DIRECTORS' REPORT ON THE OPERATIONS OF THE PGNiG GROUP AND PGNiG S.A. FOR H1 2015

Polskie Górnictwo Naftowe i Gazownictwo SA

Warsaw, July 31st 2015

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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 in Poland. The Group's trade and storage operations focus on selling natural gas imported from other countries or produced from domestic fields, and on providing 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. In 2012, the PGNiG Group expanded its operations to include electricity and heat generation and sale.

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 2015, the Group comprised PGNiG S.A. (the Parent), and 28 production, trade and service companies,
including:

- 19 direct subsidiaries of PGNiG S.A.
- 9 indirect subsidiaries of PGNiG S.A.

The list of the PGNiG Group companies as at June 30th 2015 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	PGNiG Technologie S.A.	182,127,240	182,127,240	100.00%	100.00%
11	BUD-GAZ PPUH Sp. z o.o. w likwidacji (in liquidation)	51,760	51,760	100.00%	100.00%
12	PGNiG TERMIKA S.A.	670,324,950	670,324,950	100.00%	100.00%
13	PGNiG Finance AB (SEK) [1)]	500,000	500,000	100.00%	100.00%
14	PGNiG Serwis Sp. z o.o.	9,995,000	9,995,000	100.00%	100.00%
15	PGNiG Obrót Detaliczny Sp. z o.o.	1,091,000,000	1,091,000,000	100.00%	100.00%
16	PGNiG SPV 5 Sp. z o.o.	250,000	250,000	100.00%	100.00%
17	PGNiG SPV 6 Sp. z o.o.	250,000	250,000	100.00%	100.00%
18	PGNiG SPV 7 Sp. z o.o.	250,000	250,000	100.00%	100.00%
19	B.S. i P.G. Gazoprojekt S.A.[2)]	4,000,000	900,000	22.50%	22.50%
	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
20	Powiśle Park Sp. z o.o.	81,131,000	81,131,000	100.00%	100.00%
21	XOOL GmbH (EUR)[1)]	500,000	500,000	100.00%	100.00%
22	PST Europe Sales GmbH (EUR)[1)]	500,000	500,000	100.00%	100.00%
23	Oil Tech International F.Z.E. (USD)[1)]	20,000	20,000	100.00%	100.00%
24	Zakład Gospodarki Mieszkaniowej Sp. z o.o.	1,806,500	1,806,500	100.00%	100.00%
25	Poltava Services LLC (EUR)[1)]	20,000	19,800	99.00%	99.00%
26	Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000	2,565,350	85.51%	85.51%
27	GAZ Sp. z o.o.	300,000	240,000	100.00% [3)]	100.00%
28	Gas Assets Management Sp. z o.o.	20,000	20,000	100.00%	100.00%

[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.
[3)] Please see below for explanation

Changes in the PGNiG Group structure in H1 2015:

- On February 17th 2015, Gas Assets Management Sp. z o.o. was entered in the National Court Register.
- On March 5th 2015, following the closing of the liquidation process, Polskie Elektrownie Gazowe Sp. z o.o. w likwidacji (in liquidation) was removed from the National Court Register.

- April 21st 2015 saw the establishment of PST Europe Sales GmbH, with the share capital of EUR 500,000, in which PGNiG Sales & Trading GmbH acquired 100% of shares; the company, entered in the commercial register maintained by the district court of Munich on June 23rd 2015, was established to sell natural gas and other energy products to end users
- In June 2015, GAZ Sp. z o.o. bought back its own shares from minority shareholders for cancellation; on June 30th 2015, 40 shares were cancelled and PSG Sp. z o.o. became the sole shareholder of GAZ Sp. z o.o.; the share capital of GAZ Sp. z o.o. (PLN 300 thousand) and the par value per share (PLN 1,500) did not change; the number of the shares was reduced (from 200 to 160); it is expected that the General Meeting of GAZ Sp. z o.o. will pass a resolution to increase the par value per share so that the total par value is equal to the share capital.

Changes subsequent to the end of the reporting period

On July 15th 2015 the Extraordinary General Meeting of PGNiG SPV 6 Sp. z o.o. passed a resolution to increase the share capital by PLN 51,131,000 to PLN 51,381,000 through the creation of 511,310 new shares with a par value of PLN 100 per share. All the shares were acquired by PGNiG S.A. As at the date of the this report, the share capital increase had not been entered into the National Court Register.

On June 16th 2015, Gas Assets Management Sp. z o. o., an indirect subsidiary of PGNiG S.A., acquired 36.17% of shares in GAS-TRADING S.A. from PHZ Bartimpex S.A. As a result of the transaction, the PGNiG Group holds a total of 79.58% of shares in GAS-TRADING S.A.

As at June 30th 2015, the consolidation included PGNiG S.A. (the Parent) and 21 subsidiaries. The chart below presents the consolidated companies of the PGNiG Group as at June 30th 2015 (by segment).

Consolidated PGNiG Group companies

Parent		
Polskie Górnictwo Naftowe i Gazownictwo S.A.		
Segment	Subsidiaries	% of capital 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	PGNiG Obrót Detaliczny Sp. z o.o.	100%
	PGNiG Sales & Trading GmbH	100%
	XOOL GmbH	100%
	PST Sales Europe GmbH	100%
	Operator Systemu Magazynowania Sp. z o.o.	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.	100%
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 2015, 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	4,059	8,843
Trade and Storage	1,002	3,824
Distribution	-	10,793
Generation	-	1,060
Other Activities	36	1,414
Total	5,097	25,934

In H1 2015, PGNiG S.A. implemented initiatives enabling the PGNiG Group to achieve a lasting reduction of employment costs and to improve the quality and efficiency of HR resources. Workforce was restructured mainly through voluntary redundancy programmes, benefit programmes encouraging employees who have reached state pension age to retire, as well as group and individual redundancies. As a result of the restructuring, in H1 2015 the PGNiG Group's workforce was reduced by 3.1 thousand (11%) compared with December 31st 2014. The highest reduction took place in the exploration and production segment (1,378 persons) and the distribution segment (1,380 persons).

Section II: Parent's governing bodies

1. Management Board

In H1 2015, the composition of the PGNiG S.A. Management Board was unchanged and as at June 30th 2015 was as follows:

- Mariusz Zawisza − President
- Jarosław Bauc – Vice-President, Finance
- Zbigniew Skrzypkiewicz – Vice-President, Exploration & Production
- Waldemar Wójcik – Vice-President.

Until the date of this report, there were no changes in the composition of the PGNiG Management Board.

2. Supervisory Board

On April 16th 2015, the Annual General Meeting of PGNiG S.A. appointed the following persons to the Supervisory Board of PGNiG S.A. Irena Ożóg and Maciej Mazurkiewicz

As at June 30th 2015, 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
- Janusz Pilitowski – Member
- Ryszard Wąsowicz – Member
- Irena Ożóg – Member
- Maciej Mazurkiewicz – Member

On July 22nd 2015, Wojciech Chmielewski resigned from membership of the PGNiG S.A. Supervisory Board.

On July 28th 2015, the PGNiG S.A. Supervisory Board appointed Ms Agnieszka Woś, former Deputy Chairperson of the Supervisory Board, as Chairperson of the Supervisory Board. Andrzej Janiak was appointed Deputy Chairperson of the Supervisory Board.

Section III: Shareholding structure

As at June 30th 2015, 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 2015 is presented in the table below.

Shareholding structure

Shareholder	Number of shares as at 30.06.2015	% ownership interest as at 30.06.2015	Number of voting rights conferred by shares held	% of total vote at GM as at 30.06.2015
State Treasury	4,271,708,411	72.40%	4,271,708,411	72.40%
Other shareholders	1,628,291,589	27.60%	1,628,291,589	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>

In H1 2015, the holdings of PGNiG shares by the management and supervisory personnel did not change and were as presented in the table below.

PGNiG shares held by the management and supervisory personnel as at June 30th 2015

Name	Position	Number of shares	Par value of shares (PLN)
Waldemar Wójcik	Vice-President 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 2015, the PGNiG Group reported revenue of PLN 20.4bn, ca. 84% of which was derived from sales of natural gas.

Revenue (PLNm)

	H1 2015
Natural gas, including:	17,135
- high-methane gas	16,362
- nitrogen-rich gas	773
Crude oil	1,096
Helium	37
Electricity	765
Heat	625
Geophysical and geological services	65
Drilling and well services	133
Construction and assembly services	76
Connection charge	49
Other sales	409
Total	20,390

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 2015.

Output of key products

	Unit of measure	H1 2015
Natural gas	mcm	2,294
Crude oil	'000 tonnes	704
Electricity	GWh	2,311
Heat	TJ	21,040

Sales of key products

	Unit of measure	H1 2015
Natural gas, including:	mcm	12,525
- Trade and Storage	mcm	12,138
- Exploration and Production	mcm	387
Crude oil	'000 tonnes	720
Electricity, including:	GWh	4,812
- Trade and Storage	GWh	4,789
- Generation	GWh	23
Heat	TJ	20,867

Section V: Regulatory environment

1. Licences

On May 5th 2015, the President of the Energy Regulatory Office (URE) granted PGNiG S.A. a licence to liquefy natural gas and regasify LNG at LNG regasification plants in Ełk and Olecko, for the period May 8th 2015 − May 8th 2025. On May 26th 2015, the President of the Energy Regulatory Office appointed PGNiG S.A. as the operator of the natural gas liquefaction system for the period June 1st 2015 − April 20th 2025.

As at June 30th 2015, PGNiG S.A. held the following licences granted by the President of the Polish Energy Regulatory Office 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
- one licence of liquefy natural gas and regasify LNG at LNG regasification plants.

PGNiG Obrót Detaliczny Sp. z o.o. holds the following licences:

- one licence to trade in gas fuels, effective from April 25th 2014 to April 25th 2016; on April 2nd 2015, the President of the Polish Energy Regulatory Office extended the licence term until April 25th 2026
- one licence to trade in electricity, effective from April 29th 2014 to April 29th 2016; on April 14th 2015, the President of the Polish Energy Regulatory Office extended the licence term until April 29th 2026.

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

- 75 licences for exploration and appraisal of crude oil and natural gas deposits
- 227 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 gas fuel tariffs

In H1 2015, the bulk of high-methane and nitrogen-rich natural gas sold by PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. was subject to statutory price control. Only trade in high-methane natural gas on the Polish Power Exchange was exempt from the obligation to submit tariffs for approval.

<u>Taryfa PGNiG S.A.</u>

From January 1st to April 30th 2015, PGNiG Gas Fuel Supply Tariff No. 7/2015, approved by decision of the President of the Energy Regulatory Office dated December 17th 2014, was in effect.
On April 16th 2015, the President of the Energy Regulatory Office approved a change to PGNiG Gas Fuel Supply Tariff No. 7/2015 and extended its effective term until July 31st 2015. The average price (the price of gas fuel and the subscription fee) of high-methane and nitrogen-rich gas was reduced on

average by 7.1% and 3.2%, respectively. The price of 1 kWh of high-methane gas was finally made equal with the price of 1 kWh of nitrogen-rich gas.

On July 17th 2015, the President of the Energy Regulatory Office approved new PGNiG Gas Fuel Supply Tariff No. 8/2015 for the period August 1st 2015 − December 31st 2015. The average price of high-methane and nitrogen-rich gas was reduced by ca. 5% and 4.9%, respectively.

Taryfa PGNiG Obrót Detaliczny Sp. z o.o.

In H1 2015, PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 1, approved by the President of the Energy Regulatory Office on December 17th 2014 for the period until December 31st 2015. The complete PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 1 is available at www.od.pgnig.pl and ure.gov.pl.

On June 26th 2015, PGNiG Obrót Detaliczny Sp. z o.o. applied to the President of the Energy Regulatory Office to change PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 1. As at the date of this report, the proceedings were still pending.

By decision of April 1st 2015, the President of the Energy Regulatory Office released PGNiG Obrót Detaliczny Sp. z o.o. from the obligation to submit tariffs for trade in compressed natural gas for approval.

Exemption from the obligation to submit wholesale gas trading tariffs for approval

On February 19th 2013, the President of the Energy Regulatory Office announced an exemption of energy utilities holding gas fuel trading licences 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. PGNiG S.A. submitted such application to the President of the Energy Regulatory Office, and, As at the date of this H1 2015 report, the proceedings were still pending.

Furthermore, in 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 H1 2015 report, the proceedings were still pending.

3. Regulatory risks

Polish Energy Law

The Act Amending the Energy Law and Certain Other Acts (the so-called "Small Three Pack") of September 11th 2013 has introduced a requirement to sell gas on the exchange market. The requirement to sell gas on the exchange market, which now applies to PGNiG S.A., 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 prices quoted by PGNiG S.A. and other market participants.

Meeting the requirement to sell gas on the exchange market

Due to the low demand for gas on the exchange market, in 2013-2014 PGNiG S.A. failed to sell the required volume of gas on the exchange market. In order to ensure the meeting of the requirement in the following years, a new company, PGNiG Obrót Detaliczny Sp. z o.o., commenced its operations in August 2014, consisting in buying natural gas at the Polish Power Exchange, and then selling it to customers. Since the effective date of the Act introducing the general succession of agreements, the volume of gas sold through the commodity exchange has increased substantially, which will enable the Company to meet its obligation to sell the statutorily required level of 55% of gas through the exchange market. However, the President of the Energy Regulatory Office (URE) may impose on the Company financial penalties (of up to 15% of its full-year revenue generated from the licensed activity in the preceding fiscal year) for its failure to sell the required volumes of gas through the exchange market in 2013 and 2014.

On January 13th 2015, the President of URE instigated proceedings to impose a financial penalty on PGNiG S.A. in respect of its failure to meet the obligation to sell gas through the exchange market in 2013. PGNiG S.A. filed an appeal with the Competition and Consumer Protection Court at the District Court of Warsaw against one of the interlocutory decisions made by the President of URE in the course of the proceedings. Therefore, the President of URE suspended the administrative proceedings until the Consumer Protection Court at the District Court of Warsaw resolves the appeal.

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, the volume of that revenue depends on the selling prices of gas fuel, which are regulated prices and are directly a function of the applied tariff preparation methodology. The tariff determination rules are defined in the regulations issued under the Energy Law, including primarily the Tariff Regulation. The methodology used to determine tariffs consists in defining prices and charges against forecast costs and planned gas sales volumes, as a result of which revenue is subject to forecasting risk. Inaccurate estimates of gas demand (affecting the accuracy of forecast purchase and supply volumes) and of costs on which the determination of prices and charge rates is based, may adversely affect the financial performance of the PGNiG 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. 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.

Geological and Mining Law

In 2015, the Act Amending the Geological and Mining Law and Certain Other Acts, as well as the Act on the Special Hydrocarbon Tax, entered into force. The Act Amending the Geological and Mining Law and Certain Other Acts introduced a new licensing system in which the *open door* procedure will not apply, which may significantly slow down the administrative processes, ultimately leading to a decline in the number of hydrocarbon exploration and appraisal licences issued in Poland. In addition, the amending act introduced higher royalty rates for hydrocarbon reserves other than marginal. The new royalty rates will be effective from January 1st 2016.

Section VI: Exploration and Production

1. Exploration

In H1 2015, PGNiG S.A. was involved in crude oil and natural gas exploration and appraisal projects in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands, both on its own and jointly with partners. Drilling work in areas covered by licences awarded to PGNiG S.A was performed on 16 boreholes, including eight exploration boreholes, two test boreholes and six appraisal boreholes.

In H1 2015, six wells were drilled with positive results, including one exploration borehole in Polish Lowlands (drilled in 2014), and two exploration and three appraisal boreholes in Carpathian Foothills. Six wells failed to yield a commercial flow of hydrocarbons and were abandoned.

2. Collaboration with other entities

In H1 2015, PGNiG S.A. 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. Furthermore, PGNiG S.A. collaborated with other entities in carrying out exploration work in Pakistan and Norway.

2.1. Collaboration in Poland

On May 4th 2015, PGNiG S.A. and Chevron Polska Energy Resources Sp. z o.o. terminated their collaboration agreement for the first stage of an unconventional hydrocarbon exploration project. The agreement envisaged joint evaluation of unconventional gas resources in four exploration licence areas in south-eastern Poland, including the Zwierzyniec and Grabowiec licences held by Chevron Polska Energy Resources Sp. z o.o., and the Tomaszów Lubelski and Wiszniów–Tarnoszyn licences held by PGNiG S.A. The agreement was terminated in view of the fact that the work provided for in the agreement had been completed (in the previous year) and Chevron Polska Energy Resources Sp. z o.o. decided to discontinue its involvement in unconventional gas exploration projects in Poland.

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%;
- "Kamień Pomorski" – under the agreement of August 14th 2013; licence interests: PGNiG S.A. (operator) – 51%, LOTOS Petrobaltic S.A. – 49%.
- "Górowo Iławieckie" – under the agreement on joint operations of December 31st 2014; licence interests: PGNiG S.A. (operator) – 51%, LOTOS Petrobaltic S.A. – 49%.

In the "Płotki" – "PTZ" area, a Zaniemyśl-3K production sidetrack was drilled in the Zaniemyśl gas structure. The well was abandoned as formation water was entering the well. In the "Bieszczady" area, workover of the Niebieszczany-1 well began. On July 20th 2015, ORLEN Upstream sp. z o.o. acquired interests in licence blocks 437, 438, 456, 457, 458 and in parts of licence blocks 416, 417 and 436 owned by Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o., thus becoming a party to the joint operations agreement.

Under licences held by FX Energy Poland Sp. z o.o. work was conducted in the "Warszawa-Południe" area (block 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%.

Under licences awarded to San Leon Energy PLV, work was conducted in the "Karpaty Zachodnie" area 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%. Given the fact that there was considerable exploration risk associated with the structures proposed to be drilled by the operator, in May 2015 the joint operations agreement was terminated.

2.2. Collaboration 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 2015, the drilling of the Rizq-1 borehole was completed and a fracking operation was carried out. The maximum gas-flow rate recorded during the testing of the well was 206.5 cubic metres per minute. When the tests are successfully completed, the well will be hooked up and brought on stream via the existing production facilities. Furthermore, production continued from the Rehman-1 and Hallel X-1 wells and preparations for the drilling of Rehman-2 and Rehman-3 boreholes progressed.

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, in the North Sea, and in the Barents Sea. Jointly with partners, the company has been producing hydrocarbons from the Skarv, Morvin, Vilje and Vale fields and working on the development of the Snadd and Gina Krog fields. In the other licence areas, the company is engaged in exploration projects.

The company's main asset is the Skarv field, which has been developed using a floating production, storage and offloading (FPSO) vessel. The FPSO is owned by the licence interest holders, including PGNiG Upstream International AS, and is expected to continue is operations for the next 20 years. Other producing fields (Morvin, Vilje and Vale) comprise a group of wells hooked up to the existing production infrastructure.

Produced crude oil is sold directly from the fields to Shell International Trading and Shipping Company Ltd (crude from the Skarv, Vilje and Vale fields) and to TOTSA TOTAL OIL TRADING SA (crude from the Morvin field). All the fields except for Vilje produce also – apart from crude oil – the associated gas, all of which is transferred via a gas pipeline to Germany, where it is collected by PGNiG Sales & Trading GmbH.

In H1 2015, PGNiG Upstream International AS and its partners continued the development of the Gina Krog and Snadd fields. As part of the work at the Gina Krog field, construction of a drilling platform for drilling production wells was completed, and work on setting up the structure of the production platform was under way. In late June 2015, a steel jacket was constructed over the Gina Krog field, on which a production platform will be placed next year. In the case of the Snadd field, which is at the stage of selection of the development concept, project work on selecting the optimum investment scenario was under way.

In H1 2015, the company (as a partner) completed the drilling of an exploration borehole in the area of the Gina Krog field. Initial geological and formation data analyses indicate probable presence of recoverable hydrocarbon reserves. However, a better estimate of the potential volume of the reserves can only be made after a further analysis of the acquired data. Working jointly with its partners, PGNiG Upstream International AS also continued operations in its other exploration licence areas. Among other things, the company worked on the evaluation of prospectivity of the PL646, PL702, PL703, PL707, PL711, PL756 and PL799 licence areas.

In January 2015, another licensing round was concluded, as a result of which PGNiG Upstream International AS was granted the PL799 operator licence in the Norwegian Sea. As the operator, the company acquired a 40% interest in the licence, while its partners – Statoil Petroleum AS, VNG Norge AS and Explora Petroleum AS – each received a 20% interest. This licence is located in the vicinity of the Skarv and Snadd fields, and is another operator licence granted to PGNiG Upstream International AS on the Norwegian Continental Shelf.

As far as the PL558, PL646 and PL711 licences are concerned, the geological and geophysical analyses performed for the individual licences led the company and its partners to the conclusion that the exploration risk was high, and as a consequence the licences were relinquished. In H1 2015, the company obtained a confirmation of relinquishment of its PL648S operator licence. As at June 30th 2015, PGNiG Upstream International AS held interests in 15 exploration and production licences on the Norwegian Continental Shelf, including in two licences as the operator.

<u>Libya</u>

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 2015, 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 37 sites, including 20 gas production facilities, 11 oil and gas production facilities and 6 oil production facilities.

In H1 2015, the PGNiG Group produced a total of 2,294 mcm of natural gas (high-methane gas equivalent), of which 1,989 mcm was produced from fields in Poland, and 305 mcm from fields abroad. Production of crude oil and NGL reached 704 thousand tonnes of crude oil equivalent, of which 350 thousand tonnes came from the Norwegian Continental Shelf. Natural gas and crude oil production volumes are presented in the table below.

Natural gas production volume

	Product	H1 2015	
		GWh	mcm
1.	Natural gas, including:	25,177	2,294
a.	high-methane gas, including:	11,054	1,007
	- Zielona Góra Branch	0	0
	- Sanok Branch	8,000	729
	- Norway	3,054	278
b.	nitrogen-rich gas, including:	14,123	1,287
	- Zielona Góra Branch	13,454	1,226
	- Sanok Branch	375	34
	- Pakistan Branch	294	27

* Measured as high-methane gas equivalent with a calorific value of 39.5 MJ/m^3.

Crude oil production volume

Product	Unit of measure	H1 2015
Crude oil, including:	'000 tonnes	704
- Zielona Góra Branch	'000 tonnes	331
- Sanok Branch	'000 tonnes	23
- Norway	'000 tonnes	350

In H1 2015, in the operating area of the PGNiG S.A. Sanok Branch, three wells were hooked up on producing fields, and production from the new Załęże field was launched. The total addition to production capacity was approximately 4.8 thousand cubic metres of gas per hour (high-methane gas equivalent).

In the operating area of the PGNiG S.A. Zielona Góra Branch, one well was hooked up on producing fields and production from the new Grodzisk 26 field was commenced. The total addition to production capacity was approximately 3.1 thousand cubic metres of gas per hour (high-methane gas equivalent).

Underground gas storage facilities

In H1 2015, 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 2015.

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

Nitrogen-rich gas	GWh*	mcm
Daszewo (Ls)	250	30
Bonikowo (Lw)	1,667	200

* Converted to gas with a calorific value of 30 MJ/m^3.

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 2015, the Group's sales of natural gas totalled 387 mcm, of which 361 mcm was sold in Poland, and 26 mcm − in Pakistan. In addition, the Group sold 720 thousand tonnes of crude oil and NGL. The tables below present volumes of natural gas sold directly from the fields, and sales volumes of crude oil and NGL.

Sales of natural gas

	H1 2015	
	GWh	mcm
Natural gas, including:	4,247	387
- high-methane gas	408	37
- nitrogen-rich gas*	3,839	350

* Converted to high-methane gas with a calorific value of 39.5 MJ/m^3.

Sales of crude oil

	Unit of measure	H1 2015
Crude oil, including:	'000 tonnes	720
- domestic production	'000 tonnes	365
- Norwegian Continental Shelf production	'000 tonnes	355

In Poland, the largest amounts of natural gas were sold to industrial customers, accounting for about 78% of the total sales volume. The crude oil produced on the Norwegian Continental Shelf was sold directly from the fields to Shell International Trading and Shipping Company Ltd. and TOTSA TOTAL OIL TRADING S.A. The crude oil produced in Poland was sold to Rafineria Trzebinia S.A., Rafineria Nafty Jedlicze S.A. (in 2015, these refineries were merged to form a single entity – ORLEN Południe S.A.) and to TOTSA TOTAL OIL TRADING S.A. Moreover, in accordance with the agreement of 2013 between PGNiG S.A. and Grupa LOTOS S.A., in January 2015 PGNiG S.A. began supplying crude oil to the Gdańsk refinery operated by Grupa LOTOS S.A. The crude is collected by rail from PGNiG's railway terminals located within the premises of the PGNiG Zielona Góra Branch.

5. Service activities

In H1 2015, the Exploration and Production companies were engaged in drilling exploration, appraisal, core and production boreholes as well as boreholes required for the construction and extension of underground gas storage facilities. Other important areas of their activity included provision of specialist well servicing and geophysical services.

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 external customers. In Poland, contracts were performed for companies exploring for:

- conventional gas − e.g. for PGNiG S.A. and Rawicz Energy Sp. z o.o.,
- copper deposits − for KGHM Polska Miedź S.A., Miedź Copper Sp. z o.o. and KGHM Kupfer A.G.

Moreover, storage chamber completion work was performed for PGNiG S.A. as part of expansion of the storage capacities of the Mogilno Underground Gas Storage Cavern Facility.

On foreign markets, drilling work was performed in exploration for conventional hydrocarbons for the PGNiG Group in Pakistan and for external customers, including in Pakistan, Kazakhstan and Egypt. Furthermore, the segment carried out contracts for production well drilling, which were primarily performed in Poland for PGNiG S.A. and abroad for external customers – mainly in Pakistan and Ukraine.

The segment companies also provided specialist well services such as drilling fluid services, cementing services, coiled tubing and nitrogen unit operations, mud logging, services consisting in provision of downhole equipment and well testing, reservoir measurements and production tests, as well as remedial treatments, workovers, and well abandonment services. These well services were primarily performed for PGNiG S.A. Domestically, the main external customers for well services included LOTOS Petrobaltic S.A., FX Energy Poland Sp. z o.o., Orlen Upstream Sp. z o.o., Geops Deep Drilling Sp. z o.o., Przedsiębiorstwo Budowy Kopalń PeBeKa S.A., Miedź Copper Sp. z o.o., KGHM Kupfer A.G. and the Polish Geological Institute. Abroad, PGNiG S.A. performed coiled tubing services in Ukraine and Croatia, mud logging services in Ukraine, and well treatments in the Czech Republic.

In H1 2015, 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 well logging. On the Polish market, the most important customers purchasing those services included PGNiG S.A., FX Energy Poland Sp. z o.o., NAFTA a.s., Orlen Upstream Sp. z o.o., PGE Górnictwo i Energetyka Konwencjonalna S.A., Halliburton Company Germany GmbH, Przedsiębiorstwo Budowy Kopalń PeBeKa S.A., as well as the AGH University of Science and Technology of Kraków and the Institute of Geophysics of the Polish Academy of Sciences. For PGNiG S.A., the Exploration and Production segment companies performed mainly exploration geophysics services; for external customers, they provided both exploration geophysics and well logging services. Activities in the foreign markets included work performed in the area of exploration geophysics, mainly for customers from Croatia, Slovakia and the Czech Republic.

6. Planned activities

Exploration in Poland

In H2 2015, PGNiG S.A. will carry out 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 Company also intends to pursue projects focused on exploring new opportunities, where little appraisal has so far been made. In Pomerania, three horizontal shale gas wells will be drilled and fracked. Drilling of the first of those wells commenced in June 2015. As part of exploration for tight gas, the Company is planning to carry out a fracking operation in the Kramarzówka-1K well and preparation work to drill two wells.

Exploration abroad

In H2 2015 in Pakistan, PGNiG S.A. will commence drilling of two wells in the Rehman field and seismic work aimed at acquiring detailed information on the geological structure of the Rizq field.

On the Norwegian Continental Shelf, PGNiG Upstream International AS, as a project partner, will continue to produce hydrocarbons from the Skarv, Morvin, Vilje and Vale fields and will proceed with the development of the Snadd and Gina Krog fields. Also, PGNiG Upstream International AS intends to acquire new licence areas by participating in annual licensing rounds and by acquiring interests from other entities. The company holds a diversified portfolio of exploration and production licences in the North Sea, the Norwegian Sea and the Barents Sea, and maintaining this diversification is perceived as an important factor in managing the project portfolio. 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 one licence (PL707) in the Barents Sea.

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 2015 provide for an annual natural gas production volume of approximately 4.5 bcm of high-methane gas equivalent with a calorific value of 39.5 39,5 MJ/m^3, of which 0.4 bcm will be produced from fields in the Norwegian Continental Shelf. In H2 2015, plans within the area of operations of the Sanok Branch include hooking up and bringing on stream wells in the Przemyśl, Pruchnik – Pantalowice, Zalesie and Kielanówka – Rzeszów fields. Within the Zielona Góra Branch area, a well in the Wilków field is planned to be brought on stream.

Crude oil production

The PGNiG Group estimates its 2015 crude oil output at 1.27 million tonnes, including 0.76 million tonnes produced domestically and 0.51 million tonnes from fields in the Norwegian Continental Shelf.

Service activities

In 2015, the PGNiG Group plans to provide drilling services in Poland and abroad. In Poland, the segment companies will conduct drilling work for PGNiG S.A. and for external customers. In foreign markets, services will be provided for PGNiG S.A. in Pakistan and for external customers in Kazakhstan, Pakistan, Egypt, Algeria and Ukraine.

Specialist oilfield 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 external customers in Croatia, Romania, Czech Republic, Germany, Uzbekistan, Saudi Arabia as well as in Ukraine, Lithuania, Latvia and Belarus.

Moreover, the segment will perform services consisting in the acquisition, processing and interpretation of seismic data and well logging services for PGNiG S.A. and external customers (including FX Energy Poland Sp. z o.o., Halliburton Company Germany GmbH, Przedsiębiorstwo Budowy Kopalń PeBeKa S.A.). On foreign markets, the PGNiG Group plans to provide geophysical services in Pakistan, Germany and other countries.

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 reserves, i.e. exploration risk, meaning that not all structures identified as potential hydrocarbon bearing formations actually contain a sufficient accumulation of hydrocarbons.

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's 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 laws and regulations, the process of obtaining a licence for exploration and appraisal of crude oil and natural gas reserves lasts from one to one and a half years. In the foreign markets, such procedures may even take up to two years from the time that the winning bid is awarded until the relevant contract is ratified. Prior to the commencement of field work, the Company is also required to make a number of arrangements, for instance to obtain legal permits and approvals for entering the area, and to meet the environmental protection requirements and, in some cases, requirements related to the protection of archaeological sites. It is also required to hold tenders to select a contractor. All this delays the 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.

<u>Cost of exploration</u>

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.

<u>Competition</u>

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 the PGNiG Group, especially those active globally, enjoy strong market positions and have greater financial resources than those available to the Group. 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 the Group could offer given its financial and human resources. This competitive advantage is particularly important on the international market.

<u>Political and economic situation in the regions where the PGNiG Group operates</u>

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 2011, all non-Libyan employees of POGC-Libya B.V. were evacuated 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. All Polish employees working in the Murzug 113 licence area were withdrawn to Poland. The site was sealed and secured by Libyan government forces and was left to be overseen by local subcontractors.

In Pakistan, in 2014 PGNiG S.A. had to declare a force majeure event and suspend work on the Rizq-1 exploratory well on two occasions due to armed attacks in the region. Work on Rizq-1 was resumed in December 2014.

In certain countries, operations of exploration companies may be hindered by a lack of adequate infrastructure, which may be an obstacle in transporting equipment, personnel and materials to the sites. Also, frequent changes to national legislation may lead to suspending or limiting the scope of exploration.

Unforeseen events

Hydrocarbon deposits developed by the PGNiG Group 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.

The PGNiG Group and its partners are engaged in exploration for and production of hydrocarbons on the Norwegian Continental Shelf. Offshore operations are much more complicated than those carried out onshore. If a serious failure or uncontrolled release of hydrocarbons occurs at sea, remediation can be very costly.

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.

Section VII: Trade and Storage

1. Purchases of natural gas

In H1 2015, the PGNiG Group purchased gas from abroad and, to a limited extent, from domestic suppliers.

The Company purchased gas mainly under the following contracts:
- Contract with OOO Gazprom Export for sale of natural gas to the Republic of Poland, dated September 25th 1996, effective until December 31st 2022;
- 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 2015, to fulfil its gas supply commitments, the PGNiG Group purchased a total of 10,114 mcm of natural gas, 57% of which was imported from foreign suppliers. The table below presents the structure of natural gas purchases from suppliers, measured as high-methane gas equivalent.

Structure of natural gas purchases

	H1 2015		
	GWh	mcm	%
Foreign suppliers:	63,805	5,815	57%
- Gazprom Export	44,460	4,052	70%
- other foreign suppliers	19,345	1,763	30%
Domestic suppliers:	47,161	4,299	43%
- Power exchange	46,057	4,198	98%
- Other domestic suppliers	1,104	101	2%
Total	110,966	10,114	100%

On May 13th 2015, PGNiG S.A. called PAO Gazprom and OOO Gazprom Export to arbitration proceedings before the Arbitration Court in Stockholm. The dispute relates to change of the price terms under the contract for gas supply to Poland of September 25th 1996. Commencement of arbitration proceedings was preceded by six months of negotiations of price terms under the contract. Submitting the dispute for resolution by the Arbitration Court does not preclude trade negotiations and an amicable settlement with the supplier.

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.

Sale of natural gas at the Polish Power Exchange by PGNiG S.A. and purchase of natural gas at the Polish Power Exchange by PGNiG Obrót Detaliczny Sp. z o.o. are not eliminated on consolidation.

In H1 2015, gas sales in the Trade and Storage segment reached 12,138 mcm, 11,251 mcm of which was sold on the domestic market. Compared with H1 2014, the volume of gas sold increased by approximately 55%. The increase was attributable mainly to PGNiG Obrót Detaliczny Sp. z o.o.'s launching its operations, and to a substantial increase in PGNiG S.A.'s sales at the Polish Power Exchange (intercompany transactions executed at the Polish Power Exchange are not subject to elimination). The table below presents sales of natural gas in the Trade and Storage segment (measured as high-methane gas equivalent).

Sales of natural gas

	H1 2015	
	GWh	mcm
Natural gas, including:	133,173	12,138
- high-methane gas	129,518	11,805
- nitrogen-rich gas*	3,655	333

* Converted to high-methane gas with a calorific value of 39.5 MJ/m^3.

On the domestic market, gas was purchased primarily by industrial customers (mainly from the chemical, oil refining and petrochemical sectors) and by households. The latter were identified as the largest customer group (approximately 6.6m), accounting for 97% of the entire PGNiG Group customer base. Industrial customers had the largest share in the sales volume. The table below presents the structure of sales of natural gas (measured as high-methane gas equivalent) by customer groups.

Gas sales by customer groups

	H1 2015	
	GWh	mcm
Industrial customers	39,935	3,640
Trade and services	16,143	1,471
Households	22,997	2,096
Wholesale customers	1,313	120
Exchange	52,785	4,811
Total	133,173	12,138

* Converted to high-methane gas with a calorific value of 39.5 MJ/m^3.

In H1 2015, the PGNiG Group sold 887 mcm of natural gas on foreign markets, primarily in Germany, mostly to trading companies and service providers.

Promotional schemes

In May 2015, PGNiG S.A. launched the 'Price Deregulation' discount scheme for its strategic customers, as a response to customer expectations and reaction to intensified competition and evolution of the gas market. The scheme covers gas purchased from May 1st 2015 to the earlier of December 31st 2015 or the date when PGNiG S.A. is released by the President of the Energy Regulatory Office from the obligation to submit gas tariffs for regulatory clearance. The scheme is voluntary. The customers who choose not to participate will continue to pay for gas according to the PGNiG S.A.'s current tariff. Those who opt for entering the scheme receive a discount on the tariff price. The discount amount is indexed to prices on the Polish Power Exchange and depends on the volume and stability of consumption, with the largest discounts granted to customers with stable consumption rates purchasing large volumes of gas. At present, gas prices on the Polish Power Exchange are strongly correlated to gas prices on Western European markets. The discount scheme envisages a formula that imitates such correlation. The 'Price Deregulation' discount scheme allows participants to reduce their gas purchase costs relative to the tariff prices. As a condition for joining the scheme, customers have to submit scheme participant declarations and collect at least 80% of the previously ordered gas volumes.

The 'Price Deregulation' discount scheme proved very popular, attracting more than 30 of PGNiG S.A.'s strategic customers whose aggregate orders account for 85% of the total gas volume sold by PGNiG S.A.

In H1 2015, also PGNiG Obrót Detaliczny Sp. z o.o. launched a number of promotional schemes targeted at its largest customers. In April 2015, the 'Flexible Price' scheme was offered, under which customers were given some freedom to modify the terms of their contracts with the company. As part of this offer, a customer was given a discount on the tariff price of the gas fuel and the possibility to change the due dates for payment and the number of preliminary invoices. The amount of the discount depended on the gas fuel consumption volume, the due dates for payment, the number of advance payment invoices issued to the customer and the promotional offer term (from three to nine months) selected by the customer. By introducing the discounts, the company succeeded in retaining its largest customers. Given the considerable interest in the offer among its customers, in June 2015 the company launched a new edition of the scheme − 'Flexible Price II'.

In June 2015, a 'Constant Savings' offer was also introduced, with a number of optional solutions to obtain a discount on the tariff price of gas fuel. The offer is addressed at the Company's largest customers, namely:

- customers from tariff groups W-5 to W-8C and tariff group E – for fuel supplies in 2016
- customers from tariff W-6A – for fuel supplies in 2015 and 2016; customers may obtain a discount of up to 8.5% on the gas fuel price specified in the tariff applicable on the offer announcement date.

When opting for the 'Constant Savings' offer, the customer accepts its rules. Pursuant to the rules, the customer may not be in arrears with payments for gas fuel as at the date of joining the promotional scheme and must make regular payments during the contract life (otherwise the contract may be terminated). The rules also provide for contractual penalties for breaking or failing to perform the contract.

Another discount scheme, 'Automatic 5% Promotion', is intended for those customers who did not take advantage of any of the offers described above. This scheme envisages a 5% discount on the tariff price of the gas fuel and covers the period from July 1st 2015 to December 31st 2015.

3. Electricity

In H1 2015, 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 also at the Polish Power Exchange. In Germany, the Company was engaged in futures trading on the EEX (European Energy Exchange) market.

PGNiG Sales & Trading GmbH engaged in electricity trading in Germany on the EEX and OTC markets.

Sales of electricity

In H1 2015, on the domestic market the PGNiG Group sold electricity to business customers (tariff groups A, B and C), and to households (tariff group G). The Group sells electricity with fixed price guarantee (for periods as long as until 2018) and offers full balancing of customers' electricity requirements.

The Group also sold electricity to end users in Germany and Austria, where its customers included chiefly small and medium-sized companies, as well as households.

In H1 2015, the electricity sales volume reached 4,789 GWh, of which 2,835 GWh was sold on the Polish market. The table below presents sales of electricity by customer group.

Sales of electricity (GWh)

	H1 2015	%
End user	160	3%
Trading companies	412	9%
Balancing market	155	3%
Exchange	4,062	85%
Total	4,789	100%

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, Kosakowo 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. The volume of mandatory stocks maintained by PGNiG in the period October 1st 2014 − September 30th 2015 is 9,130 GWh, i.e. 836m m^3.

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

Tariff

Until June 30th 2015, Operator Systemu Magazynowania Sp. z o.o. carried out settlements relating to storage services based on the rates provided for in Gas Fuel Storage Tariff No. 1/2014 of July 2nd 2014. On May 21st 2015, the President of the Energy Regulatory Office approved Gas Fuel Storage Tariff No. 1/2015 for the period until March 31st 2016. The new tariff, effective as of July 1st 2015, covers storage services provided through the Wierzchowice Underground Gas Storage Facility and the following Storage Facility Groups (SFG): Kawerna SFG (Kosakowo and Mogilno underground gas storage facilities) and Sanok SFG (underground gas storage facilities in Husów, Strachocina, Brzeźnica and Swarzów).

Licence

On May 14th 2015, the President of the Energy Regulatory Office expanded Operator Systemu Magazynowania Sp. z o.o.'s licence to store gas fuels in storage facilities to reflect the increased working capacities of the Husów Facility (which increased to 500m m^3) and the Kosakowo facility (which increased to 112.4m m^3). Then, on July 6th 2015, the President of the Energy Regulatory Office expanded the licence to reflect the increased working capacities of the Mogilno underground gas storage cavern facility (which rose to 468.2m m^3).

The new storage capacities of the Husów and Kosakowo facilities began to provide storage services on July 1st 2015, while the Mogilno cavern facility launched its services on July 10th 2015.

Storage capacities made available

As at June 30th 2015, the PGNiG Group held jointly 2,735.3m m^3 of working storage capacity, of which 2,502.0m m^3 was made available under long-term agreements. 1.3 m^3 is the technical reserve capacity. The table below presents the working capacities and working capacities made available as at June 30th 2015.

Working capacities and working capacities made available at the segment's storage facilities

	Working storage capacities (GWh)[1)]	Working storage capacities (mcm)	Working storage capacities made available (GWh)[1)]	Working storage capacities made available (mcm)
Brzeźnica underground gas storage facility	713	65.0	713	65.0
Husów underground gas storage facility	5,486	500.0	3,840	350.0[2)]
Mogilno underground gas storage cavern facility	4,476	407.9	4,235	386.0
Kosakowo underground gas storage cavern facility	1,233	112.4	560	51.0[2)]
Strachocina underground gas storage facility	3,950	360.0	3,950	360.0
Swarzów underground gas storage facility	988	90.0	988	90.0
Wierzchowice underground gas storage facility	13,166	1,200.0	13,166	1,200.0
Total	30,012	2,735.3	27,452	2,502

1) Converted to gas with a calorific value of 39.5 MJ/m^3

2) The increased storage capacities of the Husów Underground Gas Storage Facility and the Kosakowo Underground Gas Storage Cavern Facility became available on July 1st 2015.

5. Planned activities

Purchases of natural gas

In 2015, PGNiG S.A. will continue to purchase imported gas under the long-term contract with OOO Gazprom Export and under short- and medium-term gas supply contracts with European suppliers. With a view to optimising the costs of gas procurement, 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. Once the Świnoujście regasification terminal is completed, the Company expects to receive the first supplies of LNG under the contract with Qatar Liquefied Gas Company Limited (3). The actual date when supplies to customers are launched depends on the Świnoujście regasification terminal achieving full operational functionality.

The 'Price Deregulation' discount scheme

In August 2015, PGNiG S.A. will launch the '2015/2016 Price Deregulation' discount scheme (another stage of the discount scheme for PGNiG's strategic customers). The scheme covers gas purchased from August 1st 2015 to the earlier of December 31st 2016 or the date when PGNiG S.A. is released by the President of the Energy Regulatory Office from the obligation to submit gas tariffs for regulatory clearance. Just like in the previous edition, participation in the scheme is voluntary.

Co-generation support mechanism

The Act Amending the Energy Law and Certain Other Acts, which came into force in 2014, reinstated the co-generation support mechanism. Under the Act Amending the Energy Law and Certain Other Acts, energy utilities selling electricity to end users are obliged to purchase and redeem a 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 2015, PGNiG S.A. will continue work on expanding the Mogilno cavern facility and the Brzeźnica 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

Deregulation of natural gas prices

The PGNiG Group 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, gas trading on the exchange is exempt from the tariff obligation. Furthermore, it is expected that prices of gas for end users 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 includes customers who purchased more than 25 mcm of natural gas in the previous calendar year.

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.

Competition

Regardless of the gas price liberalisation, in H1 2015 PGNiG S.A. customers increasingly often used alternative natural gas suppliers. This trend was particularly prevalent among major 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.

This risk also applies to PGNiG Obrót Detaliczny Sp. z o.o. Competitors seek to boost sales of gas fuels by offering competitive prices or joint purchase of natural gas and electricity. The most active competitors are: Hermes Energy Group S.A., DUON Marketing&TRADING S.A., RWE Polska S.A., PKP Energetyka S.A., ENEA S.A., and Energa S.A. These companies have the largest share among customers changing their gas fuel provider in H1 2015. The activity of the competitors, as well as the growing customer awareness, result in the increasing market pressure on PGNiG Obrót Detaliczny Sp. z o.o. to lower gas fuel prices and define contract terms by way of individual negotiations. Following the implementation of the 'Price Deregulation' scheme, and the reduction of tariff prices for the wholesale customers, the customers of PGNiG Obrót Detaliczny Sp. z o.o. (retail customers) also expect lower prices of gas fuel.

Take-or-pay gas delivery contracts

PGNiG S.A. is a party to three 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. In the event of loss of market share by PGNiG S.A., there is a risk that the Company would be forced to look for new ways to utilise the surplus gas volumes in its portfolio. Otherwise, the Company will have to pay for the gas it has not collected (under the *take or pay* clauses) or sell its excess volumes at negative margins.

A supplementary agreement to the contract for sale of liquefied natural gas (LNG), executed by PGNiG S.A. and Qatar Liquefied Gas Company Limited (3) in 2014, eliminates the risk of PGNiG S.A. having to pay for uncollected LNG in 2015 under the take-or-pay clause.

Disruptions to gas supplies from countries east of Poland

In the period from September 2014 to March 2015, quantities of natural gas supplied by OOO Gazprom Export were lower than those ordered by PGNiG S.A. The reduction ranged from 6% to 46% per day and affected gas supplies from the entry points in Drozdovitse, Vysokoye, and Kondratki. To meet customer demand for gas and to continue gas injection into underground storage, the Company imported the missing volumes from the west (through Mallnow, Lasów) and the south (Cieszyn). Moreover, between October 2014 and April 2015 the Company withdrew gas from underground storage as part of the commercially available capacities. Given the continuing political instability in Ukraine, there is a risk of further limitations in gas supplies.

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 2015−2018, the share may not exceed 59%.

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, 2011, and 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). For failing to comply with the obligation to diversify supplies of imported gas in 2007−2008, the President of the Energy Regulatory Office imposed a fine of PLN 2,000,000 on the Company. The Polish Court of Competition and Consumer Protection reduced the penalty to PLN 1,500,500. Having examined PGNiG S.A.’s appeal, on January 14th 2015, the Warsaw Court of Appeals issued a decision reducing the fine further, to PLN 500,000. On January 30th 2015, the Company paid the fine. In May 2015, PGNiG S.A. filed a cassation appeal against the ruling of the Court of Appeals in Warsaw.

Public consultations concerning the draft regulation of the Council of Ministers on the minimum level of diversification of foreign sources of gas supplies began in March 2015.

Section VIII: Distribution

1. Segment's operations

Since January 1st 2015, all settlements of Polska Spółka Gazownictwa Sp. z o.o. with its customers have been performed based on Tariff No. 3 for Gas Fuel Distribution Services and LNG Regasification Services, as approved by the President of the Energy Regulatory Office on December 17th 2014. The average distribution service charge rates have increased by 3% relative to the previous tariff.

The Distribution Grid Code for Polska Spółka Gazownictwa Sp. z o.o. approved on July 29th 2014 by the President of the Energy Regulatory Office had been effective until February 28th 2015. On February 16th 2015, the President of the Energy Regulatory Office approved a new Distribution Grid Code, in effect since 6:00 am, March 1st 2015.

In H1 2015, 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 2015, preparation of project design documents for Stage 2 of the construction of the high-pressure gas pipeline from Szczytno to Rybno was completed, project design documents for the high-pressure gas pipeline from Młynowo to Muławki continued to be drafted, and construction work on the high-pressure gas pipeline from Rybno to Młynowo and the pressure reduction station in Mikołajki was completed.
- Construction of the south-eastern gas supply line for the city of Gdańsk and gas distribution network roll-out in Wiślinka and Wyspa Sobieszewska. In H1 2015, preparation of project design documentation for the entire gas network was completed, construction work on the distribution network roll-out in the Żuławy municipalities continued, construction of a medium-pressure gas network in Wiślinka and Wyspa Sobieszewska was completed, and work on the construction of grid connections in the project area continued.
- Construction of the DN 300 high-pressure gas network connecting Brodnica, Nowe Miasto Lubawskie and Iława, and distribution network roll-out. The project involves the 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 the reporting period, construction work on the high-pressure gas pipeline from Brodnica to Nowe Miasto Lubawskie (stage 1) was continued, project design documentation for the high-pressure gas pipeline from Nowe Miasto Lubawskie to Iława and the pressure reduction station in Dziarny was completed; project design and cost estimate documentation for the medium-pressure gas pipeline from Dziarny to Iława (stage 2) was continued; work also continued on the construction of medium-pressure gas pipelines in Nowe Miasto Lubawskie, and the construction of medium-pressure gas pipelines in Kurzętniki and from Dziarny to Iława was completed (stage 1).
- Distribution network roll-out in Blachownia and Herby. Due to problems with the acquisition of property titles, the scope of the project was reduced to distribution network roll-out in Herby and Blachownia, i.e. approximately 3km of high-pressure gas pipelines, approximately 43km of medium-pressure pipelines and two gas stations; in H1 2015, work on the construction of the gas pressure reduction and metering station in Aleksandria and medium-pressure gas networks in Herby and Blachownia continued; construction of a gas pressure reduction and metering station in Blachownia commenced.

- 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; in the reporting period, the construction of all high- and medium-pressure gas pipelines with auxiliary infrastructure, covered by the agreement for co-financing with EU funds, was completed; work on acquiring new customers, as well as designing and constructing new connections continued.
- Distribution network roll-out in the Włoszczowa and Małogoszcz municipalities. The scope of the project was reduced; currently, the project involves the construction of a 44 km high-pressure gas pipeline with pressure reduction stations and distribution node (stage 1), as well as construction of a 9 km medium-pressure gas network (stage 2); in H1 2015, work on acquiring new customers, as well as designing and constructing new connections continued.
- Distribution network roll-out in the Chęciny and Sitówka Nowiny municipalities. 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, as well as a metering station and gas governor stations; in H1 2015, the entire scope of construction and assembly work related to the investment was completed; work on acquiring new customers, as well as designing and constructing new connections continued.
- Natural Gas – Energy for Generations, distribution network roll-out in the Osiek and Rypin municipalities. The project involves the construction of a medium-pressure gas pipeline with a total length of ca. 50 km in the Osiek and Rypin municipalities; in H1 2015, the entire scope of construction and assembly work related to the project was completed; work on acquiring new customers, as well as designing and constructing new connections continued.
- Distribution network roll-out in selected localities in the Strzelin and Wiązów municipalities, 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 2015, construction and assembly work on all stages of the project was completed.

In H1 2015, the Company also completed two investment projects under the Regional Operational Programmes.

In H1 2015, 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;
- Continued work on the upgrade of the Łódź Ring, including the upgrade of the high-pressure gas pipeline from Konstantyna to Meszcze. The project involves a series of tasks designed to improve the technical condition of the gas network, and also provides for 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 2015, design work was completed on the Łódź–Smulsko high-pressure gas station along with high- and medium-pressure gas pipelines; work on the construction of the block/bleed/connection system on the high-pressure gas pipeline from Rzgów to the Pabianice block system in Ksawerów continued; design work on the construction and conversion of high-pressure gas stations in Niewiadów and Piotrków Trybunalski continued.
- Continued design work on the upgrade of a 37 km high-pressure gas pipeline from Parszów to Kielce. Development of project design documents is planned to be completed by the end of 2016; the completion of the project was delayed due to difficulties in acquiring legal titles to properties for the purposes of construction.
- Continued design work on the upgrade of a high-pressure gas pipeline from Lubień to Parszów. The project involves upgrade of a 21km gas pipeline; in H1 2015, work on excluding land

allocated to the designed gas pipeline from forest production and obtaining the legal title to the property continued.

- Upgrade of the high-pressure gas pipeline from Warzyce to Gorlice. In H1 2015, design work on the upgrade of a 1km Jasło section was continued, and construction and assembly work on a 2.8km section of the pipeline was performed; construction and assembly work on the remaining 17.2km of the pipeline was completed.
- Extension of high-pressure stations and gas mains fed from the Warsaw Ring. The project is designed to improve the transmission capacity and security of gas supplies within the city of Warsaw; the project involves construction of the Sękocin high-pressure station (completed in 2014), Jabłonna high-pressure station, Sokołów high-pressure station, Ząbki high-pressure station and a medium-pressure gas pipeline with a total length of ca. 11 km; in H1 2015, design work for the Ząbki high-pressure station was carried out.

PSG Sp. z o.o. also connected new customers to the gas grid. In H1 2015, the number of newly connected customers was 35,755. Major projects in this area included:

- 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 65km increased medium-pressure pipeline and a 7km medium-pressure pipeline; in H1 2015 project design work on a 30km medium-pressure Przasnysz – Chorzele pipeline was completed; design work on the Lekowo – Przasnysz gas pipeline was continued, and the construction of the Lekowo high-pressure station commenced.
- Distribution network roll-out in Bielsk Podlaski. The project involves connecting Miejskie Przedsiębiorstwo Energetyki Cieplnej S.A. of Bielsk Podlaski to the gas network; the customer has declared to accept 15,000 thousand cubic metres of gas fuel p.a. (following modernisation of the town's central boiler house); in H1 2015, design documentation for the project was prepared.
- Connecting the Bydgoszcz power utility to the gas network. The project involves the construction of an 8km high-pressure gas pipeline and a high-pressure metering station; design work related to the pipeline and the station was carried out in H1 2015.

The company also executed projects of local network roll-out using the LNG technology: provision of access to gas supplies in Mieroszów and Suwałki, with switch-over of customers from propane-butane-air to natural gas supplied from PGNiG S.A.'s LNG regasification stations in Olecko and Ełk. In H1 2015, construction of a regasification station in Mieroszów, and the switch-over of customers from propane-butane-air to natural gas in Suwałki were completed.

The tables below present the segment's key operating data.

	Jun 30 2015	
	GWh	mcm*
Volume of gas transmitted via the distribution system	56,548.7	5,073.4
- high-methane gas	52,120.5	4,669.3
- nitrogen-rich gas	3,100.2	283.0
- propane-butane-air and decompressed propane-butane	0.7	0.1
- coal gas	1,327.3	121.0

*mcm measured as high-methane gas equivalent

	Unit of measure	Jun 30 2015
Length of network, excl. connections**	km	126,006.7
No. of customers	million shares	6.8
No. of new customers connected to the network	('000)	35.8

**Own and third-party networks.

2. Planned activities

In H2 2015, 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.

In the following years, the company will focus on:
- New customer connections and infrastructure extension
- Network upgrade
- Implementation of integrated IT systems.

Infrastructure extension to enable new connections is a vital factor in the Company's operations. In some areas, upfront investments are needed to eliminate certain infrastructure inadequacies before new customers can be connected to the network, particularly in the Provinces of Warsaw, Białystok and Łódź, where the company plans its major capacity expansion projects. Plans are also in place to extend the distribution network into unserved areas.

The majority of the company's network assets are over 40 years old. The degree of physical obsolescence/wear and tear is a particular issue in the case of key sections of the high-pressure gas network, which should be in good technical condition as it enables the supply of gas to large areas of the country. Therefore, the company plans to increase the share of upgrade projects in its CAPEX budget.

Furthermore, steps are being taken to extend the functionality of the existing gas infrastructure to enable transmission of other gases, notably hydrogen; these steps pertain to both technical and regulatory issues. After this gas network upgrade is completed, the company will be able to launch new services and connect new customers from the power generation, automotive and other industrial sectors where hydrogen is used in production processes.

The implementation of integrated IT systems will facilitate the management of the company's nationwide operations. Changes to the rules governing the European gas market necessitate investment in systems supporting network balancing and settlement of distributed gas volumes. The implementation of those systems will reduce the costs of gas imbalances, which will in turn lower the prices of gas fuel offered by the companies purchasing distribution services. The systems will also make it easier for customers to change their gas suppliers.

3. Risks related to distribution

Legislation

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

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 for gas fuel distribution services. This extends the period in which the Company may obtain full return on the capital employed in its activities based on the approved tariff.

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. The activity of companies competing on the local markets will not have a significant effect on the position of Polska Spółka Gazownictwa Sp. z o.o., therefore the risk of the company losing its dominant market position is low. However, the company constantly monitors the business decisions of its key competitors.

Claims raised by property owners

More and more frequently, Polska Spółka Gazownictwa Sp. z o.o. is facing excessive financial claims raised by owners of land plots where the gas network was developed in the past. 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.

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 sometimes renders impossible further development of the gas grid within the company's key areas of operation.

Section IX: Generation

1. Segment's operations

As at June 30th 2015, 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

A tariff applicable to PGNiG TERMIKA S.A.'s sales of heat generated at the Żerań CHP, Siekierki CHP, Pruszków CHP, Wola heating plant and Kawęczyn heating plant and to the transmission and distribution of heat via the heating network supplied from the Pruszków CHP plant has been effective since August 1st 2014.

In addition, since January 1st 2015, the company was required to apply the tariffs for the transmission of heat through the heating network in the areas of Marsa Park, Annopol, Marynarska, Chełmżyńska and Jana Kazimierza, which were approved by the President of URE on November 18th 2014.

Until June 30th 2015, the company was 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, approved on January 8th 2014. On May 13th 2015, the President of URE approved a tariff for the production of heat at the Regaty heating plant and transmission of heat through the heating network in the Regaty residential estate, effective for the period from July 1st 2015 to July 31st 2016.

Production

PGNiG TERMIKA S.A.'s key products are heat and electricity. In H1 2015, 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 in H1 2015

Product	Unit of measure	Volume
Electricity	GWh	2,311
Heat	TJ	21,040

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 2015 the company had generated 52 GWh of electricity.

Sales

In H1 2015, PGNiG TERMIKA S.A. sold 20,867 TJ of heat. PGNiG TERMIKA S.A. sold heat mainly to Veolia Energia Warszawa S.A. (formerly Dalkia Warszawa S.A.), which purchased 92.4% of the heat generated by the company. In 2015, Veolia Energia Warszawa S.A. contracted 3.3 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 2015, PGNiG TERMIKA S.A. sold a total of 2,024 GWh of electricity generated at its plants. The key customer for electricity generated at PGNiG TERMIKA S.A.'s plants was PGNiG S.A., with an aggregate share in the company's electricity sales volume in H1 2015 reaching 99%. The company also sold electricity to smaller customers.

In H1 2015, management of the electricity portfolio and commercial balancing for PGNiG TERMIKA S.A. was performed through PGNiG S.A., which trades in electricity on the Commodity Derivatives Market.

Construction of a CCGT unit in Stalowa Wola

In H1 2015, as part of the 'Construction of a CCGT Unit in Stalowa Wola' project, executed jointly with Tauron Polska Energia S.A., the Group continued the installation of the steam and gas turbines and construction and assembly work in the cold water pumping station, as well as the installation of cable ducts, cabling and wiring, conductor lines and the lightning. The Group also performed a water test of the recovery boiler and the condenser and completed construction work on the San river weir. On April 3rd 2015, Elektrociepłownia Stalowa Wola S.A. received the summons to appear before the Court of Arbitration at the Polish Chamber of Commerce, filed by general contractor Abener Energia S.A. in a case for confirmation of the occurrence of a force majeure event and for increasing the contractor's remuneration. The contractor reported delays in the construction project and postponed the completion of the CCGT unit by four months (from June 26th 2015 to October 26th 2015). In the opinion of Elektrociepłownia Stalowa Wola S.A., the new completion date announced by the contractor is not achievable, and the project is delayed by at least eight months.

2. Planned activities

Electricity and heat sales will be the main source of revenue of PGNiG TERMIKA S.A. in H2 2015. The main customer for electricity generated at PGNiG TERMIKA S.A.'s plants will be PGNiG S.A., while the main customer for heat will be Veolia Energia Warszawa S.A.

In addition, PGNiG TERMIKA S.A. also intends to develop the municipal heat distribution network in cooperation with Veolia Energia Warszawa S.A. The efforts aimed at expanding the area of heat distribution from the municipal network and increasing the number of new facilities connected to the network will offset lower heat consumption resulting from improved energy management by customers.

In subsequent years, in line with the requirements of the PGNiG Group strategy, PGNiG TERMIKA S.A. will focus improving the efficiency of its existing assets and will also develop its new business area involving the acquisition of heating systems and, in economically justified cases, construction of new cogeneration units. The Company plans acquisitions of heating networks, also abroad. PGNiG TERMIKA S.A. intends to focus on projects based on gas-fired or biomass-fired generation sources, to gradually reduce its coal consumption and increase the share of low- and zero-emission fuels in its energy mix.

On May 4th 2015, the Act on Renewable Energy Sources (RES) of February 20th 2015 became effective. The Act provides for two parallel support systems: one for existing installations (certificate system), and the other for installations launched after the effective date of the Act (auction system). The provisions on the auction system will be effective as of 2016, which means that the K1 boiler, which is being upgraded at the Siekierki CHP plant (with a scheduled start-up date in the second half of 2015), will use the existing certificate system for 15 years. The new auction support system provides business opportunities for the implementation of RES projects, with the level of revenues guaranteed for 15 years.

3. Generation risks

<u>More stringent gas and dust emission standards</u>

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.

<u>Maintaining share in the municipal heat market</u>

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 Veolia Energia 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 2015, the segment companies conducted work involving construction and assembly of gas transmission pipelines and gas compressor stations, construction and expansion of underground gas storage facilities and development of hydrocarbon deposits, as well as production of surface accessories for well equipment and spare parts for drilling equipment. The segment companies were also involved in the provision of repair services for heads and casing heads, development of system designs, including for gas transport systems, and provision of hotel, restaurant and spa centre services.

The services offered by the segment were provided to both external customers and PGNiG Group companies.

The key projects executed for external customers included:

- Construction of the Jeleniów II Gas Compressor Station for OGP GAZ-SYSTEM S.A.,
- Construction of the 175.2 km DN 700 high-pressure gas pipeline from Gustorzyn to Rembelszczyzna, for OGP GAZ-SYSTEM S.A.,
- 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.; project completed,
- Performance of construction work as part of the construction of a CCGT unit with an output capacity of approximately 400 MWe, with a heating component and a cathodic protection system for the gas pipeline at the Stalowa Wola CHP plant, for Abener Energia S.A.,
- Production of injection heads and casing heads for LOTOS Petrobaltic S.A.,
- Production of equipment and spare parts for drilling rigs and drillships for MHWirth AS (Norway),
- Assembly of HDPE pipelines, valves and hydrants under the Polish LNG Project for Saipem S.P.A. S.A., Branch in Poland; project completed.

In addition, work performed by the segment’s companies for external customers included author’s supervision and design work on investment projects related to the construction of the oil terminal in Gdańsk − Stage 1, preparation of design documents, and provision of hotel, restaurant and spa centre services.

For PGNiG S.A., the segment continued the performance of construction and assembly contracts, the most important of which included:

- Extension of the Brzeźnica underground gas storage facility,
- Development of the Wilków-51k well,
- Development of the Połęcko field,
- Completion of construction of the Wierzchowice underground gas storage facility (a project previously performed by PBG),
- Construction of the water-injection system for the BMB (Barnówko – Mostno – Buszewo) field,
- Changes in the configuration of gas compressors for the Wierzchowice underground gas storage facility (reversible operation of gas compressors),
- Development of a gas well at the Krasne gas production facility.

The segment’s work for PGNiG S.A. also included continued manufacture of well equipment, such as production wellheads and casing heads, as well as spare parts to equipment accessories.

The most important contracts executed for other PGNiG Group companies included:

- Construction work related to the construction of pipelines and leaching installation together with technical infrastructure as part of the 'Kosakowo − construction of five caverns, cluster B' project;
- Installation of four nodes and ten block/bleed systems for the DN 700 high-pressure gas pipeline from Gustorzyn to Odolanów; project completed;
- Construction work on the 23.9 km DN 300 high-pressure gas pipeline from Rybno to Młynowo; project completed;
- 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, as well as provision of technical and expert consulting services.

2. Planned activities

In 2015, the segment will continue construction and assembly work related to the construction of gas pipelines and gas infrastructure, as well as development of oil and gas assets and extension of underground gas storage facilities. The segment's companies intend to maintain their market positions in the manufacturing of equipment, including well surface equipment for conventional and unconventional deposits, drilling platforms, equipment for oil and gas production facilities, and gas system design.

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 2015, capital expenditure incurred by the PGNiG Group on property, plant and equipment and intangible assets was PLN 1,355m. Over the same period, the capital expenditure of PGNiG S.A. totalled PLN 550m. The table below presents the Group's expenditure in the individual segments.

Capital expenditure (PLNm)

	H1 2015
Exploration and Production	708
Trade and Storage	107
Distribution	443
Generation	95
Other Activities	2
Total	1,355

Below are described the key capex projects implemented by the PGNiG Group in H1 2015.

Exploration and Production

The capital expenditure incurred in H1 2015 in the Exploration and Production Segment amounted to PLN 708m.

The expenditure of PGNiG S.A. on exploration work amounted to PLN 271m, the majority of which was allocated towards the drilling of research, appraisal, and exploration wells.

In H1 2015, the PGNiG Group's expenditure on gas & oil exploration and production work on the Norwegian Continental Shelf amounted to PLN 214m, the majority of which was allocated towards the development of the Gina Krog field.

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 a well in the Daszewo field,
- Completion of development of a well in the Załęże field,
- Completion of development of the Księżpol 19 well,
- Completion of development of a well in the Grodzisk field,
- Development of wells in the Brońsko field,
- Development of a well in the Wilków field,
- Development of the Połęcko oil and gas field.

Trade and Storage

The capex of the Trade and Storage segment amounted to PLN 107m. Major investment projects in H1 2015 included construction and extension of underground gas storage facilities, including:

- Construction of the Kosakowo underground gas storage cavern facility – pipelines connecting clusters A and B were completed and the leaching of cavern KB in cluster A continued,
- Expansion of the Mogilno underground gas storage cavern facility – cavern Z-15 was placed in service, cavern Z-17 was filled with gas for the first time and cavern Z-16 started to be filled with gas,
- Expansion of the Brzeźnica underground gas storage facility to reach a working capacity of 100mcm.

In March 2015, the project 'Construction of the surface installations of the Wierzchowice Underground Gas Storage Facility, phase: 3.5bn Nm3, sub-phase: 1.2bn Nm3' (commenced in 2008) was completed. In 2014, after the construction work had been completed and the storage unit had undergone acceptance, additional storage capacity was made available at the Wierzchowice underground gas storage facility, totalling 1.2 bcm. In 2015, the power section (the turboexpander) underwent start-up and the project was settled. The expenditure on the project was ca. PLN 2.3bn, while EU co-financing under the Infrastructure and Environment Operational Programme amounted to approximately PLN 475m by June 30th 2015.

Distribution

Capital expenditure incurred by the PGNiG Group in the Distribution segment amounted to PLN 443m. 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.

Generation

Starting from 2016, Poland will be subject to more stringent standards of gas and dust emission, for which reason the modernisation of power plants and CHP plants is necessary. In order to meet the more stringent emission requirements, PGNiG TERMIKA S.A. has gradually been modernising its generating assets. Capital expenditure of the Generation segment amounted to PLN 95m, of which approximately PLN 17m was spent on environmental protection projects. Furthermore, in H1 2015 the Generation segment continued some of the investment projects commenced in previous years. The most important of these were:

- Construction of a 450 MW CCGT unit at the Żerań CHP plant. In H1 2015, a final permit for the construction of the CCGT unit at the Żerań CHP plant was obtained and construction site preparation was completed;
- Conversion of the K1 boiler at the Siekierki CHP Plant. Work carried out in H1 2015 involved construction and installation work at biomass unloading, storage and feeder systems, assembly work at the boiler's ancillary equipment and systems; installation of electrical systems of the boiler and biomass management units commenced, and the boiler setting was dried;
- Conversion of the Pruszków CHP plant. Work carried out in H1 2015 included construction work at the wastewater treatment station, installation work related to connecting the new station to the Pruszków CHP plant's technological systems, and update of the conversion concept for the Pruszków CHP plant; installation of the cyclone filter at the K9 boiler also commenced;
- Construction of a gas- and oil-fired peak-load and reserve boiler house at the Żerań CHP plant; following the cancellation of the tender procedure in 2014, the tender documentation was updated in 2015.

Other Activities

In H1 2015, the Other Activities segment incurred capital expenditure on property, plant and equipment and intangible assets of PLN 2m. 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 2015, a total of 10 wells and 13 extraction pits were abandoned.

Carbon credit trading system (*EU ETS)*

In H1 2015, the PGNiG Group reviewed annual reports on its carbon dioxide emissions for 2014. Carbon emissions from the installations covered by the EU ETS scheme in 2014 totalled 5,788,782 tonnes. After reconciling its CO_2 emissions with emission rights held, and after redeeming the allowances allocated for 2014, a deficit of 2,152,777 tonnes of 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. In 2014, 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, the Mogilno Underground Gas Storage Cavern Facility, the LMG Oil and Gas Production Facility, the Wierzchowice Underground Gas Storage Facility and the Kosakowo Underground Gas Storage Cavern Facility were covered by the carbon dioxide emission trading scheme (ETS). In H1 2015, the Group emitted 3,116,070 tonnes 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 2015, following amendments to the Environmental Protection Law, land properties underwent another review to classify them as requiring reclamation, additional surveys or monitoring.

Environmental protection in drilling operations

Drilling operations performed as part of exploration for and production of hydrocarbons affect the environment in the area where they are performed. Drilling operations cause a temporary change in the character of the land, increased emissions of gases and exhaust fumes, higher noise intensity and generation of waste.

To protect land surface, drilling equipment is installed on tightly insulated ground, and any waste generated in connection with borehole drilling or human presence on the drilling site is collected in tightly-sealed vessels and transferred to authorised waste management operators. Diesel oil tanks are stored in special containers. Emissions of gases and exhaust fumes into the atmosphere are limited by maintaining the drilling rig engines in excellent operating condition and using quality fuel to run the engines. Noise intensity is reduced by using machinery and equipment that produce less noise. Special devices are used to minimise the volume of drilling waste, for instance through drilling mud recycling. On the other hand, the volume of waste generated in connection with the operation of drilling equipment is limited through the use of modern long-life engine, gear and lubricating oils.

In H1 2015, as part of the effort to limit the environmental impact of its drilling operations, Exalo Drilling S.A. purchased the final components of a mobile evaporator system (for drilling waste neutralisation), water tanks and fuel tanks, and overhauled a centrifuge.

Environmental impact of the Kosakowo underground gas storage cavern facility

One of the stages in the construction of the Kosakowo underground gas storage cavern facility consists in washing out (leaching) salt from halite deposits. The process creates brine, which is transported to the Puck Bay (Mechelinki region) through a pipeline equipped with diffusers releasing the brine 2,300 metres from the coastline at a rate of (average flow rate) Qav hour = 300 m^3/h and Qav day = 7,200 m^3/d, and with a salt concentration of 250 kg/m^3. The leaching of caverns at the Kosakowo underground gas storage cavern facility began in September 2010 and is scheduled for completion by 2021.

Steps are taken throughout the course of the project to monitor the technical condition and correct operation of the pipeline and diffusers, and the impact of the released brine on the Puck Bay’s environment. Appropriate surveys and analyses are also carried out. To date, the Kosakowo underground gas storage cavern facility has not been identified to have a harmful effect on the surrounding environment or the waters of the Puck Bay. The monitoring activities are conducted by two independent bodies: the Maritime Institute of Gdańsk and the Institute of Hydroengineering of the Polish Academy of Sciences of Gdańsk, as well as by the personnel of the Kosakowo underground gas storage cavern facility.

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). H1 2015 saw the conclusion of work on dismantling the technical infrastructure between the Żerań CHP plant and the landfill site, while macrolevelling and soil compaction continued in Cell No. 3. The full scope of the reclamation work is scheduled for completion in 2016.

Fulfilment of the requirements of the Industrial Emissions Directive and BAT

In H1 2015, in an effort to meet the environmental standards provided for in Directive 2010/75/EU of the European Parliament and of the Council on industrial emissions (IED) and future requirements related to the best available techniques (BAT), PGNiG TERMIKA S.A. is pursuing further investment projects designed to reduce atmospheric gas and dust emissions, such as:

- Conversion of coal-fired boiler No. 1 at the Siekierki CHP plant into a biomass-fired unit; the converted boiler is to be placed in service late in 2015; the expected annual reduction of pollutants into the atmosphere comprises: reduction of CO2 emissions by 227,000 tonnes, SO2 emissions − by 780 tonnes, NOx emissions − by 260 tonnes and particulate matter emissions −by 20 tonnes;
- Provision of the fluidised bed boilers at the Żerań CHP plant with high efficiency dust collectors (bag filters) and thus enhancing the desulfurisation process; the project is scheduled for completion late in 2015;
- Conversion of mazout-fired water boilers at the Siekierki CHP plant and the Wola Heating Plant into light oil units, including modernisation of their burners; the project is scheduled for completion at the end of 2015.

The company also began the upgrade of the atmosphere protection system at the Siekierki CHP plant’s boiler No. 2. Under the project, the existing semi-dry flue gas desulfurisation unit will be upgraded and a nitrogen oxide removal system will be fitted, which will reduce SO_2 emissions by 374 tonnes annually and NO_x emissions by 162.6 tonnes annually. The upgrade project is scheduled for completion in early 2017.

Noise reduction project at the Siekierki CHP plant

In H1 2015, PGNiG TERMIKA S.A. completed the construction of noise barrier walls around transformers located in the Siekierki CHP Plant switch room in the western part of the plant. The project reduce noise emissions by 9 dB. In past years, noise barrier walls along the eastern border of the Plant's premises and along coal unloading points located at the hump tracks were completed.

Biomass supplies

In the performance of the requirements stipulated in Directive 2009/28/EC on the promotion of the use of energy from renewable sources, PGNiG TERMIKA S.A. acquires biomass primarily from contracted purchases on the market. The company also concludes long-term contracts for the supply of biomass from energy willow plantations. Currently, the company procures biomass from plantations with a total area of 407ha. In H1 2015, PGNiG TERMIKA S.A. consumed 9,306 tonnes of biomass for co-fired generation. Thanks to the use of biomass as a fuel, CO_2 emissions were reduced by 8,622 tonnes in H1 2015.

Section XIII: Other information

Distribution of the 2014 profit

On April 16th 2015, the Annual General Meeting of PGNiG S.A. passed a resolution to distribute the 2014 net profit of PLN 1,895m. The profit was distributed as follows:

- PLN 715m was allocated to the Company statutory reserve funds,
- PLN 1,180m was allocated for dividend payments (dividend per share of PLN 0.20).

The Annual General Meeting of PGNiG S.A. set July 15th 2015 as the dividend record date and August 4th 2015 as the dividend payment date.

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

On April 16th 2015, 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 2014.

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. In the judgement of May 29th 2015, the Court of Appeals amended the decision issued by the President of the UOKiK where it referred to the amount of the fine by reducing the fine to PLN 5,508,581. The judgement is final. PGNiG S.A. will decide whether to lodge a cassation after reading the written grounds to the Warsaw Court of Appeals’ judgement.

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. complied with the obligations imposed by the decision of the President of UOKiK within the prescribed time limits. On August 1st 2014, PGNiG Obrót Detaliczny Sp. z o.o. took over the gas retail business from PGNiG S.A. and consequently assumed all rights and obligations under the decisions issued by the President of UOKiK on the basis of the Act on Competition and Consumer Protection to the extent they related to agreements to which PGNiG Obrót Detaliczny Sp. z o.o. became a party. PGNiG Obrót Detaliczny Sp. z o.o. performed in full (to the extent corresponding to its scope of business) the obligations set forth in the conclusion of President of UOKiK's decision of December 31st 2013.

On October 17th 2014, the President of UOKiK commenced administrative proceedings to impose a fine under Art. 107 of the Act on Competition and Consumer Protection of February 16th 2007 (consolidated text in Dz.U. of 2015, item 184) on PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. on suspicion of a delay in compliance with Section I).4) of the conclusion of the President of UOKiK's decision of December 31st 2013. In their response, PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. presented grounds for their actions and their position whereunder such actions comply with Section I).4) of the conclusion of the President of UOKiK's decision of December 31st 2013. By the date of this report, the President of UOKiK had not issued any final ruling on the case.

Collective dispute with the employer

On May 21st 2015, a collective dispute was initiated between PGNiG trade unions and the PGNiG Management Board, after the Management Board had rejected the following demands put forward by the trade unions: to set the remuneration growth rate for 2015 at 6%; to increase the value of vouchers to PLN 2,000 per year; and to distribute the 2014 annual bonus in an amount equal to 11.7% of the calculation basis, that is in accordance with the rules applied to payment of the annual bonus for 2013.

In accordance with the Collective Bargaining Agreement applicable at the Company, requests concerning remuneration growth and increase in the value of vouchers may not be the subject matter of a collective dispute. Under the Collective Labour Agreement, if a pay increase has not been negotiated with the social partners, the decision falls within the Employer's remit. As regards the vouchers, the Employer has the sole power to determine their value. Thus the subject matter of the dispute is the distribution of the 2014 annual bonus in an amount equal to 11.7% of the calculation basis, that is in accordance with the rules applied to payment of the annual bonus for 2013.

As regards payment of the annual bonus for 2014, the Company did not fulfil the expectations of the social partners for the following reasons:

- deregulation of the Polish gas market and increased competition;
- changes in the market environment (severe decline in crude oil prices on global markets); and
- changes of the regulatory regime.

Taking into account the above-mentioned reasons, the PGNiG Management Board decided not to grant the demands put forward by the PGNiG trade unions. The Management Board also 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 2015, 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 2015 have been prepared in accordance with the International Financial Reporting Standards (IFRS) as endorsed by the European Union as at June 30th 2015. The accounting policies applied in preparing the financial statements are presented in the interim condensed consolidated financial statements of the PGNiG Group for the six months ended June 30th 2015 (Note III.4).

1. Financial data of the Parent

Summary information on PGNiG S.A.'s financial performance in H1 2015 is presented in the tables below.

Financial highlights (PLNm)

	H1 2015	H1 2014
Revenue	10,223	13,689
Total operating expenses, including	(9,188)	(12,727)
Depreciation and amortisation expense	(359)	(353)
Operating profit	1,035	962
Profit before tax	1,912	1,555
Net profit	1,703	1,366
Net cash (used in)/generated by operating activities	1,073	1,771
Net cash (used in)/generated by investing activities	557	(167)
Net cash (used in)/generated by financing activities	163	(1,009)
Net increase/(decrease) in cash and cash equivalents	1,793	595
	Jun 30 2015	Dec 31 2014
Total assets	36,978	35,356
Non-current assets	27,020	27,387
Current assets, including	9,958	7,969
Inventories	2,095	2,506
Other assets	86	20
Total equity	24,475	23,780
Total non-current liabilities	7,021	7,385
Total current liabilities	5,482	4,191
Total liabilities	12,503	11,576
Total equity and liabilities	36,978	35,356

Financial ratios

Profitability

	H1 2015	2014
EBIT (PLNm) operating profit	1,035	962
EBITDA (PLNm) operating profit + depreciation/amortisation	1,394	1,315
ROE net profit to equity at end of the period	7.0%	5.7%
NET MARGIN net profit to revenue	16.7%	10.0%
ROA net profit to assets at end of the period	4.6%	3.9%

Liquidity

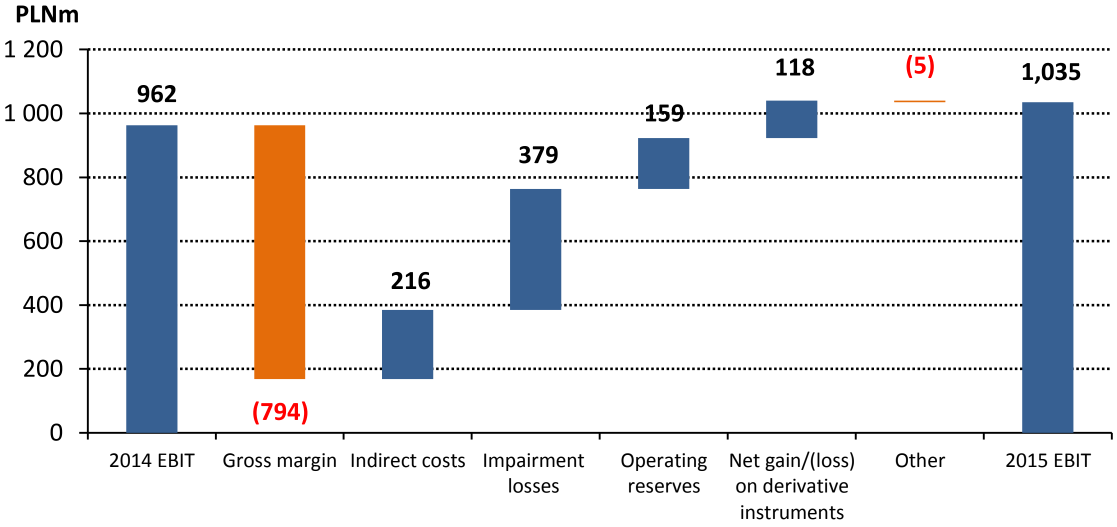
	Jun 30 2015	Dec 31 2014
CURRENT RATIO current assets to current liabilities (net of employee benefit obligations, provisions and deferred income)	2.0	2.2
QUICK RATIO current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred income)	1.5	1.5

Debt

	Jun 30 2015	Dec 31 2014
DEBT RATIO total liabilities to total equity and liabilities	33.8%	32.7%
DEBT/EQUITY RATIO total liabilities to equity	51.1%	48.7%

Year on year, PGNiG S.A.'s operating profit (EBIT) rose by PLN 73m. The chart below shows changes in EBIT from H1 2014 to H1 2015.

Change in EBIT: H1 2014 vs H1 2015



Gross margin (the difference between revenue and direct cost) on sales of products and services was down PLN 794m, chiefly due to lower average selling prices of high-methane gas, crude oil and helium. The drop in average selling prices of high-methane gas was caused mainly by a higher volume of trading executed on the Polish Power Exchange following the transfer of the retail business from PGNiG S.A. to PGNiG Obrót Detaliczny Sp. z o.o. in H2 2014. Gas selling prices were also affected by two reductions of tariff selling prices of gas fuel approved by the President of the Energy Regulatory Office on December 17th 2014 and April 16th 2015. At the same time, lower prices of gas at the *TTF* (*Title Transfer Facility*) and of Brent crude oil brought down the unit gas costs, but not enough to offset the lower selling prices. The selling prices of crude oil and helium followed the market prices of petroleum products. The progressing decline of Brent crude prices (since November 2014) had a negative effect on revenue from sales of crude oil. In H1 2015, the prices dropped by ca. 45% year on year. The weakening of the Polish zloty offset, to some degree, the impact of that process on foreign-currency revenue. The margin on sales of other products remained stable year on year.

Indirect costs were down PLN 216m, which resulted mainly from the transfer of the retail business from PGNiG S.A. to PGNiG Obrót Detaliczny Sp. z o.o. in H2 2014.

The main drivers of the increase in operating profit (EBIT) were:

- Lower impairment losses on property, plant and equipment and assets under construction for assets related to exploration for and evaluation of resources;
- Reversal of high-methane gas inventory write-downs (resulting from market valuation of high-methane gas inventories based on forecast selling prices);
- Change in operating reserves (mainly due to reversal of provisions for well decommissioning costs); and
- Improved results of the applied hedging policy.

Despite the impairment losses, the upstream business continued to secure the stability of the Company's financial position.

In H1 2015, net finance income/cost was up PLN 284m year on year, driven by PLN 304m higher dividends from subsidiaries.

The Company's financial position was reflected in its key financial ratios. ROE, ROA and net margin increased from 5.7% to 7.0%, from 3.9% to 4.6% and from 10.0% to 16.7%, respectively.

2. Financial performance of the PGNiG Group

In H1 2015, the PGNiG Group net profit was PLN 1,865m, up PLN 345m year on year.

Summary information on the PGNiG Group's financial standing in H1 2015 is presented below in the financial statements prepared in accordance with the International Financial Reporting Standards, which comprise:

- condensed consolidated statement of financial position,
- condensed consolidated statement of profit or loss,
- condensed consolidated statement of cash flows,
- selected financial ratios.

Condensed consolidated statement of financial position (PLNm)

ASSETS	Jun 30 2015	Dec 31 2014
Total non-current assets	36,882	37,692
Property, plant and equipment	33,088	33,528
Investment property	8	9
Intangible assets	1,121	1,113
Investments in equity-accounted entities	857	856
Other financial assets	250	243
Deferred tax assets	1,401	1,783
Other non-current assets	157	160
Total current assets	11,546	11,234
Inventories	2,651	3,189
Trade and other receivables	2,414	4,236
Current tax assets	26	5
Other assets	402	132
Derivative financial instrument assets	472	567
Cash and cash equivalents	5,435	2,958
Assets held for sale	146	147
Total assets	48,428	48,926

Condensed consolidated statement of financial position (PLNm) – cont.

LIABILITIES AND EQUITY	Jun 30 2015	Dec 31 2014
Total equity	31,056	30,169
Share capital	5,900	5,900
Share premium	1,740	1,740
Accumulated other comprehensive income	(66)	(270)
Retained earnings	23,478	22,794
Equity attributable to owners of the parent	31,052	30,164
Equity attributable to non-controlling interests	4	5
Total non-current liabilities	11,630	12,384
Borrowings and other debt instruments	4,800	5,069
Employee benefit obligations	532	604
Provisions	1,544	1,803
Deferred revenue	1,559	1,581
Deferred tax liabilities	3,133	3,250
Other non-current liabilities	62	77
Total current liabilities	5,742	6,373
Trade and other payables	3,791	3,589
Borrowings and other debt instruments	390	769
Derivative financial instrument liabilities	417	593
Current tax liabilities	9	191
Employee benefit obligations	368	284
Provisions	610	720
Deferred revenue	157	227
Total liabilities	17,372	18,757
Total equity and liabilities	48,428	48,926

Condensed consolidated statement of profit or loss (PLNm)

	H1 2015	H1 2014
Revenue	20,390	16,381
Total operating expenses	(17,781)	(14,212)
Raw materials and consumables used	(13,724)	(9,438)
Employee benefits expense	(1,281)	(1,373)
Depreciation and amortisation expense	(1,387)	(1,298)
Services	(1,278)	(1,400)
Work performed by the entity and capitalised	435	375
Other income and expenses	(546)	(1,078)
Operating profit	2,609	2,169
Finance income	50	46
Finance costs	(108)	(152)
Share in net profit/(loss) of equity-accounted entities	-	-
Profit before tax	2,551	2,063
Income tax	(686)	(543)
Net profit	1,865	1,520
Attributable to:		
Owners of the parent	1,864	1,519
Non-controlling interests	1	1
Earnings and diluted earnings per share attributable to holders of ordinary shares of the parent (in PLN)	0.32	0.26

Condensed consolidated statement of cash flows (PLNm)

	H1 2015	H1 2014
Net cash (used in)/generated by operating activities	4,629	3,703
Net cash (used in)/generated by investing activities	(1,510)	(1,239)
Net cash (used in)/generated by financing activities	(639)	(1,634)
Net increase/(decrease) in cash and cash equivalents	2,480	830
Cash and cash equivalents at beginning of the period	2,956	2,826
Cash and cash equivalents at end of period	5,436	3,656

Financial ratios

Profitability

	H1 2015	2014
EBIT (PLNm) operating profit	2,609	2,169
EBITDA (PLNm) operating profit + depreciation/amortisation	3,996	3,467
ROE net profit* to equity at end of the period**	6.0%	5.0%
NET MARGIN net profit* to revenue	9.1%	9.3%
ROA net profit* to assets at end of the period	3.8%	3.1%

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

** equity attributable to owners of the parent

Liquidity

	Jun 30 2015	Dec 31 2014
CURRENT RATIO current assets to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	2.5	2.2
QUICK RATIO current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred income)	1.9	1.6

Debt

	Jun 30 2015	Dec 31 2014
DEBT RATIO total liabilities to total equity and liabilities	35.9%	38.3%
DEBT/EQUITY RATIO total liabilities to equity*	55.9%	62.2%

* Equity attributable to owners of the parent.

The PGNiG Group's revenue in H1 2015 was PLN 20,390m, up by PLN 4,009m (24%) year on year. Despite higher operating expenses, up by PLN 3,569m (25%), the PGNiG Group was able to deliver a consolidated operating profit of PLN 2,609m for H1 2015, up by PLN 440m (20%) year on year.

Exploration and Production

Operating profit of the Exploration and Production segment was PLN 847m, down PLN 469m (36%) H1 2014. At PLN 1,542m, EBITDA was lower than the year before – by PLN 399m (21%).

The segment's revenue decreased by PLN 893m (26%) year on year, to PLN 2,533m, despite a 9% increase in the volume of crude oil sales (mainly from deposits in Norway, where sales grew by approximately 30%). The revenue decline reflected a slump in crude oil prices (the average price of Brent in PLN was approximately 35% lower in H1 2015 than in the previous year). The segment's operating expenses were down PLN 424m (20%) on the back of lower impairment losses on the segment's assets, which in H1 2015 lowered the segments' profit by PLN 341m (PLN 541m in H1 2014).

In addition, reversal of provisions for well decommissioning costs added PLN 139m to the segment's operating profit, compared with a negative effect of PLN -21m in the same period of the previous year. The reversal was a result of a lower average decommissioning cost and the higher discount rate.

Trade and Storage

An improvement in efficiency was recorded in the Trade and Storage segment, where operating profit went up by PLN 661m year on year, to PLN 741m. The segment's performance in H1 2015 was mainly driven by the cost and structure of gas fuel procurement.

Year on year, revenue was up by PLN 4,518m (34%), driven principally by higher revenue from gas traded on the Polish Power Exchange, whose volume was 4.4bcm as at the end of H1 2015, relative to 0.2bcm the year before. The segment's operating expenses were up by PLN 3,857m (29%) on the back of higher expenses attributable to gas fuel purchased on the Polish Power Exchange by PGNiG Obrót Detaliczny Sp. z o.o. Sales made on the Polish Power Exchange by PGNiG S.A. and purchases made on the Polish Power Exchange by PGNiG Obrót Detaliczny Sp. z o.o., which commenced operations on August 1st 2014, are not subject to elimination from the consolidated financial statements.

The segment's performance was also driven by changes in the structure and price of gas fuel imports (the volumes of gas fuel sold to external customers and gas fuel imports were similar year on year). Changes in the structure of gas imports by PGNiG S.A. in relation to the same period of the previous year were as follows:

- Higher share of imports from sources other than the markets east of Poland − an increase of 73%, to 1. bcm. These included mainly gas fuel imported from Western European markets, where prices of the fuel, in Polish zloty, fell by approximately 3% in H1 2015 relative to the corresponding period of the previous year;
- Lower share of gas fuel imports from sources east of Poland − a drop of nearly 11%, to 4.1 bcm. The price of gas fuel imported from markets east of Poland was driven by the nine-month average price of crude oil which fell, in Polish zloty, by 13.2%, as well as market prices of gas in Western Europe, which fell by approximately 3%.

The increase in the segment's operating profit followed also from a reversal of impairment losses on stocks (mainly gas stocks) − the change in write-downs added approximately PLN 189m to the segment's operating result.

Stocks of gas in underground storage facilities totalled approximately 1.8 bcm as at June 30th 2015, i.e. 12% less than a year before.

Distribution

The Distribution segment’s operating profit in H1 2015 increased 14% year on year, to PLN 779m, while its EBITDA came in at PLN 1,218m, up by PLN 105m on the year before. The performance improved partly on the back of PLN 178m higher revenue, which increased chiefly as a result of change of the tariff for gas fuel distribution services. The average distribution service charge rates increased by 3% relative to the previous tariff. There was a slight increase in the segment’s operating expenses (5%), caused mainly by recognition in Q1 2015 of a provision for workforce optimisation. The provision was used in Q2 2015, and lowered the segment’s profit by PLN 96m.

Generation

The segment’s operating profit for H1 2015 was PLN 251m, up PLN 118m year on year. EBITDA was PLN 412m, having improved by 43% on H1 2014. The following factors contributed to the significant improvement:

- Higher revenue from sale of heat, resulting mainly from a 6% increase in the heat tariff;
- Lower procurement costs of coal, the segment’s main fuel for heat production (the average price of coal in H1 2015 was 7% lower than in the same period of the previous year).

Operating performance by segment

Financial data of the PGNiG Group's segments for H1 2015 (PLNm)

H1 2015	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to external customers	1,704	17,660	260	669	97	0	20,390
Inter-segment sales	829	164	2,134	362	64	(3,553)	0
Segment's total revenue	2,533	17,824	2,394	1,031	161	(3,553)	20,390
Segment's expenses	(1,686)	(17,083)	(1,615)	(780)	(165)	3,548	(17,781)
Operating profit/(loss)	847	741	779	251	(4)	(5)	2,609
Net finance costs							(58)
Share in net profit/(loss) of equity-accounted entities	-	-	-	-	-	-	0
Profit before tax							2,551
Income tax							(686)
Net profit							1,865

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 external customers	2,484	13,120	78	608	91	0	16,381
Inter-segment sales	942	186	2,138	427	59	(3,752)	0
Segment's total revenue	3,426	13,306	2,216	1,035	150	(3,752)	16,381
Segment's expenses	(2,110)	(13,226)	(1,534)	(902)	(204)	3,764	(14,212)
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	-	-	-	-	-	-	0
Profit before tax							2,063
Income tax							(543)
Net profit							1,520

The Group's financial result was also affected by its net result on financing activities, which improved by PLN 48m (45%), chiefly on the back of lower interest expense following a reduction in borrowings.

Statement of financial position

As at June 30th 2015, total assets recognised in the consolidated statement of financial position were PLN 48,428m, down PLN 498m (-1%) on the end of 2014.

Assets

Property, plant and equipment represents the largest component of the Group's assets. As at June 30th 2015, this item amounted to PLN 33,088m, having decreased by PLN 440m (or 1%) relative to December 31st 2014.

Deferred tax assets went down by PLN 382m (or 21%) on realisation of the tax loss in Norway by subsidiary PGNiG Upstream International AS (the tax loss has been accounted for since the launch of gas production from the company's fields on the Norwegian Continental Shelf).

Trade and other receivables decreased by PLN 1,822m, to PLN 2,414m, on the back of repayment of trade receivables related to sales of gas (seasonality of sales). Lower receivables translated into higher cash and cash equivalents, which stood at PLN 5,435m as at June 30th 2015, up PLN 2,477m on the end of 2014.

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 2.5, compared with 2.2 at the end of December 2014, while the quick ratio rose to 1.9 from 1.6 at the end of 2014.

Equity and liabilities

Equity is the primary source of financing of the PGNiG Group's assets. Relative to the end of 2014, the Group's equity rose by PLN 887m (or 3%), primarily on the back of the net profit for the period of PLN 1,865m and the PLN 1,180m dividend for 2014, approved for payment.

As at June 30th 2015, non-current liabilities were PLN 11,630m, down PLN 754m on the end of December 2014. Current liabilities totalled PLN 5,742m as at June 30th 2015, having decreased by PLN 631m (10%) relative to the end of 2014. The following factors contributed to lower current and non-current liabilities:

- Lower provisions for well decommissioning costs, which were reversed because of the higher discount rate and lower average decommissioning cost per well, with non-current and current provisions down PLN 259m (14%) and PLN 110m (15%), respectively;
- Repayment of borrowings and redemption of debt securities in H1 2015, with the non-current and current portion of liabilities under borrowings and debt securities down PLN 269m (5%) and PLN 379m (49%) year on year.

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 62.2% as at the end of 2014 to 55.9% as at June 30th 2015. Debt ratio (total liabilities to total equity and liabilities) fell from 38.3% to 35.9%.

Transactions concluded on non-arm's length terms

In H1 2015, no transactions were concluded on non-arms' length terms between related entities of the PGNiG Group.

Guarantees and sureties

In H1 2015, 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 5th 2014, PGNiG S.A. published a forecast of the PGNiG Group's consolidated performance in 2015. The forecast provides for the PGNiG Group's revenue of ca. PLN 40.9bn, EBITDA of ca. PLN 5.8bn and the debt ratio of no more than 2x EBITDA.

An analysis of the financial results for H1 2015, 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 Group's financial performance will continue to be affected by the considerable volatility of hydrocarbon prices and exchange rates, natural gas prices on the regulated market and commodity exchanges, as well as the increasing deregulation of the Polish gas market. These factors will be reflected in particular in the performance of the Exploration and Production and Trade and Storage segments.

The prices of crude oil, petroleum products and gas are an essential factor determining the PGNiG Group's financial position. After falling to almost USD 40 per barrel in early 2015, crude prices stabilised at approximately USD 60 per barrel, but are expected to drop once again, driven mainly by the expected increase in crude exports from Iran following the nuclear deal, and the fact that *OPEC* (*Organization of the Petroleum Exporting Countries*) did not announce any plans to reduce oil production. High supply should lead to lower market prices, with cheap oil translating into lower sales revenue and reduced demand for seismic and exploration services provided by Group companies. If crude prices remain low in the coming quarters, the Group may have to recognise impairment losses on its exploration and production assets, which would negatively affect the performance of the Exploration and Production segment. Conversely, in the case of the Trade and Storage segment − given that oil prices affect the price of gas imported by the Company − the prevailing low oil prices may have a positive effect on the cost of gas and thus the Group's performance in this segment.

Conditions prevailing on the currency markets are another significant factor behind the PGNiG Group's financial performance. The Ukraine arrangement and the deal between Greece and its creditors reduces the risk of zloty depreciating. Market conditions causing zloty to appreciate against other currencies (in particular the US dollar) should improve the performance of the Trade and Storage segment by reducing the cost of gas imports incurred by PGNiG S.A. As the Group's performance is correlated with the exchange rates between the zloty and other currencies, Group companies will apply a hedging policy to optimise the impact of foreign exchange risk.

Other drivers of Group's performance are the rates and charges provided for in the gas fuel tariffs and quoted gas prices. The tariffs have been reduced twice already in 2015, impairing the performance of the Trade and Storage segment. If tariff rates continue to fall, the natural gas sales margins may decline.

The progressing deregulation of the Polish gas market and the resulting diversification of supplies by PGNiG's key customers may force the Group to export its surplus gas at prices which fail to cover the actual cost of procurement under long-term contracts. To maintain sales to existing customers, Trade and Storage companies are implementing discount schemes which reduce the profitability of sales. The Group is also implementing projects designed to improve its effectiveness and cut operating costs. These efforts, which target both the market and the Group's internal structure, should have a positive bearing on future performance.

In the coming quarters, the Group intends to maintain a high level of capital expenditure. Spending will focus primarily on projects involving expansion of the underground storage capacities, 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. A factor particularly important for the PGNiG Group's long-term development will be possible acquisitions of production assets outside Poland.

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	Zbigniew Skrzypkiewicz	....
Vice-President of the Management Board	Waldemar Wójcik	....