction and upgrading of gas distribution infrastructures (€16 million), recorded due to the implementation of IFRIC 12 as of 1 January 2010.

Employee benefits (€2 million) refer mainly to expenses associated with the closure of the Gas Fund pursuant to Law no. 125 of 6 August 2015[57]. These benefits are analysed in the note "Provisions for employee benefits".

The item other expenses (€18 million) mainly relates to provisions made in the period to the retirement benefits fund (€15 million).

Average number of employees

The average number of payroll employees included in the scope of consolidation, broken down by status, is as follows:

Professional status	31.12.2016
Executives	37
Managers	222
Office workers	1,909
Manual workers	1,392
	3,560

The average number of employees is calculated on the basis of the monthly number of employees for each category.

As at 31 December 2016, the number of employees in service was 3,570.

Remuneration due to key management personnel

The remuneration due to persons with powers and responsibilities for the planning, management and control of the Company, i.e. executive and non-executive directors, general managers and managers with strategic responsibilities ("key management personnel"), in office at 31 December 2016, amounted to €3 million and breaks down as follows:

(€ million)	Jun-Dec 2016
Wages and salaries	2
Other long-term benefits	1
	3

[57] As at 1 December 2015, Law no. 125 of 6 August 2015 closed the Supplementary Fund of compulsory general insurance for disability, old age and survivors for employees of private gas companies (hereinafter the "Gas Fund") in which approximately 3,500 people from the Group were enrolled, particularly in the distribution segment. The Law established a series of additional contributions payable by the employer. These expenses, which are estimated on the basis of actuarial assumptions, are currently valued at €40 million (€28 million net of tax effect).

Remuneration due to directors and statutory auditors

Remuneration due to Directors amounted to €0.3 million and remuneration due to statutory auditors amounted to €0.1 million (Article 2427, no. 16 of the Italian Civil Code). This remuneration includes emoluments and any other amounts relating to pay, pensions and healthcare due for the performance of duties as a director or statutory auditor giving rise to a cost for the Company, even if not subject to personal income tax.

26) Amortisation, depreciation and impairment

The item *amortisation, depreciation and impairment*, amounting to €77 million, breaks down as follows:

(€ million)	Jun-Dec 2016
Total amortisation and depreciation	
Property, plant and equipment	2
Intangible assets	75
	77

The amount of €75 million, relating to the amortisation and depreciation of intangible assets, includes the greater amortisation and depreciation resulting from the reduction in the useful life of traditional meters[58], subject to the plan to replace them with electronic meters, provided for by the AEEGSI resolutions as part of the implementation of the remote-reading plan (€43 million).

27) Financial income (expenses)

Net financial expenses, amounting to €123 million, breaks down as follows:

(€ million)	Jun-Dec 2016
Financial income (expense)	(124)
Financial expenses	(124)
Financial income	
Other financial income (expense)	1
Other financial expense	
Other financial income	1
	(123)

[58] In order to complete the amortisation process in consistency with the scheduled meter replacement plan, to be completed by 2018, the useful life of the meters included in the replacement plan has been updated pursuant to AEEGSI Resolution no. 631/13 and no. 554/15.

(€ million)	Jun-Dec 2016
Financial income (expense)	**(124)**
Expense on financial debt:	**(124)**
- Fees on loans and bank credit lines	**(1)**
- Interest expense on credit lines and loans due to banks and other lenders	**(123)**
Others:	**1**
- Effects associated with the passing of time (accretion discount) (*)	**1**
	(123)

(*) This item refers to the increase in provisions for risks and charges and provisions for employee benefits, which are reported at discounted value under notes "Provisions for risks and charges", and "Provisions for employee benefits".

Expenses from financial debts (€124 million) mainly relate to expenses resulting from the early extinguishment of loan agreements towards the former parent company, Snam S.p.A. (€119 million).

28) Income and expense from equity investments

Income and expense from equity investments, amounting to €3 million, break down as follows:

(€ million)	Jun-Dec 2016
Equity method valuation effect	**3**
Capital gains from valuation using the equity method	**3**
	3

Details of capital gains and capital losses from the valuation of equity investments using the equity method can be found in the note "Net equity-accounted investments".

29) Income taxes

Income taxes, amounting to €19 million, break down as follows:

(€ million)	Jun-Dec 2016		
	IRES	IRAP	Total
Current taxes	**(9)**	**3**	**(6)**
Current taxes for the year	(7)	3	**(4)**
Adjustments for current taxes relating to previous years	(2)		**(2)**
Deferred and prepaid taxes	**(12)**	**(1)**	**(13)**
Deferred taxes	(2)		**(2)**
Prepaid taxes	(10)	(1)	**(11)**
	(21)	**2**	**(19)**

Positive income taxes totalling €19 million relate to current taxes (€6 million) and net prepaid taxes (€13 million).

An analysis of deferred and prepaid taxes based on the nature of the significant temporary differences that generated them can be found in the note “Deferred tax liabilities”.

The reconciliation of the theoretical tax charge (calculated by applying the corporation tax (IRES) and regional production tax (IRAP) rates in force in Italy) with the actual tax charge for the year can be broken down as follows:

(€ million)		Jun-Dec 2016
	Tax rate	Balance
IRES		
Pre-tax profit		(91)
IRES due, calculated based on the theoretical tax rate	(27.5)	(25)
Changes to the theoretical rate:		
- Income from equity investments	1.4%	3
- Other permanent differences	3.0%	1
IRES due for the year recorded on the income statement	(23.1%)	(21)

(€ million)		Jun-Dec 2016
	Tax rate	Balance
IRAP		
Difference between value and production costs		(168)
IRAP due, calculated based on the theoretical tax rate	(4.2%)	(7)
Changes to the theoretical rate:		
Personnel costs		
Interest expense not deductible for IRAP purposes	3.0%	5
Regional IRAP adjustments	1.2%	2
Other permanent differences	2.2%	2
IRAP due for the year recorded in the income statement	2.2%	2

Taxes related to components of comprehensive income

Current and deferred taxes related to other components of comprehensive income can be broken down as follows:

(€ million)	Jun-Dec 2016		
	Pre-tax value	Tax effect	Post-tax value
Remeasurement of defined-benefit plans for employees	19	(5)	14
Portion of equity-accounted investments pertaining to "other components of comprehensive income"	(2)		(2)
Other components of comprehensive income	17	(5)	12
Deferred/prepaid taxes		(5)	

30) Profit (loss) per share

The loss per share, equal to €0.09, is calculated by dividing the net loss pertaining to Italgas (€72 million) by the weighted average number of outstanding Italgas shares during the year (809,135,502 shares).
The loss per diluted share is calculated by dividing the net loss by the weighted average number of outstanding shares during the period, excluding treasury shares, increased by the number of shares which could potentially be added to the outstanding ones as a result of the granting or disposal of treasury shares held under stock option plans. If treasury shares are not owned, the loss per share coincides with the loss per diluted share.

31) Related-party transactions

Considering the *"de facto"* control of CDP S.p.A. over Italgas S.p.A., pursuant to the international accounting standard IFRS 10 - Consolidated Financial Statements, the related parties of Italgas, based on the current Group ownership structure, are represented by Italgas' associates and joint ventures, as well as by the parent company, CDP S.p.A., and by its subsidiaries and associates and direct or indirect subsidiaries, associates and joint ventures of the Ministry of Economy and Finance (MEF). Members of the Board of Directors, Statutory Auditors and Italgas Group managers with strategic responsibilities, and their relatives, are also regarded as related parties.

As explained in detail below, related-party transactions concern the exchange of goods and the provision of regulated services in the gas sector. Transactions between Italgas and related parties are part of ordinary business operations and are generally settled under market conditions, i.e. the conditions that would apply between two independent parties. All the transactions carried out were in the interest of the companies of the Italgas Group.

Pursuant to the provisions of the applicable legislation, the Company has adopted internal procedures to ensure that transactions carried out by Snam or its subsidiaries with related parties are transparent and correct in their substance and procedure.

Directors and statutory auditors declare potential interests that they have in relation to the Company and the Group every six months, and/or when changes in said interests occur; they also inform the Chief Executive Officer (or the Chairman, in the case of the Chief Executive Officer's interests), who in turns informs the other directors and the Board of Statutory Auditors, of individual transactions that the Company intends to carry out and in which they have an interest.

Italgas is not subject to management and coordination. Italgas manages and coordinates its subsidiaries, pursuant to Article 2497 et seq. of the Italian Civil Code.

The amounts involved in commercial, financial and other transactions with the above-mentioned related parties are shown for the 2016 financial years. The nature of the most significant transactions is also stated.

Commercial and other transactions

Commercial and other transactions can be broken down as follows:

(€ million)	31.12.2016			2016				
				Costs [a]			Revenue [b]	
	Receivables	Payables	Guarantees and commitments	Goods	Services	Other	Services	Other
Companies under joint control and associates								
- Toscana Energia S.p.A.	1							
	1							
Companies owned or controlled by the State								
- Snam Group	10	31	92		14			
- Enel Group	32	3					31	1
- Eni Group	213	38					171	5
- Ferrovie dello Stato Group		1	1					
	255	**73**	**93**		**14**		**202**	**6**
Totale generale	**256**	**73**	**93**		**14**		**202**	**6**

[a] Includes costs for goods and services to be used in investment activities.
[b] Before tariff components which are offset in costs.

Companies under joint control and associates

The main active commercial transactions concern IT-related services to Toscana Energia S.p.A.

Companies owned or controlled by the State

The main active commercial transactions relate to:

- natural gas distribution and personal loans to Eni S.p.A.;
- property management services, IT-related performance and personal loans to Eni S.p.A.;
- natural gas distribution to Enel Energia S.p.A..

The main passive commercial transactions relate to:

- provision of services by Snam S.p.A.;
- supply of electricity and natural gas for domestic consumption by Eni S.p.A.;
- services pertaining to the management and maintenance of property, staff-related services canteen management and other general services by Eni Servizi S.p.A.;

Financial transactions

Financial transactions can be broken down as follows:

(€ million)	31.12.2016		2016	
	Receivables	Payables	Income	Expenses
Parent company				
- Cassa Depositi e Prestiti				1
				1
Companies owned or controlled by the State				
- Snam Group				119
				119
				120

Relations with the parent company, CDP

The main financial transactions carried out with CDP specifically concern commissions on subscribed loans.

Companies owned or controlled by the State

Passive financial transactions with Snam S.p.A. mainly relate to expenses resulting from the settlement of related loans, following the acquisition of Italgas Reti S.p.A..

Transactions with directors, statutory auditors and key managers, with reference in particular to their remuneration, are described in the note “Operating costs”, to which reference is made.

Impact of related-party transactions or positions on the balance sheet, income statement and statement of cash flows

The impact of related-party transactions or positions on the balance sheet is summarised in the following table:

(€ million)	1.1.2016			31.12.2016		
	Total	Related parties	Share %	Total	Related parties	Share %
Statement of financial position						
Trade receivables and other current receivables				579	256	44.2%
Trade and other payables				443	73	16.5%

The impact of related-party transactions on the income statement is summarised in the following table:

(€ million)	Jun-Dec 2016		
	Total	Related parties	Share %
Income statement			
Core business revenue	248	202	81.5%
Other revenue and income	26	6	23.1%
Purchases, services and other costs	(111)	(15)	13.5%
Personnel cost	(57)	1	(1,8%)
Financial expenses	(123)	(121)	98.4%

Related-party transactions are generally governed on the basis of market conditions, i.e. the conditions that would be applied between two independent parties.

The principal cash flows with related parties are shown in the following table:

(€ million)	Jun-Dec 2016
Revenue and income	208
Cost and expense	(14)
Change in trade receivables and other current receivables	(256)
Change in other current assets	
Change in trade and other payables	73
Change in other current liabilities	
Interest received (paid)	(121)
Net cash flow from operating activities	**(110)**
Investments:	
- Property, plant and equipment and intangible assets	
- Equity investments	
Financial receivables held for operations	
Change in payables and receivables relating to investments	
Cash flow from investments	
Net cash flow from investment activities	
Repayment of long-term financial debt	
Increase (decrease) in short-term financial debt	
Financial receivables not held for operations	
Net cash flow from financing activities	
Total cash flows with related parties	**(110)**

The effect of cash flows with related parties is shown in the following table:

(€ million)	1.1.2016			31.12.2016		
	Total	Related parties	Share %	Total	Related parties	Share %
Cash flow from operating activities				(45)	(110)	
Cash flow from investment activities				(1,567)		
Cash flow from financing activities				1,613		

32) Significant non-recurring events and transactions

Pursuant to Consob Communication DEM/6064293 of 28 July 2006, it should be stated that no significant non-recurring events or transactions took place during the course of the year.

33) Positions or transactions arising from atypical and/or unusual transactions

Pursuant to Consob Communication DEM/6064293 of 28 July 2006, it should be stated that no atypical and/or unusual positions or transactions took place during the course of the year.

34) Post-balance sheet events

Post-balance sheet events are described in the section "Other information" contained in the Directors' Report.

35) Publication of the financial statement

The financial statements were authorised for publication by the Board of Directors of Italgas at its meeting of 23 March 2017, in accordance with the law. The Board of Directors authorised the Chairman and the Chief Executive Officer to make any changes which might be necessary or appropriate for finalising the form of the document during the period between 23 March and the date of approval by the Shareholders' Meeting.

Certification of the consolidated financial statements pursuant to Article 154-bis, paragraph 5 of Legislative Decree 58/98 (Consolidated Finance Act)

1. The undersigned Paolo Gallo and Claudio Ottaviano, respectively as CEO and as Executive responsible for preparing the corporate accounting documents of Italgas S.p.A., certify, taking into account the provisions of Article 154-bis, paragraph 3 and 4 of Legislative Decree no. 58 of 24 February 1998:
   - the adequacy, considering the Company's characteristics, and the effective implementation of the administrative and accounting procedures for the preparation of the consolidated financial statements during the course of 2016.
2. The administrative and accounting procedures for the preparation of the consolidated financial statements at 31 December 2016 were defined and their adequacy was assessed using the rules and methods in line with the Internal Control – Integrated Framework model issued by the Committee of Sponsoring Organisations of the Treadway Commission, which represents a benchmark framework for the internal control system generally accepted at international level.
3. It is also certified that:

   3.1 The consolidated financial statements at 31 December 2016:

   a) were prepared in accordance with the applicable international accounting standards recognised in the European Community pursuant to Regulation (EC) no. 1606/2002 of the European Parliament and of the Council of 19 July 2002;

   b) are consistent with the accounting records and ledgers;

   c) are able to provide a true and fair view of the financial position, operating results and cash flows of the issuer and of the companies included in the scope of consolidation.

   3.2 The Directors' Report includes a reliable analysis of the operating performance and results, as well as the position of the issuer and of all the companies included in the scope of consolidation, together with a description of the principal risks and uncertainties to which they are exposed.

23 March 2017

Chief Executive Officer	Executive responsible for preparing the corporate accounting documents
Paolo Gallo	Claudio Ottaviano
Paolo Gallo	Ottaviano

Independent auditors' report

Building a better working world

EY S.p.A.
Via Meucci, 5
10121 Torino

Tel: +39 011 5161611
Fax: +39 011 5612554
ey.com

INDEPENDENT AUDITOR'S REPORT IN ACCORDANCE WITH ARTICLES 14 AND 16 OF LEGISLATIVE DECREE N. 39, DATED 27 JANUARY 2010

(Translation from the original Italian text)

To the Shareholders of Italgas S.p.A.

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of the Italgas Group, which comprise the balance sheet as at 31 December 2016, the income statement, the statement of comprehensive income, the statement of changes in shareholders' equity and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the consolidated financial statements

The Directors of Italgas S.p.A. are responsible for the preparation of these consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the European Union as well as with the regulations issued to implement art. 9 of Legislative Decree n. 38, dated 28 February 2005.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (ISA Italia) implemented in accordance with article 11 of Legislative Decree n. 39, dated 27 January 2010. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's professional judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

EY S.p.A.
Sede Legale: Via Po, 22 - 00198 Roma
Capitale Sociale deliberato Euro 3.250.000,00, sottoscritto e versato Euro 2.950.000,00 i.v.
Iscritta alla S.O. del Registro delle Imprese presso la C.C.I.A.A. di Roma
Codice fiscale e numero di iscrizione 00434000584 - numero R.E.A. 250904
P.IVA 00891231003
Iscritta all'Albo Revisori Legali al n. 70945 Pubblicato sulla G.U. Suppl. 13 - IV Serie Speciale del 17/2/1998
Iscritta all'Albo Speciale delle società di revisione
Consob al progressivo n. 2 delibera n.10831 del 16/7/1997

A member firm of Ernst & Young Global Limited

EY
Building a better working world

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Italgas Group as at 31 December 2016, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union and with article 9 of Legislative Decree n. 38, dated 28 February 2005.

Report on other legal and regulatory requirements

Opinion on the consistency of the Directors' Report and of specific information of the Report on Corporate Governance and Ownership Structure with the consolidated financial statements

We have performed the procedures required under audit standard SA Italia n. 720B in order to express an opinion, as required by law, on the consistency of the Directors' Report and of specific information of the Report on Corporate Governance and Ownership Structure as provided for by article 123-bis, paragraph 4 of Legislative Decree n. 58, dated 24 February 1998, with the consolidated financial statements. The Directors of Italgas S.p.A. are responsible for the preparation of the Directors' Report and of the Report on Corporate Governance and Ownership Structure in accordance with the applicable laws and regulations. In our opinion the Directors' Report and the specific information of the Report on Corporate Governance and Ownership Structure are consistent with the consolidated financial statements of the Italgas Group as at 31 December 2016.

Turin, 3 April 2017

EY S.p.A.
Signed by: Stefania Boschetti, partner

This report has been translated into the English language solely for the convenience of international readers.

Concept & Design: Inarea

Printing and page layout:
Servif RR Donnelley

Photo: Archivio Storico Italgas
www.Italgas.it

Printed in April 2017