

2. LETTER FROM THE CHAIRMAN





Letter from the Chairman



Antonio J. Zoido, Chairman of BME

Dear shareholder,

Global stock markets have responded extremely well to the upturn in global economic growth and the positive outlook for the coming years, while the bond markets have remained surprisingly stable despite the main central banks gradually shifting towards more restrictive monetary policies. Stock and bonds markets have been characterised by historically low levels of volatility, which has fuelled confidence.

Bucking the trend seen in recent years, the main international bodies upgraded their global growth forecasts on various occasions during the year. According to the IMF's October projections, global GDP growth will reach 3.6% in 2017 and 3.7% in 2018, following 3.2% growth in 2016.

For the third year running, the Spanish economy outperformed on the international stage, with estimated GDP growth of over 3% in 2017, placing it at the forefront of the world's major developed countries. Despite the political situation that unfolded in Catalonia in the second half of the year, support factors such as a healthier global economy, forceful job creation, low interest rates and the reduction of private sector debt have once again driven consumer spending, exports and also investment.

Stock market performance in 2017

The IBEX 35, the main index of the Spanish stock exchange, was back in the black in 2017, ending the year up 7.4%. Factoring in dividends, returns stood at 11.25%. The year featured two diametrically opposed episodes for the Spanish stock market: through to May it gained 19%, only to lose nearly 10% of this ground in the latter half of the year largely in response to the political uncertainty in Catalonia.

Trading on the Spanish stock exchange in 2017 followed the trend seen the previous year. Total trading came to 651.48 billion euros, with the main gains materialising from May onwards. A total of 50.9 million share transactions were completed, slightly down on the 54 million reported in 2016.

Against a backdrop of growing competition, the Spanish stock exchange remains an extremely liquid platform for the shares traded on the market and the spreads and depth offered by its trading system have continued to be a reference in the months leading up to the entry into force of MiFID II, which imposes stricter requirements on financial intermediaries on achieving the best execution of orders involving Spanish securities.

BME, a benchmark in business financing

BME's capacity to attract new investment and financing –one of the strengths of the Spanish stock exchange– reached truly exceptional levels in 2017. New investment flows and financing through shares originating from rights issues, coupled with new admissions to trading, share offers and IPOs, totalled 40 billion euros, up 39% year on year and the second highest total of the past ten years. Figures released by the World Federation of Exchanges (WFE) show that BME ranked third in Europe and eighth worldwide by new investment flows and financing in shares.

For the year as a whole, the 27 companies that joined the various segments and markets of BME secured nearly 4.3 billion euros in funding through share placements, three times the amount achieved in the previous year.

More funding through the markets and less bank financing

We have been witnessing a growing trend towards a greater diversification of business financing in Spain, particularly in the case of the main listed companies. Recent analyses of the audited accounts of Spanish non-financial listed companies that belonged to the IBEX 35 between 2010 and 2016 show that equity was up 24% while bank financing was down 42%, already well below the volume of financing achieved through Fixed Income instruments, which was up 30% according to these same studies. In a nutshell, more capital, less debt and more debt diversification.

The MAB continues to grow and consolidate

The MAB market for Growth Companies continued to consolidate its financing potential throughout 2017. Capital increases totalled 112 million euros through 11 different transactions and the number of companies present on the market climbed to 42 following the inclusion of three new members.

Real Estate Investment Trusts (known in Spain as SOCIMIs) continue to grow in both number and market value, providing investors with liquid investment vehicles linked to the real estate rental market. With 19 additions in 2017, a total of 52 SOCIMIs were trading on different segments of the Spanish stock market at year-end 2017: five on the main market and 47 in the specialised segment of the MAB. Together, they present a market value of 20 billion euros.

Dividend Pay out 96%



Fixed Income in 2017 and expansion of the MARF

The Corporate Debt segment also experienced a year characterised by a drop in yields on high-grade bonds in response to the European Central Bank's corporate sector purchase program (CSPP), which reached an average monthly volume of some 7.5 billion euros. As a result, the cost for companies of issuing debt in the Fixed Income markets has fallen by 38% since the programme began.

BME's Fixed Income Market reported a slight drop of 3.2% in the balance of Corporate Debt. Despite reporting an increase of almost 38% in issuances of long- and short-term bonds, it was penalised heavily by the reduction in issues of securitised bonds and promissory notes.

Meanwhile, the Mercado Alternativo de Renta Fija, MARF, at barely four years old, is continuing to achieve what it was designed to achieve: offering Spanish companies a new source of financing to complement bank lending through various types of Fixed Income issues: senior bonds, promissory notes and project bonds. If we include the new additions in 2017, a total of 41 companies are now obtaining financing directly through the MARF operated by BME since its inception in 2013. For the year as a whole, the volume of issuances and admissions to trading on the MARF totalled 3.9 billion euros, far in excess of the 2.2 billion euros reported in 2016.

Successful migration to T2S

The most significant event for Iberclear in 2017 was its migration to T2S. Both the trial process and the migration itself and subsequent stabilisation phase were a complete success. Several of the main financial institutions that have been settling their transactions on T2S since its start-up have confirmed that BME's incorporation has been the most successful of all companies to have undergone the process so far.

This milestone has effectively brought the post-trade systems of the Spanish market in line with those of the main European markets, making them more efficient and competitive while optimising costs, all key priorities in an increasingly global environment.

REGIS-TR is a European trade repository developed jointly by BME and the German Stock Exchange. It is now the second biggest repository in Europe, having received and processed upwards of 8 million messages a day in 2017, a year in which it was also authorised to provide reporting services under Swiss regulations. REGIS-TR now reports to 35 European regulators –almost all of them– thus consolidating its position as a valuable communication channel between market members and supervisors.

Stable earnings and dividends

BME's net profit in 2017 came to 153.3 million euros, down 4.3% year on year. The widespread slowdown in trading volumes reported by the Equities and Derivatives units was partially offset by the positive performance of other units and products in response to the Company's efforts to diversify its business model.

On the subject of shareholder remuneration, BME has maintained a solid dividend policy since 2007. This year round, the Company has laid a proposal to shareholders at the Annual General Meeting of 0.78 euros per share, gross, as an extra dividend. BME's shareholder remuneration policy and proposed pay-out of over 96% is unrivalled in its sector and is down to the Company's operational gearing, which allows it to cover operating costs with earnings not linked to trading volumes.

Outlook for 2018

One of the most immediate and significant milestones for 2018 will be the entry into force of the Markets in Financial Instruments Directive, or MiFID II. This regulation champions financial integration within the European union and improved responsiveness to new market conditions. It also seeks to correct some of the weaknesses relating to market functioning and transparency that came to light during the recent global economic and financial crisis.

MiFID II reforms and expands the scope of the previous directive and provides added protection for investors, while adding further requirements across Europe on new financial products and services and extending the requirements applicable to investment firms, regulated markets, data reporting service providers and companies from third countries that provide services or perform investment activities in the European Union.

BME expands and strengthens its range of services to comply with MiFID II on behalf of the members of the financial markets. It therefore acts as Approved Publication Arrangement (APA) and Approved Reporting Mechanism (ARM) and manages a regulatory compliant service of Systematic Internalisers (SI). These concepts and services form part of the new European regulations.

We began 2017 celebrating the 25th anniversary of the creation of the IBEX. During this period, the index gained more than 250%.

While the outlook for 2018 appears generally favourable, we are likely to encounter certain difficulties. In Spain, we must contend not only with situational economic risks, but also a number of lingering concerns, such as a worrying deficit and still high levels of debt and unemployment. Brussels and the IMF have urged Spain to press forward with its structural reforms in order to reduce existing vulnerabilities.

The financial system must continue with its process of adapting to the new reality of increasing levels of regulation and innovation. On the subject of technology, fintechs have acquired particular significance in recent years because they are changing many of the existing models and approaches to financial services, some of which are provided via the stock exchanges.

The transformation of the financial system as a whole, particularly the capital markets, has been considerable in recent years. BME has been continuously responding to this process of change without losing sight of its own identity, its business model and principles, which are ultimately transparency and security.

Thank you,

Antonio Zoido.