

**REPORT OF THE BOARD OF DIRECTORS REGARDING THE ISSUANCE OF BONDS
CONVERTIBLE
OR EXCHANGEABLE FOR SHARES WITHOUT PREEMPTIVE RIGHTS**

This report is issued pursuant to the agreement to issue bonds with no preemptive rights which are convertible or exchangeable for shares of Indra Sistemas, S.A. (the "Company") in an initial amount of 250 million euros, which may be increased by no more than 50 million euros in the event that the Company exercises completely its option to increase no later than the date for fixing the rate of interest and the conversion ratio (the "Bonds"); and the award of the Bonds to subscribers, (the "Issuance"). This report is submitted to the Board of Directors by virtue of the authority and delegation of powers conferred upon the Board of Directors at the Annual Shareholders Meeting of the Company held 30 June 2016 in accordance with the resolution adopted under the eighth item of the agenda.

This report is issued in compliance with the provisions of Articles 414.2 and 417.2.a) of the *Ley de Sociedades de Capital*, ("Spanish Corporations Act" or "LSC"), the consolidated text of which was approved by *Real Decreto Legislativo 1/2010*, 2 July, and Article 511.3 of the same statute, and is structured as follows: the first section describes the method of Issuance and the reasoning behind the placement method (book building); in the second section the bases and forms of Issuance are described; and in the last section it is explained why the Bonds do not have preemptive rights, given their nature as being convertible.

This report will be published on the Company website immediately upon determination of the final conditions of the Issuance, in accordance with recommendation 5 of the Code of Good Corporate Governance, and at the next Shareholders Meeting will be made available to shareholders, together with the corresponding report from the auditor unassociated with the Company auditor so designated by the *Registro Mercantil de Madrid*, as provided for in Article 511.2 of the LSC.

**1. DESCRIPTION OF THE METHOD OF ISSUANCE AND THE REASONING
BEHIND THE PLACEMENT METHOD**

During the last quarter of 2013 the Company embarked upon a diversification strategy regarding its financing sources by means of the issuance in October of that year of convertible bonds in a total principal amount of 250 million euros, with a 5 year maturity ("2013 Bonds"). This allowed the pursuit of two main objectives, apart from the one mentioned above -- diversification of financing sources --, to wit: (i) on the one hand, it would contribute to an improvement in the average maturity time for debt, and (ii) on the other hand, a fixed interest issuance would allow the Company to significantly mitigate risk from interest rates.

Financial market conditions counseled access to financing by issuing debt instruments with the object of obtaining outside financing at a lower cost and with longer maturity dates than those offered by bank financing at the time.

Along these lines, recent measures adopted by the European Central Bank beginning in June, 2016 -- most notably, the extension of quantitative easing in the corporate bond market -- have provided an additional stimulus to the private fixed interest market. In this environment of historically low interest rates and within the framework of the Company's financial strategy, this new Issuance seeks to take advantage of opportunities currently offered in the capital markets for prolonging average maturity dates for debt and reducing the average cost of resources, while at the same time laying a firmer foundation for the creation of long term sustainable economic value.

The transaction was designed to achieve the goals of the Issuance under the most advantageous conditions possible for the Company. The various milestones for the Issuance are explained below, including an expected partial buyback of the 2013 Bonds, from the resolution of the Board of Directors, to issuance of the Bonds, to their subscription by investors, as well as the reasons justifying the placement strategy chosen.

1.1 Description of the Issuance and Buyback Procedures

(A) Issuance Resolution

The Board of Directors of the Company expects to approve the Issuance of the Bonds without preemptive rights and the capital share increase in order to enable conversion of the bonds into newly issued shares (together, the "Issuance Resolution") in terms that are similar but not exactly the same as those of the 2013 Bonds, under the authority and delegation of power conferred upon it by resolution at the Annual Shareholders Meeting held 30 June 2016.

Additionally, the Board of Directors will delegate to the Executive Chairman and the CEO, without distinction, the power to formulate the terms and conditions of the Issuance and the discretionary amount of the capital share increase, taking into account at their discretion the results of the book building process for the Bonds.

At the same time, it is expected that a portion of the 2013 Bonds will be repurchased and cancelled (the "Repurchase"), with the money coming from a minority of the funds raised in the Issuance, as explained in a section below.

(B) Book Building Process

The Company expects to contract the services of one or various financial institutions (together the "Underwriters") who will undertake a process of accelerated book building among qualified investors (the "Book Building Process") with the goal of gauging the interest of investors in subscribing to the Issuance.

The Book Building Process will last for a period which is expected not to exceed 24 hours, and the market will be informed of its initiation by means of a proper report of Material Fact made to the *Comisión Nacional del Mercado de Valores* ("Spanish Securities Exchange Commission" or "CNMV").

(C) Setting the Issuance terms

Once the Book Building Process is complete, the Executive Chairman or the CEO will set the final terms for the Issuance in accordance with the provisions of the Issuance Resolution.

In particular, the Executive Chairman or the CEO will set the actual amount of the Issuance (up to a maximum of 300 million euros), the Conversion or Exchange Ratio (as that term is defined below), the rate of interest, and the subscription and delivery dates of the Bonds, taking into account at his or their discretion the results of the Book Building Process. These details will be communicated to the public as well by means of disclosure of a Material Fact to the CNMV.

The amount of the share capital increase necessary to cover all of the demand for the Bonds will be determined by the final amount of the Issuance and the Conversion or Exchange Ratio (as that term is defined below).

(D) Underwriting Agreement

It is expected that the Company will sign an underwriting or subscription agreement with Underwriters (the "Underwriting Agreement") under which the Company would commit to submit all of the paperwork necessary for a successful issuance of the Bonds and the Underwriters would commit to attract subscribers for the Bonds and failing that, subscribe and distribute them.

The Subscription Agreement would be subject to termination and other common conditions contained in this type of transaction, including termination of the Underwriting Agreement in the case of force majeure. After signing the Underwriting Agreement, selection of investors and confirmation of investor interest would proceed, culminating in firm subscriptions for the Bonds.

(E) Subscription and distribution of the Bonds

The Bonds will be issued, subscribed and delivered to qualified and institutional investors parties to the Issuance or, in their absence, to the Underwriters on the date determined by the Executive Chairman or the CEO, and their listing on the multinational trading system *Freiverkehr* ("Open Market") at the Frankfurt Stock Exchange will be solicited.

Parallel with the Issuance described above, the Company plans to accomplish the Repurchase by means of an offering to the holders of the 2013 Bonds of the possibility of repurchasing a part of the 2013 Bonds in circulation at a set price in order to cancel them. The Repurchase may be for up to 100 million euros of the 2013 Bonds, with the Company reserving the right to decide whether or not to carry out the Repurchase as well as the right to fix the amount.

In order to carry out the Repurchase, the Company will depend upon the assistance of one or more Underwriters as repurchase agents. The Company reserves the right at its discretion to proceed or not with the Issuance, as well as reserving for itself the discretion to go forward with the Repurchase or not.

The Repurchase will be financed with a portion of the funds raised by the issuance of the Bonds.

The Book Building Process and the Repurchase are independent from one another. Assignment of the Bonds does not depend upon any showing of interest in the sale of the 2013 Bonds by their owners, although those investors who participate in the Repurchase may receive, at the discretion of the Company, preference in the award of Bonds. The repurchase price for each existing 2013 Bond will be a fixed price no greater than 100 basis points above the highest Repurchase offer price for 2013 Bonds available immediately before launch of the Repurchase.

The settlement date for the Repurchase will not occur before delivery of the Bonds.

With the Repurchase, the Company intends to attain two goals: (i) take advantage of current market conditions in order to diversify and improve the maturity profile of its debt by increasing its average term, and (ii) minimize potential dilution experienced by shareholders caused by the amount of convertible debt of the Company in circulation after the Issuance.

1.2 Context and motivation for the transaction

The Company has recently identified the existence of possible significant interest among qualified investors in subscribing debt convertible into newly issued shares of the Company. The Company considers it fundamental to take advantage of occasional opportunities which present themselves for attracting new resources, especially in the current environment where returns demanded in the capital markets for fixed income instruments are at historic lows.

The Board of Directors believes that the ideal manner for taking advantage of this interest, or market window, is by means of a Book Building Process, already used by the Company upon issuance of the 2013 Bonds, in that it allows (a) the securing of resources in a very short period of time (from investors or Underwriters under the subscription agreement); (b) the efficient securing of these resources at market conditions, reducing costs and risks inherent to the transaction by reducing the time periods in which placement of the Bonds remains exposed to market volatility; and (c) in short, allow placement of the securities offered in market conditions more advantageous for the Company than could be expected to be obtained in the event that the Issuance were made carrying subscription rights, with less uncertainty regarding the outcome, and less execution risk.

In order to be able to carry out the Book Building Process for the issuance of convertible debt in a new issuance of shares as the Company proposes to do, it is essential, just as was done for the 2013 Bonds, to exclude preemptive rights with the goal of attracting interest on the part of qualified investors who specialize in this type of instrument, and who are able to offer the most favorable financing terms for the Company for this product, such exclusion being an inherent characteristic of the placement proposed.

The offer of the convertible or exchangeable bonds in the above mentioned book building process is especially ideal for the Company under the current circumstances for the following reasons:

- (i) On the one hand, convertible or exchangeable debt constitutes a method of debt market financing with an original cost to the Company which is lower than the issuance of bonds with the same maturity (in that the interest rate offered to

investors is partially offset by the premium received by the issuer by selling the conversion option to investors), but with the possibility of further increasing share capital, while investors receive, in exchange for the bonds, a number of newly issued Company shares with a conversion ratio which is predetermined at the time of their issuance.

- (ii) On the other hand, in addition to access to a financing source at lower initial cost as compared with an ordinary issue of bonds, the issuance of convertible bonds permits the Company to diversify its sources of capital at a known cost, giving this technique the greatest financial flexibility.
- (iii) The investor, for his part, gives up a fixed return in exchange for a higher expectation of return at the time of conversion as a result of the potential rise in share price. In this manner, future capitalization of the Company is facilitated, strengthening in this manner its own resources and reducing its degree of financial leverage in the event that the Company decides to honor eventual conversion requests by delivering newly issued shares.
- (iv) Similarly, the recent issuance of the 2013 Bonds should facilitate placement of the Bonds, having reinforced the profile and familiarity of the Company among potential investors, and taking into account that the offer to holders of the 2013 Bonds presents the opportunity, together with the possibility of selling a portion of the 2013 Bonds, to subscribe to the new Bonds. Additionally, by means of the new issuance, the Company may continue consolidating its position in the European convertible bond market as a reliable and leading player in this category.

The funds obtained from the Issuance will be used to (i) finance the Repurchase, and (ii) for general corporate purposes including, without limitation, an increase in the maturity of its debt, a reduction in average financing costs for the Company, an improvement in liquidity, and diversification in its financing sources.

Management believes that the Issuance which is the subject of this report is of great interest to the Company for the reasons laid out above.

2. REPORT OF THE BOARD OF DIRECTORS REGARDING THE BASES AND METHODS FOR CONVERSION OR EXCHANGE OF THE SHARES FOR THE PURPOSES OF ARTICLE 414.2 AS IT RELATES TO ARTICLE 511.3 OF THE *LEY DE SOCIEDADES DE CAPITAL*

The Issuance Resolution that the Board of Directors expects to approve today plans the issuance of bonds convertible to newly issued common stock of the Company or exchangeable for existing common stock of the Company.

Pursuant to the provisions of Article 414.2 of the LSC, the Board of Directors of the Company has the duty of explaining the bases and methods of conversion or exchange of the Bonds.

These bases and conversion or exchange methods will be those contained in the document entitled "Terms and Conditions of the Bonds," which the Executive Chairman and the CEO are empowered to determine on behalf of the Board of Directors.

Conditions of the Issuance, including the bases and conversion methods for the Bonds, which will be submitted to the Board of Directors, can be summarized as follows:

(a) Details regarding the issuing entity

The issuing Company is Indra Sistemas, S.A., a Spanish firm, with a registered address at Alcobendas (Madrid), Avenida de Bruselas, 35, and registered in the *Registro Mercantil de Madrid* at Volume 865, Folio 29, Section 8, Page M-11339. Its tax identification number is A-28599033. The Company is of perpetual existence.

Shares of the Company are listed on the stock exchanges in Madrid, Barcelona, Bilbao and Valencia and are included in the *Sistema de Interconexión Bursátil Español* (Mercado Continuo).

Its current share capital amounts to 32,826,507.80 euros and is represented by 164,132,539 shares with a par value of 20 euro cents each, duly subscribed and paid-up, which all confer identical rights, and which are represented by ledger entries.

The corporate purpose of the Company consists in carrying out corporate activities in the following areas: a) the design, development, production, integration, operation, maintenance, repair and marketing of systems, solutions and products -- including motor vehicles, ships, aircraft, and aerospace vehicles and devices -- which use information technology (computer, electronic and communications), as well as all the parts or components of the same and any type of services related to them, including the infrastructure work necessary for their installation, in all fields or sectors; b) delivery of services in the areas of management and business consulting, technology consulting and training in any field or sector, including land use and environment; design and execution of all types of studies and projects, as well as management, technical assistance, technology transfer, marketing and administration of such studies, projects and activities; c) the delivery of outsourcing services for activities and processes pertaining to any field or sector. The activities comprising the corporate purpose are carried out in Spain as well as abroad, and may be accomplished indirectly in any form permitted by law and, in particular, by means of ownership of shares or equity positions in other companies or artificial persons with purposes which are identical, analogous, accessory or complementary to said activities.

Auditor reports regarding the individual and consolidated financial reports of the Company as of 31 December 2015 may be accessed on the Company website (<http://www.indracompany.com>). It is specifically noted that there have not been any material facts subsequent to the closing of the annual accounts for the fiscal year ending 31 December 2015 (the last available audited accounts) which might impact the equity or value of the Company other than those which have already been made public by the Company in accordance with applicable law and which may be accessed on the Company website and on the CNMV website (<http://www.cnmv.es>).

(b) Amount of the Issuance

The initial value of the Issuance is up to 250 million euros, expandable to a maximum of an additional 50 million euros in the event that the Company exercises entirely its option to expand no later than the date for fixing the price of the Convertible Bonds.

Either the Executive Chairman or the CEO will set the exact amount of the Issuance (with a maximum value of 300 million euros) taking into account at their discretion the results of the Book Building Process.

It is expressly noted that an incomplete subscription of the Issuance is possible.

(c) Type of issue, par value, and form of Bonds

The Bonds will be issued at par, will be registered, and have a total par value of 100,000 euros. The Bonds will be of a single series and registered securities, initially under a single Global Certificate.

(d) Bond yield

The Bonds will accrue interest at a maximum fixed annual rate of 1.75% based upon their face value and paid semi-annually counting from the Delivery Date (as defined below). The Executive Chairman or the CEO will fix at their discretion the interest rate for the Issuance based upon the results of the Book Building Process.

(e) Subscription and delivery of the Bonds

Subscription of the Bonds will be done on the date or during the time fixed by either the Executive Chairman or the CEO.

The Bonds will be subscribed by qualified investors or, in their absence, by the Underwriters and delivered on the date fixed by either the Executive Chairman or the CEO ("Delivery Date").

(f) Maturity date and early redemption

The Bonds will mature on the seventh anniversary of the Delivery Date ("Maturity Date"). Once the Maturity Date arrives, those Bonds which have not been converted, exchanged, redeemed or canceled earlier will be redeemed by delivery of the principal. The Bonds may be called in their entirety (not partially) at the discretion of the Company (i) beginning on the date four (4) years and twenty-one (21) days from the Delivery Date under certain circumstances (tied to a predetermined rise in the price of the shares of the Company above the conversion ratio and, therefore, the value assigned to the Bonds) or (ii) at any moment during the issue under certain circumstances (tied to their having been redeemed, canceled, converted or exchanged in an amount that exceeds 85% of the total value of the issue, all of the terms having been described in the terms and conditions document for the Bonds (the "Terms and Conditions").

The owner of the Bonds may at his discretion request that the Company redeem the Bonds in the events (tied to change of control of the Company) and for the corresponding redemption price, as well as on the fifth anniversary of the Delivery Date under the conditions spelled out in the Terms and Conditions.

(g) Exchange or conversion. Bases and methods of conversion

Request. Bond holders will have the right to request conversion of the Bonds for new Company shares or the exchange of them for existing Company shares at any time after the Delivery date until the seventh trading day before the Maturity Date, both included (or, if applicable, until the seventh trading day before the date fixed for early redemption of the Bonds at the option of the Company, both included). The Company will decide in each case and at its sole discretion whether to honor the request by means of the delivery of existing shares or new shares, or a combination of new and existing shares.

Conversion or Exchange Ratio. For the purposes of conversion or exchange of Bonds to shares ("Conversion or Exchange Ratio"), the price of Company shares will be determined by the Executive Chairman or the CEO in accordance with the procedure appearing in section 3.2 below once the Underwriters have completed the Book Building Process, although this price will be subject to certain adjustments under circumstances appearing in the Terms and Conditions.

The Bonds will be valued at par for the purposes of conversion and exchange. No outstanding interest will be paid on the date of exercise or exchange except under exceptional circumstances provided for in the Terms and Conditions.

Rate of Conversion or Exchange. The number of shares of common stock delivered to the Bond holders who exercise their exchange or conversion rights will be determined by dividing the par value of the corresponding Bond or Bonds into the Conversion or Exchange Ratio in effect on the relevant date of exchange or conversion. The Executive Chairman or the CEO will be empowered to approve the Rate of Conversion or Exchange at any time in accordance with the provisions of the agreement for their issuance and other documents governing the Issuance, fixing the amount of share capital necessary to be issued, when applicable, to honor the conversion.

(i) Warranties

The Issuance is guaranteed in general by the entire equity of the Company. It is not guaranteed by any security in rem over any specific asset or right possessed by the Company, nor by any in personam guarantee by a third party.

(j) Anti-dilution measures

The Terms and Conditions will contain appropriate anti-dilution measures in order to guarantee that, in the event that certain corporate transactions are carried out or certain resolutions are adopted which may cause a dilution of share value, the transactions or resolutions will affect Company shareholders and Bond holders equally or, if necessary, compensate Bond holders for any loss of conversion or exchange value for their Bonds due to unforeseen circumstances which may affect the Company. Bond holders expressly renounce rights contained in Article 418 of the LSC.

(k) Order of precedence

The Bonds represent direct, unconditional, unsubordinated obligations with equal priority and pro rata, with no preference whatsoever among them or between them and any other existing or future unsecured and unsubordinated debt of the Company except as regards those debts which may have generally applied mandatory legal priority.

(l) Applicable law and jurisdiction

The Issuance will be subject to English law. Additionally, in accordance with Article 405 of the LSC, the Terms and Conditions of the Issuance, the scope of conversion rights, the structure of Bond holder committees as well as the form of evidencing the Bonds and the manner for their payment and redemption will be subject to English law as well.

For its part, Spanish law will apply to the corporate authority of the Company, to the competent corporate body and the conditions for adoption of the issue

resolution as well as the value that may place on the Bonds, limits on conversion, and the rules for excluding preemptive rights

Subject to the Terms and Conditions for the issue, and expressly renouncing the right to litigate in any other forum which may apply to the Company, any question arising from the Terms and conditions will be submitted for the benefit of the Bond holders and non-exclusively for them to the jurisdiction of the English courts.

(m) Procedure for meeting and adoption of resolutions for Bond holders

As provided for in section (l) above, and consistent with the provisions of Article 405.3 of the LSC, the structure of Bond holder committees, including procedures for meetings and adoption of resolutions by them, will be governed by English law without the need for formation of a *sindicato de obligacionistas* or appointment of a *comisario* as provided for under Article 403 of the LSC as it relates to Article 42 of the *Texto Refundido de la Ley del Mercado de Valores* ("Consolidated Text of the Stock Market Act") approved by *Real Decreto Legislativo 4/2015* of 23 October, inasmuch as the Issuance is not considered to be a public securities offering.

(n) Listing

Listing of the Bonds on the multilateral open market trading system ("Freiverkehr") of the Frankfurt stock exchange will be requested. Without prejudice to the above, the Company may request that the Bonds be listed on any other official or unofficial, regulated or unregulated, national or foreign market whatsoever during the life of the Bonds.

Additionally, it is pointed out that in accordance with the provisions of Articles 414 and 417 as they relate to Article 511 of the LSC, the present document will be delivered to PricewaterhouseCoopers Auditores, S.L., tax ID number CIF B-79031290 and registered in the *Registro Oficial de Auditores de Cuentas* number S0242, an auditor not engaged to audit the financial statements of the Company and designated by the *Registro Mercantil de Madrid* on 21 September 2016 (which designation was accepted by its legal representative the same day), so that they may issue the prescribed report, based upon this management report, expressing an opinion regarding the measures contained within it and which will be made available to shareholders at the next Shareholders Meeting.

Finally, the features of the Bonds and the bases and procedures for conversion to shares will be recorded in the corresponding public deed of issue produced by the Company for that purpose and which will include those items required by Article 407 of the LSC.

3. REPORT OF THE BOARD OF DIRECTORS REGARDING EXCLUSION OF PREEMPTIVE RIGHTS FOR THE ISSUE OF CONVERTIBLE BONDS FOR THE PURPOSES OF ARTICLE 417 AS IT RELATES TO ARTICLE 511.3 OF THE LSC

The Issue Resolution to be submitted for approval by the Board of Directors on this same date completely excludes preemptive rights related to the convertible bonds for Company shareholders.

Additionally, as an integral part of the Issue Resolution and with the goal that the Company will be able to honor requests for conversion of the Bonds, the Board of Directors intends to also approve an increase of share capital in the necessary amount -- to be determined once the amount of the Issuance and the Conversion or Exchange Ratios are set -- the Board of Administration itself as well as the

Executive Chairman and the CEO individually having been empowered to carry out the increase in each occasion necessary to execute conversions of the Bonds. The new shares to be issued, if any, will be common stock with the same par value and the same rights as existing common stock as of each date that an agreement to issue is reached. There will be no preemptive rights for Company shareholders during share capital increases resulting from the conversion of Bonds to shares in accordance with the provisions of Article 304.2 of the LSC.

Pursuant to the provisions of Article 417.2.a) of the LSC, the Board of Directors has the duty to explain the reasons which justify in each case the exclusion of preemptive rights regarding the Issuance and subsequent increase in share capital in the maximum amount necessary to carry out any conversion.

3.1. Advantages of the exclusion of preemptive rights

The Board of Directors believes that the structure of the proposed transaction with the exclusion of preemptive rights, the same as the issue of the 2013 Bonds, is ideal under current circumstances for reaching the goals for which it is intended, as the means are proportional to the ends sought.

In order to further explain the appropriateness of the proposed transaction, the advantages of the structure are detailed below:

(a) *Book Building. Taking advantage of market windows, less exposure to market volatility and cost savings.* Exclusion of preemptive rights (i) permits the execution of the Issuance by means of Book Building, which best meets the demands of international capital markets; (ii) permits as well exploitation of possible market windows or opportunities conducive to carrying out financial transactions; (iii) reduces the costs of obtaining funds; (iv) enables the achievement of market financial conditions more favourable for the Issuance than those which would be obtained were the issuance realized with preemptive rights and, generally, (v) increases the probability of success of the transaction, as described in section 1.2 of the present report.

Without approval of the exclusion of preemptive rights by the Board of Directors, the structure of the Issuance as designed would be inefficient, which would impede completion of the Book Building at a time when such has been identified as being particularly apt for it.

Therefore, exclusion of preemptive rights will permit the Issuance to be directed to qualified and institutional investors to whom the Underwriters intend to solicit signs of interest in subscription to the Bonds by means of Book Building to be carried out regarding the Issuance. This process will permit, in turn, the Company to:

- (i) take advantage of the market window (which is often of short duration) that the Company has identified at this time in which it is proposed that the Issuance be carried out, eliminating uncertainty as to whether this window will remain open during a hypothetical rights offering period of at least 15 days in duration;
- (ii) facilitate obtaining an underwriting commitment for the Issuance from the Underwriters under the Underwriting Agreement, which is expected to allow the raising of market funds of up to 300 million euros at a lower cost;
- (iii) benefit from the opportunity to carry out a transaction that will permit improvement of the mix and quality of its financial liabilities and set the volume of

the Issuance, the Conversion or Exchange Ratio, and the coupon at the end of the related Book Building, rather than having to do it before the beginning of the rights offering period which would be necessary if preemptive rights were not excluded. This will allow the Company to optimize the Conversion or Exchange Ratio and the coupon as compared with the result if they had to be fixed in advance, as would be necessary in a transaction with preemptive rights; instead setting them as a function of the market response and the list price of the shares at the time of book building;

- (iv) reduce the impact of the Issuance on Company share prices because of the ability to obtain firm subscription commitments from qualified investors in a very short period of time as compared with the longer period of time required if the Issuance were to be realized by means of a communication to the market of the proposal of the Company to issue shares, which would be the case in the event that preemptive rights were included; and
- (v) limit the underwriting risks for the Underwriters, since setting of the aggregate principal amount of the issue, the Conversion or Exchange Ratio and coupon at the end of the Book Build allow the Underwriters to understand market interest for the instrument they intend to issue before making a firm subscription commitment, which increases their inclination to underwrite the Issuance, thus facilitating the acquisition of financial resources for the Company and lowering the amount of underwriting commissions.

(b) Access to qualified investors. Exclusion of preemptive rights permits the Issuance to be directed to qualified investors, giving the Company the opportunity to attract a large volume of financial resources (and under more favourable terms if the Issuance were structured to include preemptive rights) from a limited number of investors active in international financial markets, taking advantage of the large trading volumes in those markets and the benefit to the Company represented by the opportunity to offer subscription options for the Bonds to, among others, holders of the 2013 Bonds, and enabling them at the same time to take advantage of the option of selling to the Company the 2013 Bonds which they hold. Additionally, the profile of investors to whom exchangeable or convertible debt is typically marketed is usually different from investors who operate in variable income or non-convertible fixed income markets.

Inasmuch as the investor profile in the convertible or exchangeable bond market does not necessarily coincide with that which usually operates in the variable income and in the non-convertible fixed income markets, the proposed Issuance represents an opportunity for the Company to continue along the path begun in 2013 and consolidate its image as a financially sound issuer among specialist investors who operate in the market for convertible debt of listed companies. Investors who are willing to give up a part of the guaranteed income that a coupon represents and exchange it for the expectation of obtaining a higher yield arising from the eventual reevaluation of Company shares to levels above the Conversion or Exchange Ratio during the life of the Issue. All of the above could reasonably contribute to future access by the Company to fixed income markets at a lower financing cost.

For all these reasons, the Board of Directors believes that exclusion of preemptive rights is in the best interest of the Company.

3.2. Setting of the Conversion or Exchange Ratio

The Board wishes to note that the Conversion or Exchange Ratio for the Bonds will be determined as the result of multiplying:

- (i) the list price of the Company shares during the placement process for the Bonds, defined as the volume weighted average price of the shares on the Spanish stock exchanges during the period taking place between:
 - the moment Book Building begins on the launch date for the Issuance, and
 - the moment the price of the Bonds is set, which will presumably take place later in the day of the launch date for the Issuance;
- (ii) the coefficient resulting from the application to said price of a conversion or exchange premium to be definitively established by either the Executive Chairman or the CEO at their discretion upon seeing the results of the Book Build that the Underwriters will carry out among qualified investors and which, by means of classification and analysis of investment proposals that they receive, will allow that the price be adjusted to the greatest degree possible to market expectations. The conversion or exchange premium will be at least 25% of the list price referred to in paragraph (i) above.

Due to the benefits accruing to the Company from the structure of the planned transaction and the Conversion or Exchange Ratio that will be established within the limits described in the present report, the Board of Directors believes that exclusion of preemptive rights is not only ideal in order to reach the desired outcome, but also appropriate from the perspective of corporate interests. Additionally, the Board believes that the measure of excluding preemptive rights is consistent with the balance that should exist between the advantages which will flow to the Company from the transaction and the inconvenience that may eventually be felt by some shareholders who feel that their expectations were disappointed as a consequence of the dilution which may accompany the issuance of convertible bonds without preemptive rights.

On the one hand, from an economic perspective, the expected procedure to be used for fixing the Issuance terms, described at the beginning of this report, will permit the Company to obtain market financing conditions and, in particular, ideal Conversion or Exchange Ratios and coupon for the Issuance.

On the other hand, from the point of view of its effect on voting rights, the Issuance is considered appropriate by virtue of the fact that the Board of Directors, whose members represent more than thirty percent of the capital stock of the Company and who could see their voting rights effectively diluted because of the Issuance, are in agreement with the exclusion of preemptive rights. The Board of Directors, therefore, sees the Issuance as beneficial to the corporate interests in spite of the sacrifice that an eventual dilution of their voting rights might entail.

In conclusion, realization of the Issuance by means of a book build with qualified investors excluding preemptive rights for shareholders will permit the Company to attract the resources necessary to strengthen its financial position and at the same time help it obtain market conditions more favourable than those which would be expected were preemptive rights maintained in the Issuance; reduce the risks associated with the transaction; and make it possible to take advantage of the opportunities that the current combination of international financial markets offer.

PricewaterhouseCoopers Auditores, S.L., as an accounts auditor not engaged by the Company for its external audit and chosen by the *Registro Mercantil de Madrid* will issue a special report containing a technical judgment of the reasonableness of the data included in this report as well as the appropriateness of the conversion ratio and, if applicable, its anti-dilution adjustment formulas consistent with the provisions of Article 414 regarding bases and methods of conversion and Article 417 regarding exclusion of preemptive rights, both related to Article 511.3 of the LSC.

Madrid, 26 September 2016