

Talgo, S.A.

Financial Statements for the
year ended 31 December 2017
and Directors' Report, together
with Independent Auditor's
Report

*Translation of a report originally issued in
Spanish based on our work performed in
accordance with the audit regulations in force in
Spain. In the event of a discrepancy, the
Spanish-language version prevails.*

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INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

To the Shareholders of TALGO, S.A.,

Report on the Financial Statements

Opinion

We have audited the financial statements of TALGO, S.A. (the Company), which comprise the balance sheet as at 31 December 2017, and the statement of profit or loss, statement of changes in equity, statement of cash flows and notes to the financial statements for the year then ended.

In our opinion, the accompanying financial statements present fairly, in all material respects, the equity and financial position of the Company as at 31 December 2017, and its results and its cash flows for the year then ended in accordance with the regulatory financial reporting framework applicable to the Company (identified in Note 2 to the financial statements) and, in particular, with the accounting principles and rules contained therein.

Basis for Opinion

We conducted our audit in accordance with the audit regulations in force in Spain. Our responsibilities under those regulations are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

We are independent of the Company in accordance with the ethical requirements, including those pertaining to independence, that are relevant to our audit of the financial statements in Spain pursuant to the audit regulations in force. In this regard, we have not provided any services other than those relating to the audit of financial statements and there have not been any situations or circumstances that, in accordance with the aforementioned audit regulations, might have affected the requisite independence in such a way as to compromise our independence.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Measurement of investments in Group companies

Description

As indicated in Note 5 to the accompanying financial statements, the balance of "Non-Current Investments in Group Companies and Associates" includes the cost of the ownership interest held by TALGO, S.A. in the share capital of Patentes Talgo, S.L.U., an entity that is not listed on regulated markets.

This investment is the main item in the financial statements of TALGO, S.A., representing approximately 91% of total assets.

As indicated in Note 3-a to the financial statements, TALGO assesses the possible existence of impairment losses by comparing the equity of Patentes Talgo, S.L.U. with the carrying amount of the ownership interest. If there is a risk of impairment, as the carrying amount is higher, the directors estimate the recoverable amount by taking into account, where appropriate, the future cash flow projections of Patentes Talgo, S.L.U.

The measurement of this ownership interest was identified as a significant matter in our audit due to, among other matters, the significant amount that this ownership interest represents in the context of the financial statements taken as a whole.

Procedures applied in the audit

Our audit procedures to address this matter included: i) the analysis of the methodology used by TALGO, S.A. as the basis for estimating, where appropriate, the impairment of the ownership interest; and ii) a recalculation to verify the accuracy of the measurement performed by TALGO, S.A.

Also, we assessed and reviewed the audit work performed on the financial information of Patentes Talgo, S.L.U. and its subsidiaries, in order to obtain sufficient and appropriate evidence for measuring this ownership interest in the financial statements of TALGO, S.A., in addition to having obtained the audited separate and consolidated financial statements of Patentes Talgo, S.L.U., and to verify the consistency of the financial information used to assess the investments with that contained in those financial statements.

In addition, we evaluated whether the disclosures included in Note 5 to the accompanying financial statements in connection with this matter are in conformity with those required by the applicable accounting regulations.

Other Information: Directors' Report

The other information comprises only the directors' report for 2017, the preparation of which is the responsibility of the Company's directors and which does not form part of the financial statements.

Our audit opinion on the financial statements does not cover the directors' report. Our responsibility relating to the directors' report is defined in the audit regulations in force, which establish two distinct levels of review:

- a) A specific level that applies to certain information included in the Annual Corporate Governance Report, as defined in Article 35.2.b) of Spanish Audit Law 22/2015, which consists solely of checking that the aforementioned information has been provided in the directors' report and, if this is not the case, reporting this fact.
- b) A general level applicable to the other information included in the directors' report, which consists of evaluating and reporting on whether the aforementioned information is consistent with the financial statements, based on the knowledge of the entity obtained in the audit of those financial statements and excluding any information other than that obtained as evidence during the audit, as well as evaluating and reporting on whether the content and presentation of the directors' report are in conformity with the applicable regulations. If, based on the work we have performed, we conclude that there are material misstatements, we are required to report that fact.

Based on the work performed, as described above, we have checked that the information described in section a) above is provided in the directors' report and that the other information in the directors' report is consistent with that contained in the financial statements for 2017 and its content and presentation are in conformity with the applicable regulations.

Responsibilities of the Directors and of the Audit Committee for the Financial Statements

The directors are responsible for preparing the accompanying financial statements so that they present fairly the Company's equity, financial position and results in accordance with the regulatory financial reporting framework applicable to the Company in Spain, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The audit committee is responsible for overseeing the process involved in the preparation and presentation of the financial statements.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the audit regulations in force in Spain will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is included in the Appendix to this auditor's report. This description, which is included below, forms part of our auditor's report.

Report on Other Legal and Regulatory Requirements

Additional Report to the Audit Committee

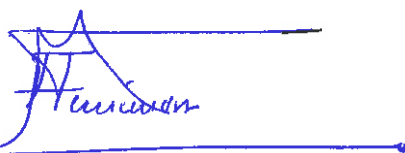
The opinion expressed in this report is consistent with the content of our additional report to the Company's audit committee dated 26 February 2018.

Engagement Period

The Annual General Meeting held on 3 May 2016 appointed us as auditors for a period of three years from the year ended 31 December 2016.

Previously, we were designated pursuant to a resolution of the General Meeting for the period of three years and have been auditing the financial statements uninterruptedly since the year ended 31 December 2013 and, therefore, since the year ended 31 December 2015, the year in which the Company became a Public Interest Entity.

DELOITTE, S.L.
Registered in ROAC under no. S0692



Francisco Fernández
Registered in ROAC under no. 20215

26 February 2018

Appendix to our auditor's report

Further to the information contained in our auditor's report, in this Appendix we include our responsibilities in relation to the audit of the financial statements.

Auditor's Responsibilities for the Audit of the Financial Statements

As part of an audit in accordance with the audit regulations in force in Spain, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the use by the directors of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the entity's audit committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the entity's audit committee with a statement that we have complied with relevant ethical requirements, including those regarding independence, and we have communicated with it to report on all matters that may reasonably be thought to jeopardise our independence, and where applicable, on the related safeguards.

From the matters communicated with the entity's audit committee, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters.

We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

TALGO, S.A.

Annual Accounts and Directors' Report for the year ended 31 December 2017

**Translation of financial statements originally issued in Spanish and prepared in accordance with generally accepted auditing standards in Spain (see Note 20). In the event of a discrepancy, the Spanish-language version prevails*

TALGO, S.A.**BALANCE SHEETS FOR THE YEARS ENDED 31 DECEMBER 2017 AND 2016**
(Expressed in thousands of euros)

ASSETS	2017	2016
NON CURRENT ASSETS	158 502	158 928
Long-term financial investments in group companies and associates (note 5)	150 317	150 317
Investments in group companies	150 317	150 317
Deferred tax assets (note 6)	8 185	8 611
CURRENT ASSETS	6 841	20 096
Short-term financial investments in group companies and associates (note 5)	-	13 251
Other financial assets	-	13 251
Trade debtors and other accounts receivable (note 7)	6 467	6 655
Receivables from Public Administrations	6 467	6 655
Short term accruals	3	-
Cash and cash equivalents (note 8)	371	190
TOTAL ASSETS	165 343	179 024
LIABILITIES AND SHAREHOLDER'S EQUITY	2017	2016
EQUITY	54 633	67 509
Equity (note 9)	54 633	67 509
Share capital	41 105	41 187
Share premium	6 784	68 451
Legal reserve	8 237	8 237
Treasury Stock	(121)	-
Results from previous years	169	(60 566)
Other Reserves	-	-
Result for the financial year	(1 541)	10 200
NON CURRENT LIABILITIES	99 700	88 504
Long-term debts (note 10)	99 700	88 504
Debts with financial institutions	45 175	51 675
Debts with group companies and associates	54 525	36 829
CURRENT LIABILITIES	11 010	23 011
Short-term debts (note 11)	10 809	22 811
Debts with group companies and associates	3 920	15 967
Debts with financial institutions	6 889	6 844
Short-term creditors and other accounts payable (note 11)	201	200
Other creditors	201	200
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	165 343	179 024

Notes 1 to 20 of these annual accounts form an integral part of the balance sheet at 31 December 2017.

TALGO, S.A.

**INCOME STATEMENT ACCOUNTS FOR THE YEARS ENDED 31 DECEMBER 2017
AND 2016**

(Expressed in thousands of euros)

CONTINUING OPERATIONS	2017	2016
Net turnover (note 5 and 12)		13 251
Other operating expenses	(981)	(1 057)
External services (note 12)	(321)	(417)
Other current operating expenses (note 12)	(660)	(640)
OPERATING RESULT	(981)	12 194
Financial expenses (note 12)	(1 074)	(1 202)
FINANCIAL RESULT (note 12)	(1 074)	(1 202)
PROFIT BEFORE TAX	(2 055)	10 992
Income tax (note 13)	514	(792)
EARNINGS FROM CONTINUING OPERATIONS	(1 541)	10 200
RESULT FOR THE YEAR	(1 541)	10 200

Notes 1 to 20 of these annual accounts form an integral part of the income statement at 31 December 2017.

TALGO, S.A.

STATEMENT OF CHANGES IN EQUITY FOR THE YEARS 2017 AND 2016
(Expressed in thousands of euros)

STATEMENT OF RECOGNIZED INCOME AND EXPENSES

	<u>2017</u>	<u>2016</u>
Result from the income statement	(1 541)	10 200
Direct assignment to equity		
Cash flow hedge	-	-
Grants, donations and bequests received	-	-
Opening balance adjustments for changes in value	-	-
	<u>-</u>	<u>-</u>
Transfers to the income statement		
Cash flow hedge	-	-
Grants, donations and bequests received	-	-
	<u>-</u>	<u>-</u>
TOTAL RECOGNIZED INCOME AND EXPENSES	<u>(1 541)</u>	<u>10 200</u>

Notes 1 to 20 of these annual accounts form an integral part of the statement of recognized income and expenses at 31 December 2017.

TALGO, S.A.

STATEMENT OF CHANGES IN EQUITY FOR THE YEARS 2017 and 2016
(Expressed in thousands of euros)

TOTAL STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Legal reserve	Treasury stock	Results from previous financial years	Other Reserves (share compensation plan)	Result for the financial year	Total
Balance at 31 December 2015	41 187	68 451	8 237	-	(90 403)	33 724	(3 887)	57 309
Total recognized income and expenses	-	-	-	-	-	-	10 200	10 200
Other movements	-	-	-	-	33 724	(33 724)	-	-
Application of results for 2015	-	-	-	-	(3 887)	-	3 887	-
Balance at 31 December 2016	41 187	68 451	8 237	-	(60 566)	-	10 200	67 509
Total recognized income and expenses	-	-	-	-	-	-	(1 541)	(1 541)
Transfers between equity items	-	(61 667)	-	-	61 667	-	-	-
Equity instruments acquisition (share buyback plan)	-	-	-	(10 000)	-	-	-	(10 000)
Capital increase	476	-	-	-	(476)	-	-	-
Share capital reduction cancellation of treasury shares	(558)	-	-	558	-	-	-	-
Equity instruments amortization	-	-	-	9 442	(9 442)	-	-	-
Dividend distribution	-	-	-	(121)	(1 192)	-	-	(1 313)
Other movements	-	-	-	-	(22)	-	-	(22)
Distribution of results for 2016	-	-	-	-	10 200	-	(10,200)	-
Balance at 31 December 2017	41 105	6 784	8 237	(121)	169	-	(1 541)	54 633

Notes 1 to 20 of these annual accounts form an integral part of the total statement of changes in equity at 31 December 2017.

TALGO, S.A.

CASH FLOW STATEMENT FOR THE YEARS 2017 AND 2016
(Expressed in thousands of euros)

	<u>2017</u>	<u>2016</u>
CASH FLOW FROM OPERATING ACTIVITIES	3 571	2 113
Result for the financial year before taxes	(2 055)	10 992
Adjustments to the result	1 074	1 202
- Financial expenses	1 074	1 202
Changes in working capital	(7)	(13 335)
- Debtors and other accounts receivable	-	(13 251)
- Creditors and other accounts payable	(7)	(84)
Other cash flows from operating activities	4 559	3 254
- Interest payments	(1 028)	(1 149)
- Income tax	5 587	4 403
CASH FLOW FROM INVESTING ACTIVITIES	-	-
CASH FLOW FROM FINANCING ACTIVITIES	(3 390)	(2 132)
Collections and payments on equity instruments	(10 000)	-
- Equity instruments acquisition	(10 000)	-
Collections and payments on financial liability instruments	7 956	(2 132)
- Payment of debt with credit institutions and other debts	(6 500)	(6 500)
- Debt with group companies and associates	14 456	4 368
Payments for dividends and remuneration on other equity instruments	(1 346)	-
- Dividends	(1 346)	-
NET INCREASE / DECREASE IN CASH AND CASH EQUIVALENTS	<u>181</u>	<u>(19)</u>
Cash and cash equivalents at the beginning of the year	190	209
Cash and cash equivalents at the end of the year	371	190

Notes 1 to 20 of these annual accounts form an integral part of the cash flow statement for the financial year 2017.

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

1. General Information

Talgo, S.A. and hereinafter the "Company" was constituted in Spain on 30 September 2005. The Company's registered office for corporate and tax purposes is in Las Rozas, Madrid (Spain) and the Company is duly registered in the Commercial Registry of Madrid. On 28 March 2015, the company changed its name from Pegaso Rail International, S.A. to Talgo, S.A., this name change was duly registered in the Commercial Registry of Madrid on 9 April 2015.

On 28 March 2015, the General Shareholder's Meeting of the Company approved the application for the admission to trading of the Company's shares on the Spanish stock exchanges, as well as their inclusion in the Spanish Stock Exchange Interconnection System.

On 23 April 2015, the National Securities Market Commission approved the prospectus and registered the supporting documents, annual accounts and prospectus in the official registers, as provided for by Article 92 of Law 24/1988, dated 28 July 1988 governing the Securities Market, in relation to the share Sales Offer aimed at qualifying investors, for the subsequent admission to trading of Talgo, S.A. shares on the Stock Exchanges of Madrid, Barcelona, Valencia and Bilbao.

On 7 May 2015, an Initial Public Offering was made for 45% of the shares of the Company and they were admitted to trading on the aforementioned markets.

The corporate purpose of the Company is as follows:

- a) The manufacture, repair, conservation, maintenance, sale & purchase, import, export, representation, distribution and marketing of transport material, systems and equipment, especially relating to the railway sector.
- b) The manufacture, assembly, repair, conservation, maintenance, sale & purchase, import, export, representation, distribution and marketing of engines, machinery and parts and components thereof, intended for the electromechanical, iron & steel and transport industries.
- c) The research and development of products and technologies relating to the previous two paragraphs, along with the acquisition, operation, assignment and disposal of patents and trademarks relating to the corporate activity.
- d) The subscription, acquisition, disposal, possession and administration of stocks, shares, or interests, within the limits set forth by the regulations governing the stock market, collective investment companies and other regulations in force that may apply.
- e) The purchase, restoration, redesign, construction, leasing, promotion, operation and sale of all types of real estate.

TALGO, S.A.

**NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017
(Expressed in thousands of euros)**

These activities may be carried out either wholly or partially by the Company, either directly or in any other way permitted by law, including through equity interests in other companies with an identical or similar corporate purpose.

2. Basis of presentation

a) Applicable regulatory financial reporting framework

These annual accounts for 2017 have been prepared on the basis of the Company's accounting records and are presented in accordance with the applicable regulatory framework for financial information, in order to show a fair presentation of the equity, financial position and results of the Company. The regulatory framework is based on:

- The Commercial Code and other commercial legislation.
- The General Accounting Plan, approved by Royal Decree 1514/2007 and its modifications, as well as the amendments made to it as a result of RD 1159/2010 and RD 602/2016. As well as the circulars issued by CNMV (Stock Market National Commission).
- The compulsory standards approved by the Accounting and Audit Institute as part of the development of the General Accounting plan and its supplementary rules.
- Other Spanish accounting regulations that may apply.

The figures contained in the documents that comprise these annual accounts, the balance sheets, the income statement accounts, the statement of changes in equity, the cash flow and this annual report, are expressed in thousands of euros, since the euro is the Company's functional currency.

b) Fair presentation

These annual accounts have been prepared from the Company's accounting records and are presented in accordance with the applicable regulatory framework and, accordingly, present fairly the Company's equity, financial position, results of operations and cash flows for the related year.

On February 22, 2018, the Directors formulated the annual accounts for the financial year 2017. The deposit of the annual accounts is made at the Commercial Registry of Madrid.

c) Critical aspects of the valuation and estimation of uncertainty

The Company's Management is not aware of the existence of any major uncertainties with regard to events or risks that may result in significant changes to the value of the assets and liabilities at the end of 2017.

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017
(Expressed in thousands of euros)

d) Grouping items

For the purposes of enabling an understanding of the balance sheets, the income statement account, the cash flow, and the statement of changes in equity, these statements are presented on an aggregated basis. All corresponding analysis is contained in the accompanying notes.

e) Comparison of information

The information contained in these annual accounts pertaining to the year 2016 is presented for comparative purposes only, alongside the information for 2017.

3. Accounting principles

The main valuation principles used by the Company in preparing its financial statements for 2017, in accordance with the General Accounting Plan in force, are as follows:

a) Financial assets

Loans and accounts receivable

Loans and accounts receivable are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market. They are reported within current assets, with the exception of those that have maturity dates that fall more than 12 months after the year-end date, which are classified as non-current assets. Loans and accounts receivable are included within "trade debtors and other accounts receivable".

These financial assets are initially valued at fair value, including transaction costs directly attributable to them, and subsequently, at amortized cost to reflect the interest accrued on the basis of their effective interest rate, which is understood to be the updated rate that equals the book value of the instrument with all of its estimated cash flows up to maturity. Notwithstanding the above, receivables for trade operations with maturity no greater than one year are valued, both at the time of initial recognition and subsequently, at their nominal value, provided that the effect of not updating the cash flows is not significant.

At least once a year, at year-end, the necessary valuation corrections are made when objective evidence exists that there has been an impairment loss and that not all of the amounts owed are therefore going to be recovered.

The amount of the loss due to impairment is the difference between the book value of the asset and the present value of the estimated future cash flows, discounted at the effective interest rate at the time of initial recognition. These corrections in value, along with their subsequent reversal where appropriate, are recognized in the income statement.

Investments in group companies, multigroup and associates

These financial assets are valued at cost less the accumulated amount of any losses due to impairment, where appropriate.

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

If objective evidence exists that the book value of these assets is not recoverable, the necessary valuation corrections are made, equal to the difference between the book value and the recoverable amount, which is understood to be the fair value of the asset less the costs of sale or the present value of the cash flows resulting from the investment, whichever is greater. When estimating the impairment of its investments, the Company takes into account the equity of the investee company, adjusted for any unrealized gains or losses at the valuation date, unless better evidence of the recoverable amount exists. Impairment losses and any reversals, where appropriate, are recognized in the income statement during the year in which they are identified.

b) Financial liabilities

Debts and accounts payable

This category includes debts due to trade and non-trade operations. These borrowings are classified as current liabilities unless the Company has an unconditional right to defer their settlement for at least 12 months after the year-end date.

Borrowings are initially recognized at fair value, net of any directly attributable transaction costs and are subsequently measured at amortized cost in accordance with the effective interest rate method. This effective interest rate is understood to be the rate that equals the book value of the instrument with all of its estimated future cash flows until maturity.

Debts for trade operations with maturity of no more than one year that do not have any contractual interest rate are valued, both initially and subsequently, at face value when the effect of not updating the cash flows is not significant.

c) Equity

The share capital of the Company is represented by shares. The costs of issuing new shares are disclosed directly against equity, as a reduction in reserves.

In the case of acquisition of own shares by the Company, the consideration paid, including any directly attributable incremental costs, is deducted from the equity until the shares are cancelled, reissued or disposed of. When these shares are sold or subsequently reissued, any amounts received, net of any directly attributable incremental transaction costs and related income tax effects, are included in the equity.

d) Current and deferred taxes

The Company forms part of the Tax Group 65/06, being the Parent of this Group. Therefore, the Company records, if applicable, the group's debt with the Tax Authority, registering as balancing entry the corresponding accounts receivable and payable with each company of the tax group, in accordance with their taxable basis contribution to the consolidated taxable base and the participation of each of them in the final balance of receivable and payable taxes.

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

The income tax charge (credit) is the amount that is accrued during the financial year. It includes the charge (credit) for both current tax and deferred tax.

The charge (credit) for both current and deferred taxes is recorded in the income statement. Nevertheless, the tax effects relating to items that are recorded directly in equity are also recognized in equity.

Assets and liabilities for current tax are valued in terms of the quantities expected to be paid to or recovered from the tax authorities, in accordance with existing regulations or approved and not yet published.

Deferred income tax is recognized, in accordance with the liability method, for temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred income tax is not accounted for if it arises upon initial recognition of an asset or liability in a transaction, other than a business combination, which at the time of the transaction affects neither the accounting result or the taxable profits or losses. The deferred income tax charge is determined using the tax rates that have been enacted or substantially enacted as at the balance sheets date and that are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred tax assets are recognized to the extent that it is likely that future taxable profits will be available against which the temporary differences may be offset.

e) Revenue recognition

Income and expenses are recognized when the actual flow of the related goods and services occurs, regardless of when the resulting monetary or financial flow arises.

Dividend income is recognized as income in the income statement when the right to receive the amount is established. Notwithstanding this, if the distributed dividends come from results generated prior to the acquisition date, they are not recognized as income, and the accounting value of the investment is reduced.

Income from the Company's financial activity (dividends) in 2016 has been considered as an ordinary activity in accordance with the consultation nº 2 of the Spanish Accounting and Audit Institute (ICAC), published in bulletin 79 in 2009, therefore it has been registered in the income statement under the heading "Net turnover".

f) Related party transactions

In general, transactions between Group companies are accounted for initially at their fair value. Where appropriate, if the agreed price differs from the fair value, then the difference is recognized, bearing in mind the economic reality of the transaction. The later valuation is done pursuant to the corresponding rules and regulations.

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

g) Provisions and contingent liabilities

Provisions are recognized when the Company has an existing obligation, legal or implicit, as a result of past events, that will likely require an outflow of resources to settle the obligation and when that amount can be estimated reliably.

No provisions are recognized for future operating losses.

Provisions are measured based on the present value of the disbursements that are expected to be necessary to settle the obligation using a pre-tax rate that reflects the current market's assessment of the time value of money and the specific risks of the obligation. Any adjustments to the provision, in order to update its value, are recognized as financial expenses as and when they accrue.

Provisions with a maturity of less than or equal to one year that do not have a significant financial effect are not discounted.

When it is expected that part of the payment to be made to settle the provision will be reimbursed by a third party, the reimbursement is recognized as a separate asset, as long as receipt is virtually certain.

Meanwhile, contingent liabilities are considered to be those potential obligations arising as a result of past events, whose materialization depends on the occurrence of future events lying beyond the will of the Company. Such contingent liabilities are not registered in the accounting records.

h) Foreign currency transactions and balances

Foreign currency transactions are converted into the functional currency using the exchange rates in force on the dates of the transactions. Foreign currency profits and losses resulting from the settlement of these transactions, and from the conversion of monetary assets and liabilities denominated in foreign currencies at closing exchange rates, are recognized in the income statement, except if they are deferred in equity as qualifying cash flow hedges or qualifying net investment hedges.

Changes in the fair value of available-for-sale monetary securities denominated in foreign currencies are analyzed as the exchange differences resulting from changes in the amortized cost of the instrument and other changes in the security's carrying value. Exchange differences are recognized in the income statement and other changes in carrying value are recognized in equity.

Exchange differences on non-monetary items, such as equity instruments recorded at fair value with changes in the income statement, are presented as part of the profit or loss on their fair value. Exchange differences on non-monetary items, such as equity instruments classified as available-for-sale financial assets are included within equity.

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

4. Information on the nature and level of risk

In view of the activity carried out by the Company, there are not significant risks additional to those related to investments in group companies and associates.

The financial risk management is centralized through the Directors of the Company, who have established the means to control the exposure to interest rates and exchange-rate variations, as well as credit and liquidity risks.

5. Long-term financial investments in group companies and associates

During 2016 and 2017 there have not been movements in the "Investments in group companies and associates":

	€ in thousands			
	Balance at 31.12.16	Additions	Disposals	Balance at 31.12.17
Investments in group companies	150 317	-	-	150 317
	150 317	-	-	150 317

The total balance registered in this caption, relates to the investments that Talgo, S.A. holds in the company Patentes Talgo, S.L.U., being this stake of 100% for the years 2016 y 2017.

Name and place of business	Activity	Ownership stake (% direct)	Voting rights
Patentes Talgo, S.L.U.	Construction and maintenance of railway rolling stock	100%	100%

The amounts of share capital, reserves, result for the financial year and other relevant information as shown in the individual audited annual accounts of subsidiary company at 31 December 2017 are shown as follows in thousands of euro:

Company	Share Capital	Reserves	Result 2017	Other items	Operating Results	Net book value in parent company books
Patentes Talgo, S.L.U.	51 914	307 260	20 835	-	41 622	150 317

The amounts of share capital, reserves, result for the financial year and other relevant information as showed in the standalone audited annual accounts of subsidiary company at 31 December 2016 are shown as follows in thousands of euro:

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

<u>Company</u>	<u>Share Capital</u>	<u>Reserves</u>	<u>Result 2016</u>	<u>Other items</u>	<u>Operating Results</u>	<u>Net book value in parent company books</u>
Patentes Talgo, S.L.U.	51 914	276 367	44 144	-	71 465	150 317

The Company is the head of a group of subsidiaries and is obliged under current legislation to prepare consolidated financial statements separately.

On December 16, 2016, the subsidiary Patentes Talgo, S.L.U approved the distribution of a dividend charged to income for the year 2016 amounting to €13,251 thousand. The aforementioned dividend was registered in the "Net Turnover" caption based on the activity like holding of the Company. The dividend has collect during 2017.

Talgo, S.A. consolidated annual accounts for the financial year 2017, have been formulated by the Directors of the Company at the meeting of the Board of Directors held on 22 February 2018, in accordance with International Financial Reporting Standards (IFRS) adopted by the European Union and deposited in the Commercial Registry of Madrid. They show that the Group recorded equity of €313,535 thousand, a profit of €34,302 thousand, total assets of €842,595 thousand and net turnover of €384,382 thousand.

The consolidated annual accounts of Talgo S.A. corresponding to 2016 were approved at the General Meeting of the Shareholders of the Parent Company on 9 May 2017 and deposited in the Commercial Registry in Madrid.

6. Other long-term assets

The breakdown of "Other long-term assets" is shown below:

	<u>2017</u>	<u>2016</u>
Long-term deferred tax assets	<u>8 185</u>	<u>8 611</u>
	<u>8 185</u>	<u>8 611</u>

This caption contains the deferred tax asset related to the negative tax basis generated during the year 2015 and pending to offset at year-end 2017 (note 13).

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

7. Trade debtors and other accounts receivable

The breakdown of the "Trade debtors and other accounts receivable" balances at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Receivables from Public Administrations	<u>6 467</u>	<u>6 655</u>
	<u>6 467</u>	<u>6 655</u>

This caption contains at year-end the refunds of corporate tax of the consolidated Tax Group for the year 2017 and 2016.

8. Cash and cash equivalents

The breakdown of the Company's Cash and cash equivalents is as follows:

	<u>2017</u>	<u>2016</u>
Cash	<u>371</u>	<u>190</u>
	<u>371</u>	<u>190</u>

The balance included in this caption is entirely freely available.

9. Equity

a) Share capital

As at 31 December 2016 the Company's share capital amounted to €41,186,702.90 and comprised 136,832,900 shares with a nominal value of €0.301 each.

On May 9, 2017, General Shareholder's Meeting approved an increase in share capital of determinable amount through the issue of new ordinary shares with a nominal value of €0.301 each, without share premium, of the same kind and range of the ones currently in circulation, being charged to reserves and offering to the shareholders the possibility of selling the free allocation rights of the shares to the Company at a guaranteed price or in the market. On July 12, 2017, it has been carried out the mentioned increase through the issue of 1,582,092 shares amounting €476 thousand, it been registered in the Commercial registry of Madrid on July 17, 2017. The new shares placed on circulation commenced trading on the market at the end of July 2017.

On May 9, 2017, General Shareholder's Meeting approved a reduction in share capital through the amortization of a maximum of 2,500,000 own shares representatives of a 1.83% of the current share capital that date of the Company and the amortization of the shares in treasury stock. On July 19, 2017, Board of Directors agreed reducing share capital through amortization of 1,852,394 shares with nominal value €0.301, by an amount of €558 thousand. The mentioned reduction of share capital was filed in Commercial registry of Madrid on August 4, 2017.

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

On December 31, 2017, share capital after the aforementioned Parent Company's operations has been set at €41,105,342 represented by 136,562,598 shares with a €0.301 nominal value.

According to the reports filed with the National Securities Exchange Commission regarding the number of company shares, the following owners held significant stakes in the share capital of the Company, both directly and indirectly, which individually exceeded 3% of the share capital as at 31 December 2017:

Company	% of share
Trilantic Capital Investment GP Limited	35,5%
MCH Inversiones Industriales S.A.R.L.	4,7%
MCH Iberian Capital Fund III, FCR	4,3%
Santa Lucia S.A. Insurance Company	3,1%
	47.6%

The percentage stake of the shareholders with more than 3% of the Share Capital at year-end 2016 was as follows:

Company	% of share
Trilantic Capital Investment GP Limited	34.9%
MCH Inversiones Industriales, S.A.R.L.	4.7%
MCH Iberian Capital Fund III, FCR	4.2%
Universities Superannuation Scheme	3.0%
AVIVA, PLC	3.0%
	49.8%

b) Share Premium

During 2017 €61,667 thousand have been transferred from the share premium account to the negative results from previous years account.

c) Legal reserve

The legal reserve has been recognized in accordance with article 274 of the Capital Company Act, which requires that a figure equals to 10% of the profit for the year be transferred to the reserve until that reserve amounts to at least 20% of the share capital.

If the reserve does not exceed the limit established, then it may not be distributed; and if it is used to offset losses, in the event that no other reserves available or sufficient for the purpose, then it must be replenished with future profits.

At 31 December 2017, the legal reserve had reached the legally required minimum.

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

d) Result for the year

The proposed distribution of the result which will be presented to the shareholders at the Company's Annual General Meeting is as follows:

	<u>2017</u>	<u>2016</u>
To dividends	-	10 000
To reserves	-	200
To results from previous financial years	<u>(1 541)</u>	<u>-</u>
	<u>(1 541)</u>	<u>10 200</u>

e) Treasury stock

On 23 February 2017, the Board of Directors of the Company agreed to carry out a repurchase program of their own shares (the "Repurchase Program") in accordance with the authorization conferred on them by the General Shareholders' Meeting held on 28 March 2015, under item 12 on the agenda and pursuant to the provisions of Regulation 596/2014 and Delegated Regulation (EU) 2016/1052 from the Commission, dated 8 March 2016, which supplemented Regulation (EU) n° 596/2014 concerning market abuse with regards to the regulatory technical standards relating to the conditions applicable to repurchase programs and stabilization measures.

In accordance with the provisions of that resolution, the Repurchase Program aims to reduce the Company's share capital through the redemption of shares, following the agreement subjected to and approved by the General Shareholders' Meeting held on 9 May 2017, all in the context of the capital increase agreements charged against reserves, with the aim of rewarding the shareholders ("scrip dividend") as proposed and approved in the aforementioned General Shareholders' Meeting.

Through the execution of the Repurchase Program, during the period from 6 April 2017 to 19 June 2017, the Company acquired a total of 1,852,394 shares for a total disbursed amount of €9,999,656.61, whereby reaching the maximum limit established as the Maximum Investment in the Repurchase Program (of 2,500,000 shares or €10 million).

Following the completion of the Repurchase Program, the Company launched a process to redeem all of the shares acquired.

On 31 May 2017, the Board of Directors resolved to carry out a capital increase, charged to reserves, and they fixed the maximum reference value for that execution at €10 million. The maximum number of new shares to be issued during the execution of the capital increase was set at 1,824,438 shares, as agreed by the General Shareholders' Meeting held on 9 May 2017 (through which an optional dividend was arranged, in shares or cash).

The price at which the Company undertook to purchase from its shareholders the free allocation rights corresponding to the aforementioned execution of the capital increase was established at a gross fixed amount of €0.072 per right.

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

All Company's shareholders who acquired shares prior to 13 June 2017 and whose operations were settled prior to 15 June 2017 received a free allocation right for each Talgo share that they held. Therefore, those shareholders will be entitled to receive one new share for every 75 old shares.

On 28 June 2017, the negotiation period for the free allocation rights corresponding to the capital increase agreed on 9 May 2017 came to an end. The owners of 86.72% of the free allocation rights (118,656,900 rights in total) received new shares in the Company. Therefore, the definitive number of ordinary shares with a nominal unitary value of €0.301 that was issued under the capital increase is 1,582,092 shares, and so the nominal amount of the capital increase amounted to €476 thousand.

On the other hand, during the term established for this purpose, the owners of 13.28% of the free allocation rights accepted the Company's irrevocable commitment to purchase their rights. As a result, the Company purchased 18,175,928 rights for a total gross amount of €1.313 thousand pursuant to the purchase commitment aforementioned; the cash consideration payable to those shareholders who opted to sell their free allocation rights to the Company took place on June 30, 2017. The Company was allocated the shares corresponding to the free allocation rights, allocating to it 22,431 shares amounting €121 thousand.

As at 31 December 2017 the Company's held 22.431 treasury shares, with no operations recorded with treasury shares at the close of 2016. The breakdown of the latter is as follows:

	<u>Nr. Shares</u>	<u>Acquisition Price</u>	<u>Quotation</u>	<u>Stock price</u>	<u>%</u>
Treasury shares at 31.12.2017	22 431	5.4	4.2	94	0.02%
Treasury shares at 31.12.2016	-	-	-	-	-

10. Long-term debts

The breakdown of the "Long-term debts" balances at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Debts with financial institutions	45 175	51 675
Debts with group companies and associates	<u>54 525</u>	<u>36 829</u>
	<u>99 700</u>	<u>88 504</u>

a) Debts with financial institutions

On 16 April 2015 the Company and the subsidiary Patentes Talgo S.L.U. have signed a loan agreement with fixed interest rate accrual, amounting to €100,000 thousand. The loan to Talgo, S.A. amounted €65,000 thousand. At year-end 2017, the balance of the

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

mentioned loan is €51,675 thousand. At year-end 2017, €45,175 thousand of the aforementioned loan was classified as a long-term liability and €6,500 thousand was classified as a short-term liability. Additionally, in the short term there were registered interests accrued by amount of €389 thousand. The aforementioned contract contains a number of associated obligations which the Group has complied with since the beginning of the contract.

The composition of this caption at 31 December 2017 and 2016 is as follows:

Balance at 31.12.16	2017	2018	2019	2020	Subsequent years	Totals
Debt with credit institutions	6 844	6 435	6 444	38 796	-	58 519
Balance at 31.12.17	2018	2019	2020	2021	Subsequent years	Totals
Debt with credit institutions	6 889	6 445	38 730	-	-	52 064

b) Debts with group companies and associates

The Company has received on 2015 a long-term loan from its subsidiary Patentes Talgo, S.L.U. amounting to €45,423 thousand it being extended during 2016 and 2017. At year-end 2017, €54,525 thousand was classified as a long-term liability, as its maturity depends on the cash flows generated to reimburse it.

11. Short-term debts and other accounts payable

The breakdown of the "Short-term creditors and other accounts payable" balances at 31 December 2017 and 2016 is as follows:

	2017	2016
Debts with group companies and associates	3 920	15 967
Debts with financial institutions (note 10)	6 889	6 844
Other creditors	201	200
	11 010	23 011

The caption "Debts with group companies and associates" contains registered balances with the subsidiary Patentes Talgo, S.L.U. for 2017 income tax outstanding balances with the Tax Authority.

The caption short-term debts contain the debts with financial institutions mentioned in note 10.a, furthermore outstanding interests and commissions at year-end 2017 are included.

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

Below is detailed the information required by the third additional Provision of Act 15/2010, of 5 July (amended by the second final Provision of Act 31/2014, 3 December) prepared in accordance with the ICAC (Accounting and Audit Institute) Resolution of 29 January 2016, on the information to provide in the annual accounts in relation to the average period of payment for trade operations to suppliers.

	€ in thousands	
	2017	2016
Average Suppliers payment period (days)	30	41
Paid operations ratio (days)	30	44
Pending to be paid operations ratio (days)	0	32
Total payments	345	580
Total pending payments	0	200

Pursuant to the ICAC (Accounting and Audit Institute) resolution, the average period of payment to suppliers calculation is based on the trade operations corresponding to goods delivered or services provided accrued from the date from which Act 31/2014, 3 December, came into force.

For the sole purpose of detailing the information required by the Resolution, it is considered suppliers the trade creditors for debts with suppliers for goods and services, included within the "suppliers" and "other creditors" items on the current liabilities side of the balance sheets.

"Average period of payment to suppliers" is understood to be the time between the supply of goods or services delivered and the effective payment of the transaction.

12. Income and expenses

a) The breakdown of the "Net turnover and other operating income" is as follows:

	2017	2016
Net turnover (note 5)	-	13 251
	-	13 251

b) The breakdown of the "Other operating expenses" is as follows:

	2017	2016
Professional services	(321)	(417)
Other current operating expenses	(660)	(640)
	(981)	(1 057)

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

c) The breakdown of the Company's financial result is as follows:

	<u>2017</u>	<u>2016</u>
Financial expenses:		
Other financial expenses	(1 074)	(1 202)
Financial result	<u>(1 074)</u>	<u>(1 202)</u>

d) Personnel expenses

The Company has not employees for the years 2017 and 2016.

13. Income tax and the fiscal situation

The Company annually presents income tax return. Profits, as determined in accordance with tax legislation, are subject to taxation at the rate of 25%. Notwithstanding, certain deductions may be applied to the resulting tax liability. As a consequence of the treatment permitted by fiscal legislation for certain transactions, the accounting profit may differ from taxable income.

The income tax expense for the year is calculated at the rate of 25% of the pre-tax profit, adjusted for permanent differences and taking into consideration any applicable deductions

The Company and its subsidiaries Patentes Talgo, S.L.U., Talgo Kazakhstan, S.L. and Motion Rail, S.A. form the consolidated Tax Group 65/06.

The reconciliation between profits before tax and taxable income for 2017 is as follows:

	<u>Increases</u>	<u>Decreases</u>	<u>31.12.17</u>
Result before tax			(2 055)
Permanent differences:	-	-	
Timing differences:	-	-	
Taxable income for the year (Tax Result)			<u>(2 055)</u>
Income tax			<u>514</u>

At 31 December 2017, the negative tax bases pending offsetting in Tax Group 65/06 (note 6) are as follows:

Year	<u>€ in thousands</u>
2015	32 768
	<u>32 768</u>

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

Under current legislation, tax returns may not be considered to be definitively settled until they have been reviewed by the tax authorities or until the statute of limitations four years period has expired. The company and its subsidiary Patentes Talgo S.L.U. have received on 10 July 2017 notification from tax authorities about partial testing of income tax of the years 2012 to 2015 and of payroll tax for years 2013 to 2015. Company's administrators consider that settlement of the mentioned taxes have been adequately made, so even if any discrepancy in the current law interpretation arose for the tax treatment provided to operations, the eventual resulting liabilities, if materialized, would not affect in significant way to the attached annual accounts.

14. Other information

a) Foreign currency

The Company does not hold foreign currency balance sheet items during 2017 and 2016; furthermore foreign currency transactions have not been made during 2017 and 2016.

b) Transactions with related parties

	<u>2017</u>	<u>2016</u>
Service delivery		
Patentes Talgo, S.L.U.	<u>15</u>	<u>15</u>
Expenses	<u>15</u>	<u>15</u>

15. Compensation for the Senior Management and Directors

The role of member of the Board of Directors of the Company was remunerated during 2017 for an amount of €660 thousand (€640 thousand during 2016).

The Company has neither regular staff nor senior management members at year-end 2017 and 2016.

16. The environment

Given the activity of the Company environmental matters are not applicable.

17. Information on Director's conflicts of interest

Pursuant to the provisions of Article 229 of the Revised Text of the Corporation Tax Law, the Directors of the Company have issued the Company with notices, in accordance with section 3 of the aforementioned Article, which indicate that neither they nor the persons linked to them, as defined by Art. 231 of the aforementioned legal text find themselves in any situations involving conflicts of interest, directly or indirectly, as provided for in the aforementioned legal text, which is why these annual accounts do not include any disclosure in this regard.

TALGO, S.A.

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR 2017
(Expressed in thousands of euros)

18. Subsequent events

No subsequent events have happened which could have a significant effect on these annual accounts.

19. Fees for audit and other services provided

During 2017, the fees regarding the services provided for the audit of the individual and consolidated annual accounts by the Company's auditor Deloitte, S.L. amounted to €24 thousand (€22 thousand in 2016).

Non-audit services have not been provided by the auditor.

20. Explanation added for translation to English

These financial statements are presented on the basis of accounting principles generally accepted in Spain. Certain accounting practices applied by the Company that conform with generally accepted accounting principles in Spain may not conform with generally accepted accounting principles in other countries.

TALGO, S.A.

DIRECTORS' REPORT FOR THE FINANCIAL YEAR 2017
(Expressed in thousands of euros)

Organizational structure

The main responsibilities of the Company's Board of Directors include: strategy management, allocation of resources, management of risks and operational control, as well as ownership of the accounts and financial reports prepared by the Company.

Business development

The evolution of the main magnitudes of the income statement was as follows:

	€ in thousands	
	2017	2016
Operating result	(981)	12 194
Profit before taxes	(2 055)	10 992
Result for the year	(1 541)	10 200

Talgo stock performance

The price of Talgo in 2017 reached maximum figures of the year in May of € 5.75 and minimums in November of € 3.81.

2017 has been positive in the main European stock markets supported mainly in a favorable economic evolution. In this context, the IBEX 35 increased by 7.4% in the year while the EuroStoxx50 made it 5.6%. Even so, the last months of the year erased some of the gains achieved in the first half of the year, mainly due to the impact caused by political uncertainty in Europe (negotiations around the Brexit or the formation of government in Germany) and specifically in Spain (political situation around the Catalan conflict). Thus, during the second semester of the year the Ibex-35 fell by 3.8% while the Eurostoxx 50 advanced an additional 1.1%. On the other hand, the main indexes of the United States have consolidated in 2017 the upward path registered in recent years, beating record highs supported mainly in the favorable monetary policy and the impulse driven by Donald Trump of the tax reform.

As for the Talgo's share, the closing price at 2017 year's end was 4.26€, recording a loss of 5.7% and a variable evolution over the period.

Talgo's average annual trading volume registered in the year increased by 9.4% to 250,620 shares, showing both high market volatility and the growing interest shown by investors in the company. The company's stock market capitalization at the end of the year reached 581.6 million euros, resulting a Price-Earnings ratio or P/E of 10.5x.

The number of shares at closing of 2017 was 136,562,598 after the Scrip dividend program carried out in order to reward the shareholder according to the results of the year 2016, and the subsequent equity reduction originated by the stock repurchase plan successfully executed during the first half of the year. Thus, the net profit per share (EPS) in 2017 was €0.25.

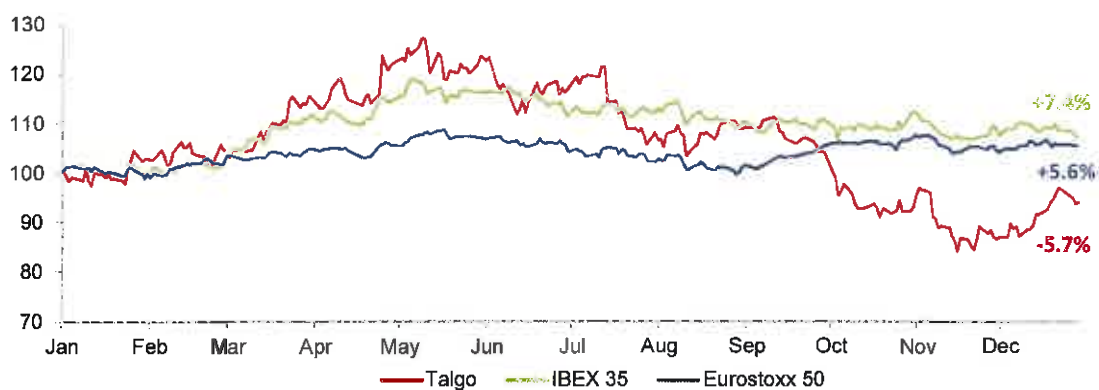
TALGO, S.A.

DIRECTORS' REPORT FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

Talgo stock performance in 2017



Price evolution Talgo vs. Ibex 35 vs. EuroStoxx 50 in 2017



Talgo key trading data at December 31, 2017

Number of publicly traded shares	136,562,598
Average number of shares in 2017	136,697,749
Share price (€)	4.26
Market capitalization (€m)	581.6
Earnings per share (€) LTM	0.25
PER over profit last 12 months (LTM)	8.5x

(1) Calculated over the average number of shares in 2017

TALGO, S.A.

DIRECTORS' REPORT FOR THE FINANCIAL YEAR 2017 (Expressed in thousands of euros)

Talgo key trading data in 2017

% change in Share price for the year 2017	-5.7%
Number of trading days (days)	255
Maximum share price (€)	5.75
Minimum share price (€)	3.81
Weighted average share price (€)	4.80
Average daily volume (# shares)	250.6

Significant events after the balance sheets date

The subsequent events that may have a significant influence on these annual accounts are detailed in note 18.

Research and development activities

The Company, as a holding company and given that its main purpose is holding shares in other companies, has not undertaken any R&D investment during 2017.

Risk policy

In view of the activity carried out by the Company, there are not significant risks additional to those related to investments in group companies and associates.

The financial risk management is centralized through the Directors of the Company, who have established the means to control the exposure to interest rates and exchange-rate variations, as well as credit and liquidity risks.

Quality and the environment

The Company has not undertaken any investment which could have impact in the environment and is not aware of the existence of any litigation for environment issues that may impact on the Company.

Information about delaying payments to suppliers

The Company, pursuant to the ICAC (Accounting And Audit Institute) Resolution of 29 January 2016, discloses the information to provide in the annual accounts (note 11).

The maximum legal payment period applicable to Spanish companies is 60 days.

Annual Corporate Governance Report

The Annual Corporate Governance Report forms an integral part of this Directors' Report and it will be published in the CNMV web, www.cnmv.es, on February 27, 2018.

TALGO, S.A.

DIRECTORS' REPORT FOR THE FINANCIAL YEAR 2017
(Expressed in thousands of euros)

Own shares

The Company holds, at 2017 year-end, 22,431 treasury shares (note 9.e).

Use of financial instruments

The Company did not make use of derivative financial instruments which could affect to the correct valuation of the **assets** or liabilities recorded in the balance sheets.

MODEL ANNEX I

**ANNUAL CORPORATE GOVERNANCE REPORT
FOR PUBLIC AND LISTED COMPANIES**

THE ISSUER'S IDENTIFICATION DETAILS

REFERENCE YEAR END DATE

31-12-2017

C.I.F. A84453075

Company name:
TALGO, S.A.

Registered address:
Paseo del Tren Talgo Nº 2 28290
Las Rozas, Madrid

ANNUAL CORPORATE GOVERNANCE REPORT FOR PUBLICLY LISTED COMPANIES

A OWNERSHIP STRUCTURE

A.1 Complete the following table detailing the Company's share capital:

Last modification date	Share capital (€)	Number of shares	Nº of voting rights
04/08/2017	41,105,342.00	136,562,598	136,562,598

Indicate whether there are different classes of shares with different associated rights:

Yes

No

Class	Nº of shares	Nominal unit	Unitary number of voting rights	Different rights

A.2 List the direct and indirect holders of significant shareholdings in the Company at year end, excluding Directors*:

Name or corporate name of the shareholder	Number of direct voting rights	Number of indirect voting rights	% of total voting rights
MCH INVERSIONES INDUSTRIALES S.A.R.L	6,460,496		4.73%
TRILANTIC CAPITAL MANAGEMENT GP LIMITED	48,467,544		35.49%
MCH IBERIAN CAPITAL FUND III FCR	5,870,837		4.30%
SANTA LUCIA S.A. COMPAÑÍA DE SEGUROS Y REASEGUROS	4,231,945		3.10%

* Data obtained from CNMV records. The Company does not have any additional information.

Indicate the most significant movements in the ownership structure during the year:

Name or corporate name of the shareholder	Date of the operation	Description of the operation
AVIVA PLC	05/04/2017	It has decreased 3% of share capital
UNIVERSITIES SUPERANNUATION SCHEME	19/10/2017	It has decreased 3% of share capital
SANTA LUCIA S.A. COMPAÑÍA DE SEGUROS Y REASEGUROS	02/10/2017	It has increased 3% of share capital

A.3 Complete the following tables about the members of the Company's Board who hold voting rights over shares in the Company:

Name or corporate name of the shareholder	Number of direct voting rights	Number of indirect voting rights	Number of equivalent shares	% of total voting rights
José M ^a Oriol Fabra	1,434,821			1.05%
Carlos de Palacio Oriol	1,181,487			0.87%
Pegaso Transportation International, S.C.A.	48,467,544			35.49%
José María Muñoz Domínguez	52,000			0.04%
Francisco Javier Bañon Treviño	182,400			0.13%
Juan José Nardiz Amurrio	25,333			0.02%

Total % of voting rights held by the Board of Directors

37,60%

A.4 Where applicable, indicate the relationships of a family, commercial, contractual or company nature that exist between the owners of significant shareholdings, to the extent that they are known by the Company, except when they are insignificant or arise as a result of ordinary commercial transfers or traffic:

Related party name or corporate name	Type of relationship	Brief description

A.5 Where applicable, indicate the relationships of a commercial, contractual or company nature that exist between the owners of significant shareholdings, and the Company and/or its group, except when they are insignificant or arise as a result of ordinary commercial transfers or traffic:

Related party name or corporate name	Type of relationship	Brief description

A.6 Indicate any shareholders' agreements that have been reported to the Company, in accordance with the provisions of Articles 530 and 531 of the Capital Companies Act. Where applicable, briefly describe these agreements and list the shareholders involved with them:

Yes

No

Participants in shareholders' agreement

DON JOSÉ MARÍA DE PALACIO Y ORIOL	DON GONZALO DEL RÍO Y ORIOL
MCH IBERIAN CAPITAL FUND III FCR	DOÑA MARÍA DE LAS NIEVES DE ORIOL PASTEGA
MCH INVERSIONES INDUSTRIALES S.A.R.L	DOÑA MARÍA DEL DULCE NOMBRE DEL RÍO Y ORIOL
PROYECTOS DUNBAR S.L.	DON EDUARDO SERRA ARIAS
DR.L.I. RECASENS S.L.	DOÑA ALEJANDRA PAULA DE ORIOL PASTEGA
SAN IGNACIO S.L.	DOÑA MARÍA MAGDALENA DE ORIOL MUÑOZ
CASA CUNA S.L.	DON SANTIAGO MARÍA DE ORIOL MUÑOZ
PEGASO TRANSPORTATION INTERNATIONAL SCA	DON ALFONSO CARLOS DE ORIOL MUÑOZ
E.D.T., S.A.	DOÑA MARÍA BEGOÑA DE ORIOL E YBARRA
INMAJOR S.A.	DOÑA MARÍA DEL PATROCINIO DE ORIOL MUÑOZ
PATRIMONIAL ORLESA S.A.	DOÑA MARÍA DE PALACIO Y ORIOL
DOÑA LEONOR MARÍA DE PALACIO DELATTRE	DON IGNACIO MARÍA DE ORIOL MUÑOZ
DOÑA ISABEL MARÍA DE PALACIO DELATTRE	DON LUCAS MARÍA DE ORIOL LOPEZ-MONTENEGRO
DON LUIS FELIPE DE PALACIO DELATTRE	DON MIGUEL DE ORIOL YBARRA
DON LUIS MARÍA DE PALACIO GUERRERO	DOÑA CATALINA CASTILLEJO ORIOL
DOÑA MARÍA SACRAMENTO DE PALACIO GUERRERO	DOÑA MARÍA DEL DULCE NOMBRE CASTILLEJO ORIOL
DON MARIO DE ORIOL PASTEGA	DON JUAN CASTILLEJO ORIOL
DON JAIME DEL RÍO Y ORIOL	DON CAMILO PEDRO DE ORIOL FABRA
DOÑA LUISA FERNANDA DEL RÍO Y ORIOL	DON JUAN PEDRO DE ORIOL MUÑOZ
DON CARLOS DEL RIO Y ORIOL	DOÑA CASILDA CASTILLEJO ORIOL
DOÑA BLANCA DEL RÍO Y ORIOL	DOÑA MARÍA DOLORES CASTILLEJO ORIOL
DON NICOLÁS DOMEQ ORIOL	

Percentage of share capital affected: 56%

Brief description of the agreement

The Shareholders' Agreement regulates certain aspects regarding the governing bodies of the company and the transmission and sale of shares.

The validity of this shareholder agreement, without prejudice to the provisions in the following paragraph, will end after the second anniversary of the date of admission at the market stock price of the Company, either on the date on which PEGASO TRANSPORTATION INTERNATIONAL, S.C.A. does not hold a significant stake in the Company any more (According to the current legislation: 3%), whichever occurs first.

Notwithstanding the foregoing, in the event that the termination of the validity of the agreement is a consequence of the passage of the indicated two-year period, the right of traction granted by the shareholders signing the agreement in favor of PEGASO TRANSPORTATION INTERNATIONAL, S.C.A. shall remain in force as long as the latter company holds a significant interest in the capital of the Company.

Indicate whether the Company is aware of the existence of any concerted actions between its shareholders. Where applicable, describe them briefly:

Yes No

In the event that any modifications have been made to these agreements or concerted actions or they have been terminated during the year, expressly indicate them below:

Not applicable

A.7 Indicate whether any person or legal entity exercises control or may exercise control over the Company under the terms set forth in Article 5 of the Securities Market Law. In this case, identify that person or entity:

Yes No

Comments

A.8 Complete the following tables about the Company's treasury stock:

At year end:

Number of shares held directly	Number of shares held indirectly (*)	% of total share capital
22,431		0.02%

(*) Through:

Explain any significant variations registered during the year, in accordance with the provisions of Royal Decree 1362/2007:

Explain significant variations

Not applicable

A.9 Describe the terms and conditions of any mandate(s) conferred upon the Board of Directors by the General Shareholders' Meeting to issue, repurchase or transfer treasury stock.

The General Shareholders' Meeting of the Company, at its meeting on 28 March 2015, agreed to expressly authorise the Board of Directors to acquire TALGO, S.A. shares in the secondary market, in accordance with the provisions of the Capital Companies Act, under the following terms:

- a) Authorise the Board of Directors, in accordance with the provisions of Article 146 et seq of the Capital Companies Act, so that it may proceed to acquire the Company's own shares in the secondary market, by any means, either directly or through companies that it controls, subject to the following limits and requirements:
- The shares may be acquired by purchasing them directly or by any other *inter vivo* act in exchange for consideration.
 - The maximum number of shares acquired, in addition to those already held by the Company and any of its subsidiaries, shall not exceed ten per cent (10%) of the Company's total share capital.
 - The shares acquired shall be free from all charges and encumbrances, fully paid up and not linked to the fulfilment of any obligations.
 - The minimum acquisition price of the shares shall not be lower than their nominal value; and the maximum price shall not exceed the share price share fixed for the purposes of the share sale offer prior to the admission of the Company's shares onto the Stock Exchange for trading, if the acquisition is made during the period for placing the shares, or more than one hundred and twenty per cent (120%) of the market value of the shares on the corresponding date, if the acquisition is made subsequently.
 - Duration of the authorisation: five (5) years, starting from the date the authorisation was approved.
- b) Authorise the Board of Directors so that it may designate, in whole or in part, the own shares acquired to the execution of remuneration programs, be they already established or established in the future, which are intended to involve or do actually involve the delivery of shares or rights over share options, or are based in any way on the evolution of the market price of the share, in accordance with the provisions of Article 146.1.a) of the Capital Companies Act. This authorisation for the acquisition of own shares shall be effective from the date that the Company's

shares are admitted for trading on the Stock Exchanges of Madrid, Barcelona, Bilbao and Valencia.

A.9 bis Estimated floating capital:

	%
Estimated free float capital	53.37

A.10 Indicate whether any restrictions exist over the transfer of shares and/or the transfer of voting rights. In particular, provide information about the existence of any kind of restriction that may hinder the takeover of the Company through the acquisition of its shares in the market.

Yes No

Description of the restrictions

See Paragraph A.6 above.

A.11 Indicate whether the General Shareholders' Meeting has agreed to adopt measures to neutralise any takeover bids by virtue of the provisions of Law 6/2007.

Yes No

Where applicable, explain the measures approved and the terms under which the restrictions would be rendered ineffective:

A.12 Indicate whether the Company has issued securities that are not traded on a regulated European market.

Yes No

Where applicable, indicate the different classes of shares together with the rights and obligations conferred for each share class.

B GENERAL SHAREHOLDERS' MEETING

B.1 Indicate whether differences exist between the minimum regime set out in the Capital Companies Act (LSC) and the quorum for the constitution of the General Shareholders' Meeting, and where applicable, provide details.

Yes No

B.2 Indicate whether differences exist between the regime set out in the Capital Companies Act (LSC) for the adoption of resolutions and, where applicable, provide details:

Yes No

Describe how it differs from the regime set out in the LSC.

B.3 Indicate the rules applicable to the modification of the Company's bylaws. In particular, provide details of the majorities set out for the modification of the bylaws, as well as, where applicable, the rules set out for the protection of the shareholders' rights in the modification of the bylaws.

Indicate the number of meetings that the different Board committees have held during the year:

Nº of meetings held by Strategy Committee	4
Nº of meetings held by the Audit Committee	3
Nº of meetings held by the Appointments & Remuneration Committee	3

C.1.30 Indicate the number of meetings that the Board of Directors has held during the year with all members in attendance. Attendance shall also include proxies appointed with specific instructions:

Number of meetings held with all members in attendance	4
% of attendances over total votes cast during the year	96.15%

C.1.31 Indicate whether the individual and consolidated annual accounts submitted to the Board for approval had been certified previously:

Yes

No

Identify, where applicable, the person(s) that certified the Company's individual and consolidated annual accounts prior to their authorisation for issue by the Board:

C.1.32 In the event that they exist, explain the mechanisms established by the Board of Directors to prevent the individual and consolidated accounts that it prepares from being presented to the General Shareholders' Meeting with a qualified audit report:

The Audit Commission holds meetings periodically with the external auditor in which, among other topics, the conclusion of the work performed in such meetings is reviewed, and in addition, in accordance with the provisions of the Rules of the Board regarding the powers of the Audit Committee, it is responsible for:

- a) Directing a unit or department in the Company that assumes the role of internal audit and that ensures the proper operation of the IT and internal control systems (that department shall functionally report to the Chairman of the Audit Committee).
- b) Supervising the process for preparing, presenting and ensuring the integrity of the mandatory financial information relating to the Company and, where applicable, to the group, as well as reviewing compliance with the regulatory requirements, the appropriate delimitation of the consolidation perimeter and the correct application of the accounting criteria.
- c) Regularly reviewing the internal control and risk management systems, so that the main risks are properly identified, managed and disclosed.
- d) Supervising the effectiveness of the Company's internal control system, the internal audit function and the risk management systems, including those relating to tax, as well as discussing any significant weaknesses detected in the internal control system with the auditor of the accounts during its performance of the audit.
- e) Establishing and supervising a mechanism that allows the employees to report, confidentially and, where appropriate, anonymously, any potentially significant irregularities, especially any relating to financial and accounting matters that arise in the core of the company.

- f) Ensuring that the Board of Directors submits the accounts to the General Shareholders' Meeting without limitations or qualifications in the audit report and that, in exceptional cases, when qualifications exist, ensuring that both the Chairman of the Audit Committee and the auditors clearly explain the content and scope of those limitations or qualifications to the shareholders.

C.1.33 Is the Secretary of the Board also a Director?

Yes

No

If the Secretary is not a Director, complete the table below

Name or corporate name of the Secretary	Representative
María José Zueco Peña	

C.1.34 Paragraph repealed.

C.1.35 In the event that they exist, indicate the specific mechanisms established by the Company to preserve the independence of the external auditors, financial analysts, investment banks and ratings agencies.

In accordance with the provisions of the Rules of the Board regarding the powers of the Audit Committee, it is responsible for:

- (a) Presenting proposals to the Board of Directors for submission to the General Shareholders' Meeting regarding the selection, appointment, re-election, evaluation and removal of the external auditors, as well as the conditions for their engagement.
- (b) Receiving regular information from the external auditor about the audit plan and the results of its implementation, and verifying that senior management take their recommendations into account.
- (c) Ensuring the independence of the external auditor and, to that end:
- Ensuring that the remuneration of the external auditor for its work does not compromise its quality or independence.
 - Ensuring that the Company notifies the National Securities Market Commission about any change in the auditors as a significant event, and that it accompanies its report with a declaration regarding the potential existence of disagreements with the outgoing auditor and, if they exist, their contents.
 - Ensuring that the Company and the external auditor adhere to current legislation regarding the provision of non-audit services, the limits in terms of the concentration of the external auditor's business and, in general, the other rules established to ensure the independence of the auditors.
 - In the event that the external auditor resigns, examining the circumstances that have caused it.
- (d) Establishing the appropriate relationships with the auditors or audit firms so as to receive information regarding those questions that may pose a risk to their independence, for consideration by the Audit Committee, as well as any other matters relating to the process to audit the accounts, as well as any other communications provided for in the audit legislation and auditing standards. In any case, they must receive a declaration of independence from the auditors on an annual basis regarding the Company and the companies related to it, directly or indirectly, as well as

information about the additional services rendered, of any kind, and the corresponding fees received from those companies by the external auditors or by people or entities linked to them, in accordance with the provisions of the legislation governing audits. Ensuring that the external auditor holds at least one meeting per year with the full Board of Directors to inform it about the work performed and about the evolution of the accounting environment and the risks facing the Company.

- (e) Issuing an annual report, prior to the issue of the audit report, in which it expresses an opinion about the independence of the auditors or the audit firms. This report should comment, in all cases, about the provision of additional services to those described in the paragraph above, considered both individually and as a whole, besides the statutory audit and regarding the framework of independence or audit regulations.
- (f) Where appropriate, encouraging the auditor of the group to take responsibility for the audits of the companies that comprise it.

C.1.36 Indicate whether the Company has changed its external auditor during the year. If so, identify the outgoing and incoming auditors:

Yes No

In the event that there were any disagreements with the outgoing auditor, explain the content of the disagreements:

C.1.37 Indicate whether the audit firm performs non-audit work for the Company and/or the group and if so, state the amount of the fees paid for such work and the percentage that the represent of the total fees invoiced to the Company and/or the group:

Yes No

	Company	Group	Total
Fees for non-audit work (€ in thousands)	0	120	120
Fee for non-audit work / Total amount invoiced by the audit firm (%)	0.00%	31.00%	31.00%

C.1.38 Indicate whether the audit report for the annual accounts last year contained any reservations or qualifications. Where applicable, indicate the reasons given by the Chairman of the Audit Committee to explain the content and scope of those reservations or qualifications.

Yes No

C.1.39 Indicate the number of consecutive years that the current audit firm has been performing the audit of the annual accounts of the Company and/or the group. Also, indicate the number of years the Company has been audited by the current audit firm as a percentage of the total number of years for which the annual accounts have been audited:

4 years 44,4%

	Company	Group
Number of uninterrupted exercises	5	5
Number of exercises audited by the current audit firm / Number of exercises that the company has been audited (in%)	55.55%	55.554%

C.1.40 Indicate whether a procedure exists whereby the Directors can receive external advice and provide details, where applicable:

Yes **X** No

Detail of the procedure

In accordance with the provisions of Article 27 of the Rules of the Board, and with the aim of being supported in the performance of their duties, External Directors may request the engagement of advisors and experts, at the expense of the Company. Their requests should relate to specific problems that carry certain importance or complexity.

The decision to engage those services must be communicated to the Chairman and shall be implemented through the Secretary to the Board of Directors, except in the cases in which the Board considers the advice to be unnecessary or inappropriate.

The Company shall establish an orientation program to provide new Directors with rapid and sufficient knowledge about the Company, as well as about its corporate governance rules. It shall also offer the Directors knowledge refresher programs when the circumstances so warrant it.

Furthermore, Article 25.6(iv)2 of the same Rules establishes that the Audit Committee may engage the services of external advisors, at the expense of the Company, to perform its functions, when it deems appropriate. And in the same vein, Article 26(iv) 2 establishes that the Appointments and Remuneration Committee may also engage the services of external advisors, at the expense of the Company, to perform its functions, when it deems appropriate.

C.1.41 Indicate whether there are procedures in place for the Directors to receive the information they need in sufficient time to prepare for meetings of the governing bodies and, where applicable, provide details:

Yes **X** No

Details of the procedure

Directors have access to a specific software application that facilitates the performance of their duties and the exercise of their right to information. The necessary and appropriate information required for the preparation of Board meetings is included in this application, in accordance with the meeting agenda specified in the meeting notices, along with the material and presentations relating to them.

C.1.42 Indicate and where appropriate, provide details as to whether the Company has established rules that oblige the Directors to report and, where applicable, resign in cases that may harm the Company's credibility and reputation:

Yes **X** No

Explain the rules

In accordance with the provisions of Article 14.3 of the Rules of the Board, Directors must tender their resignation to the Board of Directors and formally resign in the following cases:

- When an act or conduct attributable to the Director has caused serious harm to the corporate assets or reputation of the Company or a risk arises of criminal liability for the Company.
- When they lose the reputation, capability, solvency, competence, availability or commitment to their duties necessary to be a Director of the Company.

C.1.43 Indicate whether any members of the Board have notified the Company that they have been indicted or tried for any of the crimes stated in Article 213 of the Capital Companies Act:

Yes No

Indicate whether the Board has examined this matter. If so, provide a justified explanation of the decision taken as to whether or not to allow the Director to continue to hold office or, where applicable, state the actions taken or to be taken by the Board up until the date of this report.

C.1.44 List the significant agreements entered into by the Company, which would come into force, be modified or terminate in the event of a change in control of the Company as the result of a takeover bid, and their effects.

Some of the loans and other agreements signed between Talgo, S.A. and/or its subsidiaries and financial institutions may be susceptible to early repayment or may require additional guarantees in the event of a change of control. Together, they amount to approximately 139 million euro.

C.1.45 Identify in aggregate terms, and describe in detail, any agreements between the Company and its Directors, executives and employees that provide indemnities, or guarantee or protective clauses, in the event of resignation, unfair dismissal or termination as a result of a takeover bid or other type of operation.

Number of beneficiaries: 2

Type of beneficiary: Executive Directors

Agreement description: Executive Directors have right to a compensation equal to twelve months of salary in case of improper dismissal.

Indicate whether these contracts should be reported to and/or approved by the governing bodies of the Company or its group:

	Board of Directors	General Shareholders Meeting
Body authorizing clauses	Yes	Yes

	Yes	No
Is the general meeting informed of the clauses?	X	

C.2 Board Committees

C.2.1 List all of the committees in which the Board of Directors participate, their members and the proportion of Executive, Proprietary, Independent and Other External Directors that comprise each one:

AUDIT COMMITTEE

Name	Role	Type
Emilio Novela Berlín	Presidente	Independiente
Michel Moreau	Vocal	Independiente
José M ^a Muñoz Domínguez	Vocal	Dominical
María José Zueco Peña	Secretario	

% of Proprietary Directors	33,33%
% of Independent Directors	66,66%
% of Other External Directors	-

Explain the duties assigned to this committee, describe the procedures and rules for its organisation and operation, and summarise the most important actions that it has carried out during the year.

1.- FUNCTIONS:

A) In terms of the information and internal control systems, the Audit Committee shall be responsible for:

- a) Overseeing a unit or department in the Company that assumes the internal audit function and ensures the proper functioning of the information and internal control systems (this department should functionally report to the Chairman of the Audit Committee).
- b) Supervising the preparation, presentation and completeness of the mandatory financial information relating to the Company and, where applicable, to the group, reviewing compliance with regulatory requirements, the appropriate delimitation of the consolidation perimeter and the correct applicable of accounting criteria.
- c) Regularly reviewing the internal control and risk management systems, so that the main risks are properly identified, managed and disclosed.
- d) Supervising the effectiveness of the Company's internal control system, the internal audit function and the risk management systems, including those relating to tax, as well as discussing any significant weaknesses detected in the internal control system with the auditor of the accounts during its performance of the audit.
- e) Establishing and supervising a mechanism that allows employees to report, confidentially and, where appropriate, anonymously, any potentially significant irregularities, especially any relating to financial and accounting matters that arise in the core of the company.

- f) Ensuring that the Board of Directors submits the accounts to the General Shareholders' Meeting without limitations or qualifications in the audit report and that, in exceptional cases when qualifications exist, ensuring that both the Chairman of the Audit Committee and the auditors clearly explain the content and scope of those limitations or qualifications to the shareholders

B) In terms of the external auditor:

- a) Presenting proposals to the Board of Directors for submission to the General Shareholders' Meeting regarding the selection, appointment, re- election, evaluation and removal of the external auditors, as well as the conditions for their engagement.
- b) Receiving regular information from the external auditor about the audit plan and the results of its implementation, and verifying that senior management take their recommendations into account.
- c) Ensuring the independence of the external auditor and, to that end:
- Ensuring that the remuneration of the external auditor for its work does not compromise its quality or independence.
 - Ensuring that the Company notifies the National Securities Market Commission about any change in the auditors, as a significant event, and that it accompanies its report with a declaration regarding the potential existence of disagreements with the outgoing auditor and, if they exist, their contents.
 - Ensuring that the Company and the external auditor adhere to the current legislation regarding the provision of non-audit services, the limits in terms of the concentration of external auditor's business and, in general, the other rules established to ensure the independence of the auditors.
 - In the event that the external auditor resigns, examining the circumstances that have caused it.
- d) Establishing the appropriate relationships with the auditors or audit firms so as to receive information regarding those questions that may pose a risk to their independence, for consideration by the Audit Committee, as well as any other related to the process to audit the accounts, as well as any other communications provided for in the audit legislation and auditing standards. In any case, they must receive a declaration of independence from the auditors on an annual basis regarding the Company and the companies related to it, directly or indirectly, as well as information about the additional services rendered, of any kind, and the corresponding fees received from these companies by the external auditors or by the people or entities linked to it, in accordance with the provisions of the legislation governing audits. Ensuring that the external auditor holds at least one meeting per year with the full Board of Directors to inform them about the work performed and about the evolution of the accounting environment and the risks facing the Company.
- e) Issuing an annual report, prior to the issue of the audit report, in which it expresses an opinion about the independence of the auditors or the audit firms.

This report should comment, in all cases, about the provision of additional services to those described in the paragraph above, considered both individually and as a whole, besides the statutory audit and regarding the framework of independence or audit regulations.

- f) Where appropriate, encouraging the auditor of the group to take responsibility for the audits of the companies that comprise it.
- C) Reporting to the Board of Directors about the following matters, prior to its adoption of the corresponding decisions reserved for the Board of Directors:
- a) The financial information that, due to its status as a listed entity, the Company must disclose on a regular basis. The Audit Committee should ensure that the interim accounts are prepared using the same accounting criteria as the annual accounts and, to that end, should consider the appropriateness of engaging the external auditor to conduct a limited review.
 - b) The issue and admission prospectuses and other documentation relating to the emission and admission of shares.
 - c) The creation or acquisition of shares in special purpose entities or those domiciled in countries or territories considered tax havens, as well as any other transactions or operations of a similar nature that, due to their complexity, may impair the transparency of the group.
 - d) Related party transactions, except those that, by virtue of the Rules of the Board or subsequent decisions by the Board of Directors, correspond to another committee.
- D) In terms of the internal audit function:
- a) The Company shall have an internal audit function that shall operate under the supervision of the Audit Committee, to ensure the proper functioning of the information and internal control systems.
 - b) The head of the internal audit function shall present his annual work plan to the Audit Committee; he shall report directly about any incidents arising during its implementation; and he shall submit an activity report at the end of each year.
 - c) The Audit Committee shall ensure the independence and effectiveness of the internal audit function; propose the selection, appointment, re-election and removal of the head of the internal audit service; propose the budget for this service; receive regular information about its activities; and verify that senior management takes into account the conclusions and recommendations of its reports.
- E) In terms of the control and risk management policy, the Audit Committee should identify:
- a) The different types of risk (operational, technological, financial, legal, reputational, etc.) that the Company faces, including any contingent liabilities and other off balance sheet risks within the financial or economic risks.

- b) Set the level of risk that the Company considers acceptable.
- c) The measures established to mitigate the impact of the risks identified, in the event that they end up materialising.
- d) The information and internal control systems that will be used to control and manage the aforementioned risks, including any contingent liabilities or off balance sheet risks.

2. - PROCEDURES; RULES OF ORGANISATION AND OPERATION

The Board of Directors shall constitute a permanent Audit Committee, comprising between three (3) and five (5) members, who must be External Directors.

The Audit Committee shall comprise at least two (2) Independent Directors, at least one of which should be appointed taking into account his knowledge and experience in terms of accounting, audit or both. The Chairman of the Audit Committee shall be chosen from the Independent Directors that form it.

The Audit Committee shall meet at least once a quarter and whenever appropriate, when convened by the Chairman, of his own accord or in response to a request from two (2) of its members, from the Chairman of the Board of Directors or of the Executive Committee or, where applicable, from the CEO.

Audit Committee will perform in an annual basis, an annual report comprising all the activities carried out by it.

APPOINTMENTS AND REMUNERATION COMMITTEE

Name	Role	Type
DON JOHN CHARLES POPE	MEMBER	Independent
DON ALBERTUS MEERSTADT	CHAIRPERSON	Independent
DON FRANCISCO JAVIER BAÑON TREVIÑO	MEMBER	Proprietary member

% of Proprietary Directors	33.33%
% of Independent Directors	66.67%
% of Other External Directors	0.00%

Explain the duties assigned to this committee, describe the procedures and rules for its organisation and operation, and summarise the most important actions that it has carried out during the year.

1.- FUNCTIONS:

Evaluate the necessary competencies, knowledge and experience in the Board of Directors, to define the necessary functions and skills in the candidates who must fill each vacancy, and to evaluate the time and dedication necessary for them to adequately carry out their duties.

- d) Establish an objective of representation for the under-represented sex in the Governing Body, develop guidance on how to achieve this objective and report to the Council on gender diversity issues.
- e) Submit to the Board of Directors proposals for the appointment of Independent Directors for their appointment by cooptation or for their submission to the decision of the General Shareholders' Meeting, as well as proposals for the re-election or separation of said Directors by the General Meeting Of Shareholders.
- f) Inform the nomination proposals of the other Directors for their appointment by cooptation or for their submission to the decision of the General Meeting of shareholders, as well as proposals for their re-election or separation by the General Meeting of Shareholders.
- g) Inform the proposals for appointment and separation of senior managers and the basic conditions of their contracts.
- h) To examine and organize the succession of the Chairman of the Board of Directors and of the Company's chief executive and, if appropriate, make proposals to the Board of Directors for such succession to take place in an orderly and planned manner.
- i) To propose to the Board of Directors the remuneration policy of Directors and of Directors General or of those who perform their functions of senior management under the direct authority of the Board of Directors, of the Executive Committee or of the Managing Directors, as well as the individual remuneration and other contractual conditions of the Executive Directors, ensuring their compliance.
- j) Consult the Chairman and chief executive officer of the Company, especially in matters relating to executive directors and senior managers.
- k) Ensure compliance with the remuneration policy established by the Company.
- l) Inform the incentive plans.
- m) Conduct an annual review on the remuneration policy of Directors and senior executives.
- n) Prepare the annual corporate governance report and the annual report on the remuneration of Directors.
- o) Propose the appropriate modifications of this Regulation to the Board of Directors.
- p) Examine compliance with internal regulations and corporate governance rules and make proposals necessary for its improvement.
- q) In relation to transactions with related parties or involving, or likely to involve, conflicts of interest, informing and taking decisions for their approval or rejection, and requesting the reports of independent experts that might correspond to the Valuation of the same.
- r) On the occasion of the appointment, ratification or re-election of Directors, it shall prepare a report describing the result of the prior analysis of the needs of the board of directors to be published when convening the general meeting of shareholders to which ratification is submitted, Appointment or re-election of each Director.
- s) Ensure that non-executive Directors have sufficient time available for the proper performance of their duties.

2.- PROCEDURES, RULES OF ORGANIZATION AND OPERATION:

The Board of Directors shall establish a permanent Appointments and Remuneration Committee composed of between three (3) and five (5) members, who shall be external Directors.

At least two (2) Independent Directors shall form part of the Appointments and Remuneration Committee.

The Chairman of the Appointments and Remuneration Committee will be appointed from among the Independent Directors who are part of it.

The appointment of members of the Appointments and Remuneration Committee, as well as the appointment of its Chairman and Secretary, shall be made by the Board of Directors by an absolute majority. Its renewal will be made in the time, form and number decided by the Board of Directors of the Company.

The Secretary of the Appointments and Remuneration Committee may be one of its members or the Secretary or Deputy Secretary of the Board of Directors. In the latter case, the Secretary may not be a member of the Appointments and Remuneration Committee.

The Appointments and Remuneration Committee shall meet as often as necessary, in the opinion of its Chairman, for the exercise of its powers.

Shall meet when requested by at least two (2) of its members. The Chairman of the Board of Directors and the Managing Director may request informational meetings of the Appointment and Remuneration Committee, on an exceptional basis.

Notwithstanding the foregoing, the Appointments and Remuneration Committee shall meet whenever the Board of Directors requests the issuance of a report or the approval of proposals within the scope of its powers and whenever, in the opinion of the Chairman of this committee, it results convenient for the proper development of its purposes.

The Appointments and Remuneration Committee shall be validly constituted when the majority of its members attend the meeting, present or represented.

The resolutions shall be adopted by an absolute majority of the concurrent Directors (present or represented) to the

Session, being the vote of the President in case of a tie in the vote.

Any Board Member of the Company may also request that the Appointments and Remuneration Committee take into consideration, due to its suitability, potential candidates to fill vacancies as a Director.

STRATEGY COMMITTEE

NAME	POSITION	CATEGORY
MRS. BELÉN VILLALONGA MORENÉS	CHAIRPERSON	INDEPENDENT
MR. JOSÉ MARÍA ORIOL FABRA	MEMBER	EXECUTIVE
MR. MICHAEL MOREAU	MEMBER	INDEPENDENT
PEGASO TRANSPORTATION INTERNATIONAL, S.C.A.	MEMBER	PROPIETARY MEMBER
MR. JUAN JOSÉ NÁRDIZ AMURRIO	MEMBER	INDEPENDENT

% PROPIETARY MEMBERS	20%
% INDEPENDENT MEMBERS	60%
% EXECUTIVE MEMBERS	20%

Explain the duties assigned to this committee, describe the procedures and rules for its organisation and operation, and summarise the most important actions that it has carried out during the year.

This committee was created in May 2016 under the provisions of Article 23.3 of the Regulations of the Board of Directors and is governed by the same with respect to: the appointment of its members, the appointment of its Chairman and Secretary and their functioning -and, in particular, with regard to the convening of the meetings, delegation of representation through another member of the relevant committee, incorporation, non-

convened meetings, holding of a meeting, system for adopting resolutions, voting in writing and without a session ("por escrito y sin session") and approval of the minutes of the meetings available for the members of the Board of Directors.

The functions of this Committee are consultative and shall act duly coordinated in order to safeguard the company's interest, contributing towards the good corporate governance of the Company, according to what is established in the bylaws and in the Regulations of the Board of Directors.

The Strategy Committee is an internal committee of Talgo and pursues its activity under the direct indications of the Chairman of the Board of Directors and of the Chief Executive Officer of the company that, furthermore, will be members of it. This Committee will:

- (i) Support the Board of Directors in the coordination and organization of Talgo's strategy through the dissemination, implementation and monitoring of the general strategy.
- (ii) Provide information and managing services with regard to the supervision and monitoring services as well as to the planning of the business strategy, which shall be determined by the Board of Directors of the Company and executed and boosted by its Chairman and its Chief Executive Officer, thereby enabling the development of the business strategy of Talgo.

C.2.2 Complete the following table with information about the number of female Directors who sat on the various Board committees at the end of the last four years:

	Number of female Directors			
	Year 2017 Number / %	Year 2016 Number / %	Year 2015 Number / %	Year 2014 Number / %
Audit Committee	-	-	-	-
Appointments & Remuneration Committee	-	-	-	-
Strategy Committee	1 / 20%	1 / 20%	-	-

C.2.3 Paragraph repealed.

C.2.4 Paragraph repealed.

C.2.5 Indicate, if applicable, whether there are any regulations governing the Board committees. If so, indicate where they are made available for consultation and whether any amendments have been made to them during the year. In turn, indicate whether an annual report has been prepared voluntarily about the activities of each committee.

The Audit Committee and the Appointments and Remuneration Committee are governed by specific regulations, which are included within the Rules of the Board and which are made available to interested parties on the Company's website: www.talgo.com

C.2.6 Paragraph repealed

D RELATED PARTY TRANSACTIONS AND INTRA-GROUP OPERATIONS

D.1 Explain, if applicable, the procedure for approving related party and intra-group transactions.

Procedures for communicating the approval of RPTs

Article 40 of the Rules of the Board establishes that:

The Board of Directors shall be made aware of the transactions that the Company undertakes, directly or indirectly, with Directors, significant shareholders or representatives of the Board or with persons related to them. The performance of such operations or transactions shall require the authorisation of the Board of Directors, following a favourable report from the Appointments and Remuneration Committee, which must be approved with a favourable vote of, at least, eighty per cent (80%) of the Directors, present or represented, at that meeting.

The Directors affected by the aforementioned operations must not exercise or delegate their right to vote, nor may they be present in the meeting room whilst the Board of Directors discusses and votes in this regard.

Nevertheless, the authorisation established in the previous paragraph shall not be necessary when dealing with operations that simultaneously fulfil the following three conditions:

- (i) When they are undertaken by virtue of contracts whose terms and conditions are fundamentally standardised and reflect those usually applied to clients contracting the type of product or service involved.
- (ii) When they are undertaken at general prices or tariffs established by whoever acts as the supplier of the good or service involved or when the operations relate to goods or services for which no established tariffs exist, under normal market conditions, similar to those applied in commercial relationships with clients that have similar characteristics.
- (iii) The amount does not exceed one per cent (1%) of the Company's annual revenues. If these conditions are fulfilled, the affected Directors shall not be obliged to report such operations or obtain authorisation in advance from the Board.

The aforementioned operations shall be valued from the point of view of equal treatment and market conditions, and shall be reflected in the Annual Corporate Governance Report, and in the information that is regularly disclosed under the terms established in the applicable legislation.

On an exceptional basis, when reasons of urgency so require it, related party transactions may be authorised, where applicable, by the Executive Committee, and then subsequently ratified by the Board of Directors.

D.2 List any significant transactions, by virtue of their amount or importance, between the Company or its group of companies, and the Company's significant shareholders:

D.3 List any significant transactions, by virtue of their amount or importance, between the Company or its group of companies, and the Company's Directors or executives:

D.4 List any significant transactions undertaken by the Company with other companies in its group that are not eliminated in the process to prepare the consolidated financial statements and whose subject matter and terms set them apart from the Company's ordinary trading activity.

In all cases, list any intra-group transactions carried out with entities established in countries or territories that are considered to be tax havens

D.5 Indicate the amounts of any transactions carried out with other related parties.

Zero

D.6 List the mechanisms established to detect, determine and resolve any possible conflicts of interest between the Company and/or its group and its Directors, executives or significant shareholders.

Article 31 of the Rules of the Board establishes that Directors shall hold office with the loyalty of a faithful representative, acting in good faith and in the best corporate interest of the Company. To this end, Directors must comply with the obligations imposed by the law and, in particular, shall be subject to the following obligations and prohibitions, amongst others:

- (i) Directors may not undertake, for their own benefit or for the benefit of persons related to them, investments or operations linked to the assets of the Company about which they have become aware as a result of the performance of their role, when those operations have been offered to the Company, nor may they make use of company assets, including confidential information about the Company, for private purposes, or take advantage of the Company's own business opportunities.
- (ii) No Director, or any person related to him, may undertake activities for his own benefit or for the benefit of others that involve effective competition, be it actual or potential, with the Company or that, in any other way, places him in a position of permanent conflict with the interests of the Company.
Similarly, Directors may not hold office or render any services to any companies that compete with the Company or any of its subsidiaries, or any that have the same, similar or complementary activity to the Company's own corporate purpose, unless expressly authorised to do so by the Company, by resolution at the General Shareholders' Meeting.
- (iii) Directors should refrain from participating in discussions and votes about agreements and decisions in which they or any of their related parties have a conflict of interest, be it direct or indirect, except those agreements or decisions that affect him in his capacity as an administrator, such as his appointment or removal for positions on the Board of Directors or others of similar significance.

- (iv) Directors should report to the Board of Directors any situations involving conflicts of interest, be they direct or indirect, with the interests of the Company. In the case of conflict, the affected Director should refrain from participating in the operation to which the conflict relates.

The Company's Board of Directors approved the Code of Conduct for the Securities Market in which a compliance unit was created and rules were established for, amongst other things, the detection and treatment of conflicts of interest.

D.7 Is more than one Group company listed in Spain?

Yes No

Identify the listed subsidiary companies in Spain:

None.

Indicate whether the respective areas of activity and the potential business relationships between them have been disclosed accurately, as well as those between the listed subsidiary company and the other companies in the group:

Define the possible business relationships between the parent company and the listed subsidiary, and between the latter and the other companies in the group

Identify the mechanisms established to resolve potential conflicts of interest between the listed subsidiary and the other companies in the group:

Mechanisms for resolving any conflicts of interest

E CONTROL SYSTEMS AND RISK MANAGEMENT

E.1 Explain the scope of the Company's Risk Management System, including details of a fiscal nature.

In accordance with the provisions of Article 5.4 of the Rules of the Board and without prejudice to the legal powers attributed to this body, as established in a specific way in section (xiii), the Board of Directors of Talgo, S.A. is responsible for "determining the policy for controlling and managing risks, including those of a fiscal nature, as well as for the overseeing the internal information and control systems".

The Talgo Group has been undertaking actions aimed at improving the control and risk management environment, and implementing systems and methodologies that allow the identification, evaluation, management, control and mitigation of the risks that it faces (operational, technological, financial, legal, tax, reputational).

Risk management is a continuous process that takes place at all levels of the organisation and in all of the Group's companies through different procedures, the main one being the structure of supervisory levels configured in the policies approved by the Board of Directors. Therefore, given that the Board of Directors has been assigned responsibility for maintaining the Talgo Group's internal control system, this manifests itself in the monitoring and control of the significant risks facing the Talgo Group and in the approval of actions aimed at improving the existing policies and procedures.

Meanwhile, the Audit Committee conducts a regular review of the internal control and risk management systems, to ensure that they are operating properly.

Internal control forms part of the Talgo Group's Corporate Risk Management System, and the basic components of that system are as follows:

a) Control environment

The Talgo Group gives priority to maintaining a control environment in its organisation, which forms the basis of all of the other elements of internal control, providing discipline and structure. Management's philosophy and style constantly strengthens the culture of internal control within the organisation.

Senior Management is responsible for designing and reviewing the organisational structure, for defining reporting lines and authorising the appropriate distribution and segregation of tasks and functions, as well as for ensuring that sufficient procedures exist for its proper dissemination and understanding.

b) Regular evaluation of the main risks

During 2017, the risks assessed to have adequate coverage have been described in section E3.

c) Control activities

The Talgo Group (by means of the governing bodies responsible for its internal control system) designs and implements control activities to reduce the risks detected. Those activities are communicated in such a way that they are understood by the employees and performed in an appropriate way.

All of the controls are designed with the aim of preventing, detecting, mitigating, offsetting and correcting the potential impact of risks in good time, and to this end preventative and detective controls are employed, as well as manual and automatic controls.

The control and risk management function is structured around two basic lines of defence, which have different roles and responsibilities. These lines are as follows:

-The organisational units, which assume risks during the ordinary performance of their activities. They are the owners of the risks and are responsible for the identification, detection and mitigation of risk.

- The Audit Committee and the Internal Audit Function, which are responsible, primarily, for ensuring the proper functioning of the control and risk management system, for defining the regulatory and methodological framework and for conducting the regular monitoring and overall control of the Group's risks. They are also responsible for supervising the effectiveness of the risk controls established.

d) Information and communication

The information systems are designed to facilitate the data required internally and externally, which may have an impact on the organisation. These systems collect, process and distribute the necessary information to users to enable the proper performance of their functions.

e) Supervision, organisation and responsibilities in their management.

The Talgo Group considers that an oversight system is essential in order to understand the operating level of the internal control system and to maintain an updated risk map.

E.2 Identify the bodies responsible for the preparation and implementation of the Risk Management System, including tax matters.

As described in the section above, the Board of Directors is responsible for "determining the policy for controlling and managing risks, including those of a fiscal nature, as well as for supervising the internal information and control systems", as established in the Rules of the Board of Directors of Talgo, S.A..

Meanwhile, the Audit Committee, through the functions that correspond to it in terms of the information and internal control systems, is responsible for supervising the preparation and control of the financial information in general, and of all of the procedures implemented for that purpose in particular, as well as for supervising the internal audit function and the relationship with the external auditor, with the purpose of ensuring its independence and obtaining a clean audit opinion, amongst other functions. Similarly, that committee is specifically responsible for regularly reviewing the internal control and risk management systems, so that the main risks are properly identified, managed and disclosed.

Similarly, its main activities include ensuring the independence and effectiveness of the internal control systems (proposing the selection, appointment, re-election and removal of the head of the internal audit service); receiving regular information about its activities and verifying that senior management takes into account the conclusions and recommendation of its reports.

Similarly, the Internal Auditor of the Talgo Group is responsible for ensuring the control of the risks facing the Group, amongst other functions, and to that end, he shall participate in the review and evaluation of the systems and procedures for controlling and mitigating risks. The Talgo Group performs internal audit work using its own staff, as well as external advisors, when necessary, which, under the supervision of the Audit Committee, ensure the proper functioning of the information and internal control systems.

Finally, it is worth noting the direct and continuous involvement of the Company's different departments, as well as of its Directors, and ultimately, the Steering Committee, in the operation of the procedures and tools for analysing and managing the specific risks associated with the Talgo Group's activities, for both the execution of each project, as well as during the phases prior to that.

E.3 Indicate the main risks, including any tax risks, which may affect the achievement of the business objectives.

The Group is exposed to different risks inherent in the different countries in which it operates that may impede achieving its objectives.

Therefore, Talgo has implemented a risk management model, approved and monitored by the Audit Committee, applicable to all subsidiaries and permanent establishments in all the countries where it carries out its activity that ensures that the main risks are identified, valued and prioritized and, on the other hand, to establish the mechanisms and basic principles to achieve a level of risk that allows: (i) sustainable growth of the business, (ii) protect the reputation of the Group and encourage good government practices Corporate and (iii) deliver a product and provide a quality service in all those geographies where trains and Talgo auxiliary machines operate.

The risks facing the Talgo Group in the performance of its activity may be classified as follows:

Strategic and business risks

These risks are inherent to the sector in which the Talgo Group operates and are linked to losses in value resulting from external factors, economic cycles, changes in patterns of demand and market structures.

The activities that the Talgo Group undertakes are mainly affected by the following risks:

- Legal risk
- Country risk
- Delays in the development of infrastructure projects
- Variations in the regulatory framework
- The evolution of demand

Financial and tax risks

The Talgo Group is subject to risks arising due to volatility in interest rates, exchange rates, prices and credit, as well as movements in other financial variables that may negatively affect the Group's liquidity.

Prudent liquidity risk management involves maintaining sufficient cash, the availability of financing through a sufficient amount of committed credit facilities and having the capacity to liquidate market positions. The Group's Management performs regular monitoring of the Group's liquidity forecasts on the basis of its expected cash flows both over the short-term and long-term. The Group maintains sufficient cash to meet its liquidity requirements.

The Group operates with a portfolio of clients that mostly belong to the public railway sector, which means that the incidence of credit risk resulting from a lack of solvency or delay in payments by its clients is very low. Nevertheless, the Management team of the Talgo Group considers that this risk represents a key aspect in the daily management of the business, and so it focuses its efforts on the proper supervision and control of the evolution of its receivables accounts and the delinquency thereof. Credit risk represents the possible losses resulting from a failure to pay the monetary or quantifiable obligations by a counterparty to which the Talgo Group has granted net credit and that is pending settlement or collection. Counterparty risk comprises the possible failure to fulfil the requirements acquired by a counterparty by virtue of commercial contracts, generally established over the long-term.

The variable rate debt issued exposes the Talgo Group to cash flow interest rate risk, and for this, the Group's Management puts in place policies for the management of interest rate risk.

Similarly, the Group is exposed to possible changes in tax regulatory frameworks, as well as to uncertainties arising from different potential interpretations of the tax legislation in force.

Risk of cyber attack and fraud

The Talgo Group is exposed to the occurrence of criminal and fraudulent acts of a cyber nature, regardless of whether or not they are directed against the Company, in that they may affect its assets.

Compliance risk

The Talgo Group is exposed to compliance risk, which include the cost associated with possible sanctions for the infringement of laws and regulations, or those sanctions resulting from the materialisation of operational events (environmental damage, damage to third parties, leaking of confidential information, health, hygiene and safety in the workplace, etc.) or from the violation of the Company's internal policies and procedures. The Group's Compliance Unit proactively watches over the effective functioning of the Group's compliance system.

Criminal liability risks

The reforms to Article 31 bis of the Penal Code, which took place in 2010 and 2015, establish the criminal liability of legal entities. In this context, the Talgo Group may be responsible for certain crimes in Spain, if its administrators, executives or employees commit such crimes during the performance of their functions and in the interests of the Company.

To prevent the materialisation of this risk, the Talgo Group is implementing a Crime Prevention Model as well as an anti-corruption and anti-fraud policy, to introduces the necessary measures to prevent crimes from being committed in the business environment and to exempt from responsibility the different companies that compose the Group.

E.4 Identify whether the entity has a risk tolerance level, including for tax matters.

As a general premise, the Talgo Group has a low risk tolerance level and a prudent profile when it comes to taking decisions that may involve risk exposure; it always seeks to ensure sustainable growth over time. To this end, it has established a series of fundamental basic premises that characterise the target behaviour of the Talgo Group and which cut across the whole organisation. These premises relate to the solvency, liquidity and robustness of the results.

The Group operates a risk management system to address the difficulties associated with the management of the different projects that it undertakes. This begins with the selection of projects and the subsequent preparation of the offer, and it enables the identification and management of the different risks facing the Company during the normal course of its business. The results of this risk assessment are presented to the Executive Committee so that it can take decisions regarding the presentation of offers and the completion of the process. The project team, coordinated by the project manager, shall be responsible for defining actions to mitigate the risks and for controlling them until the completion of the project.

E.5 Indicate any risks, including tax risks, that have arisen during the year.

No additional material or extraordinary risks arose during 2017, including tax risks, besides those details in the Annual Financial Statements, and in any event, without comprising the results, strategic objectives or equity. These materialised risks are risks inherent to all companies in the sector and no significant incidents were generated during the last year, given that the main risks that may affect the achievement of the business risks are managed in an active way by the organisation and the mitigation and control systems in place in the different areas have worked.

E.6 Explain the plans for addressing and supervising the main risks facing the entity, including those relating to tax risks.

1. Risks of a financial nature

The management activities that are performed in the core of the Talgo Group, in this regard, focus on managing the uncertainty in the financial markets and trying to minimise its potential adverse affects on the financial profitability of the Group.

The Group's Financial Department identifies, evaluates and covers the financial risks, establishing policies for the management of global risks, as well as for specific areas, such as exchange rate risk, interest rate risk, liquidity risk, the employment of derivatives and non-derivatives, investment of surplus liquidity and deviations from project budgets.

a) Market risk

The various companies of the Talgo Group operate in the international environment and, therefore, are exposed to exchange rate risks due to foreign currency transactions. In order to control the exchange rate risk that arises on future commercial transactions, and recognised assets and liabilities, the Group's companies enter into currency hedging contracts, however the majority of the Group's operations are undertaken in the functional currency, euro.

The aim of these hedges is to try to avoid the impact of changes in foreign currencies in the different contracts signed, in such a way that the Group's results are a faithful reflection of its industrial activity and services.

b) Credit risk

The majority of the receivables and work in progress balance that the Group holds correspond to several clients located in different countries. In most cases, the contracts include on-going payments that are made as the project progresses.

It is common practice for the Company to insure certain risks of resolution or non-payment of export contracts, by taking out export insurance policies and letters of credit, in accordance with the standards for the OECD Consensus for this type of instrument. The decision as to whether or not to perform the hedge is taken on the basis of the type of client and the country in which it operates.

c) Liquidity risk

The Group's Management performs regular monitoring of the Group's liquidity forecasts on the basis of its expected cash flows both over the short-term and long-term. The Group maintains sufficient cash to meet its liquidity requirements

The search for and selection of business opportunities with the highest possible level of self-financing, within the existing market conditions, for each one of the contracts. In the case of manufacturing projects, which have an average execution period of approximately three years, the billing and execution milestones may not be aligned in terms of time, which supposes a consumption of financial resources that is managed with the opportune financing sources.

d) Cash flow interest rate and fair value risk

The Group's interest rate risk arises from its long-term borrowings. The variable rate debt issued exposes the Group to cash flow interest rate risk, and for this, the Group's Management puts in place policies for the management of interest rate risk, such as interest rate hedges and swaps, as well as negotiating financing at fixed interest rates.

e) Risk resulting from deviations in project budgets

Deviations from project budgets that serve as the basis for the preparation of the respective bids, are analysed and controlled using a detailed IT system for each cost item, which compares the budgeted cost of these items with the reality of the cost situation for each project on an on-going basis. In this way, over the life of the projects, continuous monitoring is performed of this data through a complex internal process created for that purpose, in which each department involved in each project participates.

2. Quality management system and environment

When carrying out our activities, priority is given to improving the effectiveness of our management systems in a sustainable, safe and quality way that achieves maximum satisfaction for our clients, employees and suppliers.

The guidelines that govern these activities are contained in our quality, prevention and environmental policies, which reflect the following standards: ISO 9001, ISO 14001 and IRIS.

3. Reliability of financial information

In Section F, details are provided of the Internal Control **System** for Financial Reporting (SCIIF).

4. Other preventative procedures

Employment risk prevention system.

Employment risk prevention systems have been implemented for all of the activities, in accordance with the requirements of Law 31/1995 and its draft legislation.

Model for the Prevention and Detection of Crimes

During the year 2017 the Talgo Group has consolidated and implemented the Crime Prevention Model as established in article 31 bis of the Penal Code, reformed following the approval of Organic Law 5/2010, dated 22 June 2010, establishing a compliance body, a structure of the model and an identification and supervision of risk areas.

In this regard, it is a duty of the Talgo Group to adopt and execute as efficiently as possible organizational and management procedures, which include surveillance and control measures to prevent any criminal activity in the organization and which guarantee at all times, the legality of the acts that, in the exercise of professional activities, perform all workers and managers of the Talgo Group.

F INTERNAL CONTROL AND RISK MANAGEMENT SYSTEMS RELATING TO THE FINANCIAL REPORTING PROCESS (SCIIF)

Describe the mechanisms that comprise the internal control and risk management systems relating to the process for financial reporting (SCIIF) by the entity.

F.1 The entity's control environment

Specify at least the following components, indicating the main features in each case:

F.1.1. The bodies and/or functions responsible for: (i) the existence and maintenance of an adequate and effective SCIIF; (ii) its implementation; and (iii) its supervision.

In accordance with the provisions of the Company Bylaws and the Rules that develop them, the governing bodies are: (i) the Board of Directors; (ii) the Audit Committee; and (iii) the Internal Audit Department, which provides support to the Audit Committee.

Talgo's Board of Directors is the governing body responsible for the existence and maintenance of an appropriate and effective SCIIF. The Audit Committee, which assumes the powers delegated to it by the Board of Directors, is the body responsible for supervising the process for the preparation and presentation of the regulated financial information and the effectiveness of the Company's internal control systems, the internal audit services and the risk management systems, as well as for discussing any significant weaknesses detected in the internal control system with the auditor of the accounts or the audit firms during the performance of the audit.

The Audit Committee entrusts the supervision of the effectiveness of the Internal Control System for Financial Reporting (SCIIF) to the Internal Audit team, through its exercise of a unique and independent governance function, in line with the rules and standards of professional quality that contribute to good corporate governance and to ensuring that the financial information has been prepared reliably.

The Group management, and specially the Economic-Financial Department is the area responsible for the design, implementation and maintenance over time of an appropriate and effective system of internal controls over financial information.

F.1.2 The existence or otherwise of the following elements, especially in connection with the financial reporting process:

- The departments and/or mechanisms responsible for: (i) the design and review of the organisational structure; (ii) defining clear lines of responsibility and authority, with an appropriate distribution of tasks and functions; and (iii) deploying sufficient procedures for its proper dissemination throughout the entity.

According to the provisions of the Rules of the Board, the Appointments and Remuneration Committee is responsible for analysing the process that enables the orderly succession of the Chairman and CEO, who the Board is responsible for appointing, and for reporting on the appointment and removal of the Directors that report directly into the CEO.

Meanwhile, the CEO, with the assistance of the Director of Human Resources, in her capacity as an advisor to the CEO, is responsible for determining the organisational structure for the first line of reporting in the organisation (i.e. the managers that report directly into him).

In turn, these managers are responsible for deciding any changes in the organisational structure under their immediate control, following authorisation from the CEO and advice from the Director of Human Resources.

The Compensation Department, which sits within the Human Resources Department, evaluates the classification and description of all of the jobs in the Group on a regular basis, with the aim of maintaining an appropriate segregation of duties, avoiding duplication of roles and improving coordination between the different departments, which results in the improved efficiency of the Group's operations. All employees can access the updated organisational chart through the Group's IT systems.

In terms of the scope of SCIIF, in the processes determined as critical for the preparation of financial information, the main tasks and controls to be performed are defined, along with the names of the people responsible for their execution and supervision, in such a way that the lines of responsibility and authority are clearly defined.

In addition, for these processes, details are documented of the segregation of duties for tasks that are considered to be incompatible.

- Code of conduct, approval body, degree of dissemination and instruction, principles and values covered (indicating whether there is any specific mention of record keeping and financial reporting), body responsible for analysing breaches and proposing corrective actions and sanctions.

Additionally The Talgo Group has a Code of Conduct approved by the Board of Directors, which incorporates the values ethics that are to govern all the activities that are carried out, which includes those principles and values that govern the financial responsibility for the registration of operations, financial preparation and compliance with the applicable regulations.

Control of the application of the code of conduct corresponds to the compliance unit, which operates to ensure compliance with this code.

This code has been disseminated throughout the Group and with on-line training. It is available at Intranet of the Group

Talgo also has a whistleblowing channel managed by an external company that, in coordination with the members of the Compliance Unit, analyzes the possible infractions that have been communicated, proposing if appropriate the application of the disciplinary regime applicable for that purpose.

Talgo, S.A., as the parent company of the other entities, has approved a code of conduct for the management and control of confidential information, the transparent communication of significant information, the performance of operations involving own shares and the detection and treatment of conflicts of interest; it also imposes certain obligations, limitations and prohibitions on affected persons, and the managers of the own shares.

- Channel for whistleblowing that allows irregularities of a financial and accounting nature to be communicated to the Audit Committee, in addition to potential breaches of the code of conduct and irregular activities in the organisation, stating whether reports made through this channel are confidential.

The Talgo Group has specific channels in place that employees may use to communicate any irregular circumstances that may affect the performance of their work.

Additionally, the management of the "Ethical Channel" or "Denunciation Channel" has been outsourced through an independent company specialized in this area, in order to provide it with greater independence for communication to the Compliance Unit of possible irregularities of potential transcendence. The sender of this communication must be identified, although the system guarantees the confidentiality and protection of his identity.

The Audit Committee is responsible for supervising these channels and that body is informed about both the activity and the measures taken in this regard on a regular basis by the Internal Audit Department. In its exercise of this oversight role, the Internal Audit Department meets with the Human Resources departments and the legal and employment teams, to the extent that it concludes that work needs to be performed within their respective areas of competence.

- Training programs and periodic refresher courses for staff involved in the preparation and review of financial information, as well as the assessment of SCIIF, which cover at least, accounting rules, audit standards, internal control and risk management.

The Group has a training budget at the corporate level and designs an annual training plan. Under this framework, the training needs are identified and activities are scheduled for each department, on the basis of the requirements of each job and its calendar.

A performance evaluation is conducted for every employee on an annual basis, to determine a development plan and individual training program for each employee, which is integrated into the Global Training Plan.

Training is usually classroom based and is delivered by professionals from both inside and outside the group, in accordance with the requirements in each area to involve specialists, and it also uses IT resources, which are made available to the relevant people, so that they have access to the different course and seminars.

In addition, refresher courses are provided by external specialists at least once a year, with the aim of ensuring affected employees are updated about any regulatory changes that may affect the preparation of the financial statements.

The members of the Economic-Financial department also have refresher meetings with the external auditors, tax advisors and internal auditors, to understand the main changes that have happened in the last year, covering areas such as accounting and financial reporting principles, audit guidelines and guidelines for the control and management of financial risks.

The key indicators about the training programs completed by the Economic-Financial department and other departments in the Group related to the systems of control over the Talgo Group's financial information that provide support to the different businesses in 2017 were as follows:

- Number of people in the financial department and other departments involved in training plans about financial reporting: 211
- Number of hours of training received: 1,020 hours
- Main training activities:
 - Courses related to new IFRS (International Financial Reporting Standards), NIIF 9 and NIIF 15 identified as rules with significant impact in the short-term.
 - Specific training in relation to the Control System. Internal Financial Information.
 - Specific training of the Crime Prevention and Detection Model.
 - Training in Spanish and international taxation.
 - Training in management control.
 - Finance for Non-Financial.
 - Tax news.

- IT training on all upgrades, new SAP modules and new tools that contribute to improve the control of financial information.
- The training programs are extended to those members of the organisation that may be affected by them in the performance of their tasks.

F.2 Evaluation of the risks associated with financial reporting

Report, at least:

F.2.1. The main features of the process for identifying risks, including those relating to error or fraud, stating whether :

☐ A process exists and has been documented.

The identification of risks in the area of financial information is an on-going and documented process, carried out by the Economic- Financial Department, in collaboration with the Internal Audit Department under the framework of the analysis and risk management system, which establishes frequencies, methodologies, risk types and other basic guidelines. In this regard, the Group has received external advice from the auditors and advisors.

The Talgo Group has carried out an analysis of the risks of financial information that may affect the true and fair view of the information it publishes. To do so, based on the financial statements at the end of the year, those transactions and material transactions have been identified, determining the relevant processes on which periodic monitoring and supervision is to be carried out.

From the identification and analysis of the risks **associated** to the achievement of the objectives of the reflection of the faithful image of the Talgo Group's financial information, the implemented controls are identified as well as the additional controls to be implemented.

The identification of the risks of the financial information is carried out through an understanding of the type of transactions carried out in the organization, determining their complexity and the applicable regulations, the volume of the same, the quantitative importance of the affected items, The complexity of the calculations, the need to use estimates and projections, the application of judgments and the unusual operations performed during the period under review.

☐ The process covers all of the objectives of financial reporting (existence and occurrence; completeness; valuation; presentation, disclosure and comparability; and rights and obligations), whether it is updated and how often.

Each year, analysis is performed to identify the areas and processes, as well as the companies and locations in which significant transactions are generated. This analysis includes a review of the routine processes involved in the generation of financial information. During the year, the risk areas identified are monitored and updated, taking into account any new significant events that happen during the period.

The process covers all of the financial reporting objectives. This process is ultimately overseen by the Audit Committee.

The functions to be carried out and their frequency are as follows:

1. Specification of the objectives of the financial reporting controls by those involved in the process to generate the financial information. These objectives should be aligned with the global objectives to ensure the reliability of the financial information:

- Existence and Occurrence: Registered transactions that are not valid, because they do not correspond to the exercise or due to lack of authorization (of the client, of the responsible with powers etc.).
 - Integrity: Operations and balances that must be registered are not.
 - Cutting of operations: Transactions recorded in different accrual periods.
 - Registration: Operations registered with errors in the data imputation (amounts, etc.).
 - Valuation: transactions (assets, liabilities, expenses, income and commitments) recorded in which the amounts are not correct because the valuation has not been adequate.
 - Presentation, breakdown and comparability: Incorrect classifications and breakdowns in the different lines of the financial statements as well as in the accompanying explanatory notes.
 - Rights and obligations: Transactions involving the recording of the appropriate provisions derived from the operation itself.
2. In addition, as an internal control system, the Talgo Group Internal Control System focuses on the following objectives, in addition to the objective of obtaining reliable financial information:
- Efficiency in operations: search for the realization of operations through the necessary resources, but with adequate efficiency.
 - Compliance: avoiding non-compliance with applicable regulations and / or obligations acquired with third parties due to normal operations and that may give rise to claims and therefore possible losses for the company.
 - Asset safeguard: It is related to assets acquired or liabilities incurred (or canceled) that have not been authorized in the corresponding level.
3. Explicit assessment of the probability of an error with material impact caused by fraud. To do so, the following guidelines will be taken into account:
- Agreements signed with third parties (suppliers, customers, etc.)
 - Persons authorized to sign agreements, contracts, etc.
 - The people who hold the powers in the organization
 - Valuations that are made based on judgments and / or estimates and have a significant impact on the generation of financial information.
 - Non-recurring transactions and transactions.
 - Review according to the Annual Internal Audit Plan established in the supervision process, the reliability and integrity of the IT systems that respond to the generation of financial information.
 - Continuous review of the best practices of the sector and the situation in the associations to which the Group is associated because of its relation with the evolution of the sector, etc.
4. Additionally, in the process, the possibility of risk of error is considered in certain processes not linked to specific transaction classes, but especially relevant in view of their importance in the preparation of the reported information, such as the trial review process and significant accounting policies or the closing and consolidation process. In this regard, and in order to cover the risks of these processes, the Group has appropriate control activities.
5. Conduct a periodic review of existing controls with those responsible for the generation of financial information in order to identify variations with respect to the previous period.
6. Periodic review of the control activities in each of the organization's processes that result in the financial information, establishing the recommendations detected, if necessary, for their implementation, as well as establishing those controls that are considered necessary.
- The existence of a process to identify the consolidation perimeter, taking into account, *inter alia*, the possible existence of complex corporate structures or special purpose entities or vehicles.

The Group has a process in place for identifying the consolidation perimeter, which is performed by the consolidation team that forms part of the Finance Department in collaboration with the Department for Subsidiary Oversight, and this information is identified and updated at each monthly close.

- a) The entry of new companies into the Group both due to shareholder control as well as those resulting from other types of effective control, for which an informative procedure is established for all of the agreements/contracts signed by the existing powers of attorney, relating to the taking over and loss of control of companies.
- b) Removal of Talgo group companies.
- c) Changes or amendments to the shareholding stakes or the voting rights (both directly and indirectly, due to both shareholder control, as well as those resulting from other types of effective control), for which an informative procedure is established for all the agreements and contracts signed by the existing powers of attorney, in relation to the acquisition/sale of shares and stakes in other companies.

- The process takes into account the effects of other types of risks (operational, technological, financial, legal, tax, reputational, environmental, etc.) insofar as they impact the financial statements.

The process takes into account all of the identifiable risks (operational, technological, financial, legal, reputation, environmental, etc.) to the extent that they affect the financial statements.

- Which of the Company's governing bodies is responsible for supervising the process.

The Audit Committee, through the Internal Audit Department, is the body responsible for overseeing the process for the preparation and presentation of the regulated financial information, which includes the process for the identification of risks.

F.3 Control activities

State whether the Company has the following components in place and indicate the main features in each case:

- F.3.1. Procedures for reviewing and authorising the financial information and SCIIF description, to be disclosed to the securities markets, stating who is responsible in each case, as well as documentation describing the flows of activities and controls (including those relating to fraud risk) for the different types of transactions that may materially affect the financial statements, including the procedure for the accounting close and the specific review of significant judgements, estimates, valuations and projections.

The Group **has** descriptive documentation in place about the main processes which indicate the main flow of activities and the names of the people responsible for performing the various control activities.

The main **processes** for generating financial information that affect the financial statements in a material way have been fully documented by the Group. The processes for generating financial information covered by this documentation include the following:

- Consolidation and Reporting
- Human Resources management
- Recognition of Revenues and Expenses
- Billing and Clients
- Inventory and Purchases (materials and services)
- Investments
- Taxes
- Treasury
- Costs monitoring

For each one of these processes, the risks of error that may affect the reliability of the financial information have been identified (including the risks of errors in the significant judgements, estimates, valuations and projections) and the control activities performed to mitigate those risks. The person responsible for executing and supervising each control activity has been identified, along with the frequency of their performance and the evidence required to demonstrate the execution of the control activity. This system is updated on a continuous basis and is adapted on the basis of the risks identified.

In connection with the review of relevant judgments and estimates, the Talgo Group reports in its annual accounts one of the notes to the report of those most relevant areas in which significant estimates and judgments exist, as well as the key assumptions With respect to them. In this sense, the main estimates made refer to:

- Estimated loss of goodwill
- Income tax and tax assets
- Recognition of income using the percentage of realization method
- Useful lives of property, plant and equipment and intangible assets
- Provisions

The procedures for reviewing and authorizing the financial information of the Talgo Group that is published in the markets are initiated by its review by the Economic and Financial Management of each company,

In the Consolidation Area, with the corresponding controls being established by the Economic and Financial Division of the Talgo Group. This process is controlled and supervised by the Internal Audit Department of the Talgo Group
As part of its functions.

The individual and consolidated annual accounts and the quarterly financial reports are reviewed by the Audit Committee, as a preliminary step to their formulation by the Board of Directors, as established in the Regulations of the latter. In accordance with the provisions of the Regulations of the Board of Directors, the Audit Committee proceeds to read and review the information, as well as its discussion, with the Internal Audit Department and with the External Auditors (in the case of accounts Annual), as a preliminary step to the Board of Directors.

Once the Audit Committee has reviewed this information and gives its agreement and observations to be incorporated, the annual accounts are signed by the Board of Directors.

In relation to the quarterly information, the Audit Committee reviews the critical financial information (financial information, changes in results, details on the main headings, changes in cash flows, etc.) prior to the forwarding of this information to the Board Of Administration and later to the Market.

F.3.2. Internal control policies and procedures over the IT systems (including, amongst others, access security, control of changes, system operation, operational continuity and segregation of duties) that support the entity's significant processes regarding the preparation and publication of financial information.

The Group has an IT Systems department, which maintains a proper register and control of transactions and therefore, is dependent on its proper operation.

As part of the process for identifying the risks of error in the financial information, the team identifies which systems and applications are relevant for every one of the areas and processes that are considered to be significant. The systems and applications identified

include, both those that are used directly for the preparation of financial information, as well as those that are significant for the effectiveness of the controls that mitigate the risk of errors in that information.

A methodological framework is defined in the design and implementation of the applications, which establishes the different points of control for ensuring that the solution obtained fulfils the requirements requested by the user and that the quality level fulfils the required standards of reliability, efficiency and maintainability.

The IT Systems department has established policies aimed at covering security in terms of access, through the access matrix and the segregation of duties with the definition of roles and resources, and the continuity of its operation, defining for this purpose a matrix of general controls structured around the following areas:

- Operations and safeguards for existing data, affecting the custody of it in external locations.
- Business continuity: the Group has developed appropriate systems involving access restrictions, protection plans, recovery, etc. in order to safeguard its operations.
- Security: the Group has established a Security Policy which is reviewed and updated on a regular basis, to ensure the absence of incompatibilities (matrix for the segregation of duties), and to define user profiles and adapt the access permitted by them.
- Change management: the process for all systems has been formalized (acquisition, development, amendments and maintenance, indicating the people responsible, approvals, evidence, etc.).

Talgo Group receives advice and support from independent external professionals who are experts in this field to ensure the suitability of the processes and controls implemented. In particular, during the year the new version of its ERP (Enterprises Resources Process) was updated to ensure, among other things, the safeguarding of information, data integrity, as well as greater efficiency in the Daily operation of the Talgo Group.

Likewise, the Group is in the process of implementing the GRC module of its IT tool to ensure its excellence in matters of Corporate Governance, Risk Management and Regulatory Compliance

F.3.3. Internal control policies and procedures for overseeing the management of activities outsourced to third parties, as well as those aspects involving appraisals, calculations and valuations entrusted to independent experts, when they may materially affect the financial statements.

The Group regularly reviews which activities carried out by third parties are relevant for the process for the preparation of financial information or that may indirectly affect its reliability.

Occasionally, valuations have been requested from independent experts (valuation of assets). In those cases, the departments responsible for the areas involved execute the controls and supervise their compliance with respect to the work of these experts, in order to verify their competence, training, accreditation and independence, as well as the validity of the data and methods used and the reasonableness of the hypotheses employed. In these cases, the company's policy is to use independent firms with prestigious reputations.

In this context, when the Group intends to rely on the work of an independent expert (understood as those third parties who issue advice or opinions about specialist subjects and who have adequate and accredited training and experience in the required field) that may affect the financial information in a significant way, the following aspects should be evaluated:

- Adequate professional competence and approval by the corresponding professional body (when so required by a relevant legal standard).
- The relationships or links held by the external professional with the organisation for the purposes of assessing their independence.

Additionally, the results obtained by the third party are evaluated as well as the data used for their evaluation.

During the fiscal year, valuations (valuation of assets) and reports to independent experts have been required. In these cases, it is society's policy to go to firms of recognized prestige and independence as well as to execute the necessary controls to supervise compliance with the work of these experts, intended to verify their competence, training, accreditation or independence, as well as the validity of the data and methods used and the reasonableness of the hypotheses used.

F.4 Information and communication

State whether the Company has the following components in place and indicate the main features in each case:

- F.4.1. A specific function responsible for defining and updating the accounting policies (an accounting policies team or department) and for resolving queries or conflicts resulting from their interpretation, maintaining regular communication with the managers responsible for the operations in the organisation, as well as an updated accounting policy manual that has been sent to all of the units through which the entity operates.

The Group's Economic-Financial Department is responsible for preparing the consolidated financial statements as well as the parent company's financial statements. Its responsibilities include the resolution of accounting questions for the other Group companies, with which a direct and open relationship is maintained through the controllers and financial managers assigned to each subsidiary. The Economic-Financial Department is responsible for identifying, defining and communicating the accounting policies that affect the Group, and those policies are reflected in the Manual of Accounting and Financial Procedures and Policies, which is updated regularly and is available on the Group's internal network to which the affected departments have access.

In addition, the Talgo Group has a set of documents that are adapted to the needs, requirements and size of the Group, in which the rules for the preparation of financial information are determined and explained and how these standards should be applied to the operations Of the entity called the Information Package. These documents not only explicitly refer to the rules that apply to each type of transaction, but also to develop and explain the interpretation of the same to fit exactly each type of transaction.

These documents are updated periodically and at least annually, and incorporate the applicable rules for the corresponding exercise. The significant modifications made are communicated to the dependent companies to which they are applicable via e-mail, videoconference or from the holding of specific meetings with those responsible for them.

- F.4.2. Mechanisms for collating and preparing financial information in standard formats that may be applied and used by all of the units in the entity or group, which support the main financial statements and accompanying notes, as well as disclosures concerning SCIIF.

In an annual basis, a schedule with the information needs for the preparation of the financial information of the following year is established, containing all the documents, responsible for them and dates of delivery of the documentation. This information report is made

through the Financial Information Packages prepared by the Economic and Financial Department. These packages include the information necessary to report from the subsidiaries to the parent company in preparation for the Consolidated Financial Statements as well as the Information to be included in the accompanying notes.

The process of consolidation and preparation of the financial information is carried out centralized in the subsidiary Patentes Talgo, there being a Consolidation process broken down in which all the existing subprocesses are evidenced, personnel involved, locations, documentation used support and periodicity of the activities and controls that are carried out, among others.

In this process, the financial statements reported by the subsidiaries of the Talgo Group in the established formats are used, as well as the rest of the financial information required for both the accounting homogenization process and the coverage of the established information needs.

The Talgo Group has a series of controls implemented in the financial information packages as well as adequate blocks that allow to assure the reliability and correct treatment of the information received from the different subsidiaries.

It is worth noting the centralized performance of the various consolidation entries, analysis of changes in all equity items and results, changes in results obtained over previous periods and on approved budgets, analysis of the evolution of events and most relevant variables.

F.5 Supervision of the operation of the system

State indicating the main features of at least:

F.5.1. The SCIIF monitoring activities undertaken by the Audit Committee, as well as whether the entity has an internal audit function whose competencies include providing support to the committee in its oversight of the internal control system, including SCIIF. Also, report about the scope of the SCIIF assessment conducted during the year and the procedure by which the person responsible for carrying out the assessment communicated his results, whether the entity has an action plan that details the potential corrective measures, and whether its impact on the financial information has been considered.

The Head of Internal Audit must present his work plan for the following year to the Audit Committee at least once a year. The plan shall include the tasks that will be performed to properly assess the SCIIF. The contents of the annual work plan are reviewed and updated on an on-going basis for its subsequent approval by the Audit Committee.

On the basis of this plan, the Head of Internal Audit must report his assessment of the SCIIF to the Audit Committee, summarising his most important findings, as well as the action plans proposed to address them. This report may be delivered in person, by attending the Audit Committee meetings or by means of reports send to the Committee.

In 2017, the Annual Work Plan presented and subsequently carried out by the Internal Audit team included the following aspects in relation to the SCIIF:

- Analysis of the annual plan of the company and identification of the main risks on the financial information.
- Review of the financial information sent to the CNMV on a quarterly basis, together with a review of the correct execution of the main control activities of the accounting, consolidation and information processes and of the principal judgments and estimates.
- Supervision of the process of formalization and documentation of all existing control activities

in the main business cycles of the Talgo Group. This documentation complies with the criteria established in the recommendations made by the CNMV in its guide for the preparation of the description of the internal control system on financial information, and the Internal Control System for Financial Information is in place and in operation.

- Supervision of advice by technological experts in relation to the following areas within the management of the Company's information systems: governance of information systems, information security, operations and network and application development and management Taking into account all the recommendations detected and implementing a plan of action and improvement in the short term.
- Audit of the financial information generation processes and the main subsidiaries, according to a rotation plan.
- Review of the critical processes of the Group focusing the work during the year in the following areas: Purchases, Inventories, HR, Logistics and Sales.
- Monitoring the status of proposed action plans in the face of weaknesses detected.
- Presentation to the Audit Committee of the results of the work carried out.

F.5.2. Whether a procedure is in place for discussion whereby the auditor of the accounts (in accordance with the provisions of TAS), the internal audit function and other experts may inform senior management and the Audit Committee or the Directors of the entity about significant internal control weaknesses identified during the annual accounts review process or any others entrusted to them. Also, report whether the entity has an action plan to try to correct or mitigate the weaknesses observed.

The Audit Committee meets regularly and prior to the issue of financial information to the markets. During 2017, the Audit Committee held meetings at which the Internal Audit Department reported the results of the work performed and the action plans it had put in place to introduce corrective measures.

Additionally, in the framework of the external audit, it meets with the external auditors to present the conclusions of their audit work (which include significant aspects detected in the scope of internal control). The Committee met 4 times with the external auditors in 2017, and obtained information about regulatory updates, and the progress and results of the external audit.

Meanwhile, the auditor of the Group's accounts has direct access to the highest level of the Group, through regular meetings both to obtain the information it requires to perform its work, as well as to report the weaknesses identified in its controls.

The Group has a Multi-Year Internal Control Audit Plan that, amongst other things, established the procedure that is required to implement the corrective measures required after the development of the different work to supervise and review the controls established in the Group's main processes. Similarly, an established process exists for the supervision of the SCIIF defined by the Audit Committee, which contains aspects relating to the general criteria to apply in terms of the specific supervisory activities to which the SCIIF relates. The corresponding reports, which present the situation after the work entrusted has been performed, are evaluated by the members of the Audit Committee, together with the weaknesses identified during the aforementioned work. The Committee is also responsible for approving the proposed action plan to remedy the aforementioned control weaknesses.

F.6 Other relevant information

No other relevant information exists regarding the SCIIF that has not already been included in this report.

F.7 External auditor's report

Report whether:

F.7.1. The SCIIF information provided to the markets has been subject to review by the external auditor, in which case, the entity should attach the corresponding report as an annex. If not, it should report the reasons why.

The Group did not subject the information about the "Internal Control System for Financial Reporting" for review by the external auditor in 2017.

This Annual Corporate Governance Report has been prepared in accordance with the contents and structure of the model established in the governing legislation by the National Securities Market Commission.

Although this information is not subject to review for the issue of a report by the auditor, it has been made available to the external auditors so that they are aware of it and can verify it in the context of their audit of the accounts.

The Directors of the Group are aware of the recommendations, guidelines and references established for the completion of this information, and have applied them in their entirety. The information about the "Internal Control System for Financial Reporting" contained in the Annual Corporate Governance Report, in accordance with the scope of the procedures and report templates that the I.C.A.C. and the respective corporations that represent auditors established, where applicable.

G DEGREE OF COMPLIANCE WITH CORPORATE GOVERNANCE RECOMMENDATIONS

Indicate the Company's degree of compliance with the recommendations stipulated in the Good Governance Code for listed companies.

In the event that any recommendation is not followed or is only partially followed, a detailed explanation should be provided of the reasons so that the shareholders, investors and the market in general, have sufficient information to assess the conduct of the Company. Explanations of a general nature are not acceptable.

- 1. The bylaws of listed companies should not place an upper limit on the number of votes that may be cast by a single shareholder, nor should they contain any other restrictions that hinder the takeover of the Company by means of share purchases in the market.**

Compliant Explain

- 2. When the parent company and a subsidiary company list on the stock exchange, they should accurately disclose:**
 - a) Their respective areas of activity and any potential business relationships between them, as well as any business dealings between the listed subsidiary company and the other companies in the group.**
 - b) The mechanisms in place for resolving any potential conflicts of interest that may arise.**

Compliant Partially compliant Explain Not applicable

3. During an ordinary General Shareholders' Meeting, in addition to distributing the written Annual Corporate Governance Report, the Chairman of the Board of Directors should verbally inform the shareholders about the most relevant corporate governance considerations for the Company, in sufficient detail, and, in particular, he should provide information about:

- a) Any changes that have happened since the previous ordinary General Shareholders' Meeting.
- b) The specific reasons why the Company is not following any of the recommendations from the Corporate Governance Code and, where applicable, the alternative rules that apply in this regard.

Compliant Partially compliant Explain

4. The Company should define and promote a policy of communication and contact with shareholders, institutional investors and advisors with a right to vote, which is fully respectful of the rules against market abuse and ensures the similar treatment of shareholders who find themselves in the same position.

And the Company should publish this policy on its website, including information about the way in which the policy has been put into practice and identifying the contact people or managers responsible for carrying it out.

Compliant Partially compliant Explain

5. The Board of Directors should not present any proposals to the General Shareholders' Meeting for the delegation of powers, to issue shares or convertible securities excluding the right to preferential subscription, for an amount exceeding 20% of the capital at the time of delegation.

And when the Board of Directors approves the issue of any shares or convertible securities excluding the right to preferential subscription, the Company should immediately publish reports about this exclusion on its website, as referred to by commercial legislation.

Compliant Partially compliant Explain

6. The listed companies that prepare the reports cited below, be they mandatory or voluntary, must publish them on their website sufficiently in advance of the date of the ordinary General Shareholders' Meeting, even though their distribution is not mandatory:

- a) Report about the independence of the auditor.
- b) Reports about the operation of the Audit Committee and the Appointments and Remuneration Committee.
- c) Report from the Audit Committee about related party transactions.
- d) Report about the policy regarding corporate social responsibility.

Compliant Partially compliant Explain

The Company does not publish the reports.

7. The Company should stream the General Shareholders' Meetings live on its website.

Compliant Explain

8. The Audit Committee ensures that the Board of Directors presents the accounts to the General Shareholders' Meeting without limitations or qualifications in the audit report and, in the exceptional cases in which qualifications exist, both the Chairman of the Audit Committee and the auditors must clearly explain to the shareholders the content and scope of those limitations or qualifications.

Compliant Partially compliant Explain

9. The Company should permanently publish on its website the requirements and procedures that it accepts for proving the ownership of shares, the right to attend the General Shareholders' Meeting and the exercise or delegation of the right to vote.

And those requirements and procedures should favour the shareholders' attendance and exercise of their rights and be applied in a non-discriminatory manner.

Compliant Partially compliant Explain

10. When a legitimate shareholder has exercised his right to add an item to the meeting agenda or to present new agreement proposals, prior to the date on which the General Shareholders' Meeting is held, the Company:

- a) Should immediately communicate those complementary points and new proposed agreements.
- b) Should publish the attendance card template or vote delegation form or proxy vote form with the necessary amendments so that votes may be cast on the new agenda items and alternative agreement proposals, under the same terms and conditions as those proposed by the Board of Directors.
- c) Should subject all of those points and alternative proposals to a vote and apply the same voting rules to them as to those formulated by the Board of Directors, including, in particular, assumptions and inferences about the direction of the vote.
- d) After the General Shareholders' Meeting, the Company should communicate the breakdown of the vote on all of the complementary points and alternative proposals.

Compliant Partially compliant Explain Not applicable

11. In the event that the Company intends to pay attendance premiums for the General Shareholders' Meeting, establish, in advance, a general policy for such premiums and that policy should be stable.

Compliant Partially compliant Explain Not applicable

12. The Board of Directors should perform its duties with unity of purpose and independence of judgement, affording the same treatment to all shareholders who find themselves in the same position. It should also be guided by the corporate interest, understood as the achievement of a profitable and sustainable business over the long-term, which promotes continuity and maximises the Company's economic value. And in pursuit of the corporate interest, as well as with respect for the laws and rules and a behaviour based on good faith, the ethics and the respect for the uses and the commonly accepted good practices, it should try to reconcile its own corporate interest with, as appropriate, the legitimate interest of its employees, its suppliers, its clients and the other stakeholder groups that may be affected, as well as the impact of the Company's activity on the community as a whole and on the environment.

Compliant Partially compliant Explain

13. The Board of Directors should have the necessary size for its effective and participatory operation, which means that it is advisable for it to comprise between five and fifteen members.

Compliant Explain

14. The Board of Directors should approve a policy for selecting Directors that:

- a) Is specific and verifiable.
- b) Ensures that the proposals for appointment or re-election are based on previous analysis of the needs of the Board.
- c) Favours diversity in terms of knowledge, experience and gender.

The results of the prior analysis of the needs of the Board of Directors should be collated in a justification report by the Appointments Committee, which should be published when the General Shareholders' Meeting is convened for the ratification, appointment or re-election of each Director.

And the policy for selecting Directors should promote the objective that the number of female Directors should represent, at least, 30% of the total number Board members by 2020.

The Appointments Committee shall verify compliance with the Director selection policy on an annual basis and shall report its findings in the Annual Corporate Governance Report.

Compliant Partially compliant Explain

15. The Proprietary and Independent Directors should constitute a large majority of the Board of Directors and the number of Executive Directors should be the minimum necessary, taking into account the complexity of the company group and the percentage shareholdings held by the Executive Directors in the Company's share capital.

Compliant Partially compliant Explain

16. The percentage of Proprietary Directors over the total number of Non-Executive Directors should not be greater than the proportion of the share capital held by those Directors, over the total share capital balance.

This criteria may be relaxed:

- a) For companies with high levels of capitalisation, in which only a few of the shareholders' stakes are legally considered to be significant.
- b) In the case of companies with a plurality of shareholders represented on the Board of Directors that have no relationships between them.

Compliant Explain

17. The number of Independent Directors should represent, at least, half of the total number of Directors.
Nevertheless, when the Company does not have a high level of capitalisation or even if it does, when one or several shareholders, who control more than 30% of the share capital, are acting together, then the number of Independent Directors should represent, at least, one third of the total number of Directors.

Compliant Explain

18. The companies should publish and update the following information about their Directors on their website:

- a) Professional and biographical profile.
- b) Details of other Board of Directors to which they belong, regardless of whether they are listed companies or not, as well as the other paid activities that they perform, whatever their nature.
- c) An indication of the category of Director to which they belong, stating, in the case of Proprietary Directors, the shareholder that they represent or with whom they have links.
- d) Date of their first appointment as a Director of the Company, as well as the dates of any subsequent re-elections.
- e) Any shares that they own in the Company, and options they hold over them.

Compliant Partially compliant Explain

19. In the Annual Corporate Governance Report, following verification by the Appointments Committee, reasons should be provided to explain why Proprietary Directors have been appointed at the request of shareholders whose shareholdings represent less than 3% of the total share capital; and reasons should be provided to explain why formal requests to participate in the Board have been denied for shareholders whose shareholdings are the same size or larger

than those held by others who have been appointed as Proprietary Directors upon request

Compliant Partially compliant Explain Not applicable

20. Proprietary Directors should submit their resignation when the shareholder that they represent sells its entire shareholding. And they should also resign when the shareholder that they represent reduces its shareholding to a level that requires a reduction in the number of Proprietary Directors, to the extent required.

Compliant Partially compliant Explain Not applicable

21. The Board of Directors should not propose the removal of any Independent Director before he has completed his statutory term in office, except when just cause requires it, as assessed by the Board of Directors based on a report from the Appointments Committee. In particular, just cause shall be understood to exist when: the Director takes over new roles or enters into new obligations that prevent him from devoting the necessary time to the performance of the duties inherent to the role of Director; when he breaches the duties inherent to his role; or when circumstances arise that cause him to lose his independent status, in accordance with the provisions of applicable law.

The removal of Independent Directors may also be proposed as a result of a takeover bid, merger or other similar corporate transaction that involves a change in the share capital of the Company, when such changes in the structure of the Board of Directors are promoted by the criteria of proportionality indicated in recommendation 16.

Compliant Explain

22. The companies should establish rules that oblige the Directors to report and, where applicable, resign in those cases that may harm the Company's credibility and reputation and, in particular, that oblige them to report any criminal proceedings in which he appears as the accused, as well as any subsequent legal proceedings, to the Board of Directors.

And if a Director is prosecuted or brought to trial for any of the crimes mentioned in corporate law, the Board shall examine his case as soon as possible and, in light of the specific circumstances, shall decide whether or not it is appropriate for him to remain in office. Furthermore, everything that the Board is aware of shall be included, in a reasoned way, in the Annual Corporate Governance Report.

Compliant Partially compliant Explain

23. All of the Directors should clearly express their opposition when they consider that a proposed resolution submitted to the Board may be contrary to the corporate interest of the Company. And this should apply, in particular, to the Independent Directors, as well as to any other Directors not affected by the potential conflict of interest, in cases of decisions that may harm the shareholders not represented on the Board.

And when the Board adopts significant or repeated decisions about which the Director has expressed serious reservations, he should draw the appropriate conclusions and, resign if he so chooses, explaining the reasons in a letter that makes reference to the following recommendation. This recommendation also applies to the Secretary of the Board, even if he is not a Director.

Compliant Partially compliant Explain Not applicable

24. When a Director leaves office before the end of his term, either because he resigns or for another reason, he should explain the reasons in a letter that should be sent to all of the members of the Board. And, notwithstanding the fact that this should be communicated as a significant event, the reason for the departure should be included in the Annual Corporate Governance Report.

Compliant Partially compliant Explain Not applicable

25. The Appointments Committee should ensure that the Non-Executive Directors have sufficient time available to properly carry out their functions. And the Rules of the Board should establish the maximum number of company boards on which its Directors may sit.

Compliant Partially compliant Explain

26. The Board should meet with the necessary frequency to properly perform its functions and, at least, eight times a year, in accordance with the calendar of dates and agendas established at the beginning of the year, to which each Director may propose the addition of other items, not initially considered.

Compliant Partially compliant Explain

27. Director absences should be kept to a bare minimum and quantified in the Annual Corporate Governance Report. And when Directors have no choice but to delegate their vote, they should do so with instructions.

Compliant Partially compliant Explain

28. When the Directors or the Secretary express concerns about a proposal or, in the case of the Directors, about the Company's performance and those concerns are not resolved at the Board meeting, then the person expressing them can request that they be recorded in the meeting minutes.

Compliant Partially compliant Explain Not applicable

29. The Company should establish appropriate channels for the Directors to be able to obtain the advice they need to carry out their duties, including, when the circumstances so require it, external advice at the expense of the Company.

Compliant Partially compliant Explain

30. Independently of the knowledge that the Directors need to perform their duties, the Companies should also provide the Directors with training programs to update their knowledge when the circumstances so require it.

Compliant Explain Not applicable

31. Meeting agendas should clearly state the points regarding which the Board should adopt a decision or agreement, so that the Directors can study or request the necessary information for such adoption, in advance of the meeting.

When, on an exceptional basis, for reasons of urgency, the Chairman wants to submit to the Board, decisions or agreements that do not appear on the agenda, then the prior and express consent of a majority of the Directors in attendance shall be required, and that event should be duly noted in the meeting minutes.

Compliant Partially compliant Explain

32. The Directors should be periodically informed about movements in shareholdings and about the opinions that the significant shareholders, investors and ratings agencies have about the Company and the group.

Compliant Partially compliant Explain

33. The Chairman, as the person responsible for the effective operation of the Board, in addition to exercising the functions that are legally and statutorily attributed to him, should prepare and submit to the Board: a calendar of dates and matters to discuss; organise and coordinate the periodic evaluation of the Board, as well as, where applicable the CEO of the Company; be responsible for the leadership of the Board and for the effectiveness of its operation; ensure that sufficient discussion time is dedicated to strategic questions; and adopt and review the programs for updating the knowledge of each Director, when the circumstances so require it.

Compliant Partially compliant Explain

34. When there is a coordinating Director, the bylaws and Rules of the Board should attribute him with the following powers, in addition those powers that correspond to him legally: to chair the Board in the absence of the Chairman and the Vice-Chairman, where applicable; to echo the concerns of the Non-Executive Directors; to maintain contact with investors and shareholders to understand their points of view for the purposes of forming an opinion about their concerns and, in particular, regarding the corporate governance of the Company; and to coordinate the succession planning for the Chairman.

Compliant Partially compliant Explain Not applicable

35. The Secretary of the Board should act in a special way to ensure that the Board is mindful in its actions and decisions of the recommendations regarding good governance contained in this Good Governance Code, where applicable to the Company.

Compliant Explain

36. The Board plenary should evaluate, at least once a year, and adopt an action plan, where applicable, to correct deficiencies identified regarding:

- a) The quality and efficiency of the operation of the Board.
- b) The operation and composition of its committees.
- c) Diversity in terms of the composition and competencies of the Board.
- d) The performance of the Chairman of the Board and the CEO of the Company.

- e) **The performance and contribution made by each Director, paying special attention to those Directors who are responsible for the various Board committees.**

In order to carry out the evaluation of the different committees, the Board will begin with the reports that those committees submit to it, and for the evaluation of the Board itself, it shall depend on the report submitted to it by the Appointments Committee.

Every three years, the Board will be assisted in the performance of its evaluation by an external consultant, whose independence shall be verified by the Appointments Committee.

The business relationships that the consultant or any company in the group has with the Company, or any company in the group, should be disclosed in the Annual Corporate Governance Report.

The process and areas evaluated shall be described in more detail in the Annual Corporate Governance Report.

Compliant Partially compliant Explain

37. **When there is an Executive Committee, the structure of the participation of the different categories of Directors should be similar to that of the Board of Directors and the Secretary of the Board should also serve as the Secretary of the Executive Committee.**

Compliant Partially compliant Explain Not applicable

38. **The Board should always be aware of the matters discussed and the decisions adopted by the Executive Committee, and all of the members of the Board should receive copies of the minutes of the meetings of the Executive Committee.**

Compliant Partially compliant Explain Not applicable

39. **The members of the Audit Committee and in particular, its Chairman, should be appointed taking into account their knowledge and experience in terms of accounting, audit and risk management, and the majority of the members should be Independent Directors.**

Compliant Partially compliant Explain

40. **The Company should have a unit that assumes the functions of internal audit, under the supervision of the Audit Committee, to ensure the proper functioning of the information and internal control systems. Such a unit should functionally report to the non-executive Chairman of the Board or to the Audit Committee.**

Compliant Partially compliant Explain

41. The head of the unit who assumes the internal audit function should present his annual work plan to the Audit Committee, and report directly about any incidents arising during its implementation, as well as submit an activity report at the end of each year.

Compliant Partially compliant Explain Not applicable

42. In addition to the functions established by law, the following functions correspond to the Audit Committee:

1. In relation with the information and control systems:

- a) Supervise the preparation process and the completeness of the financial information relating to the Company and, where applicable, to the group, reviewing compliance with regulatory requirements, the appropriate delimitation of the consolidation perimeter and the correct application of accounting criteria.
- b) Ensure the independence of the unit that assumes the internal audit function; propose the selection, appointment, re-election and removal of the head of the internal audit services; propose the budget for this service; approve the direction and work plans, ensuring that its activity is focused primarily towards the most significant risks facing the Company; receive periodic information about its activities; and verify that senior management takes into account the conclusions and recommendations of its reports.
- c) Establish and supervise a mechanism that allows the employees to report, in a confidential way and, where possible and if appropriate, anonymously, any irregularities of potential importance, especially of a financial and accounting nature, that they identify in their positions in the Company.

2. In relation with the external auditor:

- a) In the event that the external auditor resigns, examine the circumstances that have given rise to his resignation.
- b) Ensure that the remuneration received by the external auditor for his work does not compromise his quality or his independence.
- c) Supervise that the Company notifies the CNMV of the change of auditor as a significant event, and that its report is accompanied by a declaration regarding the potential existence of disagreements with the outgoing auditor and, if they exist, their contents.
- d) Ensure that the external auditor holds an annual meeting with the full Board of Directors to inform them about the work performed and about the evolution of the accounting environment and the risks facing the Company.
- e) Ensure that the Company and the external auditor adhere to governing legislation regarding the provision of services other than those of an audit nature, the limits in terms of the concentration of the auditor's business and, in general, the other rules relating to the independence of auditors.

Compliant Partially compliant Explain Not applicable

43. The Audit Committee should be able to call upon any employee or manager of the Company, and even request that they appear without the presence of any other executive.

Compliant Partially compliant Explain

44. The Audit Committee should be informed about operations of a structural change and corporate nature that the Company plans to undertake, for analysis and reporting to the Board of Directors regarding the economic conditions and the accounting impact and, in particular and where applicable, about the proposed exchange ratio.

Compliant Partially compliant Explain Not applicable

45. The control and risk management policy should identify at least:
- The different types of risk, financial and non-financial (amongst others, operating, technological, legal, social, environmental, political and reputational risks) that the Company faces, including any contingent liabilities and other offbalances heetrisks within the financial or economic risks.
 - The level of risk that the Company considers acceptable.
 - The measures established to mitigate the impact of the risks identified, in the event that they ended up materialising.
 - The information and internal control systems that will be used to control and manage the aforementioned risks, including any contingent liabilities or off balance sheet risks.

Compliant Partially compliant Explain

46. Under the direct supervision of the Audit Committee or, where applicable, a specialist Board Committee, an internal control and risk management function should exist, exercised by a unit or internal department of the Company that is expressly attributed the following functions:
- Ensure the proper functioning of the control and risk management systems and, in particular, that all of the important risks that affect the Company are identified, managed and quantified appropriately.
 - Actively participate in the preparation of the risk strategy and in important decisions regarding its management.
 - Ensure that the control and risk management systems adequately mitigate the risks within the framework of the policy defined by the Board.

Compliant Partially compliant Explain

47. The members of the Appointments and Remuneration Committee - or of the Appointments Committee and the Remuneration Committee, if they are separate groups - should be responsible for ensuring that they have the knowledge, skills and experience required for the duties that they have been called upon to perform, and the majority of those members should be Independent Directors.

Compliant Partially compliant Explain

48. Companies with a high level of capitalisations should have two separate committees for Appointments and Remuneration.

Compliant Partially compliant Explain

49. The Appointments Committee should consult with the Chairman of the Board and the CEO of the Company, especially when dealing with matters relating to the Executive Directors.

And any Director should be able to request that the Appointments Committee take into consideration potential candidates to fill any Director vacancies, if they are suitable in his opinion.

Compliant Partially compliant Explain

50. The Remuneration Committee should exercise its functions independently and, as well as the functions attributed to it by law, the following functions correspond to it:

- a) Propose the basic conditions to the Board for the senior management contracts.
- b) Check compliance with the remuneration policy established by the Company.
- c) Periodically review the remuneration policy applied to the Directors and senior management, including any remuneration systems involving shares and their application, as well as ensuring that individual remuneration is proportionate to the amounts paid to the other Directors and senior managers of the Company.
- d) Ensure that any potential conflicts of interest do not harm the independence of the external advice rendered to the Committee.
- e) Verify the information about Director and senior manager remuneration contained in the different corporate documents, including the annual report about Director remuneration.

Compliant Partially compliant Explain

51. The Remuneration Committee should consult the Chairman and CEO of the Company, especially when dealing with matters relating to Executive Directors and senior management.

Compliant Partially compliant Explain

52. The rules governing the composition and operation of the supervision and control committees should feature in the Rules of the Board and are consistent with those legally binding rules that apply to the committee, in accordance with the previous recommendations, including:

- a) It should comprise exclusively Non-Executive Directors, with a majority of Independent Directors.
- b) Its Chairmen should be Independent Directors.
- c) The Board should appoint the members of these Committees, taking into account the knowledge, skills and experience of the Directors and the duties of each committee; it should deliberate over their proposals and

reports; and it should be accountable for their activity and respond to the work performed, in the first full Board meeting after their respective meetings.

- d) The Committees should be able to engage external advisors when they consider it necessary for the performance of their functions.
- e) Minutes should be kept of all meetings, which should then be made available to all of the Directors.

Compliant Partially compliant Explain Not applicable

53. The job to supervise compliance with the rules of corporate governance, the rules of the internal codes of conduct and the rules pertaining to the corporate social responsibility policy should be attributed to one or shared amongst several Board Committees, which may be the Audit Committee, the Appointments Committee, the Corporate Social Responsibility Committee, if one exists, or a specialist committee that the Board of Directors, exercising its powers of self-organisation, decides to create for this purpose, to which the following minimum functions will be specifically attributed:

- a) Supervision of compliance with internal codes of conduct and the Company's corporate governance rules.
- b) Supervision of the communication strategy and of the relationship with shareholders and investors, including small and medium-sized shareholders.
- c) The periodic evaluation of the adequacy of the Company's corporate governance system, with the aim of enabling it to fulfil its mission to promote the corporate interest and taking into account, as appropriate, the legitimate interests of the other stakeholders.
- d) Review of the Company's corporate responsibility policy, ensuring that it is focused on value creation.
- e) Monitoring the strategy and corporate social responsibility practices and evaluating the degree of compliance.
- f) Supervising and evaluating the processes relating to different stakeholder groups.
- g) Evaluation of everything relating to the Company's non-financial risks, including any operating, technological, legal, social, environmental, political and reputational risks.
- h) Coordination of the process for reporting about non-financial information and diversity, in accordance with applicable legislation and international standards of reference.

Compliant Partially compliant Explain

54. The corporate social responsibility policy should include details of the principles or commitments that the Company assumes voluntarily in its relationship with the different stakeholder groups and it should identify, at least:

- a) The aim of the corporate social responsibility policy and the development of support tools.

- b) The corporate strategy relating to sustainability, the environment and social questions.
- c) The specific practices in questions relating to: shareholders, employees, clients, suppliers, social questions, the environment, diversity, fiscal responsibility, respect for human rights and prevention of illegal behaviour.
- d) The methods or systems used to monitor the results of the application of the specific practices described in the previous paragraph, the associated risks and their management.
- e) The mechanisms for monitoring non-financial risk, ethics and business conduct.
- f) The channels of communication, participation and dialogue with stakeholders.
- g) Responsible communication practices that prevent the manipulation of information and protect the integrity and honour of the Company.

Compliant Partially compliant Explain

55. The Company should report, in a separate document or in its management report, about matters relating to corporate social responsibility, using one of the internationally accepted methodologies established for that purpose.

Compliant Partially compliant Explain

Being a holding company do not apply, but yes to your Group it is included in the consolidated annual accounts.

56. The Directors' remuneration should be sufficient to attract and retain Directors of the desired profile and to remunerate the dedication, qualification and level of responsibility required by the role, but not so high as to compromise the independence of judgement of the Non-Executive Directors.

Compliant Explain

57. The Executive Directors' variable remuneration that is linked to the performance of the Company and individual performance should be limited, as should the remuneration paid through shares or share options or instruments that depend on the share value, as well as the long-term savings plans, such as pension plans, retirement plans and other social welfare systems.

Shares may be considered as remuneration for Non-Executive Directors when those Directors are obliged to hold those shares until the end of their term in office. This shall not apply to the shares that Directors need to transfer, where applicable, to meet the costs related with their acquisition.

Compliant Partially compliant Explain

58. In the case of variable remuneration, the remuneration policy should incorporate the necessary limits and technical safeguards to ensure that such remuneration relates to the professional performance of its beneficiaries and does not only depend on the general evolution of the markets or the Company's sector or other similar circumstances.

And, in particular, the variable components of the remuneration should:

- a) Be linked to the performance criteria that are determined in advance and are measurable, and that those criteria reflect the risk assumed to obtain a result.
- b) Promote the sustainability of the Company and include non-financial criteria that are appropriate for the creation of value over the long-term, such as compliance with the Company's rules and internal procedures and its policies for the control and management of risks.
- c) Are configured on the basis of a balance between fulfilling the short-term, medium-term and long-term objectives, which allow the remuneration of continued performance over a sufficiently long period of time to appreciate the contribution to the sustainable creation of value, in such a way that the measurement elements of that performance do not revolve solely around one-off, occasional or extraordinary events.

Compliant Partially compliant Explain Not applicable

59. The payment of a significant proportion of the variable components of remuneration should be deferred for a minimum period of time that is sufficient to enable checks to be performed to verify that the performance conditions established previously have been met.

Compliant Partially compliant Explain Not applicable

60. The remuneration relating to the results of the Company should take into account any potential qualifications that appear in the external auditor's report and reduce those results.

Compliant Partially compliant Explain Not applicable

61. A significant percentage of the variable remuneration paid to the Executive Directors should be linked to the delivery of shares or financial instruments linked to the share value.

Compliant Partially compliant Explain Not applicable

62. Once the corresponding shares or share options or rights over shares have been allocated to the remuneration systems, the Directors may not transfer ownership of a number of shares equivalent to twice their fixed annual remuneration, nor may they exercise the options or rights until a period of, at least, three years has elapsed since their allocation.

This shall not apply to shares that Directors need to transfer, where applicable, to meet the costs relating to their acquisition.

Compliant Partially compliant Explain Not applicable

63. Contractual agreements should include a clause that allows the Company to demand the return of the variable components of the remuneration when the payment has not reflected the performance conditions or when it has been paid on the basis of data whose accuracy is subsequently discredited.

Compliant Partially compliant Explain Not applicable

64. Payments for contract terminations should not exceed an established amount equivalent to two years of total annual remuneration, nor should payments be made until the Company has been able to check that the Director has complied with the performance criteria previously established.

Compliant Partially compliant Explain Not applicable

H OTHER INFORMATION OF INTEREST

1. If there are any relevant aspects relating to the corporate governance of the Company or entities of the group that have not been captured in the other sections of this report, but which should be included to ensure a more complete and reasoned set of information about the governance structure and practices of the entity or group, briefly describe them.
2. Within this section, you may also include any other information, clarification or details relating to the previous sections of the report to the extent that there are relevant and not repetitive.

Specifically, indicate whether the Company is subject to legislation other than Spanish law in terms of corporate governance and, where applicable, include details of the information that it is obliged to supply and that is different from the information required in this report.

3. The Company may also state whether it has voluntarily acceded to any international, sectorial or other codes of ethical principles or codes of good practice. Where applicable, the code in question should be identified along with the date of accession. In particular, mention should be made as to whether the Company has adhered to the Code of Good Tax Practices, dated 20 July 2010.

We attached to the present Report the Diversity policy of the Board of Directors of Talgo, S.A. and Director candidate selection policy approved by the Board on February 22, 2018.

This Annual Corporate Governance Report has been approved by the Board of Directors of the Company, at its meeting on: February 22, 2018.

Indicate whether any Directors voted against or abstained from voting on the approval of this Report.

Yes No

***DIVERSITY POLICY OF THE BOARD OF
DIRECTORS OF TALGO S.A. AND
DIRECTOR CANDIDATE SELECTION
POLICY***

Talgo



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I. Introduction

The Board of Directors of TALGO S.A. (hereinafter, the “Company” or “TALGO”) recognises transparency in all of its actions, as one of the key elements of its corporate governance strategy, including the process for selecting candidates for the Board of Directors and the diversity of the Board of Directors.

On 15 February 2015, the Board of Spain’s National Securities and Exchange Commission approved the Code of Good Governance for Listed Companies.

In its Recommendation 14, the aforementioned Code of Good Governance establishes that “the Board of Directors approves a selection policy for directors that: a) is specific and verifiable; b) ensures that nominations for appointments and re-elections are grounded in a prior analysis of the needs of the Board of Directors and; c) promotes diversity in terms of knowledge, experience and gender”.

Similarly, on 25 November 2017, Royal Decree Law 18/2017, dated 24 November, was published in the Official State Gazette, which modified the Commercial Code, the revised text of the Capital Companies Act approved by Royal Decree Law 1/2010, dated 2 July, and Law 22/2015, dated 20 July, governing the Audit of Accounts in terms of non-financial information and diversity.

In this regard, and in accordance with the new wording of Article 540.4.c, sub- section 6 of the Capital Companies Act, listed limited companies must include in their Annual Corporate Governance Report “a description of the diversity policy applied in relation to the Board of Directors, including its objectives, the measures adopted, the manner in which those measures have been applied and the results thereof during the reporting period, as well as the measures that, where appropriate, the Appointments Committee has agreed in this regard”.

In this context, the Board of Directors of TALGO S.A. has approved this diversity policy for the composition of the Board of Directors and the public

selection of director candidates, which is specific and verifiable, and which ensures that nominations for the appointment of Company directors are grounded in a prior analysis of the needs of the Board of Directors and guarantees that the Board of Directors is characterised by diversity in terms of knowledge, experience, origins, nationalities, age and gender.

II. Purpose and scope of application

The Diversity Policy for the Board of Directors of TALGO, S.A. and the Selection of Directors has the aim of ensuring that nominations for the appointment and re- election of Directors are grounded in a prior analysis of the needs of the Board of Directors of the Company and promote diversity in terms of knowledge, training and professional experience, age and gender, without suffering from implicit biases that may imply discrimination of any kind, in particular, due to gender, disability or any other personal condition.

To this end, this Diversity Policy shall be applied to the election of director candidates who are physical persons and, in the event that director candidates are legal persons, to the election of the physical persons who act as their representatives.

III. Selection process

The selection of candidates for TALGO's Board will follow the principles detailed below

- 1. The Board of Directors shall have a balanced composition, with an ample majority of non-executive directors and an appropriate split between proprietary and independent directors.*
- 2. The Board of Directors shall ensure that the selection process for directors promotes diversity in terms of knowledge, training, professional experience, age and gender, without suffering from implicit biases that may imply discrimination of any kind. All of this, to*

ensure that the Board of Directors has a diverse and balanced composition that, as a whole: (i) enriches analysis and

debate; (ii) contributes diverse points of view and positions; (iii) facilitates decision-making; and (iv) enjoys absolute independence.

Likewise, the Board will ensure that candidates for non-executive director positions have sufficient time available to be able to properly perform their functions.

3. Similarly, the process for selecting candidates for the Board shall be based on a prior analysis of the needs of the Company and the Group. This analysis shall be carried out by the Board of Directors of the Company, on the basis of advice and following a mandatory justification report from the Appointments and Remuneration Committee, and as established in the Regulations governing the Board of Directors of the Company.

4. This justification report from the Appointments and Remuneration Committee shall be published when the General Shareholders' Meeting to which the ratification, appointment or re-election of each director shall be submitted is convened.

5. Each year, the Appointments and Remuneration Committee shall verify compliance with the Diversity Policy for the Board of Directors of TALGO, S.A. and the selection of directors and shall report its findings in the Annual Corporate Governance Report and in those other documents that it deems appropriate.

IV. Director candidates.

1. The Board of Directors – and the Appointments and Remuneration Committee - shall ensure, within the scope of their remit, that nominations for candidates that are submitted to the General Shareholders'

Meeting for appointment or re-election as Directors, and appointments that are made directly to cover vacancies in the exercise of their powers of co-optation, shall fall to honourable and suitable people, with recognised solvency, competence, experience, qualifications, training, availability and commitment to their function. It shall also ensure that the selection of candidates achieves an appropriate balance across the Board of Directors as a whole, to enrich decision-making and contribute diverse points of view to the debates held about the matters within its remit.

2. In the event that a director is a legal person, the physical person that represents it, in the exercise of the duties inherent to the position of director, shall be subject to the same requirements indicated in the previous section. The incompatibilities and enforceable duties established for directors in the Corporate By- Laws, in the Regulations governing the Board of Directors and in this present document, shall also be applicable to him/her in a personal capacity.

In relation to this, director candidates shall be persons of recognised prestige, solvency, training and professional experience, especially in the fields of railway services, economics-finance, accounting, audit, legal, risk management and/or business administration, with leadership in teams formed by people belonging to different areas of activity, and extensive knowledge in large companies.

V. Diversity in the composition of the Board

Efforts shall be made to ensure that the selection of candidates achieves a diverse and balanced composition of the Board of Directors as a whole, to enrich decision-making and contribute diverse points of view to the debates held about the matters within its remit.

In this sense, the Board of Directors assumes the commitment to promote diversity in its composition and, to that end, the director candidate selection process shall assess candidates with profiles whose appointment favours the diversity of the director group in terms of their abilities, knowledge,

experience, origins, nationalities, age and gender.

The criteria of diversity shall be chosen on the basis of the nature and complexity of the businesses carried out by the Company and its Group, as well as the social and environmental context in which it is present. In addition, depending on the needs of the Board of Directors, other criteria may also be taken into consideration.

The candidate selection process shall avoid any type of bias that may imply discrimination of any kind, including for reasons of gender, ethnic origin, age or disability, amongst others. In particular, any type of bias that hinders the appointment of female directors and that may prevent the fulfilment of the objective established by the National Securities and Exchange Commission, whereby the number of female directors shall account for at least 30% of all Board members by 2020, shall be avoided.

The Board of Directors shall periodically evaluate the degree of compliance and effectiveness of the National Securities and Exchange Commission, its Diversity Policy and, in particular, the percentage of female directors on the Board at any given time. Moreover, the Annual Corporate Governance Report will include a detailed description of that Policy, as well as of the objectives set in that regard and the results obtained.

VI. Grounds for incompatibility established by Law or by the Corporate Governance System

People who are subject to any legal incompatibility for the performance of their role may not be considered as director candidates, nor may those who do not meet the requirements established by the Company's Corporate Governance System, included in the Regulations governing the Board of Directors to become directors. In particular, the following persons may not be considered as director candidates:

- a) Companies, domestic or foreign, and those whose major shareholder, directly or indirectly, holds a stake, directly or indirectly, in a company that operates in the railway sector or other sectors, as*

a competitor of the Company, as well as directors or senior managers thereof and persons who, where appropriate, were nominated by them in their capacity as shareholders.

b) Persons who, in the two (2) years prior to their possible appointment, have held senior positions in public administrations that are incompatible with the performance of their duties as a director of a listed company, in accordance with regional or state legislation, or have held positions of responsibility in any sector in which the company carries out its activity. In any case, the appointment, ratification and re-election of directors must comply with the provisions of the law and the Rules governing the Company's Corporate Governance System.

c) Physical or legal persons that are subject to any other case of incompatibility or prohibition governed by the general rules, including those who may have interests that are opposed to those of the Company or any of the companies in the Group, in any way.

VII. External validation

The Company may rely on collaboration from external advisors to validate that director candidates meet the conditions referred to in Section IV and that they are not subject to any of the impediments set out in Section VI.

The Company's policy for the selection of directors is contained in the Regulations governing the Board of Directors, approved by the General Shareholders' Meeting held on 28 March 2015, and was expanded and amended by agreement of the Board of Directors on 22 February 2018.

