DIRECTORS' REPORT ON THE OPERATIONS OF THE PGNiG GROUP AND PGNiG S.A. FOR H1 2014

Warsaw, July 31st 2014

Contents

Section I: PGNiG Group

1. Business range

The PGNiG Group operates in the energy sector in Poland and abroad. The parent of the PGNiG Group is Polskie Górnictwo Naftowe i Gazownictwo S.A.

The PGNiG Group holds the leading position in most segments of the Polish gas sector, i.e. in oil and gas exploration and production, gas fuel storage, natural gas trading and natural gas distribution. The Group's oil and gas upstream operations, carried out primarily in Poland and on the Norwegian Continental Shelf, provide it with a competitive advantage on the liberalised gas market. The Group sells natural gas imported from other countries or produced from domestic fields, and provides gas supplies at times of peak demand. The distribution operations involve the supply of gas to customers via the distribution network, as well as extending and upgrading of the gas network. The PGNiG Group also generates and sells heat and electricity.

Pursuant to its Articles of Association, the PGNiG S.A.'s role is to perform activities aimed at ensuring energy security of Poland. These relate in particular to:

- ensuring continuity of gas supplies to consumers and maintaining the necessary stocks of gas,
- ensuring safe operation of gas networks,
- balancing the gas system, managing the operations and capacity of the power equipment connected to the common gas network,
- production of natural gas.

2. PGNiG Group structure

As at June 30th 2014, the Group comprised PGNiG S.A. (the Parent), and 30 subsidiaries, including:

- 22 direct subsidiaries of PGNiG S.A.
- 8 indirect subsidiaries of PGNiG S.A.

The list of the PGNiG Group companies as at June 30th 2014 is presented in the table below.

Companies of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	Ownership interest held by PGNiG S.A.	% of total voting rights held by PGNiG S.A.
	Direct subsidiaries of PGNiG S.A. – first tier				
1	Exalo Drilling S.A.	981,500,000	981,500,000	100.00%	100.00%
2	GEOFIZYKA Kraków S.A.	64,400,000	64,400,000	100.00%	100.00%
3	GEOFIZYKA Toruń S.A.	66,000,000	66,000,000	100.00%	100.00%
4	PGNiG Upstream International AS (NOK)[1)]	1,092,000,000	1,092,000,000	100.00%	100.00%
5	Polish Oil and Gas Company – Libya B.V. (EUR)1)[1)]	20,000	20,000	100.00%	100.00%
6	PGNiG Sales & Trading GmbH (EUR)[1)]	10,000,000	10,000,000	100.00%	100.00%
7	Operator Systemu Magazynowania Sp. z o.o.	15,290,000	15,290,000	100.00%	100.00%
8	Polska Spółka Gazownictwa Sp. z o.o.	10,454,206,550	10,454,206,550	100.00%	100.00%
9	Geovita S.A.	86,139,000	86,139,000	100.00%	100.00%
10	Biogazownia Ostrowiec Sp. z o.o. w likwidacji (in liquidation)	165,000	165,000	100.00%	100.00%
11	PGNiG Technologie S.A.	182,127,240	182,127,240	100.00%	100.00%
12	BUD-GAZ PPUH Sp. z o.o. w likwidacji (in liquidation)	51,760	51,760	100.00%	100.00%
13	Polskie Elektrownie Gazowe Sp. z o.o. w likwidacji (in liquidation)	1,212,000	1,212,000	100.00%	100.00%
14	PGNiG TERMIKA S.A.	670,324,950	670,324,950	100.00%	100.00%
15	PGNiG Finance AB (SEK)[1)]	500,000	500,000	100.00%	100.00%
16	PGNiG Serwis Sp. z o.o.	9,995,000	9,995,000	100.00%	100.00%
17	PGNiG Obrót Detaliczny Sp. z o.o.	1,000,000	1,000,000	100.00%	100.00%
18	PGNiG SPV 5 Sp. z o.o.	250,000	250,000	100.00%	100.00%
19	PGNiG SPV 6 Sp. z o.o.	250,000	250,000	100.00%	100.00%
20	PGNiG SPV 7 Sp. z o.o.	250,000	250,000	100.00%	100.00%
21	B.S. i P.G. Gazoprojekt S.A.[2)]	4,000,000	900,000	22.50%	22.50%
22	NYSAGAZ Sp. z o.o.	9,881,000	6,549,000	66.28%	66.28%
	Indirect subsidiaries of PGNiG S.A. – second tier	Share capital (PLN)	Value of shares held by PGNiG S.A.'s subsidiaries (PLN)	Ownership interest held by PGNiG S.A.'s subsidiaries	% of total voting rights held by PGNiG S.A.'s subsidiaries
23	Powiśle Park Sp. z o.o.	81,131,000	81,131,000	100.00%	100.00%
24	XOOL GmbH (EUR)[1)]	500,000	500,000	100.00%	100.00%
25	Oil Tech International F.Z.E. (USD)[1)]	20,000	20,000	100.00%	100.00%
26	Zakład Gospodarki Mieszkaniowej Sp. z o.o.	1,806,500	1,806,500	100.00%	100.00%
27	Poltava Services LLC (EUR)[1)]	20,000	19,800	99.00%	99.00%
28	Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000	2,565,350	85.51%	85.51%
29	GAZ Sp. z o.o.	300,000	240,000	80.00%	80.00%
30	Zakład Separacji Popiołów Siekierki Sp. z o.o.	1,000,000	700,000	70.00%	70.00%

[1)] In foreign currencies
[2)] PGNiG S.A. has the right to appoint the majority of the company's Supervisory Board members. Also, PGNiG S.A. holds a 52.50% indirect interest in the company through PGNiG Technologie S.A.

Changes in the PGNiG Group's structure in H1 2014:

- On January 20th 2014, following completion of the liquidation process, PT Geofizyka Torun Indonesia LLC w likwidacji (in liquidation) was deleted from the commercial register; the company was a subsidiary of GEOFIZYKA Toruń S.A.
- On May 22nd 2014, Zakład Separacji Popiołów Siekierki Sp. z o.o. was established with the share capital of PLN 1,000,000, divided into 10,000 shares with a par value of PLN 10 per share; PGNiG S.A. holds indirectly, through PGNiG TERMIKA S.A., 70% of shares in that company.

PGNiG Obrót Detaliczny Sp. z o.o. was established in 2013 in order to meet the requirement to sell gas on the exchange market, introduced under the Energy Law. In H1 2014, the company was preparing the launch of operations in the area of retail trade in gas. It will commence full-scale operating activities on August 1st 2014. PGNiG Obrót Detaliczny Sp. z o.o. will take over PGNiG S.A.'s existing retail sales business and its share capital will be increased. The capital increase will be effected through the contribution of an organised part of business connected with retail gas sales.

As at June 30th 2014, the consolidation included PGNiG S.A. (the Parent) and 19 subsidiaries. The chart below presents the consolidated companies of the PGNiG Group as at June 30th 2014 (by segment).

Consolidated PGNiG Group companies

Segment	Name	Ownership interest held by PGNiG S.A.
Exploration and Production	Exalo Drilling S.A.	100%
	Oil Tech International F.Z.E.	100%
	Poltava Services LLC	99%
	GEOFIZYKA Kraków S.A.	100%
	GEOFIZYKA Toruń S.A.	100%
	PGNiG Upstream International AS	100%
	Polish Oil and Gas Company – Libya B.V.	100%
Trade and Storage	Operator Systemu Magazynowania Sp. z o.o.	100%
	PGNiG Sales & Trading GmbH	100%
	XOOL GmbH (EUR)	100%
	PGNiG Finance AB	100%
Distribution	Polska Spółka Gazownictwa Sp. z o.o.	100%
	Powiśle Park Sp. z o.o.	100%
	GAZ Sp. z o.o.	80%
Generation	PGNiG TERMIKA S.A.	100%
Other Activities	Geovita S.A.	100%
	PGNiG Technologie S.A.	100%
	PGNiG Serwis Sp. z o.o.	100%
	B.S. i P.G. Gazoprojekt S.A.*	75%

* PGNiG S.A. has the right to appoint the majority of the company's Supervisory Board members.
PGNiG S.A.'s direct interest in the share capital of B.S. i P.G. Gazoprojekt S.A. is 22.50%.
Also, PGNiG S.A. holds a 52.50% indirect interest in the company through PGNiG Technologie S.A.

3. Workforce

The table below presents PGNiG S.A.'s and the PGNiG Group's workforce as at June 30th 2014, by segment. Employees of the PGNiG Head Office are included in the Trade and Storage segment.

Workforce by segment (no. of staff)

	PGNiG S.A.	PGNiG Group
Exploration and Production	4,161	9,891
Trade and Storage	3,869	4,030
Distribution	-	12,821
Generation	-	1,055
Other Activities	37	1,968
Total	8,067	29,765

In H1 2014, the Voluntary Termination Programme was launched at PGNiG S.A. 208 Company employees participated in the programme, with the majority (199 persons) terminating their employment contracts with effect from June 30th 2014.

Section II: Parent's governing bodies

1. Management Board

As at January 1st 2014, the composition of the PGNiG Management Board was as follows:

- Mariusz Zawisza − President
- Jarosław Bauc – Vice-President, Finance
- Jerzy Kurella – Vice-President, Trade
- Andrzej Parafianowicz – Vice-President, Corporate Affairs
- Zbigniew Skrzypkiewicz – Vice-President, Exploration & Production

On April 3rd 2014, the Supervisory Board of PGNiG S.A. appointed Waldemar Wójcik as member of the Management Board of PGNiG S.A. for a joint three-year term of office ending December 30th 2016. Waldemar Wójcik is a Management Board member elected by the PGNiG S.A. employees in the election held in January and February 2014.

On June 18th 2014, the Supervisory Board of PGNiG S.A. resolved to suspend Mr Andrzej Parafianowicz from duties as Vice-President of the PGNiG Management Board for Corporate Affairs.

As at June 30th 2014, the Management Board of PGNiG S.A. was composed of the following six persons:

- Mariusz Zawisza − President
- Jarosław Bauc – Vice-President, Finance
- Jerzy Kurella – Vice-President, Trade
- Andrzej Parafianowicz – Vice-President, Corporate Affairs (suspended from duties)
- Zbigniew Skrzypkiewicz – Vice-President, Exploration & Production
- Waldemar Wójcik – Member of the Management Board

2. Supervisory Board

As at January 1st 2014, the composition of the PGNiG Supervisory Board was as follows:

- Wojciech Chmielewski – Chairperson
- Marcin Moryń – Deputy Chairperson
- Mieczysław Kawecki – Secretary
- Agnieszka Chmielarz – Member
- Józef Głowacki – Member
- Janusz Pilitowski – Member
- Ewa Sibrecht-Ośka – Member
- Jolanta Siergiej – Member

On March 26th 2014, the Extraordinary General Meeting of PGNiG S.A. appointed Mr Andrzej Janiak as member of the Company's Supervisory Board. Mr Andrzej Janiak meets the independence criteria defined in the Company's Articles of Association.

In connection with the expiry of the Supervisory Board's term of office, on May 15th 2014 the Annual General Meeting of PGNiG S.A. removed all members of the Supervisory Board and appointed, for a joint three-year term of office commenced on May 15th 2014, the Supervisory Board composed of:

Wojciech Chmielewski, Sławomir Borowiec, Andrzej Janiak (independent member), Bogusław Nadolnik, Janusz Pilitowski, Agnieszka Trzaskalska, Ryszard Wąsowicz, Agnieszka Woś and Magdalena Zegarska.

Janusz Pilitowski represents the State Treasury and was appointed in consultation with the Minister of Economy.

Sławomir Borowiec, Ryszard Wąsowicz and Magdalena Zegarska are Supervisory Board members elected by the PGNiG S.A. employees in the election held in January and February 2014.

On May 20th 2014, at its first meeting, the Supervisory Board constituted itself with Wojciech Chmielewski as Chairperson, Agnieszka Woś as Deputy Chairperson and Magdalena Zegarska as Secretary.

As at June 30th 2014, the Supervisory Board of PGNiG S.A. was composed of the following nine persons:

- Wojciech Chmielewski – Chairperson
- Agnieszka Woś – Deputy Chairperson
- Magdalena Zegarska – Secretary
- Sławomir Borowiec – Member
- Andrzej Janiak – Member
- Bogusław Nadolnik – Member
- Janusz Pilitowski – Member
- Agnieszka Trzaskalska – Member
- Ryszard Wąsowicz – Member

On July 30th 2014, Agnieszka Trzaskalska resigned as Member of the Supervisory Board of PGNiG S.A.

Section III: Shareholding structure

As at June 30th 2014, the share capital of PGNiG S.A. amounted to PLN 5,900,000,000 and was divided into 5,900,000,000 shares with a par value of PLN 1 per share. The Polish State Treasury was the only shareholder with a large direct holding of PGNiG shares. The shares of all series, that is Series A, A1 and B, were ordinary bearer shares and each share conferred the right to one vote at the General Meeting. The shareholding structure of PGNiG S.A. as at June 30th 2014 is presented in the table below.

Shareholding structure

Shareholder	Number of shares as at Jun 30 2014	% ownership interest as at Jun 30 2014	Number of votes conferred by shares held	% of total vote at GM as at Jun 30 2014
State Treasury	4,271,737,336	72.40%	4,271,737,336	72.40%
Other shareholders	1,628,262,664	27.60%	1,628,262,664	27.60%
Total	5,900,000,000	100.00%	5,900,000,000	100.00%

<u>PGNiG shares and shares in PGNiG S.A.'s related entities held by management and supervisory personnel</u>

The table below presents the management and supervisory personnel's holdings of PGNiG shares as at June 30th 2014.

PGNiG shares held by the management and supervisory personnel

Name	Position	Number of shares	Par value of shares (PLN)
Waldemar Wójcik	Member of the Management Board	19,500	19,500
Ryszard Wąsowicz	Member of the Supervisory Board	19,500	19,500

Section IV: Operating review of the PGNiG Group

In H1 2014, the PGNiG Group reported revenue of PLN 16.4bn, ca. 76% of which was derived from sales of natural gas.

Revenue (PLNm)

	H1 2014
Natural gas, including:	12,496
- high-methane gas	11,771
- nitrogen-rich gas	725
Crude oil	1,605
Electricity	866
Heat	582
Geophysical and geological services	129
Drilling and well services	255
Construction and assembly services	68
Connection charge	45
Other sales	337
Total	16,383

The tables below set forth natural gas and crude oil production volumes, electricity and heat generation volumes, as well as sales volumes for those products in H1 2014.

Output of key products

	Unit of measure	H1 2014
Natural gas	mcm	2,314.5
Crude oil	'000 tonnes	631.9
Electricity	GWh	2,381.6
Heat	TJ	20,923.8

Sales of key products

	Unit of measure	H1 2014
Natural gas, including:	mcm	8,213.6
- Trade and Storage	mcm	7,825.7
- Exploration and Production	mcm	387.9
Crude oil	'000 tonnes	659.2
Electricity, including:	GWh	5,266.7
- Trade and Storage	GWh	5,242.2
- Generation	GWh	24.5
Heat	TJ	20,770.0

Section V: Regulatory environment

1. Licences

As at June 30th 2014, PGNiG S.A. held the following licences granted by the President of the Polish Energy Regulatory Office (URE) under the Energy Law:

- one licence to trade in gas fuels
- one licence to trade in natural gas with foreign partners
- one licence to trade in liquid fuels
- one licence to produce electricity
- one licence to trade in electricity.

As at June 30th 2014, PGNiG S.A. held the following licences, granted pursuant to the Geological and Mining Law:

- 81 licences for exploration and appraisal of crude oil and natural gas deposits
- 229 licences for production of crude oil and natural gas from deposits
- 9 licences for storage of gas in underground facilities (underground gas storage facilities)
- 3 licences for storage of waste.

2. Changes in PGNiG S.A.'s tariffs

In H1 2014, the PGNiG Gas Fuel Tariff (Part A Gas Fuel Supply Tariff No. 6/2014), approved by decision of the President of the Energy Regulatory Office dated December 17th 2013, was in effect. On average, the prices and charge rates for the supply of high-methane gas type E, and nitrogen-rich gas types Lw and Ls were increased by 1.5%, 4.7% and 7.3%, respectively.

On June 13th 2014, the President of the Energy Regulatory Office (URE) approved an amendment to the PGNiG Gas Fuel Tariff. (Part A Gas Fuel Supply Tariff No. 6/2014) and extended its validity until December 31st 2014. The amendment was designed to harmonise the tariff with the Minister of Economy's Regulation dated June 28th 2013, under which, starting from August 1st 2014, settlements with customers are to be based on energy units, while earlier they were based on units of volume. The new settlement rules will not significantly affect the amounts of payments for gas fuel supplies. The prices of gas fuels, as well as distribution and transmission charge rates were recalculated from amounts expressed per cubic metre into amounts expressed per 1 kWh, with use of the calorific value adopted to determine prices per unit of volume. Changes in payments, if any, may result from differences between calorific values at different places of the gas network or rounding recalculation results (which should not exceed +/-1%).

The following tables present the average rates (PLN/cubic metre) applicable in H1 2014 in settlements with customers purchasing gas fuels, by fuel type and place of delivery. The amounts do not include excise duty introduced on November 1st 2013.

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Wrocław Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.4969	2.6150	4.7%
W-2.1	1.9816	2.0512	3.5%
W-3.1	1.8029	1.9005	5.4%
W-4	1.6693	1.7912	7.3%
W-5 – W-7C	1.7071	1.7001	-0.4%
W-8A – W-10C	1.4651	1.4653	0.0%

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
S-1	1.7900	1.8950	5.9%
S-2	1.4044	1.5152	7.9%
S-3	1.3013	1.4098	8.3%
S-4	1.1801	1.3035	10.5%
S-5 – S-7B	1.2338	1.2468	1.1%
S-8 – S-9	1.1225	1.1394	1.5%

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
Z-1	1.4156	1.5102	6.7%
Z-2	1.2888	1.3774	6.9%
Z-3	1.1623	1.2508	7.6%
Z-4	1.0841	1.1759	8.5%
Z-5 – Z-7B	1.1793	1.1772	-0.2%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Zabrze Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.4726	2.6051	5.4%
W-2.1	2.0440	2.1095	3.2%
W-3.1	1.7660	1.8807	6.5%
W-4	1.6909	1.8102	7.1%
W-5 – W-7C	1.7314	1.7379	0.4%
W-8A – W-11C	1.4681	1.4696	0.1%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Tarnów Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.3594	2.4663	4.5%
W-2.1	1.9590	2.0228	3.3%
W-3.1	1.7288	1.8246	5.5%
W-4	1.6843	1.7779	5.6%
W-5 – W-7BC	1.7355	1.7524	1.0%
W-8A – W-10C	1.4310	1.4423	0.8%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Warsaw Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.7039	2.7874	3.1%
W-2.1	1.8693	1.9397	3.8%
W-3.1	1.6877	1.7924	6.2%
W-4	1.6755	1.7673	5.5%
W-5 – W-7C	1.7086	1.7275	1.1%
W-8A – W-10C	1.3669	1.3700	0.2%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Gdańsk Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.5658	2.6739	4.2%
W-2.1	2.0058	2.0806	3.7%
W-3.1	1.8006	1.9066	5.9%
W-4	1.7451	1.8457	5.8%
W-5 – W-7C	1.7606	1.7742	0.8%
W-8A – W-10C	1.4601	1.4500	-0.7%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Poznań Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.5856	2.6962	4.3%
W-2.1	1.9143	1.9939	4.2%
W-3.1	1.7881	1.8870	5.5%
W-4	1.7032	1.8098	6.3%
W-5 – W-7C	1.6715	1.6640	-0.5%
W-8A – W-10C	1.4140	1.4110	-0.2%

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
S-1	1.8046	1.9231	6.6%
S-2	1.3774	1.5069	9.4%
S-3	1.2602	1.3967	10.8%
S-4	1.1889	1.3290	11.8%
S-5 – S-7B	1.2365	1.2772	3.3%

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
Z-1	1.6422	1.7424	6.1%
Z-2	1.2408	1.3500	8.8%
Z-3	1.1208	1.2362	10.3%
Z-4	1.0570	1.1753	11.2%
Z-5 – Z-7B	1.1157	1.1464	2.8%

Customers connected to the transmission grid of OGP GAZ-SYSTEM S.A.

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
E-1A – E-2C	1.3302	1.3141	-1.2%
Lw-1 – Lw-2	1.0196	1.0283	0.8%
Ls-1 – Ls-2	0.8537	0.8794	3.0%

Exemption from the obligation to submit wholesale gas tariffs for approval

On February 19th 2013, the President of the Energy Regulatory Office announced that energy utilities holding gas fuel trading licences were exempt from the obligation to submit wholesale gas trading tariffs for approval. However, energy utilities must individually apply to the President of the Energy Regulatory Office for the exemption.

On August 30th 2013, PGNiG S.A. applied to the President of the Energy Regulatory Office to be exempted from the obligation to submit wholesale gas trading tariffs for approval. As at the date of this report, the proceedings were still pending.

Furthermore, on October 23rd 2013, PGNiG S.A. applied to the President of the Energy Regulatory Office to be exempted from the obligation to submit for approval tariffs for high-methane natural gas (E) traded at a virtual gas trading point (OTC market). As at the date of this report, the proceedings to approve the new Distribution Grid Code were still pending.

3. Regulatory risks

Polish Energy Law

On September 11th 2013, the Act Amending the Energy Law and Certain Other Acts (the so-called "Small Three Pack") came into force. The amendment introduced a number of changes in the regulatory regime governing the natural gas market, relating, in particular, to the need to harmonise Polish legislation with the provisions of the 3rd energy package, as well as the necessity to deregulate the gas market, especially by imposing the requirement to sell gas on the exchange market.

The requirement to sell gas on the exchange market, which now applies to the Company, is aimed to deregulate the Polish gas market and boost competition. The mechanism improves the market's transparency and allows market participants to purchase products on equal terms. On the other hand, it may cause PGNiG to gradually lose its market share. However, the actual rate at which PGNiG S.A.'s market share might shrink will depend on the number and size of new players entering the gas market and the price differentials between the tariff price and the contractual prices offered on the exchange markets.

Meeting the requirement to sell gas on the exchange market

In terms of supply, PGNiG S.A. is fully prepared to meet its statutory obligation to sell gas through the exchange market. In 2014, the Company is required to sell 40% of its total sales volume through the exchange market. Starting from January 1st 2015, this requirement will cover 55% of the total gas sold. If an energy utility fails to meet the requirement to sell gas through the exchange market, the President of the Energy Regulatory Office may impose on it a fine of up to 15% of its full-year revenue generated from the licensed activity in the previous fiscal year. Due to the low demand for gas on the exchange market, in 2013 the Company failed to sell the required volume of gas via this channel. In order to ensure the meeting of the requirement, a new company PGNiG Obrót Detaliczny Sp. z o.o. will launch its operations in August 2014. It will buy natural gas at the Polish Power

Exchange, and then sell it to retail customers. However, there is still the risk that in 2014 PGNiG S.A. may fail to sell the required gas volumes through the exchange market.

Tariff calculation

Dependence of the PGNiG Group's revenue on tariffs approved by the President of the Energy Regulatory Office is the key factor affecting the Group's regulated business. Tariffs are crucial to the Company's ability to generate revenue that would cover its reasonable costs and deliver a return on the capital employed. Currently, a significant portion of that revenue depends on the selling prices of gas fuel, which − except to the extent that the gas is sold through the Polish Power Exchange − are regulated prices. The tariff determination rules are defined in the regulations issued under the Energy Law, including primarily the Tariff Regulation. The tariff determination methodology is based on planned volumes. Inaccurate estimates of customer demand for gas (affecting the accuracy of projected purchase and supply volumes), changes in imported gas prices which cannot be accurately projected, as well as unpredictable fluctuations in currency exchange rates (ultimately affecting the cost of gas imports) may have an adverse effect on the financial performance of the Group.

Act on Stocks of Crude Oil, Petroleum Products and Natural Gas

Meeting the statutory requirements related to mandatory stocks exposes PGNiG S.A. to balancing and technology risks, and threatens the performance of its contractual obligations.

The balancing risk is related to the Company's inability to meet peak demand for natural gas in autumn and winter months. During longer spells of low temperatures, it may happen that – despite maximum gas supplies under long-term contracts and from underground gas storage facilities (remaining at the disposal of PGNiG S.A.) – the demand for gas will exceed the volumes which the Company is able provide. This risk may arise even assuming the maximum use of import capacities. To note, given the legally required technical parameters necessary to deliver mandatory gas stocks to the system, a significant portion of the stocks had to be placed at the Mogilno underground gas storage cavern, which is a peak-demand storage facility. As a result, the mandatory stocks significantly limit the commercial use of the facility's storage capacity and deliverability. As gas from mandatory stocks may be withdrawn only upon the Minister of Economy's consent and only after gas supply limits have been introduced for users, the Company may fail to ensure continuity of gas supplies to consumers. Notwithstanding the above, withdrawal of gas from stocks may lead to a situation where users face gas supply limits despite high volumes of gas held in storage.

The technology risk follows from the fact that the need to maintain mandatory stocks has a negative impact on the operating parameters of underground storage facilities. In a longer run, if gas is not drawn from water-drive storage facilities (such as the Husów Underground Gas Storage Facility), gas will migrate to the reservoir section with poorer porosity and permeability, which will lead to a decrease in gas withdrawal capacity. This could make gas withdrawal more difficult at the end of the withdrawal process, and will reduce withdrawal capacity in the next cycle. In order to restore the operating parameters of the facility, it may be necessary to inject more gas to increase buffer volumes, which will in turn entail additional costs.

Another consequence of maintaining mandatory stocks is that the storage capacities remain partially filled after the winter season is over, which reduces the injection capacities in the summer. In the 2013/2014 season, nearly a half of the total underground gas storage capacities was filled with mandatory stocks and base gas enabling mandatory stocks to be withdrawn by the statutory deadline. Injection of gas into storage during the summer season, when demand for gas is low, enables the Company to receive the minimum volumes required to be imported under the Yamal contract, as it increases total demand for natural gas. A risk exists that PGNiG may not be able to meet its contractual obligations concerning offtake of imported gas if the gas volumes in storage are high at the beginning of summer due to the maintenance of mandatory stocks.

Geological and Mining Law

In the first half of 2014, legislative work continued on a fundamental change in the regulatory regime for the exploration and production segment, comprising two bills: the draft act amending the Geological and Mining Law and certain other acts, and the draft act on the special hydrocarbon tax, and on amendment to the act on the tax on production of certain minerals and certain other acts. In July 2014, the new acts were passed by the lower house of the Polish Parliament. They provide for increasing the fiscal burden on production of minerals and for a change to the existing licensing system. The introduction of the special hydrocarbon tax as of 2020 will considerably impair PGNiG S.A.'s capabilities to make new investments, while the new licensing system (under which the open door procedure will not apply) may significantly slow down the administrative processes, ultimately leading to a decline in the number of hydrocarbon exploration and appraisal licences issued in Poland.

Section VI: Exploration and Production

1. Exploration

Exploration in Poland

In H1 2014, PGNiG S.A. was engaged in exploration for both conventional and unconventional gas (shale gas and tight gas). In Poland, PGNiG S.A. carried out exploration and appraisal work, both on its own and jointly with partners, in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands. Drilling work in Poland was performed on ten boreholes, including five exploration boreholes, four core boreholes and one appraisal borehole. Out of the ten boreholes mentioned, seven were drilled in search for unconventional hydrocarbons.

In H1 2014, two boreholes were classified as successful, including an exploration borehole in the Polish Lowlands (drilled in the previous years) and an appraisal borehole in the Carpathian Foothills (drilled in search for unconventional reserves). Six wells failed to yield a commercial flow of hydrocarbons and were abandoned, including one in the Carpathian Foothills and five in the Polish Lowlands (two of which had been drilled in previous years).

Exploration abroad

In Egypt, PGNiG S.A. conducted exploration work in the Bahariya licence area (Block 3) under an Exploration and Production Sharing Agreement (EPSA) executed with the government of Egypt of May 17th 2009. The Company held a 100% interest in the licence. As results of the exploration campaign were negative, a decision was made to terminate the licence and liquidate the Egypt branch. In H1 2014, final settlements with Egyptian General Petroleum Corporation (EGPC) were made.

2. Joint ventures

In H1 2014, the PGNiG Group conducted joint operations with other entities in licence areas awarded to PGNiG S.A., FX Energy Poland Sp. z o.o., and San Leon Energy PLC (the company acquired licence interests from the former partner, Aurelian Oil & Gas PLC). Furthermore, the PGNiG Group collaborated with other entities in carrying out exploration work in Pakistan, Norway and Libya.

2.1 Joint ventures in Poland

On August 14th 2013, PGNiG S.A. and LOTOS Petrobaltic S.A. signed an agreement for joint operations within the Kamień Pomorski licence area. The performance of the agreement was conditional upon fulfilment of certain conditions precedent, i.e. obtaining positive tax interpretations from the Ministry of Finance and the Ministry of Environment's approval of sub-lease of the mining usufruct (mineral extraction rights). As at June 30th 2014, not all of the conditions precedent had been fulfilled and thus the agreement had not taken effect.

On March 31st 2014, PGNiG S.A. entered into a collaboration agreement with Chevron Polska Energy Resources Sp. z o.o. covering the first stage of an unconventional hydrocarbon exploration project. The agreement envisages joint evaluation of unconventional gas reserves in four exploration licence areas in south-eastern Poland, including the Zwierzyniec and Grabowiec licences held by Chevron, and the Tomaszów Lubelski and Wiszniów–Tarnoszyn licences held by PGNiG S.A. The scope of work includes drilling a vertical exploration borehole.

Under the licences awarded to PGNiG S.A., work continued in the following areas:

- "Płotki" – under the agreement for joint operations dated May 12th 2000; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%;
- "Płotki" – "PTZ" (the Extended Zaniemyśl Area) – under the operating agreement dated October 26th 2005; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 24.5%, Calenergy Resources Poland Sp. z o.o. – 24.5%;
- "Poznań" – under the agreement for joint operations dated June 1st 2004; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%;
- "Bieszczady" – under the agreement for joint operations dated June 1st 2007; licence interests: PGNiG S.A. (operator) – 51%, Eurogas Polska Sp. z o.o. – 24%, and Energia Bieszczady Sp. z o.o. – 25%;
- "Sieraków" – under the agreement for joint operations dated June 22nd 2009; licence interests: PGNiG S.A. (operator) – 51%, Orlen Upstream Sp. z o.o. – 49%.

In the "Poznań" licence area, wells were hooked up and production was launched in the Komorze gas field, while the Pławce-2 tight gas well was abandoned due to low gas flows. In the "Sieraków" area, production tests were carried out in the Szymanowice-1K exploration well. The tests failed to yield satisfactory results and the well was abandoned.

Under licences held by FX Energy Poland Sp. z o.o. work was conducted in the "Warszawa-Południe" area (bloc 254 and bloc 255), on the basis of the joint operations agreement dated May 26th 2011. The licence interests are as follows: FX Energy Poland Sp. z o.o. (operator) – 51%, and PGNiG S.A. – 49%.

In H1 2014, FX Energy Poland Sp. z o.o. filed an application with the Ministry of Environment declaring its relinquishment of the oil and gas exploration and appraisal licences in bloc 254. However, the company was granted a new oil and gas exploration and appraisal licence in bloc 255.

Under licences awarded to San Leon Energy PLC, work was conducted in the following areas:
- "Karpaty Zachodnie" − under the agreement for joint operations dated December 17th 2009, concluded with Energia Karpaty Zachodnie Sp. z o.o. Sp. k. (a subsidiary of San Leon Energy PLC); licence interests: Energia Karpaty Zachodnie Sp. z o.o. Sp. k. (operator) – 60%, PGNiG S.A. – 40%;
- "Karpaty Wschodnie" − under the agreement for joint operations dated December 17th 2009, concluded with Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (a subsidiary of San Leon Energy PLC); licence interests: Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (operator) – 80%, PGNiG S.A. – 20%.

In H1 2014, San Leon Energy PLC filed an application with the Ministry of Environment declaring its relinquishment of the Mszana Dolna and Jordanów licences. Relinquishment of the licences will result in termination of the "Karpaty Wschodnie" joint operations agreement.

2.2. Joint ventures abroad

Pakistan

PGNiG S.A. conducts exploration work in Pakistan under an agreement for hydrocarbon exploration and production in the Kirthar licence area executed between PGNiG S.A. and the government of Pakistan on May 18th 2005. Work in the Kirthar block is conducted jointly with Pakistan Petroleum Ltd., with production and expenses shared in proportion to the parties' interests in the licence: PGNiG S.A. (operator) – 70%, PPL – 30%. In H1 2014, work continued on preparations to drill the Rizq-1 exploration borehole, and the licence holders also embarked on preparations to drill the Rehman-2, Rehman-3 and Rehman-4 appraisal boreholes (these are planned to be drilled in 2014–2015).

Norway

PGNiG Upstream International AS, a PGNiG Group company, holds interests in exploratory and production licences on the Norwegian Continental Shelf, in the Norwegian Sea and in the Barents Sea. Jointly with its partners, the company has been pursuing the Skarv project, which comprises production from the Skarv and Idun fields, and development of the Snadd field. In the other licence areas, the company is engaged in exploration projects.

Hydrocarbons are produced using a floating production, storage and offloading vessel (FPSO), which is moored in the vicinity of the field. In H1 2014, the company produced a total of 245.4 thousand tonnes of crude oil and other fractions (measured as tonnes of crude oil equivalent) and 232mcm of natural gas. The oil is sold directly from the FPSO vessel to Shell International Trading and Shipping Company Ltd. and transported by the trading partner's fleet of shuttle tankers. The produced gas is transmitted over the Gassled Area B System gas pipeline to the onshore terminal in Kårsto, and then redirected to Germany over the Gassled Area D System gas pipeline, where it is received by PGNiG Sales & Trading GmbH.

Also in H1 2014, the company continued work on the development of the Snadd field and other exploration licence areas. Among other things, it worked on evaluation of prospectivity of the PL646, PL707, PL711, PL756 and PL648S licences and was involved as a partner in drilling of an exploration borehole (ultimately classified as a dry hole) in the PL558 licence area. Moreover, the company participated in the acquisition of 3D seismic data covering a vast area in the eastern part of the Barents Sea and 2D seismic data from a large bloc in the vicinity of the Hoop uplift in the central part of the Norwegian shelf of the Barents Sea.

In H1 2014, another licensing round was concluded, as a result of which PGNiG Upstream International AS was granted the PL756 operator licence in the Norwegian Sea. As the operator, the company acquired a 50% interest in the licence. PGNiG Upstream International's licence partners are Idemitsu Petroleum Norge AS and Rocksource Exploration Norway AS, with a 25% interest each. The PL756 licence is located in a well appraised area, close to a number of producing fields, including the large Aasgard field. This licence is the second operator licence granted to PGNiG Upstream International AS on the Norwegian Continental Shelf.

Geological and geophysical analyses were performed in the PL599 and PL600 licence areas, on the basis of which the exploration risk was assessed as high, and so the company and its partners relinquished the licences. As at June 30th 2014, PGNiG Upstream International AS held interests in 12 exploration and production licences on the Norwegian Continental Shelf.

Libya

Polish Oil and Gas Company – Libya B.V., the Group's subsidiary, conducted exploration work in licence area No. 113 within the Murzuq petroleum basin in Libya, under an exploration and production sharing agreement of February 25th 2008 concluded with the Libyan government.

Due to the tense political situation and growing threat to the safety of employees, the exploration work in Libya was discontinued in January 2014.

3. Production

In H1 2014, the PGNiG Group conducted hydrocarbon production in Poland, in the Norwegian Continental Shelf and in Pakistan.

Natural gas and crude oil in Poland is extracted by two branches of PGNiG S.A.: the Zielona Góra Branch and the Sanok Branch. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 22 sites, including 13 gas production facilities, 6 oil and gas production facilities and 3 oil production facilities. The Sanok Branch produces high-methane and nitrogen-rich natural gas and crude oil at 38 sites, including 20 gas production facilities, 12 oil and gas production facilities and 6 oil production facilities.

In H1 2014, the PGNiG Group produced a total of 2,314.5 mcm of natural gas (high-methane gas equivalent), of which 2,053.4 mcm was produced from fields in Poland, and 261.1 mcm from fields abroad. Production of crude oil and other fractions reached 631.9 thousand tonnes of crude oil equivalent. Natural gas and crude oil production volumes are presented in the table below.

Production volumes

	Product	Unit of measure	H1 2014
1.	Natural gas, including:	mcm	2,314.5
a.	high-methane gas, including:	mcm	960.4
	- Zielona Góra Branch	mcm	0.0
	- Sanok Branch	mcm	728.4
	- Norway	mcm	232.0
b.	nitrogen-rich gas, including:	mcm*	1,354.1
	- Zielona Góra Branch	mcm*	1,286.0
	- Sanok Branch	mcm*	39.0
	- Pakistan	mcm*	29.1
2.	Crude oil, including:	'000 tonnes	631.9
	- Zielona Góra Branch	'000 tonnes	362.9
	- Sanok Branch	'000 tonnes	23.6
	- Norway	'000 tonnes	245.4

* Measured as high-methane gas equivalent.

In H1 2014, in the area of operations of the PGNiG S.A. Zielona Góra Branch, one well (with a production capacity of 1.2 thousand cubic metres per hour (high-methane gas equivalent)) was hooked up in the Radlin field. In addition, the Komorze field, with a production capacity of 1.2 thousand cubic metres per hour (high-methane gas equivalent), was also brought on stream in partnership with FX Energy Poland Sp. z o.o.

<u>Underground gas storage facilities</u>

In H1 2014, the Exploration and Production segment used the working capacities of the Daszewo and Bonikowo nitrogen-rich gas storage facilities. Storage capacities used to meet the needs of the Production segment are not storage facilities within the meaning of the Polish Energy Law.

The table below presents the working capacities of the underground storage facilities used by the Exploration and Production segment as at June 30th 2014.

Working capacities of the underground storage facilities used by the Exploration and Production segment (mcm)

Nitrogen-rich gas	H1 2014
Daszewo (Ls)	30.0
Bonikowo (Lw)	200.0

4. Sales of key products

The key products sold by the Trade and Storage segment are crude oil, high-methane gas and nitrogen-rich gas. Other products, obtained in the process of crude refining, include crude condensate, sulfur and propane-butane. Some of the produced nitrogen-rich gas is further treated into high-methane gas at the Odolanów and Grodzisk Wielkopolski nitrogen rejection units. Apart from high-methane gas, the cryogenic processing of nitrogen-rich gas yields such products as liquefied natural gas (LNG), gaseous and liquid helium and liquid nitrogen.

In H1 2014, the Group's sales of natural gas totalled 387.9 mcm, of which 359.2 mcm was sold in Poland, and 28.7 mcm − in Pakistan. Moreover, thanks to the launch of production from the Lubiatów, Międzychód and Grotów (LMG) fields and from one field in the Norwegian Continental Shelf, sales of crude oil were up 210.1 thousand tonnes compared with H1 2013. The table below presents volumes of natural gas (including LNG) sold directly from the fields, and sales volumes of crude oil and other fractions.

Sales of key products

	Unit of measure	H1 2014
Natural gas, including:	mcm	387.9
- high-methane gas	mcm	35.6
- nitrogen-rich gas*	mcm	352.3
Crude oil	'000 tonnes	659.2

*Measured as high-methane gas equivalent.

In Poland, the largest amounts of natural gas were sold to industrial customers, accounting for about 83% of the total sales volume. PGNiG S.A. sold crude oil to Shell International Trading and Shipping Company Ltd., Rafineria Trzebinia S.A., Rafineria Nafty Jedlicze S.A., TOTSA TOTAL OIL TRADING S.A. and BP Europe SE.

5. Service activities

In H1 2014, the Exploration and Production companies were engaged in drilling exploration, appraisal, core and production boreholes as well as boreholes required for the construction of underground gas storage facilities. Other important areas of their activity included provision of specialist well servicing and geophysical services. Drilling services were performed mainly for PGNiG S.A., while other services were chiefly provided to third-party customers.

Exploration, appraisal and core boreholes were drilled mainly in search for hydrocarbons, but also for copper. Drilling services were rendered in Poland and abroad for both the PGNiG Group and for third-party customers. In Poland, contracts were performed for companies exploring for:

- conventional gas, e.g. for PGNiG S.A. and FX Energy Poland Sp. z o.o.,
- unconventional gas, e.g. for PGNiG S.A, Orlen Upstream Sp. z o.o. (exploration for shale gas) and the Polish Geological Institute (coalbed methane),
- unconventional crude oil, for Wisent Oil & Gas Sp. z o.o. (exploration for shale oil),
- copper deposits, for KGHM Polska Miedź S.A., Zielona Góra Copper Sp. z o.o. and Mozów Copper Sp. z o.o.

Furthermore, boreholes were drilled for PGNiG S.A. as part of the Kosakowo underground storage facility construction project.

On foreign markets, drilling was conducted in exploration for conventional hydrocarbons for third-party customers in Uganda, Ethiopia, Pakistan, Kazakhstan, Lithuania, and in Ukraine. Furthermore, the segment carried out contracts for production well drilling projects, which were primarily performed in Poland for PGNiG S.A. and abroad for third-party customers – mainly in Kazakhstan, Pakistan, and in Ukraine.

The segment companies also provided specialist well servicing services such as drilling fluid services, cementing services, recovery enhancement treatments, services consisting in provision of downhole equipment and well testing, coiled tubing and nitrogen unit operations, as well as remedial treatments, workovers, and well abandonment services. The customers for well servicing were PGNiG S.A. and third parties, including mainly KGHM Polska Miedź S.A., Zielona Góra Copper Sp. z o.o., Mozów Copper Sp. z o.o., LOTOS Petrobaltic S.A., FX Energy Poland Sp. z o.o., Wisent Oil & Gas Sp. z o.o. and Geops Deep Drilling. The services provided in foreign markets included well abandonment and workover treatments in the Czech Republic, and coiled tubing operations in Ukraine and Romania.

In H1 2014, companies of the Exploration and Production segment performed geophysical services in the area of exploration geophysics (including acquisition, processing and interpretation of seismic data) and downhole seismic surveys. In the domestic market, their most important customers included PGNiG S.A., Chevron Polska Energy Resources Sp. z o.o., FX Energy Poland Sp. z o.o., Lane Energy Poland Sp. z o.o. and KGHM Polska Miedź S.A. For PGNiG S.A., the Exploration and Production segment companies performed exploration geophysics services; for third-party customers, they provided both exploration geophysics and downhole seismic data acquisition services. On foreign markets, the Group performed seismic field work for customers in Oman and Georgia, as well as seismic data processing and interpretation mainly for customers in Pakistan.

6. Planned activities

Exploration in Poland

In H2 2014, PGNiG S.A. will continue exploratory geophysical work and drilling in Poland on a number of prospects in the Carpathian Mountains, Carpathian Foothills and the Polish Lowlands. The work will be conducted by PGNiG S.A. on its own or jointly with partners. The exploration for conventional reserves in the less-well appraised area of the Carpathian Mountains will include continuation of drilling the Fredropol-1 deep well.

The Company also intends to pursue projects focused on exploring new potential opportunities offered by unconventional resources (shale gas/oil and tight gas), where little appraisal has so far been made. In the Polish Lowlands, the Company plans to continue drilling the Miłowo-1 and Będomin-1 boreholes and to commence drilling new wells.

Exploration abroad

In Pakistan, in order to verify the potential of the structure located to the north of the Kirthar discovery, PGNiG S.A. plans to drill the Rizq-1 well.

In the Norwegian Continental Shelf, PGNiG Upstream International AS will continue appraisal and documentation work in the Snadd field (as a partner) and analysis of the seismic data acquired in H1 2014. Also, PGNiG Upstream International AS intends to acquire new licence areas by participating in annual licensing rounds and by acquiring interests from other entities. In the future, the company may participate, as a partner, in drilling projects in deep-sea waters (below 1,000 metres) and in the Arctic Zone. This is connected with its interests in two licences (PL702 and PL703) in the Vøring Basin in the Norwegian Sea shelf, where sea depth exceeds 1,000 metres, and in two licences (PL707 and PL711) in the Barents Sea shelf, in the Arctic Zone.

Natural gas production

The PGNiG Group is implementing an investment programme aimed at maintaining, in a long-term perspective, its natural gas production capacity. As part of the programme, PGNiG S.A. plans to develop new deposits and wells, modernise and expand the existing gas production facilities, build new underground gas storage facilities and expand the existing ones.

Plans for 2014 provide for an annual natural gas production volume of approximately 4.63 bcm of high-methane gas equivalent with a calorific value of 39.5 MJ/cm. Within the Sanok Branch area, plans for H2 2014 include launch of production from new wells in the Przemyśl, Dzików and Lubliniec–Cieszanów producing fields, as well as launch of production from the new Pogwizdów field. Within the Zielona Góra Branch area, there are plans to hook up the Lisewo-2k well.

Crude oil production

In 2014, the PGNiG Group plans to produce 1,185 thousand tonnes of crude oil. The Group will produce crude oil from fields located in Poland and in the Norwegian Continental Shelf.

Service activities

In H2 2014, the PGNiG Group plans to provide drilling services in Poland and abroad. In Poland, the segment companies will conduct drilling for PGNiG S.A. and for third-party customers. In foreign markets, services will be provided for PGNiG S.A. in Pakistan and for third-party customers in Ethiopia, Egypt, Kazakhstan, Pakistan, Lithuania, Ukraine and elsewhere. Potential markets where the Group companies have submitted bids to win contracts include Tanzania, Congo, Iraq (Kurdistan Region), Uzbekistan, Russia and the Czech Republic.

Specialist well servicing services are planned to be performed in Poland chiefly for PGNiG S.A., but also for foreign companies that hold licences to explore for minerals (mainly hydrocarbons), and in foreign markets for third-party customers in Croatia, Romania, Slovakia, Czech Republic, Uzbekistan, Ukraine, Lithuania and in other countries.

The segment companies will also perform seismic data acquisition, processing and interpretation services for PGNiG S.A. and third-party customers (e.g. for PKN Orlen, AGH, LOTOS Petrobaltic S.A.) and well logging services for the segment's own needs. On foreign markets, the PGNiG Group plans to provide geophysical services in Tunisia, Oman, Pakistan, Kenya, Cameroon, Uruguay, Yemen, India, Georgia and the EU countries (for instance in Germany and Hungary).

7. Risks related to exploration and production

Resource discoveries and estimates

The main risk inherent in exploration activities is the risk of failure to discover resources, i.e. exploration risk. This means that not all the identified potential deposit sites actually have deposits of hydrocarbons which can qualify as an accumulation.

The reserves estimates and production projections may be erroneous due to imperfections inherent in the equipment and technology, which affect the quality of the acquired information concerning the geological factors and the characteristics of the deposit site. Irrespective of the methods applied, data on the volume and quality of commercial reserves of crude oil and natural gas is always an estimate. Actual production, income and expenses relating to a given deposit may significantly differ from the estimates. The weight of this risk is further increased by the fact that in the full business cycle the period from the commencement of exploration to the launch of production from a developed field takes six to eight years, while the production lasts from 10 to 40 years. Formation characteristics determined at the stage of preparing the relevant documentation are reviewed after production starts. Each downgrade of the size of the reserves or production quantities may lead to a lower revenue and adversely affect the PGNiG Group financial performance.

Exploration for unconventional deposits of gas

The risk associated with exploration for unconventional deposits of gas in Poland relates to the lack of confirmed presence of shale gas and tight gas. Furthermore, even if existence of in-place petroleum is confirmed, its production may prove uneconomic due to insufficient gas recovery rates and high investment expenditure necessary to drill wells and construct production facilities. Another material factor is connected with difficult access to unconventional gas plays given the environmental regulations and the necessity to obtain the landowners' consent for access to the area.

Delayed work

Under the applicable Polish legal regulations, obtaining a licence for exploration for and appraisal of crude oil and natural gas deposits lasts from one to one and a half years. On foreign markets, such procedures may take even two years from the time that the winning bid is awarded in a licensing tender for until the relevant contract is ratified. Prior to the commencement of field work, the Company is also required to make a number of arrangements, including obtaining formal and legal permits and approvals for entering the area, meeting environmental protection-related requirements and, in some cases, requirements related to protection of archaeological sites, and abiding by the regulations governing tenders held to select a contractor, which delays execution of an agreement with a contractor by another few months. Frequently the waiting time for customs clearance of imported equipment is very long. These factors create the risk of delays in the start of exploration work.

Formal and legal hurdles beyond PGNiG S.A.'s control include:
- local governments' failure to approve local zoning plans or amendments to those already approved;
- obstacles in having investment projects incorporated into the local zoning plans;
- need to obtain and comply with administrative or other formal and legal decisions, including environmental decisions or building permits;
- amendments to the current investment project;
- obstacles in obtaining permission from land owners to enter the site.

These factors significantly delay implementation of investment projects and commencement of on-site construction work. Further, PGNiG S.A.'s obligation to comply with the Public Procurement Law frequently protracts the tender procedure. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing an entire project. A protracted investment process exacerbates the risk related to estimation of capital expenditure.

Cost of exploration

Exploratory work is capital intensive, given the prices of energy carriers and materials. Cost of exploratory work is especially sensitive to steel prices, which are passed onto prices of casing pipes and lifting casing used in drilling. An increase in prices of energy and materials translates into an increase in the cost of exploratory work. Moreover, profitability of foreign exploration projects depends to a significant extent on the prices of oil derivative products and on exchange rates. To reduce drilling costs, PGNiG S.A. introduced the daily rate system into its drilling contractors selection procedure in 2011.

Qualified personnel

The presence of foreign companies on the Polish market has intensified competition for highly qualified employees with extensive professional experience. This risk of losing experienced personnel is especially high with respect to oil and gas exploration professionals. In countries where PGNiG S.A. operates, highly qualified staff is difficult to recruit.

Competition

Both on the Polish market and abroad there is a risk of competition from other companies in the area of acquisition of licences for exploration for and appraisal of hydrocarbon deposits. Certain competitors of PGNiG S.A., especially those active globally, enjoy strong market positions and have greater financial resources than those available to PGNiG S.A. Thus, it is probable that such companies would submit their bids in tender procedures and be able to acquire promising licences, offering better terms than PGNiG S.A. could offer given its financial and human resources. This competitive advantage is particularly important on the international market.

Safety, environmental protection and health regulations

Ensuring compliance with environmental laws in Poland and abroad may significantly increase PGNiG S.A.'s operating expenses. Currently, PGNiG S.A. incurs significant capital expenditure and costs on ensuring compliance of its operations with ever more complex and stringent regulations concerning safety and health at work, as well as environmental protection. The act of May 18th 2005 amending the Natural Environment Protection Law and certain other acts (Dz.U. No. 113, item 954 of June 27th 2005) rendered the regulations governing the execution of projects which might affect Natura 2000 sites more stringent and enhanced the environmental protection-related requirements with regard to entering the areas of the occurrence of protected plant species and habitats of protected animals.

Changes in laws and regulations

Frequent changes in laws and regulations (especially in countries with authoritarian regimes) may cause difficulties for entities involved in exploration activity.

Political and economic situation in the regions where the PGNiG Group operates

In some countries where the PGNiG Group conducts exploration activities there is a number or risks, which may lead to a limitation, suspension or even discontinuation of the exploration and production activities. These risks include armed conflicts, terrorist attacks, social or political unrest, internal conflicts and civil disturbance.

In February 2011, PGNiG S.A. evacuated all non-Libyan employees of POGC-Libya B.V. from the country following the occurrence of a *force majeure* event. Operations were resumed in the second half of 2012. A similar situation took place in January 2014. PGNiG S.A. evacuated all Polish staff working on the Murzuq 113 licence back to Poland. The site was sealed and secured by Libyan government forces and was left to be overseen by local subcontractors.

In certain countries, operations of exploration companies may be hindered by the lack of adequate infrastructure, which may be an obstacle in transporting equipment, personnel and materials to the sites. Problems may also arise in providing supplies and ensuring appropriate health care. These risks may lead to a limitation or suspension of the Company's exploration activities.

Unforeseen events

Hydrocarbon deposits developed by PGNiG S.A. are usually located at great depths, which involves extremely high pressures and, in many cases, the presence of hydrogen sulfide. Consequently, the risk of hydrocarbon blowout or leakage is very high, which in turn may pose a threat to people (workers and local population), natural environment and production equipment.

Section VII: Trade and Storage

1. Purchases of natural gas

In H1 2014, the PGNiG Group purchased gas from abroad and, to a limited extent, from domestic suppliers.

PGNiG S.A. bought natural gas mainly under the agreements and contracts specified below, i.e. the long-term contract with OOO Gazprom Export and short- and medium-term gas supply contracts with European suppliers:

- Contract with OOO Gazprom Export for sale of natural gas to the Republic of Poland, dated September 25th 1996, effective until December 31st 2022;
- Individual Agreement with Vitol S.A. for sale of natural gas, dated May 13th 2011, effective until October 1st 2014;
- Agreement with VNG-Verbundnetz Gas AG for sale of Lasów natural gas, dated August 17th 2006, effective until October 1st 2016.

PGNiG Sales & Trading GmbH purchased natural gas on the German market, mainly in OTC transactions on the NCG (NetConnectGermany) and Gaspool virtual trading platforms. The company also purchased gas on the European Energy Exchange (EEX).

In H1 2014, to fulfil its trading obligations, the PGNiG Group purchased a total of 6,037.4 mcm of natural gas. The table below presents the structure of natural gas purchases from suppliers, measured as high-methane gas equivalent.

Structure of natural gas purchases by supply source (mcm)

	H1 2014	%
Foreign suppliers:	5,827.8	96.5%
- Gazprom Export	4,540.7	77.9%
- Other foreign suppliers	1,287.1	22.1%
Domestic suppliers	209.6	3.5%
Total	6,037.4	100.0%

2. Sales of natural gas

The key products sold by the Trade and Storage segment are high-methane gas and nitrogen-rich gas. The PGNiG Group sold gas to customers in Poland and abroad (chiefly on the German market), and on the power exchanges in Poland and Germany. In H1 2014, gas sales of the Trade and Storage segment totalled 7,825.7 mcm and were ca. 7% lower relative to H1 2013, owing mainly to the higher average air temperature prevailing in H1 2014. The table below presents sales of natural gas in the Trade and Storage segment (measured as high-methane gas equivalent).

Sales of natural gas (mcm)

	H1 2014	%
Domestic sales	6,922.8	88.5%
- high-methane gas	6,666.7	96.3%
- nitrogen-rich gas	256.1	3.7%
Foreign sales (high-methane gas)	902.9	11.5%
Total	7,825.7	100.0%

On the domestic market, gas was purchased primarily by industrial customers (mainly in the chemical, oil refining, petrochemical and metallurgical sectors) and by households. The latter were identified as the largest customer group (approximately 6.5m), accounting for 97% of the entire PGNiG Group customer base. Industrial customers had the largest share in the sales volume. The Group sold ca. 246.7 mcm of natural gas on the Polish Power Exchange. The table below presents the structure of domestic sales of natural gas (measured as high-methane gas equivalent) by customer group.

Domestic sales of natural gas (mcm)

	H1 2014	%
Industrial customers	3,815.0	55.1%
Trade and services	757.0	10.9%
Households	1,994.6	28.8%
Wholesale customers	109.5	1.6%
Exchange	246.7	3.6%
Total	6,922.8	100.0%

In H1 2014, the PGNiG Group sold 902.9 mcm of natural gas on foreign markets, primarily in Germany, where households and SME's were the largest customer group.

New contracts

On January 30th 2014, PGNiG S.A. and KGHM Polska Miedź S.A. signed an annex to the comprehensive gas fuel supply contract of July 30th 2010 for the period until June 30th 2033. Under the annex, the annual volume of gas supplies was reduced from 266 mcm to 41.5 mcm. The change follows from a decision by KGHM to reduce the output of co-generated electricity and heat due to changes in the co-generation support mechanisms and low prices of electricity. The estimated value of the annexed contract is approximately PLN 830m. The parties may restore the original supply volume in the future. The parties also signed annexes to three other contracts for gas fuel supplies to KGHM, i.e. the contracts of September 25th 2001, January 4th 1999, and October 1st 1998. The annexes changed only the duration of the contracts, from indefinite term to the period until June 30th 2033. The estimated aggregate value of the three contracts over their entire term is approximately PLN 2.8bn.

3. Electricity

In H1 2014, PGNiG S.A. engaged in wholesale trading in electricity and related products in Poland and Germany. In Poland, the Company traded on the OTC market (under EFET (European Federation of Energy Traders) standard agreements and through brokers) and on the Polish Power Exchange. In Germany, the Company engaged in spot contract trading on the EPEX (European Power Exchange) Spot market, and in the inter-system Poland-Germany exchange (between the areas covered by PSE and 50 Hertz Transmission).

PGNiG Sales & Trading GmbH engaged in electricity trading in Germany on the EPEX Spot, EEX Power Derivatives and OTC markets.

Purchase of electricity

In H1 2014, the Trade and Storage segment of the PGNiG Group purchased 3,279.3 GWh of electricity, of which 1,100.7 GWh was purchased in Poland. The purchases of electricity were handled by two PGNiG Group companies: PGNiG S.A. and PGNiG Sales & Trading GmbH.

Sales of electricity

In H1 2014, PGNiG S.A. sold electricity to business customers (tariff group A, B and C), and also engaged in sales to households (tariff group G). The Company sells electricity with fixed price guarantee (for periods as long as until 2016) and offers full balancing of customers' electricity requirements. In H1 2014, PGNiG S.A. continued its promotional campaign "Energia w dwupaku" ("Energy double play"), as part of which it offers to subsidise its customers' electricity bills. This offer is addressed primarily to small and medium-sized companies which already buy gas from the Company or want to sign gas-supply contracts with PGNiG S.A.

PGNiG Sales & Trading GmbH sold electricity to end users, mainly on the German market. Its customers included chiefly small and medium-sized companies, as well as households.

In H1 2014, the Trade and Storage segment of the PGNiG Group sold 5,242.2 GWh of electricity, of which 3,027.2 GWh was sold on the Polish market. The table below presents sales of electricity by customer group.

Sales of electricity (GWh)

	H1 2014	%
End customers	124.2	2.4%
Trading companies	1,659.8	31.7%
Balancing market	226.9	4.3%
Exchange	3,231.3	61.6%
Total	5,242.2	100.0%

4. Storage

The Trade and Storage segment uses for its own needs the working capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica underground gas storage facilities, as well as the Mogilno and Kosakowo underground gas storage cavern facilities. A part of the working capacity of the Mogilno facility, which was made available to OGP GAZ-SYSTEM S.A., is not a storage facility within the meaning of the Polish Energy Law.

Short-term peak fluctuations in demand for natural gas may be balanced by the supplies from the Mogilno and Kosakowo facilities, where gas is stored in worked-out caverns. The capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica facilities are used to minimise the effect of changes in demand for natural gas in the summer and winter seasons, to meet the obligations under the take-or-pay import contracts, to ensure the continuity and security of natural gas supplies, and to meet the obligations under contracts for gas deliveries to customers' premises.

The capacities of the Wierzchowice, Husów, Mogilno and Strachocina facilities are also used by PGNiG S.A. to meet its obligation to maintain mandatory stocks, imposed by the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on the Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market, dated February 16th 2007.

Storage capacities of PGNiG S.A.'s facilities are managed by Operator Systemu Magazynowania Sp. z o.o.

In H1 2014, Operator Systemu Magazynowania Sp. z o.o. carried out settlements relating to storage services based on the rates provided for in the amendment to Gas Fuel Storage Tariff No. 1/2012 of December 17th 2012. By way of decision of July 2nd 2014, the President of the Energy Regulatory Office approved Gas Fuel Storage Tariff No. 1/2014 for the period until March 31st 2015. The new tariff accounts for the new storage capacities made available at the Kosakowo cavern facility, as well as expanded capacities of the Wierzchowice and Strachocina facilities. Furthermore, the tariff provides for making settlements with customers in energy units starting from August 1st 2014.

By way of decision of May 16th 2014, the President of the Energy Regulatory Office expanded Operator Systemu Magazynowania Sp. z o.o.'s licence to reflect the increased working capacities of Wierzchowice (up from 575 mcm to 1,200 mcm) and Strachocina (up from 330 mcm to 360 mcm) facilities, and to include the Kosakowo cavern facility (51 mcm).

The new storage capacities of the Strachocina and Wierzchowice facilities began to be used to provide storage services on May 20th 2014, while the Kosakowo cavern facility launched its services on July 17th 2014 (i.e. the date on which Gas Fuel Storage Tariff No. 1/2014 became effective).

As at June 30th 2014, the PGNiG Group made available a total of 2,472.5 mcm of working storage capacity for third party access and for OGP GAZ-SYSTEM S.A.; of this volume, 2,451.0 mcm was made available under long-term agreements and 21.5 mcm – under short-term agreements. 0.39 mcm is allocated for the Mogilno cavern facility's own needs. The table below presents the working capacities and working capacities made available as at June 30th 2014.

Working capacities and working capacities made available at the storage facilities of the Trade and Storage segment

	Working storage capacities (mcm)	Working storage capacities made available (mcm)
Brzeźnica underground gas storage facility	65.0	65.0
Husów underground gas storage facility	350.0	350.0
Mogilno underground gas storage cavern facility	407.9	407.5
Kosakowo underground gas storage cavern facility	51.2	-
Strachocina underground gas storage facility	360.0	360.0
Swarzów underground gas storage facility	90.0	90.0
Wierzchowice underground gas storage facility	1,200.0	1,200.0
Total	2,524.1	2,472.5

5. Planned activities

Purchases of natural gas

In H2 2014, PGNiG S.A. will continue to purchase imported gas under the long-term contract with OOO Gazprom Export and short- and medium-term gas supply contracts with European suppliers. With a view to optimising the costs of gas purchases, the Company will purchase natural gas on the German market, under short-term contracts. The gas will be delivered using the virtual reverse flow service on the Yamal gas pipeline.

Separation of wholesale and retail trading

In order to meet the requirement to sell gas on the exchange market, in August 2014, PGNiG Obrót Detaliczny Sp. z o.o. will launch its operations. The company will purchase gas on the Polish Power Exchange to resell it to retail customers. End-user agreements will be automatically transferred to PGNiG Obrót Detaliczny Sp. z o.o. by way of universal succession.

Formation of PGNiG Obrót Detaliczny Sp. z o.o. is another step in the process of separating wholesale and retail trading, after the establishment of Wholesale Trading Division at PGNiG S.A. The Wholesale Trading Division took over the relations with customers who in the previous calendar year purchased more than 25 mcm of natural gas, who purchase gas directly from the fields, and who purchase crude oil. Launch of PGNiG Obrót Detaliczny Sp. z o.o.'s operations will ensure appropriate demand for natural gas sold on the power exchange and will enable fair competition between the PGNiG Group's subsidiary and other participants of the Polish gas market.

Co-generation support mechanism

On April 30th 2014, the Act Amending the Energy Law and Certain Other Acts came into force and reinstated the co-generation support mechanism. Under the Act, energy utilities selling electricity to end users are obliged to purchase and redeem certain number of certificates of origin for electricity produced by co-generation. The reinstated mechanism, which supports CHP plants, creates an opportunity for PGNiG S.A. to increase the volume of gas sold in this segment.

Storage

In H2 2014, PGNiG S.A. will continue work on extending the Mogilno cavern facility and the Husów facility. The Company will also continue the construction (begun in 2007) of the Kosakowo underground gas storage cavern for high-methane gas.

6. Risks related to Trade and Storage

Obligation to diversify imported gas supplies

The Council of Ministers' Regulation of October 24th 2000 on the minimum level of diversification of foreign sources of gas supplies prescribes the maximum share of gas imported from a single country in total gas imports in a given year. In previous years, the President of the Energy Regulatory Office instigated administrative proceedings to impose a fine on PGNiG S.A. for its failure to comply with the diversification requirement in 2007, 2008, 2009, 2010 and 2011. In a letter of April 28th 2014, the President of the Energy Regulatory Office notified PGNiG S.A. of administrative proceedings being instigated to impose a fine on PGNiG S.A. for its failure to comply with the obligation to diversify supplies of imported gas in 2012.

As long as the Regulation is not amended, the President of the Energy Regulatory Office will be able to impose fines on the Company for failing to comply with the diversification requirement until gas starts to be supplied from other sources (e.g. through the LNG terminal). The fine imposed on PGNiG S.A. for its failure to comply with the obligation to diversify supplies of imported gas in 2007–2008 was PLN 1,500,000 (on January 21st 2014, PGNiG S.A. appealed against the decision to the Warsaw Court of Appeals).

Deregulation of natural gas prices

PGNiG S.A. is the largest supplier of natural gas in Poland. However, the pending gas market deregulation in Poland is bound to trigger major changes, in the market itself and in the related legal framework. In 2012, a natural gas market was launched on the Polish Power Exchange. Under a decision of the President of the Energy Regulatory Office, PGNiG S.A.'s gas trading on the exchange is exempt from the tariff obligation. Furthermore, it is expected that prices of gas for end customers will be gradually liberalised as the process of deregulation of the natural gas market in Poland advances. The first customer group in respect of which the tariff requirement will be disapplied is those who purchased more than 25 mcm of natural gas in the previous calendar year. As a result of the expected changes, the Company's and the PGNiG Group's share in the natural gas market may fall, to the benefit of both existing and new gas trading entities.

As regards gas trading on the Polish Power Exchange, there is a risk that revenues from sale of natural gas will be lower than the cost of its purchase, as a result of the growing disparity between market prices of gas and of petroleum products, which still influence the prices in long-term import contracts.

Regardless of the gas price liberalisation, in Q2 2014 PGNiG S.A.'s customers increasingly often used alternative natural gas suppliers. This trend was particularly prevalent among largest industrial customers. The situation was caused mainly by the prices of natural gas on western markets, which were lower than prices in PGNiG S.A.'s tariff. The rate at which this trend continues indicates that failure to deregulate prices for this customer group strengthens the risk that the volumes of gas sold by PGNiG S.A. will decrease.

Take-or-pay gas delivery contracts

PGNiG S.A. is a party to four long-term take-or-pay contracts for gas fuel deliveries to Poland. The most important of these are the contracts with OOO Gazprom Eksport and Qatar Liquefied Gas Company Limited (3). Assuming that PGNiG S.A.'s customer portfolio remains unchanged, the volume of gas imports specified in the take-or-pay contracts will limit its purchases of spot gas, currently the most attractively priced. If PGNiG S.A. loses its market share, there is a risk that the Company will have to look for new opportunities to sell or utilise surplus gas to avoid payment of penalties for the uncollected quantities under the take-or-pay contracts, or to sell the surplus with a negative margin. There is also a risk that if Polskie LNG S.A. fails to place the LNG Terminal in operation by December 31st 2014, PGNiG S.A. will have to pay penalties for uncollected quantities of liquefied natural gas, as required under the take-or-pay contract with Qatar Liquefied Gas Company Limited (3). Another risk is that with the existing contract terms and market conditions, the tariffs approved by the President of the Energy Regulatory Office will not cover PGNiG S.A.'s weighted average cost of gas purchase.

Disruptions to gas supplies from the countries east of Poland

In H1 2014, there were no disruptions to gas imports from across Poland's eastern border. However, the unstable situation in Ukraine creates the risk that gas deliveries to European customers may be limited. PGNiG S.A. monitors the situation on the eastern market and is communicating with OOO Gazprom Eksport on an ongoing basis. The Russian supplier asserts that it is taking and will continue to take all measures to secure stable and uninterrupted supplies of natural gas to Poland in quantities specified in the contract. It also assumes that the Ukrainian party will fully conform with its obligations pertaining to transport of gas to European countries.

Section VIII: Distribution

1. Core business

In H1 2014, the segment's core business consisted mainly in the transmission of high-methane, nitrogen-rich and coal gas, as well as small amounts of propane-butane gas over the distribution network. Also, the segment was engaged in extending and upgrading the gas network and connecting new customers to the existing network and to new sections of the network.

Since January 1st 2014, all settlements of Polska Spółka Gazownictwa Sp. z o.o. with its customers have been performed based on Tariff No.1 for Gas Fuel Distribution Services and LNG Regasification Services, as approved by the President of the Energy Regulatory Office on December 17th 2013. In connection with the obligation to perform gas settlements in energy units, implemented as of August 1st 2014, the company applied for approval of the new tariff. The President of the Energy Regulatory Office, by virtue of a decision of June 18th 2014, approved Tariff No. 2 for Gas Fuel Distribution Services and LNG Regasification Services to be effective as of August 1st 2014.

In addition, the consolidated text of the Distribution Grid Code for Polska Spółka Gazownictwa Sp. z o.o., as approved by the President of the Energy Regulatory Office on December 23rd 2013, took effect on January 1st 2014 (from 6:00 am). On May 16th 2014, Polska Spółka Gazownictwa Sp. z o.o. filed with the President of the Energy Regulatory Office a draft of the new Distribution Grid Code containing changes in the method of settlements. As at the date of this report, the proceedings to approve the new Distribution Grid Code were still pending.

In H1 2014, Polska Spółka Gazownictwa Sp. z o.o. continued 18 projects involving construction, extension and modernisation of its distribution networks, for which agreements for EU co-financing under the Infrastructure and Environment Operational Programme had been signed. The key projects included:

- Construction of a high-pressure gas network connecting Szczytno, Młynowo and Muławki near Kętrzyn, and distribution network roll-out in the municipalities; in H1 2014, project design documents continued to be drafted for stage II of construction of the high-pressure gas pipeline from Szczytno to Rybno and the high-pressure gas pipeline from Młynowo to Muławki; construction work was also continued on the high-pressure gas pipeline from Rybno to Młynowo and on pressure reduction stations in Mikołajki and Muławki near Kętrzyn; work was also continued on the construction of grid connections in the project area;
- Construction of the south-eastern gas supply line for the city of Gdańsk, and distribution network roll-out in Wiślinka and Wyspa Sobieszewska; in H1 2014, work continued on design documentation for the distribution network roll-out in the Wiślinka and Żuławy communes and in Wyspa Sobieszewska; construction work was carried out in Wiślinka and Wyspa Sobieszewska; work was also continued on the construction of grid connections in the project area;
- Construction of the DN 300 high-pressure gas network connecting Brodnica, Nowe Miasto Lubawskie and Iława, and distribution network roll-out. The project involves construction of high-pressure gas pipelines from Brodnica to Nowe Miasto Lubawskie with a pressure reduction station, and from Nowe Miasto Lubawskie to Iława, as well as medium-pressure gas pipelines in Nowe Miasto Lubawskie and Kurzętnik; in H1 2014, construction work was continued on the high-pressure gas pipeline from Brodnica to Nowe Miasto Lubawskie (stage I), project design documentation was completed for the medium-pressure gas pipelines in Nowe Miasto Lubawskie and Kurzętnik and the high-pressure gas pipeline from Brodnica to Nowe Miasto Lubawskie (stage II) with a pressure reduction station in Kurzętnik; work also continued on the design and cost estimate documentation for the high-pressure gas pipeline from Nowe Miasto Lubawskie to

Iława and the medium-pressure gas pipeline from Dziarny to Iława; grid connections were also carried out in the project area;

- Distribution network roll-out in Blachownia, Herby, Wręczyca Wielka, Kłobuck, Opatów and Krzepice. Due to problems with the acquisition of real property titles in some areas of the project, the scope of the project was reduced to distribution network roll-out in Herby and Blachownia, i.e. approximately 3 km of high-pressure gas pipelines, approximately 43 km of medium-pressure pipelines, and two gas stations; in H1 2014, design work continued on the selected sections of the pipelines;
- Distribution network roll-out in the Włodawa area. The project comprises construction of a 58 km high-pressure gas pipeline from Kamień to Włodawa, with a 43 km medium-pressure gas network and three pressure reduction stations; the project is scheduled for completion in 2015; in H1 2014, the construction of high- and medium-pressure gas pipelines with auxiliary infrastructure (stage I, II and III) was continued; construction work started on the medium-pressure pipeline in Włodawa (stage IV, part 1), and design work continued for stage IV (part 2);
- Distribution network roll-out in the Włoszczowa and Małogoszcz communes. The project comprises construction of a 44 km high-pressure gas pipeline with pressure reduction stations, and a 35 km medium-pressure gas pipeline network with eight gas governor stations; the project is scheduled for completion in 2015; in H1 2014, construction and assembly work continued on stage I of the project, and construction work started on stage II of the project;
- Distribution network roll-out in the Chęciny and Sitówka Nowiny communes. The project comprises construction of a 4.5 km high-pressure gas pipeline with a pressure reduction station, and a 63 km medium-pressure gas pipeline network with connections and gas governor stations; the project is scheduled for completion in 2015; in H1 2014, construction work continued on stage I of the project, which included construction of high- and medium-pressure pipelines with auxiliary infrastructure; at the same time, design work continued on stage II;
- Natural Gas – Energy for Future Generations project, and distribution network roll-out in the Osiek and Rypin communes. The project involves construction of a medium-pressure gas pipeline with a total length of ca. 50 km, running through the Osiek and Rypin communes; in H1 2014, construction of the medium-pressure gas pipeline in Osiek was completed; work was also completed on the design documents for the medium-pressure pipeline in Rypin (stage II);
- Distribution network roll-out in selected localities in the Strzelin and Wiązów communes, Strzelin county. The project involves construction of high-pressure and medium-pressure gas pipelines with connections, two pressure reduction stations, as well as connections and a pressure reduction station for a key customer; in H1 2014, design work on the high-pressure gas network was completed, and construction work on the project started.

The Company also implemented seven investment projects under the Regional Operational Programmes.

In H1 2014, the Company also pursued projects financed directly with its own funds. Key among these were:

- Continued design work on the upgrade of a 61 km high-pressure gas pipeline from Sandomierz to Ostrowiec Świętokrzyski; the project completion date was rescheduled to 2016;
- Continued work on the upgrade of the Łódź Ring, including the upgrade of the high-pressure gas pipeline from ul. Konstantyna to Meszcze. The project involves a series of tasks whose execution will enable the technical condition of the gas network to be improved, and also provides for the redevelopment of ca. 52 km of gas pipelines, overhaul and upgrading work on gas stations on the gas pipelines of the Łódź Ring and the construction of high-pressure regulating stations; execution of the individual stages of the project is scheduled until 2020; in H1 2014, work on the Brzezińska station was completed and work on the Olechów station continued; design work was carried out on the Łódź–Smulsko high-pressure gas station;

- Continued design work on the upgrade of a 37 km high-pressure gas pipeline from Parszów to Kielce. The project is scheduled for completion in 2015;
- Continued design work on the upgrade of a 21 km section of the high-pressure gas pipeline from Lubienia to Parszów;
- Continued design work on the upgrade of a 5 km Jasło section of the high-pressure gas pipeline from Warzyce to Gorlice; construction and assembly work on the remaining 14.2 km of the pipeline was completed;
- Distribution network roll-out in Przasnysz and Chorzele. The project involves construction of a high-pressure reduction station, two increased medium-pressure reduction stations, a 65 km increased medium-pressure pipeline and a 7 km medium-pressure pipeline; in H1 2014, design work continued on gas stations and increased medium-pressure pipelines;
- Connecting PGE Górnictwo i Energetyka S.A., Zespół Elektrociepłowni Bydgoszcz Branch, to the gas network. The project involves construction of high-pressure gas pipelines with a total length of ca. 53 km and construction of a high-pressure metering station; in H1 2014, design work was carried out on stage I of the project;
- Connecting the Michelin Polska S.A. Production Plant to the gas network. The project involves construction of a 22 km high-pressure gas pipeline, as well as construction of a high-pressure metering station and a 3 km high-pressure connecting pipeline; in H1 2014, the contractor was selected to draft the project's design documents.

The table below presents segment's key operating data.

	Unit of measure	Jun 30 2014
Volume of gas transmitted via the distribution system*	mcm	4,984.0
- high-methane gas	mcm	4,616.5
- nitrogen-rich gas	mcm	240.0
- propane-butane-air and decompressed propane-butane	mcm	0.9
- coal gas	mcm	126.6
Length of network, excl. connections**	km	123,569.6
No. of customers	million	6.8
No. of new customers connected to the network	('000)	30.1

*Measured as high-methane gas equivalent.
**Own and third-party networks.

2. Planned activities

In H2 2014, Polska Spółka Gazownictwa Sp. z o.o. will mainly continue working on projects for which EU co-financing agreements have been signed and projects financed with its own funds.

Polska Spółka Gazownictwa Sp. z o.o. will also focus on maintaining its market position and increasing the volumes of transmitted gas by taking the following measures:

- Extending the pipeline infrastructure to reach new customers,
- Ensuring adequate transmission capacity and securing sources of gas supply for the gas distribution system,
- Upgrading high-, medium- and low-pressure networks,
- Deploying new LNG-based gas distribution systems,
- Improving the quality of customer service,
- Using EU funds to refinance the extension of distribution systems.

3. Risks related to distribution

Direct competition

Liberalisation of the gas market is contributing to intensified competition in the segment. Companies distributing natural gas are progressively expanding their gas networks and attracting new customers. Additionally, companies have emerged which offer LNG distribution services. The market entry barriers are significantly lower here, as LNG distribution involves much lower capital expenditure and does not require a connection to the gas system or adequate reserve capacity to be maintained in the transmission and distribution networks. Another issue which affects the segment's competitive position is the tariff policy of the Energy Regulatory Office, which makes it difficult for the PGNiG Group to operate a flexible pricing policy for some groups of customers. With the lack of flexible pricing, competitors' offers may prove to be an attractive alternative to the PGNiG Group's customers.

Legislation

The complex provisions of the Construction Law and regulations governing implementation of investment projects impose the obligation to prepare extensive project and legal documentation, which is an integral part of any investment process. Preparation of the documentation protracts the time needed for project preparation and thus may significantly delay project execution and expose the company to the risk of cost overruns caused by potential delays in contract performance, as well as to the risk of lower revenues.

Sources of gas supply for the distribution system

Polska Spółka Gazownictwa Sp. z o.o.'s distribution network is connected to the transmission system operated by OGP GAZ-SYSTEM S.A., which is its main source of gas supplies. The transmission system's limited capacity in terms of the volume and pressure of supplied gas hinders or renders impossible further development of the gas grid within the company's key areas of operation.

Claims raised by property owners

More and more frequently, the PGNiG Group is facing excessive financial claims raised by owners of land plots where the gas network was developed in the past. Under applicable laws, Polska Spółka Gazownictwa Sp. z o.o. does not hold clear legal title to use these land plots – no transmission easements have been established. Transmission easement serves as a basis for determining the extent of the use of third-party property by a transmission company, for which relevant consideration is due to the owner. The owners' claims give rise to additional, frequently considerable costs, and thus may adversely affect the financial performance of the segment.

Tariff policy

By setting tariffs, the President of the Energy Regulatory Office, citing social considerations, limits the growth of regulated revenue, which is the basis for calculation of charge rates. Furthermore, the protracting tariff approval proceedings result in tariffs becoming effective later than as requested by PGNiG, leading to lower revenue from provision of distribution services.

Section IX: Generation

1. Segment's operations

In H1 2014, the segment's business consisted in the production of heat and electricity, as well as execution of major natural gas-fired projects in the power sector.

Licences

As at June 30th 2014, PGNiG TERMIKA S.A. held an electricity trading licence valid until December 31st 2030, as well as the following licences, each valid until December 31st 2025:
- for production of heat
- for transmission and distribution of heat
- for production of electricity.

Tariffs

In H1 2014, the tariff approved by the President of the Energy Regulatory Office on June 12th 2013 was applicable to the heat produced by PGNiG TERMIKA S.A.'s generating units (the Żerań CHP plant, Siekierki CHP plant, Pruszków CHP plant, Wola heating plant and Kawęczyn heating plant), and for the transmission and distribution of heat via the heating network supplied from the Pruszków CHP plant.

Until October 31st 2014, the company is required to apply the following tariffs for the transmission of heat through the heating network in the following areas:
- Marsa Park – tariff approved on May 17th 2013,
- Annopol – tariff approved on May 17th 2013,
- Marynarska – tariff approved on August 13th 2013,
- Chełmżyńska – tariff approved on May 17th 2013,
- Jana Kazimierza – tariff approved on August 13th 2013.

Moreover, until April 30th 2015, the company is also required to apply the tariff for the production of heat at the Regaty heating plant and transmission of heat through the heating network in the Regaty residential estate − tariff approved on January 8th 2014.

Production

PGNiG TERMIKA S.A.'s key products are heat and electricity. In H1 2014, 93% of total electricity output was electricity cogenerated with heat. The table below presents PGNiG TERMIKA S.A.'s production volumes.

Electricity and heat production volumes

Product	Unit of measure	Volume
Electricity	GWh	2,381.6
Heat	TJ	20,923.8

The company also provided Network Constrained Generation services under an agreement with PSE Operator S.A., pursuant to which the company maintains a long-term plant margin and keeps a specific number of generating units available, so as to overcome limitations in the operation of power sources in the national power system and to ensure Warsaw's energy security. PGNiG TERMIKA S.A.

is required to generate electricity whenever so instructed by the Transmission System Operator. In performance of the agreement, by June 30th 2014 the company had generated 87.6 GWh of electricity.

Sales

In H1 2014, PGNiG TERMIKA S.A. sold 20,770 TJ of heat. PGNiG TERMIKA S.A. sold heat mainly to Dalkia Warszawa S.A. which purchased 95.9% of the heat generated by the company. In 2014, Dalkia Warszawa S.A. contracted 3.6 GW of PGNiG TERMIKA's heat generation capacity. The balance of the produced heat was sold to local customers, mainly in Pruszków and the surrounding areas.

In H1 2014, PGNiG TERMIKA S.A. sold 2,037.8 GWh of electricity, including 78.4 GWh under its Network Constrained Generation services. The key customer for electricity generated at PGNiG TERMIKA S.A.'s plants was PGNiG S.A., with its aggregate share in the company's electricity sales volume reaching 99% in H1 2014. The company also sold electricity to smaller customers.

Construction of a CCGT unit in Stalowa Wola

In H1 2014, as part of the project to construct a CCGT unit in Stalowa Wola (executed jointly with Tauron Polska Energia S.A.), construction and assembly work was carried out, which included: erection of the recovery boiler's supporting structure, roofing of the steam turbine building, erection of side walls of the turbine house, and construction of the cooling water pump house. Basic and auxiliary equipment was also transported to the construction site. In the period under review, the acceptance of stage I of work on the San river weir took place, and work on stage II of the project commenced.

2. Planned activities

In H2 2014, PGNiG TERMIKA S.A. will seek to develop the heating distribution system by entering into heat sale contracts directly with end customers on a third-party-access (TPA) basis.

In H2 2014, management of the electricity portfolio and commercial balancing for PGNiG TERMIKA S.A. will be performed through PGNiG Energia S.A., which trades in electricity on the Commodity Derivatives Market. In addition, PGNiG S.A. will be the key customer for electricity generated at PGNiG TERMIKA S.A.'s plants.

April 30th 2014 saw entry into force of the amended Energy Law, which reintroduced the support system for electricity cogeneration by reinstating the obligation to hold and redeem red certificates (23.2% of the portfolio of electricity supplied to end users) and yellow certificates until the end of 2018. Certificates are issued for generation of electricity using high-efficiency co-generation technology. Proceeds from the sale of certificates of origin will add to the revenue of PGNiG TERMIKA S.A., which will be able to use the extra funds to continue the upgrade of its existing assets. This will increase the efficiency of cogeneration, which in turn will improve the competitiveness of PGNiG TERMIKA S.A.

3. Generation risks

More stringent gas and dust emission standards

In order to meet the more stringent gas and dust emission standards expected to be effective as of 2016, producers will have to thoroughly modernise their power and CHP plants and may be forced to shut down a number of generating units (to a total capacity 4,000–6,000 MWe by 2020) where installation of expensive flue gas treatment systems is not economically viable.

Maintaining share in the municipal heat market

Following expansion of the Warsaw municipal waste incineration plant, the quantity of heat supplied to the city's municipal network will increase. As a result, PGNiG TERMIKA S.A.'s share in total heat supplies to the Warsaw municipal network will fall from the current 98%, to 95% in 2019.

Marketing efforts conducted jointly with Dalkia Warszawa S.A., and connecting further western districts of Warsaw to the municipal heating network should significantly reduce potential future decline in the volume of energy produced at PGNiG TERMIKA S.A.'s generating plants. To maintain its share in the municipal heat market, the company will also offer "green" heat generated at biomass-fired units, and will continue to sell energy at competitive prices and take advantage of the TPA rule to gain access to new end users.

Section X: Other Activities

1. Segment's operations

In H1 2014, the segment's companies conducted work involving construction and assembly of gas transmission pipelines, gas compressor stations, and distribution and metering nodes, as well as development of hydrocarbon deposits. They were also involved in production of drilling equipment, design of systems, including gas transport systems, and provision of hotel, restaurant and spa centre services.

The services offered by the segment were provided to both third-party customers and PGNiG Group companies. The key projects executed in H1 2014 included construction and assembly of high-pressure gas pipelines, gas distribution and metering nodes and gas compressor stations, as well as production of drilling equipment and spare parts for drilling rigs and drillships.

The key projects executed for third-party customers included:
- Construction of the 175.2 km DN 700 high-pressure gas pipeline from Rembelszczyzna to Gustorzyn, for OGP GAZ-SYSTEM S.A.,
- Construction of a 20.1 km section of the DN 700 high-pressure gas pipeline from Trojane to Vodice, for Plinovodi d.o.o. (Slovenia),
- Construction of a 64 km section of the DN 700 high-pressure gas pipeline from Szczecin to Gdańsk (stage I: Płoty–Karlino section) for OGP GAZ-SYSTEM S.A.,
- Construction of the Jeleniów II Gas Compressor Station for OGP GAZ-SYSTEM S.A.,
- Upgrade of the Hermanowice distribution and metering node for OGP GAZ-SYSTEM S.A.,
- Development of the Komorze natural gas field for FX Energy Poland Sp. z o.o.,
- Production of drilling rig and drillship equipment parts for Aker Solutions (Norway),
- Assembly of HDPE pipelines, valves and hydrants under the Polish LNG Project for Saipem S.P.A. S.A. Polish Branch,
- Production of construction equipment parts for EXACTA Sp. z o.o.

In addition, work performed by the segment's companies for third-party customers included: preparation of design documents and author's supervision of investment projects related to the construction of the oil terminal in Gdańsk, engine repairs, as well as hotel, restaurant and spa centre services.

Projects executed by the segment for PGNiG S.A. included commencement of work under construction and assembly contracts such as:
- Construction of the water-injection system for the BMB (Barnówko–Mostno–Buszewo) field,
- Development of gas wells at the Łapanów and Krasne gas production facilities,
- Changes in the configuration of gas compressors for the Wierzchowice underground gas storage facility (reversible operation of gas compressors),
- Completion of construction of the Wierzchowice underground gas storage facility (completion of a project previously constructed by PBG).

The segment's work for PGNiG S.A. also included continued assembly of a new compressor at the Husów underground gas storage facility and modernisation of a gas compressor station in Żuchlów, as well as manufacture of well equipment, such as casing heads and production wellheads.

The most important contracts executed for other PGNiG Group companies included:
- Installation of four nodes and ten block/bleed systems for the DN 700 high-pressure gas pipeline from Gustorzyn to Odolanów,

- Construction work on the 23.9 km DN 300 high-pressure gas pipeline from Rybno to Młynowo,
- Extension of the Mogilno underground gas storage cavern facility.

In addition, the segment's work for other PGNiG Group companies included preparation of gas infrastructure technical and design documents.

2. Planned activities

In H2 2014, the segment will continue its ongoing construction and assembly projects, including the construction of high-pressure gas pipelines and gas compressor stations, and the installation of nodes and block/bleed systems for high-pressure gas pipelines. The segment's companies intend to maintain their market positions in the manufacturing of drilling equipment, including well surface equipment for conventional and unconventional deposits, drilling platforms, and equipment for oil and gas production facilities; and also in the gas system design, construction and assembly services for oil and gas facilities.

3. Risks related to Other Activities

Legislation

Administrative regulations and procedures on the preparation of investment projects and obtaining building permits, including in particular regulations governing compliance with environmental requirements, may significantly delay project execution and expose the segment to the risk of cost overruns caused by potential delays in contract performance, and to the risk of lower revenue. The Public Procurement Law and other regulations which stipulate contract price as the only criterion in bid evaluation cause the segment's companies to lose out to competitors offering lower prices for inferior quality services.

Competition

The operations of companies offering construction and assembly services, design services, as well as manufacturers of drilling equipment, are significantly exposed to growing competition from foreign companies, both those operating in their local markets abroad and those entering the Polish market, and from Polish market players. Given the current level of investment in the segment's area of operations, the growing competition results in a continued downward pressure on prices for the services offered by the segment companies. As far as designing of gas transmission installations is concerned, acquisition of medium-sized design companies by large contractors and setting up of new design units within gas industry operators are unfavourable phenomena which adversely affect the segment companies' ability to form consortia with project execution companies and secure new orders. Another major risk in this area is the growing competition from new business groups and international engineering corporations.

Qualified personnel

Increasing competition from local and foreign companies on the Polish market has intensified the process of highly qualified employees with extensive professional experience leaving and taking up employment with the competitors.

Section XI: Investments

In H1 2014, capital expenditure incurred by the PGNiG Group on property, plant and equipment and intangible assets was PLN 901.8m. Over the same period, capital expenditure of PGNiG S.A. totalled PLN 440.4m. The table below presents the Group's expenditure in the individual segments.

Capital expenditure (PLNm)

	H1 2014
Exploration and Production	457.1
Trade and Storage	126.6
Distribution	216.6
Generation	96.9
Other Activities	4.6
Total	901.8

Below are described the key capex projects implemented by the PGNiG Group in H1 2014.

Exploration and Production

The capital expenditure incurred in H1 2014 in the Exploration and Production Segment amounted to PLN 457.1m.

The capital expenditure of PLN 188.7m incurred by PGNiG S.A. on exploration work comprised chiefly the cost of geophysical surveys, two wells drilled with positive results, and wells on which work is still underway. The segment's other investment projects involved the development of documented gas reserves (including already producing fields), projects executed to sustain or restore hydrocarbon production rates, and projects for the operation of the hydrocarbon production area. The key investment projects included:

- Completion of development of the Skarv and Idun fields,
- Completion of development of the Lisewo gas field,
- Completion of development of a well in the Radlin field,
- Upgrade of the processing line at the Zielin oil and gas production facility and development of the Różańsko field,
- Drilling work and development of a well in the Daszewo field,
- Drilling work and development of wells in the Brońsko field,
- Drilling work and development of a well in the Maćkowice3K field,
- Development of the Księżpol 19 well.

Trade and Storage

The capex of the Trade and Storage segment amounted to PLN 126.6m. In H1 2014, major investment projects included:

- Removal of defects in the power section (the turboexpander) of the Wierzchowice underground gas storage facility,
- Leaching of three caverns (K-2, K-3 and K-5) and continuation of drilling work on next five caverns at the Kosakowo underground gas storage cavern facility,

- Completion of leaching at the Mogilno underground gas storage cavern facility (caverns Z-15 and Z-17),
- Continuation of construction and assembly work at the Husów underground gas storage facility.

On April 2nd 2014, PGNiG S.A. terminated its contract with the consortium contracted to carry out construction work at the Wierzchowice underground gas storage facility, comprising PBG S.A. w upadłości układowej (in company voluntary arrangement), Tecnimont S.p.A., Société Française d'Etudes et de Réalisation Equipements Gazier SOFREGAZ, Plynostav Pardubice Holding A.S. and Plynostav – Regulace Plynu A.S. in organisational bankruptcy. The grounds for the termination were improper performance of the project in conflict with the contract, as well as a delay in execution of work exceeding 30 business days, which continued unrectified even though the consortium had been given an extended deadline to remove the default. The work related to the power section (the turboexpander) of the Wierzchowice underground gas storage facility will be completed by PGNiG Technologie S.A.

In H1 2014, PGNiG S.A. continued a project consisting in LNG-based distribution of gas fuel to customers in Ełk and Olecko. This project is a part of an initiative to switch Pisz, Ełk, Suwałki and Olecko to high-methane gas (PESO project), and involves construction of an LNG regasification station and two-step pressure reduction, metering and odorising stations in Ełk and Olecko, and switching customers in those towns to high-methane gas. In H1 2014, the Company continued work on the construction of an LNG regasification station and pressure reduction and metering stations in Ełk and Olecko.

<u>Distribution</u>

Capital expenditure incurred by the PGNiG Group in the Distribution segment amounted to PLN 216,6m. The capex budget was spent on upgrading and extending the gas network and on connecting new customers. For a discussion of key projects in the Distribution segment, see Section VIII Distribution.

<u>Generation</u>

Capital expenditure of the Generation segment amounted to PLN 96.9m, of which approximately PLN 13.9m was spent on environmental protection projects. Furthermore, in H1 2014 the Generation segment continued some of the investment projects commenced in previous years. The most important of these were:

- Construction of a 450MW CCGT unit at the Żerań CHP plant; in H1 2014, design documents were completed for individual stages of the project,
- Conversion of the K1 boiler at the Siekierki CHP plant into a biomass-fuelled unit; in H1 2014, the construction design was completed, a building permit was obtained, and construction work related to dismantling of the boiler's auxiliary equipment and pressurised section, and preparing the site for biomass use was commenced,
- Conversion of the Pruszków CHP; in H1 2014, the contractor was selected to construct the water treatment plant,
- Construction of a gas- and oil-fired peak-load and reserve boiler house at the Żerań CHP plant; in H1 2014, the tender procedure was cancelled, as all bids exceeded the planned budget.

In addition, the segment continued upgrading projects on:

- Dust collectors of fluidised bed boilers at the Żerań CHP plant,
- K8 and K9 boilers at the Siekierki CHP plant,
- K2, K3 and K4 boilers at the Wola Heating plant.

Other Activities

In H1 2014, the Other Activities segment incurred capital expenditure on property, plant and equipment and intangible assets of PLN 4.6m. Major investment projects included purchase of production plant and equipment, software, buildings and structures, and vehicles.

Section XII: Environmental protection

Well and extraction pit abandonment

Pursuant to the Polish Geological and Mining Law, PGNiG S.A. is required to properly abandon worked-out extraction pits, eliminate the danger and repair any damage caused by mineral extraction, and restore the land to its original condition. Plugging of wells and pits prevents leakage of crude oil and natural gas to the surface and into water courses. Furthermore, if gas wells remain unplugged, there is a risk that escaping gas could accumulate, posing a fire hazard. In H1 2014, a total of 23 wells and 8 extraction pits were abandoned.

Carbon credit trading system (EU ETS)

In H1 2014, the PGNiG Group reviewed annual reports on its carbon dioxide emissions for 2013. Carbon emissions from the Group's installations covered by the EU ETS scheme totalled 6,111,102 Mg. After reconciling its CO_2 emissions with emission rights held, and after redeeming the allowances allocated for 2013, a deficit of 2,587,715 Mg CO_2 free emission units was identified. The deficit was covered with reserves accumulated in the accounts of the Group installations (unused free allocations from previous years) and with allowances purchased on the Intercontinental Exchange Futures Europe. The PGNiG Group facilities covered by the EU ETS system in 2013 were the installations of PGNiG TERMIKA S.A. (the Siekierki, Żerań and Pruszków CHP plants and the Kawęczyn and Wola heating plants), the Zielona Góra Branch and the Odolanów Branch, as well as the Mogilno underground gas storage cavern facility and the LMG oil and gas production facility. In H1 2014, the Group emitted 3,208,552 Mg of CO_2 from its installations.

In the current trading period (2013–2020), the free allocation of CO_2 emission allowances covers only a part of the actual emissions. The free allocations will decrease gradually, reaching zero in 2027.

Land reclamation and non-productive asset surveying

Pursuant to the Environmental Protection Law, PGNiG S.A. conducts diagnostic tests, surveys and land reclamation work in areas polluted in the course of past activities, with a view to restoring them to the condition required under the environmental quality standards. In H1 2014, recultivation work continued on a property in Warsaw. The land reclamation work involved decommissioning of tar pits and removal of local soil contaminations (most often found near reservoirs) through their extraction and neutralisation by operators contracted by the Company. The Company also monitored the soil-water environment of the reclaimed landfill site and a property in Zabrze.

REACH and CLP

In H1 2014, PGNiG S.A. supervised compliance by its subcontractors using chemical substances for well treatments with the regulations of the European Parliament and of the Council of the European Union on safe use of chemicals (REACH) and on the classification, labelling and packaging of substances and mixtures (CLP). At the request of the Polish Exploration and Production Industry Organization, the Company also compiled a list of all substances and mixtures it had used for fracturing operations.

Reclamation of the fuel ash landfill site

PGNiG TERMIKA S.A. is carrying out reclamation of the Myśliborska fuel ash landfill site for the Żerań CHP plant. The project will involve reclamation of the land as green areas (Cells No. 1 and 2) and for residential and commercial development (Cell No. 3). In H1 2014, technical reclamation of Cell No. 2 continued, earth for filling Cell No. 3 was acquired, and technical infrastructure connecting the Żerań CHP plant with the landfill was being disassembled. All of the reclamation work is scheduled to be completed in 2016.

Noise reduction project at the Siekierki CHP plant

In H1 2014, noise barrier walls around coal unloading points located at the hump tracks on the plant's premises were completed. As part of the same project, noise barrier walls were constructed along the eastern boundary of the CHP plant in 2013. The purpose of the project was to reduce the risk of exceeding the permitted noise levels during the execution of future projects at the Siekierki CHP plant.

Biomass supplies

In order to fulfil the requirements of Directive 2009/28/EC on the promotion of the use of energy from renewable sources and use of biomass other than forest biomass, that is biomass from plantations and energy plant crops at commercial power plants (Regulation of the Minister of Economy dated October 18th 2012), PGNiG TERMIKA S.A. procures the fuel under long-term contracts for the supply of biomass from energy willow plantations. Currently, the company procures biomass from plantations with a total area of ca. 386 ha. Thanks to the use of biomass as a fuel, CO_2 emissions were reduced by 61,704 Mg in H1 2014.

Section XIII: Other information

Distribution of the 2013 profit

On May 15th 2014, the Annual General Meeting of PGNiG S.A. adopted a resolution on the distribution of the 2013 net profit of PLN 1,688.6m. The profit was distributed as follows:

- PLN 797.0m was allocated to the Company's statutory reserve funds,
- PLN 885.0m was allocated for dividend payments (dividend per share of PLN 0.15),
- PLN 6.6m was allocated to cover accumulated losses taken over by PGNiG S.A. on merger with PGNiG Energia S.A.

The Annual General Meeting of PGNiG S.A. set August 14th 2014 as the dividend record date and September 4th 2014 as the dividend payment date.

Discharge granted to Management Board and Supervisory Board members in respect of their duties

On May 15th 2014, the Annual General Meeting of PGNiG S.A. approved the financial statements and the Directors' Report on the operations of PGNiG S.A., as well as the consolidated financial statements and the Directors' Report on the operations of the PGNiG Group, and granted discharge to members of the Management and Supervisory Boards of PGNiG S.A. in respect of their duties in the financial year 2013.

Proceedings before the President of the Polish Office of Competition and Consumer Protection (UOKiK)

On December 28th 2010, the President of the Polish Office of Competition and Consumer Protection ("UOKiK") instigated, ex officio, anti-trust proceedings concerning alleged abuse by PGNiG S.A. of its dominant position on the domestic natural gas wholesale market, which consisted in inhibiting sale of gas against the interests of other business players or consumers and in impeding the development of market conditions necessary for the emergence or development of competition by refusing to sell gas fuel under a comprehensive supply contract to an entrepreneur that intended to further resell the gas, i.e. NowyGaz Sp. z o.o. of Warsaw. In its decision of July 5th 2012, the President of UOKiK found these practices to be anti-competitive, concluded that PGNiG S.A. had discontinued those practices as of November 30th 2010, and imposed on the Company a fine of PLN 60,016,474.40. On July 24th 2012, PGNiG S.A. filed an appeal against the decision of the President of the UOKiK with the Competition and Consumer Protection Court at the Regional Court of Warsaw. In the judgement of May 12th 2014, the Regional Court of Warsaw dismissed PGNiG's appeal. On June 4th 2014, PGNiG S.A. appealed against the decision to the Warsaw Court of Appeals. As at the date of this report, the Warsaw Court of Appeals had not notified PGNiG S.A. of a hearing date.

On February 22nd 2013, the President of UOKiK instigated anti-trust proceedings concerning alleged employment by PGNiG S.A. of practices infringing collective consumer interests. The President of UOKiK accused PGNiG S.A. of using provisions classified as abusive clauses in contract forms based on which comprehensive gas fuel supply contracts are concluded. PGNiG S.A. voluntarily agreed to revise the above contract forms with respect to the questioned clauses. By virtue of a decision of June 28th 2013, the President of UOKiK resolved not to impose a fine on PGNiG S.A. and obliged the Company to fulfil its commitment. PGNiG S.A. is in the process of fulfilling this obligation.

On April 3rd 2013, the President of UOKiK instigated anti-trust proceedings concerning alleged abuse by PGNiG S.A. of its dominant position on the domestic wholesale and retail natural gas market, which consisted in impeding the development of market conditions necessary for the emergence or development of competition by:

- limiting the ability of business customers to reduce ordered volumes of gas fuel and contractual capacity,
- limiting the ability of business customers to resell gas fuel,
- requiring that business customers define the maximum volume of gas fuel purchased for resale in the contract,
- refusing to grant wholesale customers the right to a partial change of supplier.

In the course of the proceedings, PGNiG S.A. voluntarily agreed to revise certain provisions in contracts with its non-household customers. By virtue of a decision of December 31st 2013, the President of UOKiK resolved not to impose a fine on the Company and obliged the Company to fulfil its commitment. PGNiG S.A. is in the process of fulfilling this obligation.

Entry of PGNiG trade unions into a collective dispute with the employer

On July 9th 2014, a collective dispute was initiated between PGNiG trade unions and the PGNiG Management Board, after the Management Board had rejected demands put forward by the trade unions.

Given the Company's current standing, including the ongoing PGNiG Group Efficiency Improvement Programme, the Management Board decided not to grant the demands put forward by the PGNiG trade unions, which concerned setting the remuneration growth rate for 2014 at 5.59% per year, increasing the value of vouchers to PLN 2,000 per year, and revoking the termination of Agreements on Annual Bonus of March 27th 2013 and June 24th 2013.

The Management Board declares that it will make every effort to resolve this dispute taking into account the Company's financial capacity**.**

Proceedings with a value in excess of 10% of the Company's equity

In H1 2014, neither PGNiG S.A. nor its subsidiaries were engaged in any proceedings before a court, arbitration tribunal or administrative authority concerning liabilities or claims whose value (whether in any single case or in two or more cases jointly) would represent at least 10% of the Company's equity.

Section XIV: Financial performance

The interim condensed consolidated financial statements of the PGNiG Group and the interim condensed separate financial statements of PGNiG S.A. for the six months ended June 30th 2014 have been prepared in accordance with the International Financial Reporting Standards (IFRS) as endorsed by the European Union as at June 30th 2014.

The accounting policies applied in preparing the interim condensed consolidated financial statements and the interim condensed separate financial statements are presented in the interim condensed consolidated financial statements of the PGNiG Group for the period of six months ended June 30th 2014.

1. Financial data of the Parent

Summary information on PGNiG S.A.'s financial performance in H1 2014 is presented below.

Financial highlights (PLNm)

	H1 2014	H1 2013
Revenue	13,689	14,504
Total operating expenses, including	(12,727)	(13,196)
Depreciation and amortisation	(353)	(353)
Operating profit	962	1,308
Profit before tax	1,555	1,676
Net profit	1,366	1,422
Net cash flows from operating activities	1,771	3,034
Net cash flows from investing activities	(167)	(916)
Net cash flows from financing activities	(1,009)	(1,551)
Net change in cash	595	567

Financial highlights (PLNm) – cont.

	Jun 30 2014	Dec 31 2013
Total assets	34,941	35,424
Non-current assets	26,613	26,946
Current assets	8,328	8,478
Total equity	23,231	22,969
Total non-current liabilities	7,175	7,023
Total current liabilities	4,535	5,432
Total liabilities	11,710	12,455
Total liabilities and equity	34,941	35,424

Financial ratios

Profitability

	H1 2014	2013
EBIT (PLNm) operating profit	962	1,308
EBITDA (PLNm) operating profit + depreciation/amortisation	1,315	1,661
ROE net profit to equity at end of the period	5.9%	6.2%
NET MARGIN net profit to revenue	10.0%	9.8%
ROA net profit to assets at end of the period	3.9%	4.0%

Liquidity

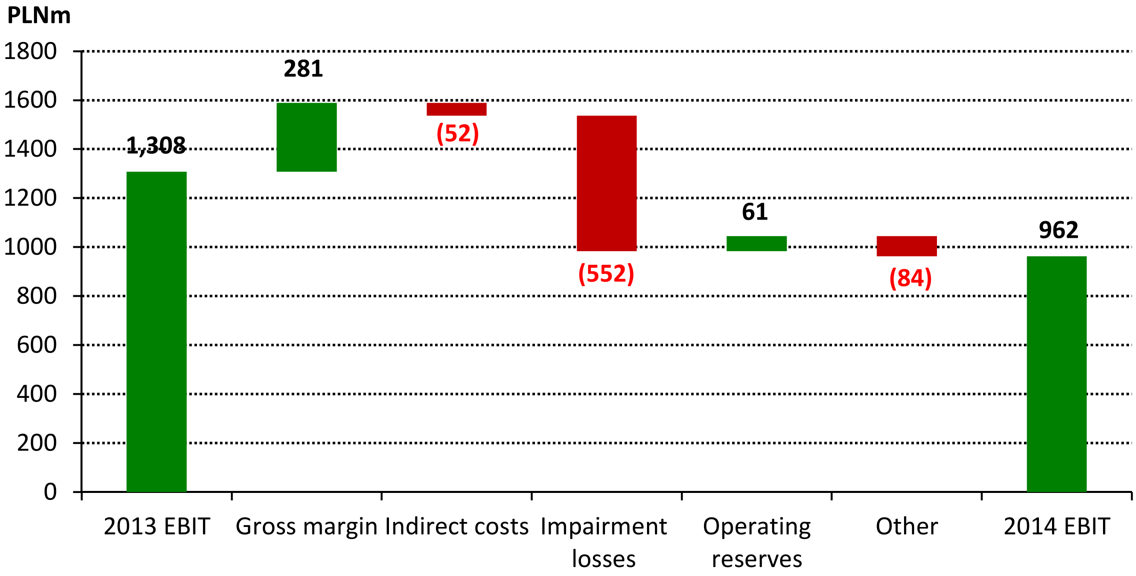
LIQUIDITY	Jun 30 2014	Dec 31 2013
CURRENT RATIO current assets to current liabilities (net of employee benefit obligations, provisions and deferred income)	2.0	1.7
QUICK RATIO current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred income)	1.4	1.2

Debt

DEBT	Jun 30 2014	Dec 31 2013
DEBT RATIO total liabilities to total equity and liabilities	33.5%	35.2%
DEBT/EQUITY RATIO total liabilities to equity	50.4%	54.2%

Year on year, the PGNiG S.A.'s operating profit (EBIT) decreased by PLN 346m. The chart below presents the items which contributed to the decrease.

Change in EBIT: H1 2013 vs H1 2014



Gross margin (the difference between revenue and direct cost) on sales of products and services was up PLN 281m, chiefly driven by higher margins on sales of high-methane gas, which improved following the introduction of the new PGNiG Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 6/2014) effective from January 1st 2014, and because of a 4% reduction in gas purchase costs. The lower gas purchase costs were attributable to a drop in gas prices at the TTF (Title Transfer Facility), as well as lower average exchange rate of the US dollar, which was the main currency used in settlements of gas imports. The margin on sales of other products was stable.

The decrease in operating profit was driven by recognition of impairment losses and write-downs of PLN 552m on:

- property, plant and equipment associated with hydrocarbon production,
- tangible exploration and evaluation assets under construction,
- inventories of high-methane natural gas.

In H1 2014, net finance income/cost was up PLN 225m year on year, driven by PLN 185m higher dividends from subsidiaries.

The Company's financial position was reflected in its key financial ratios. Return on equity (ROE) fell from 6.2% to 5.9%. Return on assets (ROA) was 3.9%, against 4.0% in 2013, and net margin increased from 9.8% to 10.0%.

2. Financial performance of the PGNiG Group

In H1 2014, the PGNiG Group's net profit was PLN 1,520m, up PLN 92m year on year. This increase was mainly attributable to substantially larger volumes of crude sold and higher margins on gas sales.

Summary information on the PGNiG Group's financial standing in H1 2014 is presented below in the financial statements prepared in accordance with the International Financial Reporting Standards, which comprise:

- statement of financial position,
- income statement,
- statement of cash flows,
- selected financial ratios.

Consolidated statement of financial position (PLNm)

ASSETS	Jun 30 2014	Dec 31 2013	Jan 1 2013
Total non-current assets	36,820	37,479	38,343
Property, plant and equipment	32,538	33,033	33,784
Investment property	9	9	11
Intangible assets	1,128	1,164	1,146
Investments in equity-accounted associates	728	727	771
Financial assets available for sale	49	51	48
Other financial assets	195	191	124
Deferred tax assets	2,104	2,233	2,383
Other non-current assets	69	71	76
Total current assets	10,377	10,905	10,833
Inventories	3,011	3,378	3,064
Trade and other receivables	3,084	4,086	5,374
Current tax assets	1	48	150
Other assets	393	171	84
Derivative financial instrument assets	224	307	105
Cash and cash equivalents	3,656	2,827	1,948
Assets held for sale	8	88	108
Total assets	47,197	48,384	49,176

Consolidated statement of financial position (PLNm) – cont.

LIABILITIES AND EQUITY	Jun 30 2014	Dec 31 2013	Jan 1 2013
Total equity	28,881	28,453	27,197
Share capital	5,900	5,900	5,900
Share premium	1,740	1,740	1,740
Accumulated other comprehensive income	(256)	(49)	(152)
Retained earnings	21,490	20,856	19,705
Equity attributable to owners of the parent	28,874	28,447	27,193
Equity attributable to non-controlling interests	7	6	4
Total non-current liabilities	12,268	12,093	12,366
Borrowings and other debt instruments	5,341	5,385	5,509
Employee benefit obligations	555	502	381
Provisions	1,569	1,405	1,792
Deferred income	1,577	1,533	1,448
Deferred tax liabilities	3,158	3,210	3,183
Other non-current liabilities	68	58	53
Total current liabilities	6,048	7,838	9,613
Trade and other payables	3,618	4,033	3,667
Borrowings and other debt instruments	792	2,276	4,702
Derivative financial instrument liabilities	413	124	393
Current tax liabilities	145	184	24
Employee benefit obligations	312	375	356
Provisions	539	645	350
Deferred income	229	186	101
Liabilities associated with assets held for sale	-	15	20
Total liabilities	18,316	19,931	21,979
Total liabilities and equity	47,197	48,384	49,176

Consolidated income statement (PLNm)

	H1 2014	H1 2013
Revenue	16,383	16,740
Total operating expenses	(14,214)	(14,566)
Raw material and consumables used	(9,509)	(10,838)
Employee benefits	(1,373)	(1,418)
Depreciation and amortisation	(1,298)	(1,162)
Services	(1,400)	(1,280)
Work performed by the entity and capitalised	375	424
Other income and expenses	(1,009)	(292)
Operating profit	2,169	2,174
Finance income	46	150
Finance costs	(152)	(383)
Share in net profit/(loss) of equity-accounted entities	-	(42)
Profit before tax	2,063	1,899
Income tax	(543)	(471)
Net profit	1,520	1,428
Attributable to:		
Owners of the parent	1,519	1,425
Non-controlling interests	1	3
Earnings and diluted earnings per share attributable to holders of ordinary shares of the parent (in PLN)	0.26	0.24

Consolidated statement of cash flows (PLNm)

	H1 2014	H1 2013
Net cash flows from operating activities	3,703	4,554
Net cash flows from investing activities	(1,239)	(1,559)
Net cash flows from financing activities	(1,634)	(2,283)
Net change in cash	830	712
Cash and cash equivalents at beginning of the period	2,826	1,947
Cash and cash equivalents at end of the period	3,656	2,659

Financial ratios

Profitability

	H1 2014	2013
EBIT (PLNm) operating profit	2,169	2,174
EBITDA (PLNm) operating profit + depreciation/amortisation	3,467	3,336
ROE net profit* to equity at end of the period	5.3%	5.0%
NET MARGIN net profit* to revenue	9.3%	8.5%
ROA net profit* to assets at end of the period	3.2%	2.9%

* Net profit for the financial year attributable to owners of the parent.

Liquidity

	Jun 30 2014	Dec 31 2013
CURRENT RATIO current assets to current liabilities (net of employee benefit obligations, provisions and deferred income)	2.1	1.6
QUICK RATIO current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred income)	1.5	1.1

Debt

DEBT	Jun 30 2014	Dec 31 2013
DEBT RATIO total liabilities to total equity and liabilities	38.8%	41.2%
DEBT/EQUITY RATIO total liabilities to equity*	63.4%	70.1%

* Equity attributable to owners of the parent.

Consolidated operating profit (EBIT) for H1 2014 was PLN 2,169m, relatively flat year on year, and EBITDA reached PLN 3,467m, up PLN 131m on H1 2013.

Exploration and Production

The H1 2014 operating profit (EBIT) of the Exploration and Production segment was PLN 1,316m, down PLN 59m (-4%) year on year. The segment's EBITDA was PLN 1,941m, up PLN 100m (5%) relative to the end of H1 2013. The segment's revenue rose by PLN 714m (26%) as a result of a 47% increase in sales volumes of crude oil, chiefly that produced from the Skarv field on the Norwegian Continental Shelf. A PLN 773m (58%) increase in operating expenses was a consequence of recognising impairment losses of PLN 343m on exploration and production assets in H1 2014. The impairment losses were recognised as a result of a change in the calculation of future cash flows (for impairment test purposes): previously the tariff price of gas was used in the calculations, while now they are based on the market price. This followed from changes on the gas market, in particular the gradual gas price deregulation and the requirement to sell gas on the exchange market. Moreover, in H1 2014 the Group decided to charge PLN 198m of expenditure incurred on dry wells and seismic data acquisition to the segment's expenses (due to licence relinquishment).

Trade and Storage

The Trade and Storage segment's operating result rose by PLN 50m year on year, to PLN 80m. This improvement follows from gas sales profitability increase from -2% in H1 2013 to almost 0.5% in H1 2014, attributable to a drop in gas prices quoted at TTF (Title Transfer Facility), lower average exchange rate of the US dollar (the main currency of import gas purchases), as well as the introduction of a new PGNiG S.A. Gas Fuel Tariff (Part A Gas Fuel Supply Tariff No. 6/2014) as of January 1st 2014. Moreover, the margin on gas sales benefited from lower quantities of imported gas thanks to mild winter.

Distribution

The Distribution segment's operating result (EBIT) rose by PLN 46m (7%) year on year, to PLN 682m. The segment benefited from a PLN 33m (-2%) fall in operating expenses. The increase in EBIT was achieved despite a 12% decline in the volume of transmitted gas. The gas transmission volume shrank as the average air temperature in H1 2014 was 2°C higher than in H1 2013.

Generation

The Generation segment posted an operating result (EBIT) of PLN 133m, down PLN 10m year on year. This minor decline was a product of an 8% fall in the segment's revenue and expenses. H1 2014 saw a drop in the volume of heat and electricity sold as a result of higher average air temperature.

Operating performance by segment

Financial data of the PGNiG Group's segments for H1 2014 (PLNm)

H1 2014	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to third-party customers	2,484	13,120	80	608	91	-	16,383
Inter-segment sales	942	186	2,239	427	59	(3,853)	-
Segment's total revenue	3,426	13,306	2,319	1,035	150	(3,853)	16,383
Segment's expenses	(2,110)	(13,226)	(1,637)	(902)	(204)	3,865	(14,214)
Operating profit/(loss)	1,316	80	682	133	(54)	12	2,169
Net finance costs	-	-	-	-	-	-	(106)
Share in net profit/(loss) of equity-accounted entities	-		-	-	-	-	-
Profit before tax							2,063
Income tax	-	-	-	-	-	-	(543)
Net profit							1,520

Financial data of the PGNiG Group's segments for H1 2013 (PLNm)

H1 2013	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to third-party customers	1,972	13,647	85	898	138	-	16,740
Inter-segment sales	740	180	2,221	230	55	(3,426)	-
Segment's total revenue	2,712	13,827	2,306	1,128	193	(3,426)	16,740
Segment's expenses	(1,337)	(13,797)	(1,670)	(985)	(203)	3,426	(14,566)
Operating profit/(loss)	1,375	30	636	143	(10)	-	2,174
Net finance costs	-	-	-	-	-	-	(233)
Share in net profit/(loss) of equity-accounted entities	-	(42)	-	-	-	-	(42)
Profit before tax							1,899
Income tax	-	-	-	-	-	-	(471)
Net profit							1,428

The result on financing activities was up PLN 169m on H1 2013. The increase is attributable to a PLN 209m drop in the loss on foreign exchange differences related to valuation of liabilities under eurobonds and a credit facility taken out by PGNiG Upstream International AS.

In H1 2014, the PGNiG Group's net profit amounted to PLN 1,520m, a year-on-year improvement of PLN 92m (6%) following from the better result on financing activities. The net profit was affected by a PLN 72m increase in tax expense, including mainly the tax related to realisation of the deferred tax asset on a tax loss of PGNiG Upstream International AS.

The PGNiG Group's financial position is reflected in its key financial ratios. Return on equity (ROE) went up to 5.3% in H1 2014 from 5.0% in H1 2013. Return on assets (ROA) was 3.2%, against 2.9% in H1 2013, and net margin rose from 8.5% to 9.3% in H1 2014.

Statement of financial position

As at June 30th 2014, total assets recognised in the consolidated statement of financial position were PLN 47,197m, down PLN 1,187m (-2.5%) on the end of 2013.

Assets

Property, plant and equipment represent the largest component of the Group's assets. As at the end of H1 2014, this item amounted to PLN 32,538m, having decreased PLN 495 (1.5%) relative to December 31st 2013, primarily due to higher impairment losses on exploration and production assets. Deferred tax assets went down by PLN 129m (5.8%) on realisation of the tax credits in Norway, which have been accounted for since the launch of gas production from the Skarv field.

Significant changes took place in trade and other receivables, which fell PLN 1,002m (24.5%) relative to December 31st 2013. Inventories as at the end of H1 2014 amounted to PLN 3,011m and were down PLN 367m on December 31st 2013. This drop follows from lower gas and coal inventories and recognition of a PLN 141m write-down on gas inventories. The above changes in current assets are related to seasonality of the Group's operations involving gas sale and heat and electricity production.

As at June 30th 2014, the Group's cash and cash equivalents stood at PLN 3,656m, up PLN 829m relative to the end of 2013. The increase was attributable to the excess of cash flows from operating activities (including payment of receivables from gas sales), totalling PLN 3,703m, over the PLN -1,634m cash flows from financing activities (including redemption of debt and loan repayment) and the PLN -1,239m cash flows from investing activities.

The value and structure of current assets held by the Group guaranteed its ability to settle all liabilities in a timely manner. The current ratio was 2.1, compared with 1.6 as at the end of December 2013, while the quick ratio rose from 1.1 to 1.5.

Equity and liabilities

Equity is the primary source of financing of the PGNiG Group's assets. Relative to the end of 2013, the Group's equity rose by PLN 428m (1.5%), primarily on the back of the net profit for the period of PLN 1,520m, adjusted for announced dividend of PLN 885m from the 2013 profit.

As at June 30th 2014, non-current liabilities were PLN 12,268m, up PLN 175m on the end of December 2013. The increase is an outcome of higher provisions for well decommissioning costs.

As at June 30th 2014, PGNiG Group's current liabilities amounted to PLN 6,048m, down PLN 1,790m (22.8%) on the end of 2013. This decrease followed mainly from loan repayment and redemption of debt securities, which reduced current liabilities by a total of PLN 1.484m.

Due to a decrease in external financing used by the PGNiG Group, the ratios of equity to liabilities changed. Debt to equity was down from 70.1% as at the end of 2013 to 63.4% as at June 30th 2014. Debt ratio (total liabilities to total equity and liabilities) fell from 41.2% to 38.8%.

Transactions concluded on non-arm's length terms

In H1 2014, no transactions were concluded on non-arms' length terms between related entities of the PGNiG Group.

Guarantees and sureties

In H1 2014, the Parent and its subsidiaries did not issue any sureties with respect to borrowings or guarantees, whose total amount would represent 10% or more of the Parent's or the subsidiary's equity.

Feasibility of meeting published performance forecasts

On February 28th 2014, PGNiG S.A. published a forecast of the PGNiG Group's consolidated performance in 2014. The forecast provides for the PGNiG Group's revenue of ca. PLN 32.7bn, EBITDA of ca. PLN 5.9bn and the debt ratio of no more than 2x EBITDA.

An analysis of the financial results for H1 2014, in the context of the seasonality and risks of the Group's business, has not revealed any material deviation from earlier projections which would pose a threat to delivery of the results.

3. Projected future financial standing

The PGNiG's financial performance will largely depend on oil, natural gas and petroleum product prices, the situation on currency markets, as well as the price of natural gas on the regulated market and on the Polish Power Exchange. Legislative changes are another driver of the PGNiG Group's financial results.

The prices of crude oil, petroleum products and gas are an essential factor determining the PGNiG Group's financial position. In H1 2014, Brent oil prices remained at around USD 110 per barrel. Natural hedging in the form of higher sales of crude oil and a change of pricing formulas in gas purchases from OOO Gazprom Export will reduce the sensitivity of the Group's performance to volatility in crude oil prices over the next 12 months. However, commencement of supplies under the Qatar contract will increase the effect of crude oil and petroleum product prices on the unit cost of gas fuel.

A significant factor behind the PGNiG Group's financial performance are conditions prevailing on the currency markets. The Gdańsk Institute for Market Economics projected that the Polish currency would continue to appreciate in 2014. Despite the tensions in eastern Ukraine, in H1 2014 the projections proved to be correct. Since the PGNiG Group's financial performance is strongly co-related with the PLN/USD exchange rate, the Group will continue the hedging policy to optimise the exchange rate's effect on the cost of gas imports from east of Poland.

Other drivers of the Group's performance are the rates and charges provided for in the gas fuel tariffs. However, from August 1st 2014 their effect will be limited as the PGNiG S.A.'s business model will be adapted to the regulations related to the Act Amending the Energy Law and Certain Other Acts, which require that a defined percentage of gas volumes fed into the transmission network in Poland be sold on the energy exchange (40% in 2014 and 55% from 2015 onwards). As a result of organisational changes at the Company (establishment of PGNiG Obrót Detaliczny Sp. z o.o. in 2013 and creation of the Wholesale Trading Division) from 2015 approximately 60% of gas will be sold on the Polish Power Exchange. PGNiG Obrót Detaliczny Sp. z o.o. will be the key buyer. The unit selling price of high-methane gas on the exchange will depend on the number of sellers. An increase in the number of gas sellers may lead to a drop in the unit selling price of high-methane gas on the exchange, which will affect the PGNiG Group's financial performance.

At the transition of 2012 into 2013, the Group launched production from the Lubiatów, Międzychów and Grotów oil and gas fields in Poland, and from the Skarv field on the Norwegian Continental Shelf. This contributed to a substantial increase in crude oil production in 2013. Production from those fields will support the Group's future performance. In 2013, PGNiG S.A. intensified exploration for both conventional and unconventional hydrocarbon deposits, but the economic effects of this effort will only be visible in several years. The Group's future performance will also be influenced by the legislation on special hydrocarbon tax, which will impose a new tax on crude oil and natural gas production as of January 1st 2020. This means further fiscal burdens for the Exploration and Production segment, which will have an adverse effect on its financial performance.

Since January 1st 2013, PGNiG S.A., as a trading company, has been obliged to purchase energy efficiency certificates (white certificates) in the amount set in the Energy Efficiency Act or else to pay a buy-out price. This obligation has inflated gas sale costs. Amendments to be introduced under the Energy Efficiency Act in 2015 will limit the ability to reduce the basis for the calculation of the financial liability under the system in place, which will be another source of cost increase at the PGNiG Group.

H1 2014 also saw the entry into force of the amended Energy Law, which reintroduced the support system for electricity cogeneration (red and yellow certificates). This change will benefit the results of the Generation segment.

Given the high level of current and planned capital expenditure, the PGNiG Group uses external financing raised primarily by issuing debt securities on the domestic and foreign markets. PGNiG S.A. intends to issue notes under its issuance programme agreements of May 2012 and June 2010, depending on its liquidity needs and market conditions in H2 2014.

In the coming quarters, the Group intends to maintain a high level of capital expenditure. Spending will focus primarily on projects involving maintenance of hydrocarbon production rates, and diversification of gas supply sources, as well as on projects in the exploration for and appraisal of crude oil and natural gas deposits, and development of the power generation segment.

Members of the Management Board

President of the Management Board	Mariusz Zawisza	....
Vice-President of the Management Board	Jarosław Bauc	....
Vice-President of the Management Board	Jerzy Kurella	....
Vice-President of the Management Board	Zbigniew Skrzypkiewicz	....
Member of the Management Board	Waldemar Wójcik	....