DIRECTORS' REPORT ON THE OPERATIONS PGNiG S.A. IN 2015

Polskie Górnictwo Naftowe i Gazownictwo SA

Warsaw, February 19th 2016

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Section I: Company's highlights

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG S.A.), with its registered office in Warsaw, ul. Marcina Kasprzaka 25, was incorporated through transformation of the state-owned enterprise Polskie Górnictwo Naftowe i Gazownictwo into a state-owned stock company. The Deed of Transformation, together with the Company's Articles of Association, were executed in the form of a notary deed (No. A 18871/96 in the Register of Notary Deeds) on October 21st 1996.

On October 30th 1996, the Company was entered in the commercial register as Polskie Górnictwo Naftowe i Gazownictwo S.A. of Warsaw, under No. RHB 48382. As of the date of entry in the commercial register, the Company became a legal entity. On November 14th 2001, it was entered in the register of entrepreneurs of the National Court Register under No. 0000059492.

Currently, the share capital of PGNiG S.A. amounts to PLN 5.9bn and is divided into 5,900,000,000 shares with a par value of PLN 1 per share.

The Company floated its shares on the Warsaw Stock Exchange on September 23rd 2005. PGNiG shares have been listed on the Warsaw Stock Exchange since October 20th 2005.

1. Business scope

PGNiG S.A. is the largest Polish company in the hydrocarbon exploration and production industry, and on the natural gas market. In 2015, it remained the leader in all areas of the Polish gas sector, including natural gas import, exploration, oil and gas production, gas fuel storage and sale of natural gas.

Pursuant to its Articles of Association, the Company'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. Organisational structure of PGNiG S.A.

On December 31st 2014, the Wierzchowice Underground Gas Storage Facility Branch in Czarnogoździce was wound up. By a decision of the PGNiG Management Board, it was incorporated into the Zielona Góra Branch.

On March 1st 2015, following reorganisation of the underground gas storage cavern facility business, the Mogilno Underground Gas Storage Cavern Facility Branch in Palędzie Dolne was wound up.

On April 7th 2015, the Egypt Branch was wound up and deleted from the Egyptian commercial register (maintained by the *General Authority for Investments* (*GAFI*)). The decision to terminate the Bahariya licence (Block 3) and close down the branch was made after completion of the exploration work within the licence area in 2013.

PGNiG S.A. operates as a multiple-unit structure. As at December 31st 2015, the structure comprised the Head Office and 8 branches. The table below presents the business scope of PGNiG S.A.'s organisational units.

Business scope of PGNiG S.A.'s organisational units

Organisational unit	Business scope
Head Office in Warsaw	Corporate supervision of the Company branches Owner's supervision of the PGNiG Group
Geology and Hydrocarbon Production Branch in Warsaw	Exploration for crude oil and natural gas in Poland and abroad Supervision of Group companies engaged in hydrocarbon exploration and production
Sanok Branch	Production of natural gas and crude oil and operation of underground gas storage facilities Supply of natural gas to municipal and industrial customers
Zielona Góra Branch	Production of natural gas and crude oil and operation of underground gas storage facilities Supply of natural gas to municipal and industrial customers
Odolanów Branch	Processing of nitrogen-rich natural gas into high-methane gas
Operator Branch in Pakistan	Exploration for and production of hydrocarbons in licence areas in Pakistan
Well Mining Rescue Station in Kraków	Provision of rescue services to the petroleum extraction industry
Wholesale Trading Division in Warsaw	Trade in natural gas, electricity and related products, crude oil and condensate Organisation and supervision of wholesale trade within the PGNiG Group
Central Measurement and Testing Laboratory in Warsaw	Provision of services ensuring the accuracy and reliability of measurements related to natural gas

As at December 31st 2015, PGNiG S.A. operated foreign representative offices in Moscow (Russia), Brussels (Belgium), Kiev (Ukraine) and Vysokoye (Belarus).

<u>Changes in management policies</u>

In 2015, the PGNiG Group reorganised its underground gas storage cavern facility business. The Group designated Operator Sytemu Magazynowania Sp. z o.o. to operate and maintain the Mogilno Underground Gas Storage Cavern Facility, and to manage the extraction facility operations. The employees of the Mogilno Underground Gas Storage Cavern Facility in Palędzie Dolne were transferred to OSM Sp. z o.o., and the branch was liquidated.

In 2015, the PGNiG Group also made organisational changes in its trade business. Based on the assets of PGNiG Sales & Trading GmbH operating in Germany a new company was established – PST Europe Sales GmbH. The principal business of the new entity is the sale of natural gas and electricity to end consumers. The business of PGNiG Sales & Trading GmbH (whose name was changed to PGNiG Supply & Trading GmbH) now consists in the wholesale of natural gas and electricity.

3. Ownership interests in other related entities

PGNiG S.A. holds shares in companies involved in production, trade or services. As at December 31st 2015, PGNiG S.A. had 38 directly and indirectly related entities, including:

- 30 subsidiaries (including 19 directly held)
- 8 other related entities (including 5 directly related)

The tables below present related entities of PGNiG S.A. as at December 31st 2015.

Subsidiaries of PGNiG S.A.

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	Ownership interest: PGNiG S.A.	Ownership interest: PGNiG Group
	Subsidiaries – 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)	20,000	20,000	100.00%	100.00%
6	PGNiG Supply & 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	PGNiG TERMIKA S.A.	670,324,950	670,324,950	100.00%	100.00%
12	PGNiG Finance AB (SEK)1)	500,000	500,000	100.00%	100.00%
13	PGNiG Serwis Sp. z o.o.	9,995,000	9,995,000	100.00%	100.00%
14	PGNiG Obrót Detaliczny Sp. z o.o.	1,091,000,000	1,091,000,000	100.00%	100.00%
15	PGNiG SPV 5 Sp. z o.o.	250,000	250,000	100.00%	100.00%
16	PGNiG SPV 6 Sp. z o.o.	51,381,000	51,381,000	100.00%	100.00%
17	PGNiG SPV 7 Sp. z o.o.	250,000	250,000	100.00%	100.00%
18	GAS-TRADING S.A.	2,975,000	1,291,350	43.41%	79.58%2)
19	B.S. i P.G. Gazoprojekt S.A.	4,000,000	900,000	22.50%	75.00%3)
	Subsidiaries – second tier				
20	Powiśle Park Sp. z o.o.	81,131,000	81,131,000	-	100.00%
21	PST Europe Sales GmbH (EUR)1)	1,000,000	1,000,000		100.00%
22	Oil Tech International F.Z.E. (USD)1)	20,000	20,000	-	100.00%
23	Zakład Gospodarki Mieszkaniowej Sp. z o.o.	1,806,500	1,806,500	-	100.00%
24	NYSAGAZ Sp. z o.o.	9,881,000	9,881,000	-	100.00%
25	GAZ Sp. z o.o.	300,000	240,0004)	-	100.00%
26	Gas Assets Management Sp. z o.o.	20,000	20,000	-	100.00%
27	Poltava Services LLC (EUR)1)	20,000	19,800	-	99.00%
28	Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000	2,565,350	-	85.51%
29	Gas-Trading Podkarpacie Sp. z o.o.	6,670,627	5,257,524	-	78.82%5)

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	Ownership interest: PGNiG S.A.	Ownership interest: PGNiG Group
	Subsidiaries – third tier				
30	XOOL GmbH (EUR)[1)]	500,000	500,000	-	100%

[1)] In foreign currencies.
[2)] Indirect interest through PGNiG SPV 6 Sp. z o.o.: 36.17%.
[3)] Indirect interest of 52.50% through PGNiG Technologie S.A.; PGNiG S.A. has the right to appoint the majority of the company's Supervisory Board members.
[4)] See below for explanation.
[5)] Indirect interest through GAS-TRADING S.A., which holds 99.04% of the share capital and total voting rights in Gas-Trading Podkarpacie Sp. z o.o.

In 2015, the following changes took place among PGNiG S.A.'s subsidiaries:

- 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 for cash; 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).
- 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.; the share capital increase was registered with the National Court Register on September 22nd 2015.
- On July 16th 2015, Gas Assets Management Sp. z o.o. acquired from PHZ Bartimpex S.A. 21,523 shares in GAS-TRADING S.A., representing 36.17% of the share capital and total voting rights at the General Meeting of GAS-TRADING S.A.; as a result of the transaction, the PGNiG Group acquired a total of 79.58% of the shares and total voting rights at the General Meeting of GAS-TRADING S.A. and increased its interest in the share capital of Gas-Trading Podkarpacie Sp. z o.o. (a subsidiary of GAS-TRADING S.A.) to 78.82%; GAS-TRADING S.A. holds 99.04% of the share capital and total voting rights at the General Meeting of Gas-Trading Podkarpacie Sp. z o.o.
- On August 28th 2015, the Extraordinary General Meeting of PGNiG Obrót Detaliczny Sp. z o.o. passed a resolution to reduce the company's share capital by PLN 490,950,000 (from PLN 1,091,000,000 to PLN 600,050,000) by decreasing the par value of 10,910,000 shares (from PLN 100 to PLN 55 per share); the share capital reduction was registered with the National Court Register on January 4th 2016.
- On October 13th 2015, a separation from PGNiG Sales & Trading GmbH of its assets related to the sale of gas and electricity to end consumers and contribution of the assets to PST Europe Sales GmbH was registered with the commercial register maintained by the district court of Munich; the contribution included 100% of the shares in XOOL GmbH, a subsidiary of PGNiG Sales & Trading GmbH; as a result of the separation of the assets, the share capital of PST Europe Sales GmbH was increased from EUR 500,000 to EUR 1,000,000; following the transactions, PGNiG Sales & Trading GmbH holds 100% of the shares in PST Europe Sales GmbH, and PST Europe Sales GmbH holds 100% of the shares in XOOL GmbH; PST Europe Sales GmbH's activities

consist in the sale of gas and electricity to end consumers; the business of PGNiG Sales & Trading GmbH consists in the wholesale of natural gas in Europe.

- On October 13th 2015, a change of the name of PGNiG Sales & Trading GmbH to PGNiG Supply & Trading GmbH was registered with the commercial register maintained by the district court of Munich.
- On October 26th 2015, the General Meeting of GAZ Sp. z o.o. passed a resolution to amend the company's Articles of Association by increasing the par value of its shares to make their total par value equal to the share capital; as a result of the amendment, the share capital of PLN 300,000 is divided into 160 shares with a par value of PLN 1,875 per share; the amendment to the company's Articles of Association was registered with the National Court Register on February 9th 2016.
- On October 28th 2015, 21,523 shares in GAS-TRADING S.A. were transferred from Gas Assets Management Sp. z o.o. to PGNiG SPV 6 Sp. z o.o. by a court enforcement officer as part of enforcement proceedings against the debtor Gas Assets Management Sp. z o.o. initiated by the creditor PGNiG SPV 6 Sp. z o.o.
- On October 28th 2015, the share capital of Gas Assets Management Sp. z o.o. was increased by PLN 1,340,000, to PLN 1,360,000; 6,700 shares in the increased share capital were acquired by PGNiG SPV 6 Sp. z o.o. by way of conversion of debt (a loan from PGNiG SPV 6 Sp. z o.o.) to the company's equity; the share capital increase was registered with the National Court Register on January 14th 2016.
- On October 28th 2015, PGNiG S.A. sold its entire holding of shares (65,490) in NYSAGAZ Sp. z o.o. to PGNiG TERMIKA S.A.; concurrently, on October 28th 2015 PGNiG TERMIKA S.A. acquired 33,320 shares in NYSAGAZ Sp. z o.o. from VNG Polska Sp. z o.o., the company's other shareholder; following the transactions PGNiG TERMIKA S.A. is the sole shareholder of NYSAGAZ Sp. z o.o.
- On December 30th 2015, following the closing of the liquidation process, BUD-GAZ PPUH Sp. z o.o. w likwidacji (in liquidation) was removed from the National Court Register.

Other related entities of PGNiG S.A.

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	Ownership interest: PGNiG S.A.	Ownership interest: PGNiG Group
	Related entities of PGNiG S.A.				
1	System Gazociągów Tranzytowych EUROPOL GAZ S.A.	80,000,000	38,400,000	48.00%	51.18%[2)]
2	Dewon Z.S.A. (UAH)[1)]	11,146,800	4,055,206	36.38%	36.38%
3	Sahara Petroleum Technology llc w likwidacji (in liquidation) (OMR)[1)]	150,000	73,500	49.00%	49.00%
4	PFK GASKON S.A.	13,061,325	6,000,000	45.94%	45.94%
5	ZWUG INTERGAZ Sp. z o.o.	4,700,000	1,800,000	38.30%	38.30%
	Related entities of PGNiG S.A. subsidiaries				
6	Elektrociepłownia Stalowa Wola S.A.	28,200,000	14,100,000	-	50.00%
7	Zakład Separacji Popiołów Siekierki Sp. z o.o.	10,000,000	7,000,000	-	70.00%
8	Geotermia Sp. z o.o.	4,000	1,000	-	25.00%

1) In foreign currencies.

2) Indirect interest through GAS-TRADING S.A. (3.18%); The PGNiG Group's share in total voting rights is 52%.

Changes in other ownership interests of PGNiG S.A. in 2015:

- On March 12th 2015, the share capital of Zakład Separacji Popiołów Siekierki Sp. z o.o. was increased by PLN 9,000,000, to PLN 10,000,000, through an issue of 90,000 new equal and indivisible shares with a par value of PLN 100 per share; all the new shares were acquired by the existing shareholders pro rata to their existing holdings; as a result, the percentage share of PGNiG TERMIKA S.A. in the share capital and total voting rights has remained unchanged; the share capital increase was registered with the National Court Register on April 23rd 2015; PGNiG S.A. holds indirectly, through PGNiG TERMIKA S.A., a 70% equity interest in that company.

- On October 8th 2015, InterTransGas GmbH w likwidacji (in liquidation) of Leipzig was removed from the commercial register.
- On October 22nd 2015, PGNiG S.A. sold 2,525 shares in ZRUG Sp. z o.o. of Poznań with a total par value of PLN 1,515,000.

Equity investments outside the group of related entities

As at the end of 2015, the total par value of PGNiG S.A.'s equity interests held outside the group of related entities was PLN 23.3m. In 2015, PGNiG S.A. made no material equity investments outside the group of related entities.

4. Workforce

The table below presents employment at the PGNiG Group as at December 31st 2015, by segments. Employment at the PGNiG Head Office is presented in the Trade and Storage segment.

Workforce by segment (no. of staff)

	2015	2014
Exploration and Production	3,849	4,080
Trade and Storage	988	1,072
Other Activities	37	36
Total	4,874	5,188

In 2015, PGNiG S.A. continued its efficiency improvement programme, an important part of which was to reduce over-staffing. In the workforce reduction process, strong emphasis was laid on minimising social costs. Compared with December 31st 2014, the number of employees at PGNiG S.A. fell by 314 (6%). The reduction was achieved mainly on the back of an attractive voluntary redundancy scheme and spin-off of the business responsible for maintenance of the Mogilno underground gas storage cavern facility. 224 employees opted to take advantage of the voluntary reduction scheme, while 43 persons were transferred (pursuant to Article 23^1 of the Labour Code) from the Mogilno Underground Gas Storage Cavern Facility Branch to OSM Sp z o.o.

5. Sales and production

In 2015, PGNiG S.A. reported revenue of PLN 18.6bn, 83% of which was derived from sales of natural gas.

Revenue (PLNm)

	2015	2014	2013	2012
Natural gas, including:	15,383	19,729	23,416	23,548
- high-methane gas	14,215	18,404	21,978	22,154
- nitrogen-rich gas	1,168	1,325	1,438	1,394
Crude oil	1,057	1,789	2,058	1,263
Helium	74	120	184	161
Propane-butane	53	83	76	67
Electricity	1,101	1,161	639	133
Other sales	978	856	737	514
Total	18,646	23,738	27,110	25,686

In 2015, PGNiG S.A. sold 13.7 bcm of natural gas (measured as high-methane gas equivalent), with 94% of that amount representing sales from the transmission and distribution systems and the balance – direct sales from gas fields.

Natural gas sales volume (mcm)

	2015	2014	2013	2012
Trade and Storage	12,938	13,073	14,129	14,006
Exploration and Production	770	807	755	723
Total	13,708	13,880	14,884	14,729

PGNiG S.A. produced a total of 4.1 bcm of natural gas (measured as high-methane gas equivalent), of which 99% was produced from fields in Poland, and the balance – from fields in Pakistan.

Natural gas production volume (mcm)

	2015	2014	2013	2012
Poland	4,005	4,027	4,211	4,317
Abroad	52	58	31	0
Total	4,057	4,085	4,242	4,317

Section II: Company's Governing Bodies

1. Management Board

Pursuant to PGNiG S.A.'s Articles of Association, its Management Board is composed of two to seven members. The number of Management Board members is determined by the Supervisory Board. Individual members or the entire Management Board are appointed for a joint three-year term of office.

A member of the Management Board is appointed following a recruitment and selection procedure carried out pursuant to the Regulation of the Polish Council of Ministers of March 18th 2003 concerning qualification procedures for members of management boards of certain commercial-law companies (Dz. U. No. 55, item 476, as amended). The Regulation does not apply to Management Board members elected by employees.

As long as the State Treasury holds Company shares and the Company's average annual headcount exceeds 500, the Supervisory Board appoints one person elected by the Company's employees to serve on the Management Board during its term. The Supervisory Board adopts the rules governing election and removal from office of the Management Board member representing the employees, and the rules of by-elections.

Each member of the Management Board may be removed from office or suspended from their duties by the Supervisory Board or the General Meeting.

As at January 1st 2015, the composition of the PGNiG Management Board was as follows:

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

On December 11th 2015, the PGNiG Supervisory Board removed the following persons from office and from their positions on the PGNiG Management Board: Mr Mariusz Zawisza – President, Mr Jarosław Bauc – Vice-President, Finance, and Mr Zbigniew Skrzypkiewicz – Vice-President, Exploration & Production. At the same time, the PGNiG Supervisory Board delegated Mr Piotr Woźniak, a Member of the PGNiG Supervisory Board, to temporarily perform the duties of President of the Management Board in the period from December 11th 2015 to March 11th 2016.

As at December 31st 2015, the composition of the PGNiG Management Board was as follows:

- Piotr Woźniak – Member of the PGNiG Supervisory Board delegated to temporarily perform the duties of President
- Waldemar Wójcik – Vice-President.

<u>Changes subsequent to the end of the reporting period</u>

At its meeting on February 10th 2016, the PGNiG Supervisory Board appointed the following persons to the PGNiG Management Board, as of February 11th 2016, for a joint term of office ending on December 30th 2016:

- Piotr Woźniak – President
- Bogusław Marzec – Vice-President, Finance
- Janusz Kowalski – Vice-President, Corporate Affairs

- Łukasz Kroplewski – Vice-President, Development
- Maciej Woźniak – Vice-President, Trade.

Piotr Woźniak graduated from the University of Warsaw in 1980 with a degree in geology. Until 1989, he was an assistant at the Geological Institute in Warsaw. In 1990−1991, he served as an adviser to the Minister of Agriculture and to the Minister of Industry. He was the Trade Commissioner of the Republic of Poland in Canada in 1992−1996. In 1998−2000, Mr Woźniak was an adviser on infrastructure to the Polish Prime Minister. He served as a member of the PGNiG Supervisory Board in 1999−2000, and Vice-President of the Management Board from June 2000. In the 2002−2006 term, he was a member of the Warsaw City Council, and in 2005−2007 he was the Minister of Economy. From December 2011 to December 2013, Mr Woźniak served as the Deputy Minister of Environment and Chief State Geologist. He is a lecturer at the Łazarski University and at the Warsaw School of Economics, and he is also a member of the Council of the Maria Grzegorzewska University in Warsaw. From December 2009 he served as the Chairman, and as of March 2014 the Deputy Chairman of the Administrative Board of the Agency for the Cooperation of Energy Regulators (ACER).

Bogusław Marzec is a graduate of the Szczecin University of Technology and Szczecin University. He holds a master's degree in mechanical engineering and a PhD degree in economics. Mr Marzec was a senator of the Szczecin University. He has also completed a number of courses and training programmes, passed an examination for candidates to supervisory boards and is a certified quality management system lead auditor. He served as CEO at such companies as Morska Stocznia Remontowa SA of Świnoujście, Szczecińska Stocznia Remontowa Gryfia SA, and Huta Bankowa Sp. z o.o. Mr Marzec has twice served on the governing bodies of PGNiG S.A. – once as Vice-President and CFO, and once as President of the Management Board – and is a Grade I Mining Director. He has experience in corporate supervision. Mr Marzec served on the supervisory boards at such companies as EUROPOL GAZ S.A., INVESTGAS S.A., Polskie LNG, Walcownia Dziedzice S.A., Centrostal Lublin S.A. He was also Deputy Chairman of the Supervisory Board and member of the Credit Committee of AmerBank SA.

Janusz Kowalski was Deputy Mayor of Opole in 2014–2015. He holds master's degrees in law and administration. In 2006−2007, Mr Kowalski was an energy security analyst at the government proxy team for diversification of energy supply sources at the Ministry of Economy. Mr Kowalski also served as a member on the supervisory boards of Operator Logistyczny Paliw Płynnych, INVESTGAS S.A., Ostrołęckie Towarzystwo Budownictwa Społecznego Sp. z o.o., and Energetyka Cieplna Opolszczyzny S.A. of Opole. He worked as an energy security analyst at the National Security Office in 2008, and was a member of the energy security team at the Chancellery of President of Poland Lech Kaczyński from October 2008 to April 2010. He co-authored 'Lech Kaczyński. Biografia polityczna' [Lech Kaczyński. A Political Biography]. In 2009–2014, Mr Kowalski served as a Member of the Management Board of a sports marketing agency. He is also a columnist.

Łukasz Kroplewski holds MA degrees in law and in administration. He has gained professional experience working in public administration − at the Tax Office, the Self-Government Board of Appeals, and the Chancellery of the Prime Minister. He has been a member of the Self-Government Board of Appeals since 2009. From 2014 to 2015, Mr Kroplewski worked as a legal and business consultant. He was also a lecturer at the Koszalin University of Technology. He worked in HR intermittently from 2005 to 2011, holding managerial and consultancy positions. Mr Kroplewski is one of the founders of the Mediation Centre at the Association of Merchants and Entrepreneurs in Koszalin, where he works as a business mediator.

Maciej Woźniak is a graduate of the Cracow University of Economics (holding a master's degree in economics) and the National School of Public Administration. He also completed a post-graduate course in property valuation at the Warsaw University of Technology. He is a member of the Polish Civil Service Corps. In 2011, he participated in the International Visitor Leadership Program run by the US Department of State. In 2003−2008, he worked at the Ministry of Finance and at the Ministry of Economy, where he led the Oil and Gas Department and was responsible for implementation of the act on mandatory oil, gas and fuels stocks and for securing Poland's accession to OECD's International Energy Agency based in Paris. After it joined the IEA, he represented Poland at IEA Governing Board meetings a number of times. He also coordinated preparations ahead of implementation of the second package of the EU gas market liberalisation legislation and participated in the EU's work on the third package. In 2008−2010, he was Prime Minister's chief adviser on energy security and secretary of the Prime Minister's interdepartmental energy security policy team. He represented Poland in the V4 High-Level Group on Energy and the EC's Group for the Baltic Energy Market Interconnection Plan. He supervised the pre-construction phase of the Świnoujście LNG terminal project. He was on the team negotiating the intergovernmental gas supply contract between Poland and Russia. He resigned from the position of Prime Minister's adviser only after the contract was signed in November 2010. In 2011−2013, he advised the Environment Minister and Chief Geologist on the geological and mining law reform. He sat on the Supervisory Boards of Operator Logistyczny Paliw Płynnych and Wielkopolska Spółka Gazownictwa and served as Chairman of the Supervisory Board of the Provincial Fund for Environmental Protection and Water Management of Warsaw.

Contracts with Management Board members

In 2015, members of the PGNiG Management Board – Mr Mariusz Zawisza, President, and Mr Jarosław Bauc, Mr Zbigniew Skrzypkiewicz and Mr Waldemar Wójcik, Vice-Presidents, performed their duties under managerial contracts and non-competition agreements.

Mr Piotr Woźniak, acting President of the Management Board, performed his duties based on a resolution of the PGNiG Supervisory Board.

Mr Piotr Woźniak, Mr Bogusław Marzec, Mr Janusz Kowalski, Mr Łukasz Kroplewski and Mr Maciej Woźniak, appointed to the Management Board of PGNiG S.A. as of February 11th 2016, until the date of preparation of this report performed their duties on the basis of the appointment. Mr Waldemar Wójcik performs his duties under a managerial contract and a non-competition agreement.

2. Supervisory Board

Pursuant to the Articles of Association of PGNiG S.A., the Supervisory Board is composed of five to nine members, appointed by the General Meeting for a three-year joint term of office.

As long as the State Treasury holds Company shares, the State Treasury, represented by the minister competent for matters pertaining to the State Treasury, has the right to appoint and remove one member of the Supervisory Board (amendment to the Articles of Association registered on May 11th 2015).

In accordance with the Articles of Association, the General Meeting appoints one independent member of the Supervisory Board. The independent Supervisory Board member is elected in separate voting.

Written nominations of candidates for the position of an independent Supervisory Board member may be submitted to the Chairman of the General Meeting by the shareholders present at the General Meeting whose agenda includes the election of such a Supervisory Board member. Any such written proposal should be submitted along with a written representation by a given candidate to the effect that the candidate agrees to stand for the election and meets the criteria for an independent member of the Supervisory Board. If no candidates for the position are proposed by the shareholders, such candidates are nominated by the Supervisory Board.

If the Supervisory Board is composed of up to six members, two members are appointed from among candidates elected by the Company's employees. If the Supervisory Board is composed of seven to nine members, three members are appointed from among candidates elected by the Company's employees.

As at January 1st 2015, the composition of the PGNiG Supervisory Board was as follows:

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

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

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

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

On October 19th 2015, the Extraordinary General Meeting of PGNiG S.A. removed Agnieszka Woś from the PGNiG Supervisory Board and appointed Mr Grzegorz Nakonieczny as a new Supervisory Board member.

On October 29th 2015, the PGNiG Supervisory Board appointed Grzegorz Nakonieczny as Chairman of the Supervisory Board.

On December 4th 2015, the Minister of State Treasury appointed Piotr Woźniak as a member of the Supervisory Board of PGNiG S.A.

On December 11th 2015, the PGNiG Supervisory Board delegated Mr Piotr Woźniak to temporarily perform the duties of President of the PGNiG Management Board from December 11th 2015 to March 11th 2016.

On December 29th 2015, the Extraordinary General Meeting of PGNiG S.A. removed Andrzej Janiak, Janusz Pilitowski, Maciej Mazurkiewicz and Irena Ożóg from the Supervisory Board, and appointed Mateusz Boznański, Andrzej Gonet, Krzysztof Rogala and Wojciech Bieńkowski as new members of the Supervisory Board.

As at December 31st 2015, the Supervisory Board of PGNiG S.A. was composed of nine persons, including:

- Grzegorz Nakonieczny – Chairman
- Magdalena Zegarska – Secretary
- Sławomir Borowiec – Member
- Mateusz Boznański – Member
- Andrzej Gonet – Member
- Ryszard Wąsowicz – Member
- Krzysztof Rogala – Member

- Wojciech Bieńkowski – Member
- Piotr Woźniak – Member of the Supervisory Board delegated to temporarily perform the duties of President of the PGNiG Management Board.

Changes subsequent to the end of the reporting period

On January 7th 2016, the PGNiG Supervisory Board appointed Mr Wojciech Bieńkowski as Deputy Chairman of the Supervisory Board.

The PGNiG Management Board and the PGNiG Supervisory Board accepted Mr Piotr Woźniak's resignation from his position of member of the PGNiG Supervisory Board as of February 10th 2016.

Remuneration of management and supervisory personnel

For information on the remuneration paid to management and supervisory personnel, see the full-year separate financial statements for the year ended December 31st 2015 (Note 37.4).

Section III: Shareholding structure

The share capital of PGNiG S.A. amounts to PLN 5.9bn and is divided into 5,900,000,000 shares with a par value of PLN 1 per share. Company shares have been listed at the Warsaw Stock Exchange since September 23rd 2005.

1. Shareholding structure

On December 2nd 2015, following the Minister of State Treasury's acquisition of new shares in the increased share capital of Towarzystwo Finansowe Silesia Sp. z o.o. and acquisition of 92,936,803 Company shares by TF Silesia Sp. z o.o., the percentage of PGNiG S.A.'s share capital and total vote in the Company held by the State Treasury decreased.

Prior to the change, the State Treasury held 4,271,708,411 Company shares, representing 72.40% of the total vote in PGNiG S.A. and the same percentage of its share capital. As the new shares in TF Silesia Sp. z o.o. were acquired in exchange for Company shares, the number of Company shares held by the State Treasury fell to 4,178,771,608, conferring the right to 70.83% of the total vote in PGNiG and representing the same percentage of its share capital.

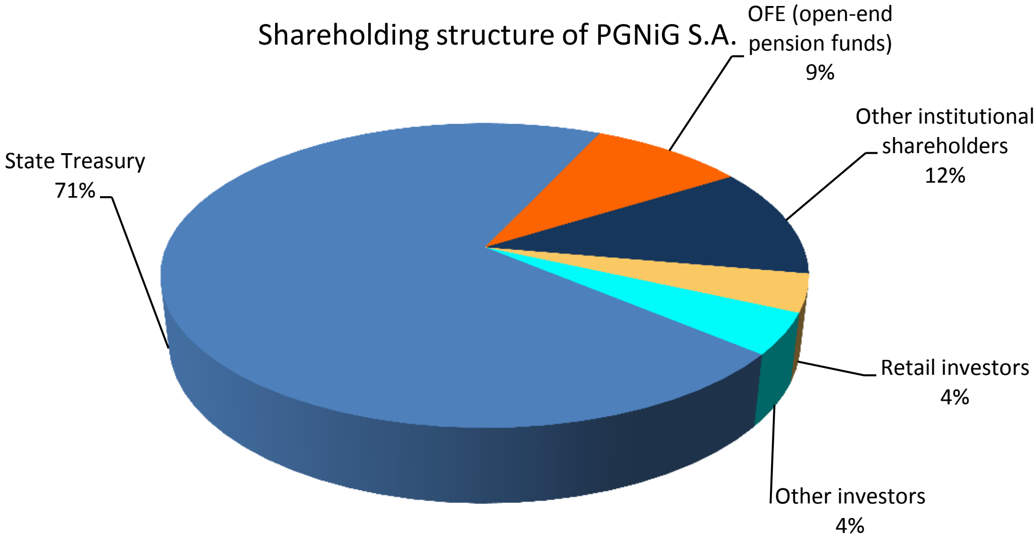
As at December 31st 2015, the share capital of PGNiG S.A. amounted to PLN 5,900,000,000 and was divided into 5,900,000,000 shares with a par value of PLN 1 per share. The Polish State Treasury was the only shareholder with a large direct holding of PGNiG shares. The shares of all series, that is Series 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 December 31st 2015 is presented in the table below.

Shareholding structure

Shareholder	Number of shares as at Dec 31 2015	Percentage of share capital held as at Dec 31 2015	Number of voting rights conferred by shares held	Percentage of total voting rights at GM as at Dec 31 2015
State Treasury	4,178,771,608	70.83%	4,178,771,608	70.83%
Other shareholders	1,721,228,392	29.17%	1,721,228,392	29.17%
Total	5,900,000,000	100.0%	5,900,000,000	100.0%

85% of PGNiG shares are held by domestic shareholders. 15% of the shares are held by foreign investors, chiefly institutional investors from Europe (nearly 50% of them from the UK).

The major shareholder of PGNiG is the Polish State Treasury. Over 20% of the shares are held by institutional investors, 60% of whom are Polish investors. The chart below presents PGNIG S.A.'s shareholding structure as at the end of 2015.



Substantial holdings of PGNiG shares are included in the portfolios of open-end pension funds, which as at the end of 2015 held more than 9% of PGNiG's equity, valued at just under PLN 3bn. The share of open-end pension funds in the PGNiG shareholder base has risen significantly since the IPO in 2005, when it accounted for a mere 3.5% of the share capital (valued at PLN 711m), but compared with 2014 the share has decreased by 17%. Sale of PGNiG shares may have been impacted by the PGNiG Group's financial performance for Q3 2015, published in November (which was below market expectations) and negative analyst recommendations (13 of 19 recommendations were to 'Sell'). The funds with the largest equity interests in PGNiG S.A. were those which manage the largest portfolios of future pensions, that is ING, Aviva and PZU Złota Jesień. Pension funds are typically long-term investors whose equity portfolios are characterised by low turnover, especially with respect to large dividend-paying companies, such as PGNiG S.A. They have a stabilising effect on the Company's shareholding structure, while limiting its *free float*, which can translate into lower trading volumes. The average daily value of trading in PGNiG shares in 2015 was PLN 28m, which is a solid result considering the low *free float*.

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

The table below presents PGNiG shares held by the management and supervisory personnel as at December 31st 2015.

PGNiG shares held by the management and supervisory personnel

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

<u>Agreements which may give rise to future changes in the interests held by the existing shareholders or bondholders</u>

As at the date of this report, PGNiG S.A. was not aware of any agreements which could lead to future material changes in the equity interests held in the Company by its existing shareholders.

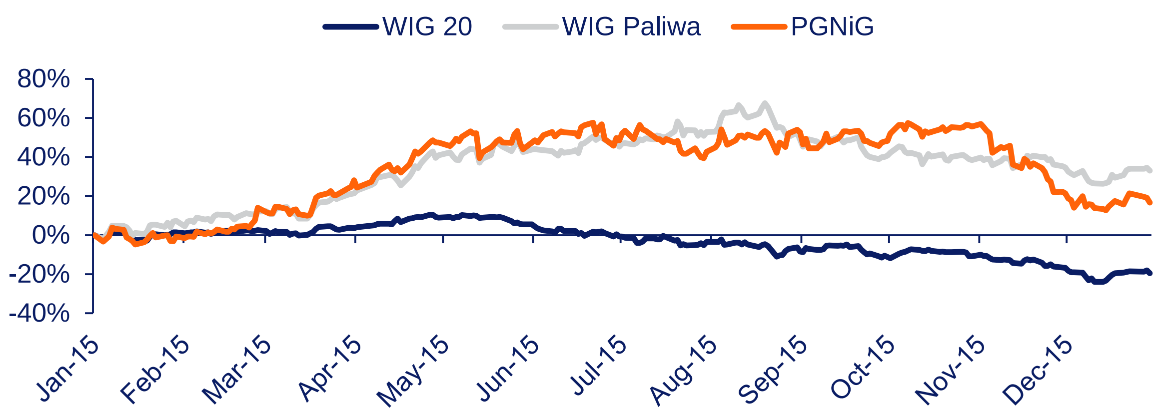
2. Share price

As at December 31st 2015, PGNiG was included in the following indices listed at the WSE:

- WIG – all-cap index
- WIG20 – blue-chip index of the 20 largest and most liquid companies
- WIG-Paliwa – index of the fuel sector companies
- WIG-div – index of highest dividend yield companies which have paid dividends at least three times in the last five years
- Respect Index – index of socially responsible companies.

The following figure presents the relative performance of the PGNiG stock against the WIG 20 and WIG-Paliwa indices in 2015.

PGNiG share price vs the WIG 20 and WIG Paliwa indices



Relative to the 2014 closing price, in 2015 PGNiG shares moved within the range from -6% to +56%, while WIG20 fluctuated between -24% and +10%. Key reasons of this volatile performance of PGNiG stock included a continued decline in oil prices from July 2015, a fall in gas prices on the Polish Power Exchange from April 2015 and increasing deregulation of the Polish gas market.

Throughout the year, the price of PGNiG shares ranged from PLN 4.20 to PLN 6.95. Strong volatility was seen at the beginning of the year, when the price per oil barrel on the New York Stock Exchange slid below USD 50, to its lowest since April of 2009. On January 16th 2015, the Company stock hit the year's low of PLN 4.20. Then the prices started to climb, backed by the PGNiG Group's financial performance for 2014 (published on March 5th 2015), which significantly exceeded analyst expectations. Investors also welcomed the PGNiG Annual General Meeting's decision of April 16th 2015 on payment of record-high dividend of PLN 1.18bn (PLN 0.20/share). On May 6th 2015, the price of PGNiG shares was PLN 6.59, hitting a new high from the peak of PLN 6.55 in August 2013. The share price remained stable after the Q1 2015 results were published on May 8th 2015, showing a 7% EBITDA growth year on year, further supported by a notice released by the Company on May 13th 2015 of calling PAO Gazprom and OOO Gazprom Export to arbitration proceedings before the Arbitration Court in Stockholm. With the call, PGNiG S.A. opened an arbitration procedure provided for under the Yamal Contract regarding the pricing terms of the long-term gas supply contract of September 25th 1996. Investors were able to price in the agreement with PAO Gazprom and OOO Gazprom Export anticipating a one-off compensation similar to the one received in 2013, and continued buying PGNiG shares. As a consequence, at the close of trading on June 22nd 2015, the shares hit an all-time high of PLN 6.95.
Until November 16th 2015, the share price remained above PLN 6.00. On November 6th 2015, upon publication of the Q3 2015 financial results, the price dipped by nearly 7% to PLN 6.27, marking a

downward trend which persisted until the end of the year. The fact that the PGNiG Group's financial performance fell short of market expectations was attributable to a decline in gas and oil prices, resulting in a retail tariff cut as well as a reduction in the wholesale tariff announced by the President of Energy Regulatory Office twice in 2015. Furthermore, in order to retain customers and sales volumes, both PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. launched discount schemes in May and June 2015. Their effects were seen in the Q3 2015 performance.

On December 30th 2015 (the last session day in the year), the PGNiG stock price closed at PLN 5.14. The price was nearly 73% above the issue price of 2005 and nearly 35% above the closing price on the first day of listing. The rate of return on the PGNiG stock in 2015 was 15.51%. Taking into account the dividends paid in 2005–2015, at the level of PLN 1.28 per share, investors who acquired PGNiG shares at their issue price and held them until the end of 2015 earned a return of 115%.

The tables below show the performance of the WSE indices and PGNiG stock in 2015, as well as the rates of return on the WSE indices and PGNiG stock in 2015 and from PGNiG's IPO.

Performance of WSE indices and PGNiG stock

Index	Value/price as at Dec 30 2014	2015 high	2015 low	Value/price as at Dec 30 2015	PGNiG's weight in the index as at Jan 7 2016
WIG (points)	51,416	57,379	43,887	46,467	3.27%
WIG20 (points)	2,316	2,549	1,755	1,859	5.11%
WIG-Paliwa (points)	3,381	5,626	3,289	4,468	25.50%
WIG-div	1,152	1,277	897	959	9.75%
Respect Index (points)	2,674	3,055	2,145	2,269	9.81%
PGNiG S.A. (PLN)	4.45	6.95	4.20	5.14	-

Source: gpwinfostrefa.pl.

Rates of return on WSE indices and PGNiG stock

Index	Rate of return in 2015, %	Rate of return from PGNiG’s IPO(1) to Dec 31 2015, %
WIG	-9.62	39.90
WIG20	-19.72	-24.30
WIG-Paliwa	32.15	25.50[2)]
WIG-div	-16.76	-4.13[3)]
Respect Index	-15.15	126.90[4)]
PGNiG S.A.	15.51	34.90[5)]

Source: WSE.

1) Closing price on September 23rd 2005.
2) Calculated in relation to the reference value of the index (reference date: December 30th 2005).
3) Calculated in relation to the reference value of the index (reference date: December 31st 2010).
4) Calculated in relation to the reference value of the index (reference date: December 31st 2008).
5) Relative to the issue price of PLN 2.98, PGNiG shares yielded a rate of return of 68.5%.

Section IV: Regulatory environment

PGNiG S.A.'s activities are regulated by the following laws:

- Polish Energy Law of April 10th 1997 (consolidated text in Dz. U. of 2012, item 1059) with secondary legislation, to the extent it governs gas fuel trading, distribution and storage, as well as foreign trade in natural gas.
- Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, and on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market, dated February 16th 2007 (consolidated text in Dz. U. of 2014, item 1695) with secondary legislation, to the extent it governs gas fuel storage and foreign trade in natural gas.
- Polish Geological and Mining Law of June 9th 2011 (Dz. U. of 2011, No. 163, item 981, as amended), to the extent it governs production and sale of gas.
- Act on a Special Hydrocarbon Tax of July 25th 2014 (Dz.U. of 2014, item. 1215) − to the extent it introduces a special hydrocarbon tax and adds oil and gas to the list of items subject to tax on production of certain minerals.

1. Polish Energy Law

The activities of the PGNiG Group companies in the area of gas fuel trading, distribution and storage, electricity trading and generation, as well as heat generation, transmission and distribution are quite heavily regulated, and require a licence granted by the President of the Energy Regulatory Office.

The amended Polish Energy Law of 2013 introduced the requirement of public sale on commodity exchanges of a specific portion of high-methane gas volumes fed into the transmission network in a given year. As from January 1st 2015, the Company is required to sell 55% of its total sales volumes through the exchange market. The regulation is one of key factors determining the Company's sales policy. To meet the exchange sale requirement, on June 26th 2014, an amendment to the Polish Energy Law introducing the so-called general succession of agreements was passed. Following its entry into force, on August 1st 2014, PGNiG Obrót Detaliczny Sp. z o.o. commenced its operations, taking over a part of PGNiG S.A.'s retail customer portfolio.

On September 11th 2015, a new Act Amending the Energy Law and Certain Other Acts was passed, implementing Regulation (EU) No. 1227/2011 of the European Parliament and of the Council of October 25th 2011 on wholesale energy market integrity and transparency *(REMIT)*. Under the Act, the President of the Energy Regulatory Office is formally given the status of the national regulatory authority as well as a wide range of powers to monitor and supervise wholesale energy markets (by carrying out investigations and inspections with searches), including the power to impose financial penalties on market participants if they are found to be in breach of *REMIT*.

1.1. 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 December 31st 2015, PGNiG S.A. held the following licences granted by the President of the Polish Energy Regulatory Office (URE) under the Energy Law:

- one licence to trade in gas fuels

- one licence to trade in natural gas with foreign partners
- one licence to trade in liquid fuels
- one licence to produce electricity
- one licence to trade in electricity
- one licence of liquefy natural gas and regasify LNG at LNG regasification plants.

1.2. Changes in gas fuel tariffs

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

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 prices of high-methane and nitrogen-rich were reduced by ca. 5% and 4.9%, respectively. Moreover, the new tariff introduced separate prices for customers reselling gas fuel.

On December 16th 2015, the President of the Energy Regulatory Office approved new PGNiG Gas Fuel Supply Tariff No. 9/2016 for the period January 1st 2016 − March 31st 2016. The average prices of high-methane and nitrogen-rich gas were reduced by 6.6% and 6.1%, respectively.

Applications for exemption from the obligation to submit 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 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 2015 report, the proceedings were still pending.

On August 10th 2015, PGNiG S.A. applied to the President of the Energy Regulatory Office to be exempted from the obligation to submit for approval tariffs for the sale of high-methane natural gas to energy companies purchasing it for the pursuit of natural gas transmission, distribution, storage, liquefaction or regasification activities. As at the date of this 2015 report, the proceedings were still pending.

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

The Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market regulates matters related to ensuring the national fuel security, and sets the rules for building up, maintaining, and financing stocks of natural gas by those energy companies whose business involves international trade in natural gas or which import gas for their own needs. With respect to the business activity of PGNiG S.A., the Act:

- specifies the volume of mandatory stocks, which since October 1st 2012 is equivalent to 30 days' average daily imports of gas (for the period from April 1st of the previous year to March 31st of the current year, calculated based on the figures contained in the Company's statistical reports);
- provides that the return on capital employed in the storage business should be at least 6%;
- stipulates that the cost related to maintaining, releasing and restocking the mandatory stocks represents a justified operating cost within the meaning of Art. 3.21 of the Polish Energy Law;
- introduces the possibility of storing mandatory stocks in another EFTA or EU member state, upon fulfilment of certain conditions set forth in the Act;
- introduces the possibility of exempting an energy company whose business involves international trade in natural gas or an entity which imports natural gas from the obligation to build and maintain mandatory stocks, if the number of its customers does not exceed 100 thousand and the natural gas volume imported in a calendar year does not exceed 100 mcm.

3. Polish Geological and Mining Law

The Polish Geological and Mining Law of June 9th 2011 regulates:

- geological work;
- extraction of minerals from deposits;
- storage of waste matter in rock mass, including in worked-out caverns;
- protection of mineral deposits, underground waters and other components of the environment in connection with geological works and extraction of minerals.

Business activities involving exploration for and appraisal of mineral deposits, extraction of minerals from deposits, tankless storage of substances and storage of waste matter in rock mass, including in worked-out caverns, require licences.

Geological and mining activities are subject to supervision by competent geological and mining supervision authorities. The Geological and Mining Law provides for criminal sanctions for a failure to comply with its regulations, and specifies the upper and lower limits of royalty fees.

On January 1st 2015, an Act Amending the Geological and Mining Law of July 11th 2014 came into force, with new or amended secondary legislation thereto taking effect after another six months. The amended Act introduced a number of material changes to the regulatory environment of the exploration and production segment. The most important of these are:

- introduction of obligatory qualification procedures to secure Poland's interests when awarding licences for hydrocarbon exploration, appraisal and production, and to increase Poland's energy security
- introduction of an integrated licence for hydrocarbon exploration, appraisal and production
- change in the licence award procedure; award of a licence is possible only in an ex officio tender procedure (for 2016, the Minister of Environment defined only ten tender areas)
- a possibility for consortia to apply for licences
- preparation of a new type of geological and pre-engineering documentation to be approved by the Minister of Environment
- a significant increase in royalty rates (while maintaining the previous royalty regime for marginal deposits).

Under the new Act, a qualification procedure was carried out for PGNiG S.A., during which the Company was reviewed and evaluated in terms of both the state's security and relevant experience. At the end of 2015, PGNiG S.A. and LOTOS Petrobaltic S.A. were Poland's only companies to have been approved following the qualification procedure. The approval is required to apply for new licences for exploration and appraisal of hydrocarbon deposits and for production of hydrocarbons from deposits, which are to be awarded in 2016 in ex officio tender procedures announced by the Minister of Environment, and for the purposes of converting the hydrocarbon exploration and appraisal licences held by the Company into integrated licences.

In 2015, the Ministry of Environment did not extend, upon PGNiG S.A.'s request, six licences for exploration and appraisal of crude oil and natural gas deposits. In addition, the Company relinquished 10 licences prior to their expiration. The Company was also granted six licences for production of crude oil and natural gas, while six other licences were allowed to expire.

As at December 31st 2015, PGNiG S.A. held the following licences, granted pursuant to the Geological and Mining Law:

- 60 licences for exploration and appraisal of crude oil and natural gas deposits, and one suspended licence (the proceedings for its conversion into a licence for exploration, appraisal and production of crude oil and natural gas are pending)
- 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.

4. Act on Special Hydrocarbon Tax

The Act of July 25th 2014introduces a special hydrocarbon tax to the Polish tax regime and adds oil and gas to the list of items subject to tax on production of certain minerals. The Act sets the rates of the new taxes at:

- special hydrocarbon tax – 0-25% of profit from upstream operations, depending on the ratio of revenue to eligible expenditure incurred by the company;
- tax on production of certain minerals – 3% (in the case of gas produced from conventional deposits), 1.5% (in the case of gas produced from unconventional deposits), 6% (in the case of oil produced from conventional deposits), and 3% (in the case of oil produced from unconventional deposits).

The Act came into force on January 1st 2016. The obligation to pay the special hydrocarbon tax will apply to revenue earned as of January 1st 2020, and the obligation to pay the tax on production of certain minerals, in the case of oil and gas, will arise as of January 1st 2020.

5. 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. Accordingly, the volume of gas sold through the commodity exchange increased substantially, which enabled the Company to meet its obligation to sell the statutorily required level of 55% of gas through the exchange market in 2015. If this market trend persists, the regulatory risk related to failure to meet the exchange sale requirement in the coming years is low.

The President of the Energy Regulatory Office may impose financial penalties (of up to 15% of the Company's 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. Two proceedings were initiated in 2015.

On January 13th 2015, the President of Energy Regulatory Office 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 Regional Court of Warsaw against one of the interlocutory decisions made by the President of Energy Regulatory Office in the course of the proceedings. Therefore, the President of Energy Regulatory Office suspended the administrative proceedings until the Consumer Protection Court at the Regional Court of Warsaw resolves the appeal. As at the date of this report, the Regional Court issued no decision on the matter.

On October 28th 2015, the President of Energy Regulatory Office 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 2014. As at the date of preparation of this report, the proceedings to approve the new Distribution Grid Code were pending.

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 PGNiG S.A.

Deregulation

On September 10th 2015, the Court of Justice of the European Union ruled on the system of regulated gas fuel prices in Poland. The CJEU ruled that the mandatory state intervention in Poland, obliging energy companies to charge natural gas delivery prices approved by the President of the Energy Regulatory Office, without setting a time limit and regardless of customer groups (market segments), is non-compliant with EU regulations. The ruling follows from the European Commission's complaint against Poland, filed in January 2014, concerning the regulation of gas prices in Poland. The CJEU did not impose a financial penalty on Poland for breaching EU laws. However, the ruling obligates Poland to promptly change its regulations to bring them into compliance with EU law. If Poland fails to do so, the European Commission will again apply to the CJEU for imposing high financial penalties on Poland.

In 2015, the government announced its plans to initiate, in 2016, a legislative process to draft the 'deregulation act'. Key changes planned by the government include gradual deregulation of natural gas prices with respect to individual consumer groups of a given gas trading company, depending on the volume of consumption. The largest customers will be the first group in respect of which the tariff requirement will be disapplied. This approach is to mitigate the risk of uncontrolled gas price hikes. Natural gas prices for households are to be deregulated as of January 1st 2023 (as announced by the Council of Ministers). The statutory deregulation of gas prices may necessitate amendments to trade contracts.

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. This means that during longer spells of low temperatures, it may happen that – despite maximum gas supplies under long-term contracts, utilisation of available capacities at Western and Southern interconnectors, and gas withdrawal from underground storage facilities (remaining at the disposal of PGNiG S.A.) – the demand for gas will exceed the volumes which the Company is able provide. Interconnector capacities are available to all market participants on equal terms. To note, given the legally required technical parameters necessary to deliver mandatory gas stocks to the system, almost one-third of the stocks had to be placed at the Mogilno and Kosakowo underground gas storage caverns, which are peak-demand storage facilities. As a result, the obligation to maintain mandatory stocks significantly limits 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, including a system for converting a licence for exploration and appraisal into a licence covering also hydrocarbon production. Favourable as it is, in the transitional period (until the end of 2016) the change may significantly slow down the administrative processes of the licensing authority. In addition, the new Act introduced higher royalty rates for hydrocarbon reserves other than marginal, effective since January 1st 2016. The amended rates will adversely affect the financial performance of PGNiG S.A.

Section V: Exploration and Production

The segment's business focuses on extracting hydrocarbons from deposits and preparing products for sale. The segment comprises the entire process of oil and gas exploration and production, from geological analyses, to geophysical surveys and drilling work, to field development and hydrocarbon production. The work is conducted by the segment on its own or jointly with partners, under joint operations agreements. It relies on storage capacities available at the Daszewo and Bonikowo Underground Gas Storage Facilities.

1. Exploration

In 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 26 wells, including 13 exploration wells, 3 research wells and 10 appraisal wells.

In 2015, 11 wells were drilled with positive results, including 2 exploration boreholes in Polish Lowlands (including one drilled in 2014), and 4 exploration boreholes (including one drilled in 1999) and 5 appraisal boreholes in Carpathian Foothills. 9 wells failed to yield a commercial flow of hydrocarbons and were abandoned.

As at December 31st 2015 (i.e. as at the date of this report – although, in accordance with the Geological and Mining Law, the final calculation of reserves is made in March), the Company's recoverable reserves were:

- 77.7 bcm of natural gas measured as high-methane equivalent
- 17.8m tonnes of crude oil with condensate.

PGNiG S.A. also finished drilling Rizq-1, a well in the Kirthar licence area in Pakistan, where a tight gas deposit was discovered.

2. Collaboration with other entities

In 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., San Leon Energy PLC, LOTOS Petrobaltic S.A., and ORLEN Upstream Sp. z o.o. 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%; on July 20th 2015, ORLEN Upstream Sp. z o.o. acquired a 49% interest in licence blocks 437, 438, 456, 457, 458 and in parts of licence blocks 416, 417 and 436 held by Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o., thus becoming a party to the joint operations agreement;
- "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, and decommissioning of the surface infrastructure at the Zaniemyśl production facility began. The Miłosław-4K exploration well was drilled in the "Poznań" area, where a maximum commercial gas-flow rate of approximately 160 cubic metres/min. was recorded. The formal and legal work then began to develop the discovered deposit. Drilling work began on the Paruchów-1K exploration well, and the development of the Karmin deposit continued. In the "Bieszczady" area, workover of the Niebieszczany-1 well began. In the "Sieraków" area, preparatory work was carried out to upgrade the Sieraków-1 well.

In 2015, no work was carried out in the "Warszawa-Południe" section (block 255) of the licence area held by FX Energy Poland Sp. z o.o. The agreement on joint operations of May 26th 2011 was still in effect. 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

Germany

On August 4th 2015, PGNiG S.A. acquired a licence interest from Central European Petroleum Gmbh and became party to a joint operations agreement concerning a subdivision of a licence area in eastern Germany (Brandenburg). The joint operations relate to oil and gas exploration, appraisal and production. PGNiG S.A. acquired a 36% interest in future revenue from the potential production of crude oil and natural gas. PGNiG's project partners are Central European Petroleum Gmbh (39% interest and operatorship) and Austria's Rohöl-Aufsuchungs AG (25% interest). In December 2015, work began on the Markische Heide-1 exploration well.

Pakistan

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. In September, the construction of surface installations was completed enabling an increase in the production rate to 800 cubic metres/min. The Rizq-1 well discovered another unconventional gas accumulation comprising 4.5 bcm of tight gas. In order to utilise the potential of the new discovery, a joint development strategy for the Rehman and Rizq deposits was prepared, which in the first stage will involve the hook-up and start of production from Rizq-1 and the drilling of two further wells: Rehman-2 and Rehman-3 (scheduled to commence in H1 2016). In 2015, construction work was also carried out on a gas pipeline to connect Rizq-1 to the Rehamn production facility. As part of further exploration and documentation work, work also began on a new 3D seismic survey. Furthermore, the Company continued production from the Rehman-1 and Hallel X-1 wells.

The production facility on the Rehman field, the first one operated by the Company abroad, was placed in service in November 2015. For the first time in its history, the Company carried out a complete project abroad – from obtaining a licence, through exploration and appraisal, to production launch. The facility construction is one of the stages leading to full development of the Rehman and Rizq fields.

3. Production

In 2015, PGNiG S.A. was engaged in hydrocarbon production in Poland 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 21 sites, including 12 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 36 sites, including 18 gas production facilities, 13 oil and gas production facilities and 5 oil production facilities.

In 2015, PGNiG S.A. produced a total of 4,057 mcm of natural gas (high-methane gas equivalent), of which 4,005 mcm was produced from fields in Poland, and 52 mcm from fields abroad. Production of crude oil and other fractions reached 765 thousand tonnes of crude oil equivalent. Natural gas and crude oil production volumes are presented in the table below.

Natural gas production volume

Product	2015		2014	
	GWh	mcm	GWh	mcm
Natural gas, including:	44,083	4,057	44,891	4,085
high-methane gas, including:	15,952	1,458	15,983	1,457
- Zielona Góra Branch		-	-	-
- Sanok Branch	15,952	1,458	15,983	1,457
nitrogen-rich gas, including:	28,131	2,599	28,908	2,628
- Zielona Góra Branch	26,778	2,476	27,393	2,490
- Sanok Branch	788	71	879	80
- Pakistan Branch	565	52	636	58

Crude oil production volume

Product	Unit of measure	2015	2014
Crude oil, including:	'000 tonnes	765	789
- Zielona Góra Branch	'000 tonnes	719	742
- Sanok Branch	'000 tonnes	46	47

In 2015, in the operating area of the PGNiG S.A. Sanok Branch, six wells were hooked up on producing fields, test production began from one well, and production from two new fields (Załęże and Białoboki) was launched. The total addition to production capacity was approximately 7 thousand cubic metres of gas per hour (high-methane gas equivalent).

In the operating area of the PGNiG S.A. Zielona Góra Branch, two gas wells and two oil wells were hooked up on producing fields and production from the new Grodzisk 26 field was commenced. The total addition to production capacity was approximately 4.3 thousand cubic metres of gas per hour (high-methane gas equivalent).

<u>Underground gas storage facilities</u>

In 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 December 31st 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/cm

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 2015, the Exploration and Production segment's sales of natural gas totalled 770 mcm, of which 719 mcm was sold in Poland, and 51 mcm was sold in Pakistan. In addition, the Company sold 772 thousand tonnes of crude oil and NGL. The tables below present volumes of natural gas sold directly from the fields (measured as high-methane gas equivalent), and sales volumes of crude oil and NGL.

Sales of natural gas

	2015		2014	
	GWh	mcm	GWh	mcm
Natural gas, including:	8,438	770	8,953	807
- high-methane gas	939	86	769	69
- nitrogen-rich gas	7,499	684	8,184	738

Sales of crude oil

	Unit of measure	2015	2014
Poland	'000 tonnes	518	360
Abroad	'000 tonnes	254	420
Total	'000 tonnes	772	780

In Poland, the largest amounts of natural gas were sold to industrial customers, accounting for about 78% of the total sales volume. Crude oil was sold to customers in Poland and Germany. Major customers included Rafineria Trzebinia S.A., Rafineria Nafty Jedlicze S.A. (in 2015, these refineries were merged to form a single entity – ORLEN Południe S.A.), TOTSA TOTAL OIL TRADING S.A. and BP Europa SE. 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 refinery in Gdańsk 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. Planned activities

Exploration in Poland

In 2016, 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, fracturing is to be performed in two wells drilled in 2015. As part of exploration for tight gas, the Company is planning to drill wells in the Polish Lowlands, the Carpathian Mountains, and Carpathian Foothills.

Exploration abroad

In 2016 in Pakistan, PGNiG S.A. will spud the Rehman-2 and Rehman-3 wells, and will perform seismic work on the Rizq field. In the following years, under the Kirthar licence, the Company will perform work to gradually expand the capacity of the production installations as well as drilling work on the Rehman and Rizq fields. Furthermore, PGNiG S.A. plans to carry out exploration work within three potential fields: N2, W1 and W2.

Hydrocarbon production

In 2016, PGNiG S.A. will be engaged in hydrocarbon production in Poland and in Pakistan. The Company is implementing an investment programme to maintain, 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.

In the Sanok Branch area, plans for 2016 include launch of production from the new Markowice field and hook-up of wells on the Przemyśl, Pruchnik-Pantalowice, Przeworsk, Lubliniec, Kielanówka-Rzeszów, Smolarzyny, Blizna-Ocieka, Draganowa, and Siedleczka fields. In the Zielona Góra Branch area, production is to be launched from the new Karmin field and from wells on the Gajewo, Brońsko, and Połęcko fields.

6. 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 protracting project exacerbates the risk related to estimation of capital expenditure.

Cost of exploration

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

Competition

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

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

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

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

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 VI: Trade and Storage

The principal activity of the segment is trade in natural gas. The segment sells domestically produced gas and, predominantly, imported gas. Sale of natural gas through the transmission and distribution network is regulated by the Polish Energy Law, and gas prices are determined based on tariffs approved by the President of the Energy Regulatory Office (except for the natural gas sold at the Polish Power Exchange).The segment also trades in electricity, certificates of origin for electricity, and CO_2 emission allowances. The segment operates seven underground gas storage facilities (Mogilno, Kasakowo, Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica).

1. Purchases of natural gas

In 2015, PGNiG S.A. 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;
- Individual transactions for natural gas supplies with PGNiG Supply & Trading GmbH, including transactions with the use of reverse flow on the Yamal Pipeline;
- Agreement with VNG-Verbundnetz Gas AG for sale of Lasów natural gas, dated August 17th 2006, effective until October 1st 2016.

The table below presents the structure of natural gas purchases from suppliers, measured as high-methane gas equivalent.

Structure of natural gas purchases

	2015			2014		
	GWh	mcm	%	GWh	mcm	%
Foreign suppliers:	102,364	9,330	97%	108,711	9,700	96%
- Gazprom Export	89,476	8,155	87%	90,733	8,097	83%
- other foreign suppliers	12,888	1,175	13%	17,978	1,603	17%
Domestic suppliers:	3,005	274	3%	4,082	368	4%
- Power exchange	1,695	155	56%	409	37	10%
- Other domestic suppliers	1,310	119	44%	3,673	331	90%
Total	105,369	9,604	100%	112,793	10,068	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 a change of the pricing terms under the contract for gas supply to Poland of September 25th 1996. Commencement of the arbitration proceedings was preceded by six months of negotiations of the pricing terms. The fact of referring the dispute to the Arbitration Court does not preclude commercial negotiations and an amicable settlement with the supplier. On February 1st 2016, the Company filed a suit against PAO Gazprom and OOO Gazprom Export with the Arbitration Court, in accordance with the relevant procedure.

New contracts

On October 21st 2015, PGNiG S.A. and Qatar Liquefied Gas Company Limited (3) executed a new supplementary agreement to the contract for sale of liquefied natural gas (LNG) of June 29th 2009. The new supplementary agreement extends the effective term of the amended (in 2015) terms of the contract. The gas volumes originally intended for PGNiG S.A. in H1 2016 will be transferred by Qatar Liquefied Gas Company Limited (3) to other markets. PGNiG will cover the potential difference between the LNG price specified in the contract and the market price obtained by Qatar Liquefied Gas Company Limited (3).Should the price be lower than PGNiG finds satisfactory, any unsold LNG supplies will be shifted to subsequent years of the contract. The agreement eliminates the risk of PGNiG S.A. having to pay for uncollected LNG in H1 2016 under the take or pay clause.

The first LNG supplies necessary in the cool-down and start-up of the LNG terminal in Świnoujście were delivered in December 2015 and February 2016. In January 2016, PGNiG S.A., Operator Gazociągów Przesyłowych GAZ-SYSTEM S.A. and Polskie LNG S.A. began testing the delivery of gas from the LNG terminal into the Polish transmission system. Pursuant to an agreement with Polskie LNG S.A. of December 28th 2015, PGNiG S.A. is purchasing gas from the start-up process and feeding it into the transmission system.

2. Sales of natural gas

The key products sold by the Trade and Storage segment are high-methane gas and nitrogen-rich gas. PGNiG S.A. sold gas to customers in Poland. In 2015, gas sales of the Trade and Storage segment totalled 12,938 mcm and were ca. 1% lower than in 2014. The table below presents sales of natural gas in the Trade and Storage segment (measured as high-methane gas equivalent).

Sales of natural gas

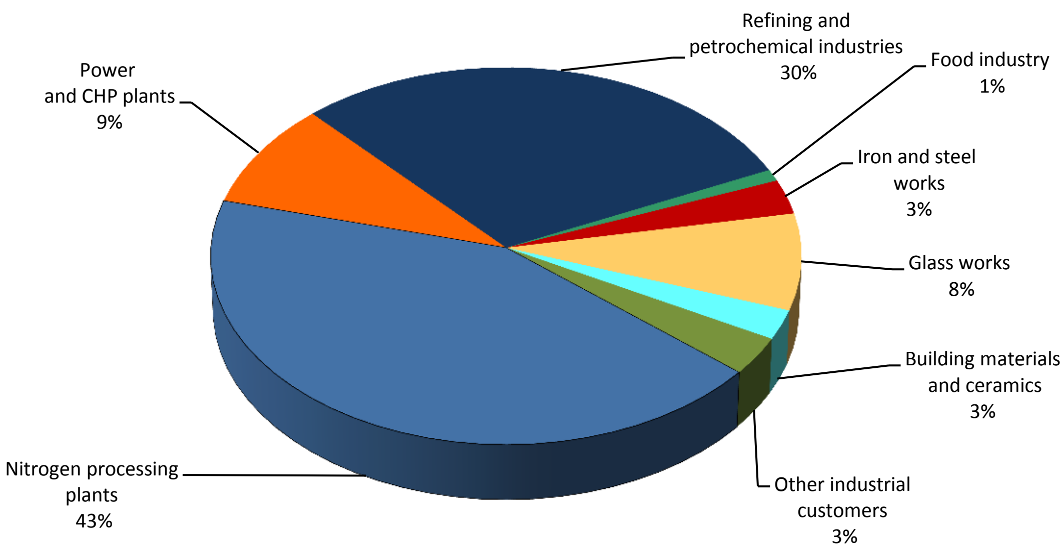
	2015		2014	
	GWh	mcm	GWh	mcm
Natural gas, including:	141,960	12,938	145,713	13,073
- high-methane gas	135,280	12,330	139,850	12,543
- nitrogen-rich gas	6,680	608	5,863	530

In 2015, the majority of sales took place on the Polish Power Exchange, where PGNiG S.A. sold 8,088 mcm of gas – an increase of some 116% on 2014. This substantial increase was attributable to the launch of operations by PGNiG Obrót Detaliczny Sp. z o.o., which is the largest buyer of gas on the Polish Power Exchange, in August 2014. In 2014, the company operated for 5 months only, but in 2015 − for the full 12 months. Gas was also purchased by industrial customers (mainly from the chemical, oil refining and petrochemical sectors). 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

	2015		2014	
	GWh	mcm	GWh	mcm
Industrial customers	44,812	4,084	66,582	5,972
Trade and services	732	67	9,214	825
Households	0	0	23,852	2,132
Wholesale customers	7,669	699	4,331	403
Exchange	88,747	8,088	41,734	3,741
Total	141,960	12,938	145,713	13,073

Structure of natural gas sales to industrial customers in 2015



<u>Promotional schemes</u>

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 covered 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 was voluntary. Customers who chose not to participate continued to pay for gas according to PGNiG S.A.'s current tariff. Those opting for the scheme received a discount on the tariff price. The discount amount was indexed to prices on the Polish Power Exchange and depended on the gas volumes and stability of consumption. The highest discounts were offered to customers buying large volumes of gas at stable rates. As a condition for joining the scheme, customers had 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 the Company.

On July 1st 2015, PGNiG S.A. launched the 2015/2016 edition of the 'Price Deregulation' scheme. 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 and customers receive a discount on the tariff price. Key differences include: the rules of settling the minimum offtake obligation, option to obtain fixed or indexed prices (indexed to the price of an exchange-traded product selected by the customer), and introduction of 'flexible' and 'base' products.

Given the introduction of the discount schemes and execution by PGNiG customers of new agreements with individual pricing terms, at the end of 2015 most of the high-methane gas grid volumes were sold by the Company at market prices.

3. Electricity

In 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 and on the Polish Power Exchange. In Germany, the Company was engaged in futures trading on the EEX (European Energy Exchange) market. PGNiG S.A. also provided services to PGNiG Obrót Detaliczny Sp. z o.o. and PGNiG TERMIKA S.A. under a commercial balancing agreement as the entity responsible for balancing, liaising directly with the power transmission system operator.

Sales of electricity

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

In 2015, PGNiG S.A. purchased electricity from PGNiG TERMIKA S.A., on the Polish Power Exchange and on the OTC market (under standardised EFET contracts) The Company sold 6,573 GWh of electricity, that is approximately 10% less than in 2014. The decline was caused by migration of some customers from PGNiG S.A. to PGNiG Obrót Detaliczny Sp. z o.o. and a milder winter, which affected the amount of energy produced by PGNiG TERMIKA S.A. The table below presents the sales of electricity by customer group.

Sales of electricity (GWh)

	2015	%	2014	%
End user	156	2%	260	4%
Trading companies	874	13%	2,869	39%
Balancing market	353	5%	425	6%
Exchange	5,190	79%	3,728	51%
Total	6,573	100%	7,282	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 Mogilno, Kosakowo, Wierzchowice, Husów and Strachocina storage 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 was 9,130 GWh, i.e. 836 mcm. In the period from October 1st 2015 to September 30th 2016, PGNiG S.A. is required to maintain mandatory stocks of 8,919 GWh or approximately 817 mcm.

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

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 500 mcm) and the Kosakowo facility (which increased to 112.4 mcm). 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 468.2 mcm).

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. The table below presents the working capacities of underground storage facilities as at December 31st 2015 and December 31st 2014.

Working storage capacities (mcm)

	2015	2014
Kawerna SFG, including:	580.6	459.1
– Mogilno underground gas storage cavern facility	468.2	407.9
– Kosakowo underground gas storage cavern facility	112.4	51.2
Wierzchowice underground gas storage facility	1,200.0	1,200.0
Sanok SFG, including:	1,015.0	865.0
– Husów underground gas storage facility	500.0	350.0
– Strachocina underground gas storage facility	360.0	360.0
– Swarzów underground gas storage facility	90.0	90.0
– Brzeźnica underground gas storage facility	65.0	65.0
Total	2,795.6	2,524.1

5. Planned activities

Purchases of natural gas

In 2016, 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. 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).

Storage

In 2016, PGNiG S.A. will continue to work on expanding the Mogilno and Brzeźnica underground storage facilities and on constructing the Kosakowo underground cavern facility for high-methane gas storage.

6. Risks related to trade and storage

Deregulation of natural gas prices

The pending deregulation of the Polish gas market 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. It is also 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 groups in respect of which the tariff requirement will be disapplied are wholesale customers and the largest business customers. In response to changes taking place on the natural gas market, PGNiG S.A. introduced a number of discount schemes.

As regards gas trading on the Polish Power Exchange and direct sales to customers at prices similar to those quoted 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 the 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 2015 some of PGNiG S.A.'s existing customers procured gas from alternative suppliers. Increased interest in purchasing gas directly at border entry points could be seen, particularly among major industrial customers, chiefly because this procedure does not require them to obtain energy efficiency certificates and surrender them for redemption, or to pay a buy-out price. If this trend continues in 2016, it will increase the risk that the volumes of gas sold by PGNiG S.A. may drop.

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).

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 2015, eliminates the risk of PGNiG S.A. having to pay for uncollected LNG in H1 2016 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 in supplies ranged from 6% to 46% per day. To meet customer demand for gas, 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. Despite limitations in natural gas supplies, PGNiG S.A. was able to secure stable supplies to its own customers. 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%. PGNiG S.A. is a party to a long-term take-or-pay contract with OOO Gazprom Export of September 25th 1996. However, the Regulation does not take into account the specific position of PGNiG S.A. related to its obligations under the contract. In 2015, the Ministry of Economy recognised the need to amend the Regulation and began work on a new draft.

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, 2012 and 2013.

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. As at the date of preparation of this report, the proceedings were pending. On December 30th 2015 and December 31st 2015, the President of the Energy Regulatory Office imposed on PGNiG S.A. fines of PLN 2,000,000 and PLN 4,000,000, respectively, for PGNiG S.A.'s failure to comply with the requirement, provided for in the licence to trade in natural gas with foreign partners, to diversify its gas supplies from abroad in 2009 and 2010. On January 21st 2016 and January 22nd 2016, PGNiG S.A. filed appeals against the decisions of the President of the Energy Regulatory Office with the Competition and Consumer Protection Court at the Regional Court of Warsaw.

Section VII: Other Activities

PGNiG S.A.’s organisational unit classified in the Other Activities segment is the Central Measurement and Testing Laboratory Branch. The Branch provides services ensuring accurate and reliable measurements of natural gas quality and volume. It also performs calibration, attestation, compliance verification, and testing of measurement devices and systems used in the natural gas industry, including testing of new measurement and analysis apparatus. The Laboratory also offers occupational training and advisory services, issues opinions, prepares expert reports, as well as validates and supervises field quality-testing laboratories.

In 2015, the Laboratory’s main areas of activity included:

- Metrological inspections of measurement systems on the Yamal-Europe transit gas pipeline (Polish section),
- Metrological inspections of measurement systems at industrial customers’ metering stations (26 facilities),
- Checking and evaluation of natural gas measurement systems for the purposes of assessment of CO_2 emissions by large industrial emitters,
- Measurement oversight of process analyser systems for the evaluation of gas quality in transmission and distribution networks, at production sites and in storage facilities,
- Optimisation testing of equipment for measuring gas temperatures inside pipelines,
- Preparation of agreements and rules of settlement related to LNG shipments by independent international inspectors at the Świnoujście terminal.

In 2015, the Laboratory also continued to work in a consortium building a laboratory for high-pressure gas meter calibration − a project carried out by OGP GAZ-SYSTEM S.A. As a consortium member, the Laboratory is responsible for the preparation of documentation for the laboratory’s quality management system. The project is scheduled for completion in 2016.

The Laboratory mainly rendered its services to PGNiG Group entities, EUROPOL GAZ S.A. and OGP GAZ-SYSTEM S.A.

<u>Planned activities</u>

The Central Measurement and Testing Laboratory Branch wants to maintain its position as the leading research laboratory and attestation centre, carrying out metrological inspections of measurement systems and devices used in the natural gas industry. The Laboratory also intends to remain the key laboratory in the area of quality assessment of natural gases of all types and forms, including LNG, CNG and biogas; evaluation of measurement and process analyser systems used to estimate CO_2 emissions and other types of emissions; settlement of gas fuels in units of energy; industry and technical training; and measurement supervision of field laboratories.

Section VIII: Investments

In 2015, capital expenditure incurred by PGNiG S.A. on property, plant and equipment and intangible assets was PLN 1,211m, having gone down by ca. 5% year on year. The table below presents PGNiG S.A.’s expenditure in the individual segments.

Capital expenditure (PLNm)

	2015	2014
Exploration and Production	983	946
Trade and Storage	228	330
Other Activities	0	0
Total	1,211	1,276

Below are described the key capex projects implemented by PGNiG S.A. in 2015.

Exploration and Production

The expenditure of PGNiG S.A. on exploration work amounted to PLN 526m and was incurred chiefly on geophysical surveys and the drilling of hydrocarbon exploration and appraisal wells (the segment’s 2014 data in the table above were restated to ensure comparability.).

The segment’s other investment projects involved the development of documented gas reserves (including already producing fields), projects executed to sustain or restore hydrocarbon production rates, and projects for the operation of the hydrocarbon production area. The key investment projects included:

- Completion of development of the Księżpol-19 well and of wells on the Daszewo, Załęże, Grodzisk, Wilków, and Łapanów fields,
- Development of wells on the Brońsko field,
- Development of the Połęcko oil and gas field,
- Development of the Sowia Góra-11K, Lubiatów-11H and Lubiatów-13K wells,
- Development of wells on the Przeworsk field,
- Start of development of the Radoszyn oil and gas field.

Trade and Storage

Capital expenditure of the Trade and Storage segment amounted to PLN 228m. Major investment projects in 2015 included construction and extension of underground gas storage facilities, including:

- Construction of the Kosakowo underground gas storage cavern facility – process pipelines connecting clusters A and B were completed, the leaching of cavern K5 was completed, and the leaching of caverns K-6, K-8 and K-9 began; the facility’s working capacity was increased to 112.4 mcm,
- Extension of the Mogilno underground gas storage cavern facility – caverns Z-15, Z-16 and Z-17 were placed in service; the facility’s working capacity was increased to 468.2 mcm,
- Extension of the Brzeźnica underground gas storage facility – two gas compressors were being installed.

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’ was completed. The project was commenced in 2008. After completion of the construction work and acceptance of the upgraded installation, the additional working capacity of the Wierzchowice underground gas storage facility totalling 1.2 bcm was made available in 2014. 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,

In 2015, the co-financing of three underground gas storage facilities under the EU Infrastructure and Environment Operational Programme for 2007–2013 was accounted for. The project to expand the Husów underground gas storage facility (completed in 2014) was co-financed with ca. PLN 35m, the Wierzchowice underground gas storage facility – with ca. PLN 485m, and the Kosakowo underground gas storage cavern facility – with ca. PLN 115m.

Section IX: 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 2015, a total of 51 wells and 41 extraction pits were abandoned.

Carbon credit trading system (*EU ETS)*

In 2015, PGNiG S.A. Branches in Odolanów (gas compressor station, boiler house and process gas heaters) and Zielona Góra (LMG oil and gas production facility, Wierzchowice underground gas storage facility, boiler house, and Dębno oil and gas production facility), as well as the Mogilno and Kosakowo underground gas storage cavern facilities were covered by the carbon dioxide emission trading scheme (ETS). In 2015, CO_2 emissions from these installations reached 156,378 Mg. In 2015, PGNiG S.A. reviewed annual reports on its carbon dioxide emissions for 2014. Carbon emissions from the installations covered by the EU ETS scheme in 2014 totalled 146,591 tonnes. After reconciling its CO_2 emissions with emission rights held, and after redeeming the allowances allocated for 2014, a deficit of 85,466 tonnes of CO_2 free emission units was identified. The deficit was covered with reserves accumulated in the accounts of PGNiG’s installations (unused free allocations from previous years) and with allowances purchased on the Intercontinental Exchange Futures Europe.

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 2015, following amendments to the Environmental Protection Law, land properties underwent another review to classify them as requiring reclamation, additional surveys or monitoring.

Section X: 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 its judgment 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 its 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 judgment is final. On June 12th 2015, PGNiG S.A. paid the penalty imposed by the judgment of the Warsaw Court of Appeals. Both PGNiG S.A. and the President of UOKiK filed cassation complaints against the Court of Appeals judgment to the Supreme Court. PGNiG S.A.'s cassation complaint seeks to challenge the finding of competition law infringement, whereas the President of UOKiK's cassation complaint seeks to question the Court of Appeal's decision to reduce the penalty imposed on PGNiG S.A. As at the date of this report, the Supreme Court had not examined the matter.

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.

On September 24th 2015, the President of UOKiK issued a decision stating that PGNiG S.A. did not fully implement Section I).4 of the decision of December 31st 2013 and imposed a financial penalty of PLN 10,442,535 on the Company for the delay in ensuring compliance with the decision. Under the same decision, the President of UOKiK discontinued the administrative proceedings against PGNiG Obrót detaliczny Sp. z o.o., stating that the company had satisfied the requirement imposed by the decision of December 31st 2013. On November 2nd 2015, PGNiG S.A. filed an appeal against the decision of the President of UOKiK to the Competition and Consumer Protection Court at the Regional Court of Warsaw. As at the date of this report, the Competition and Consumer Protection Court had not notified PGNiG S.A. of a hearing date.

<u>Collective dispute with the employer</u>

On December 16th 2015, the PGNiG S.A. Management Board executed an agreement with all the trade unions, ending the collective dispute started on May 21st 2015. The resulting agreement provides for:

- distribution of annual bonuses for 2014 in the gross amount of PLN 5,050 per employee, calculated in proportion to FTEs and length of service in 2014. The annual bonuses will be distributed by December 24th 2015,
- increase in the value of gift vouchers by PLN 950 per employee by December 24th 2015.

The parties also agreed that a percentage rise in base pay for 2016 would be determined by the end of April 2016, taking into account the lack of pay adjustments in 2015.

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

In 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 XI: Financial performance

1. Financial performance in 2015

The financial statements of PGNiG S.A. for 2015 are audited by PKF Consult Sp. z o.o. Sp. k. The agreement with the auditor was signed on February 5th 2013, for three years (2013−2015). Detailed information on the auditor's fees has been provided in the separate financial statements of PGNiG S.A. for the year ended December 31st 2015 (Note 37.5).

1.1. Key financial and business data

The separate financial statements of PGNiG S.A. for the year ended December 31st 2015 have been prepared in accordance with the International Financial Reporting Standards (IFRS) as endorsed by the European Union as at December 31st 2015. The accounting policies applied in preparing the financial statements are presented in the separate financial statements of PGNiG S.A. for the year ended December 31st 2015 (Note 2).

In 2015, PGNiG S.A. posted a net profit of PLN 1,472m, down by PLN 423m year on year.

Summary information on PGNiG S.A.'s financial standing in 2015 relative to 2014 is presented below in the financial statements prepared in accordance with the International Financial Reporting Standards, which comprise:

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

Separate statement of financial position (PLNm)

ASSETS	Dec 31 2015	Dec 31 2014
Total non-current assets	26,137	27,387
Property, plant and equipment	13,234	13,520
Investment property	-	1
Intangible assets	213	254
Shares	8,623	8,611
Other financial assets	3,321	4,403
Deferred tax assets	624	469
Other non-current assets	122	129
Total current assets	8,890	7,969
Inventories	1,638	2,506
Trade and other receivables	1,329	1,307
Other assets	18	20
Current financial assets	364	1,805
Derivative financial instrument assets	346	388
Cash and cash equivalents	5,190	1,942
Non-current assets held for sale	5	1
Total assets	35,027	35,356

Separate statement of financial position (PLNm) – contd.

EQUITY AND LIABILITIES	Dec 31 2015	Dec 31 2014
Total equity	23,738	23,780
Share capital	5,900	5,900
Share premium	1,740	1,740
Accumulated other comprehensive income	(518)	(185)
Retained earnings	16,616	16,325
Total non-current liabilities	7,205	7,385
Borrowings and other debt instruments	4,513	4,498
Employee benefit obligations	159	134
Provisions	1,303	1,414
Deferred revenue	641	690
Deferred tax liabilities	538	580
Other non-current liabilities	51	69
Total current liabilities	4,084	4,191
Trade and other payables	2,209	2,414
Borrowings and other debt instruments	469	656
Derivative financial instrument liabilities	814	423
Current tax liabilities	50	181
Employee benefit obligations	110	43
Provisions	396	472
Deferred revenue	36	2
Total liabilities	11,289	11,576
Total equity and liabilities	35,027	35,356

Separate statement of profit or loss (PLNm)

	2015	2014
Revenue	18,646	23,738
Total operating expenses	(17,852)	(22,105)
Raw materials and consumables used	(13,374)	(15,101)
Employee benefits expense	(704)	(750)
Depreciation and amortisation expenses	(799)	(722)
Services	(1,836)	(4,156)
Work performed by the entity and capitalised	13	10
Other income and expenses	(1,152)	(1,386)
Operating profit	794	1,633
Finance income	1,180	966
Finance costs	(357)	(377)
Profit before tax	1,617	2,222
Income tax	(145)	(327)
Net profit	1,472	1,895

Separate statement of cash flows (PLNm)

	2015	2014
Net cash (used in)/generated by operating activities	2,474	3,982
Net cash (used in)/generated by investing activities	2,222	(1,845)
Net cash (used in)/generated by financing activities	(1,530)	(2,149)
Net increase/(decrease) in cash and cash equivalents	3,166	(12)
Cash and cash equivalents at beginning of period	1,673	1,685
Cash and cash equivalents at end of period	4,839	1,673
including restricted cash	506	451

Financial ratios

Profitability

	2015	2014
EBIT (PLNm) operating profit	794	1,633
EBITDA (PLNm) operating profit + depreciation/amortisation	1,593	2,355
ROE net profit to equity at end of period	6.2%	8.0%
NET MARGIN net profit to revenue	7.9%	8.0%
ROA net profit to assets at end of period	4.2%	5.4%

Liquidity

	Dec 31 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 revenue)	2.0	1.5

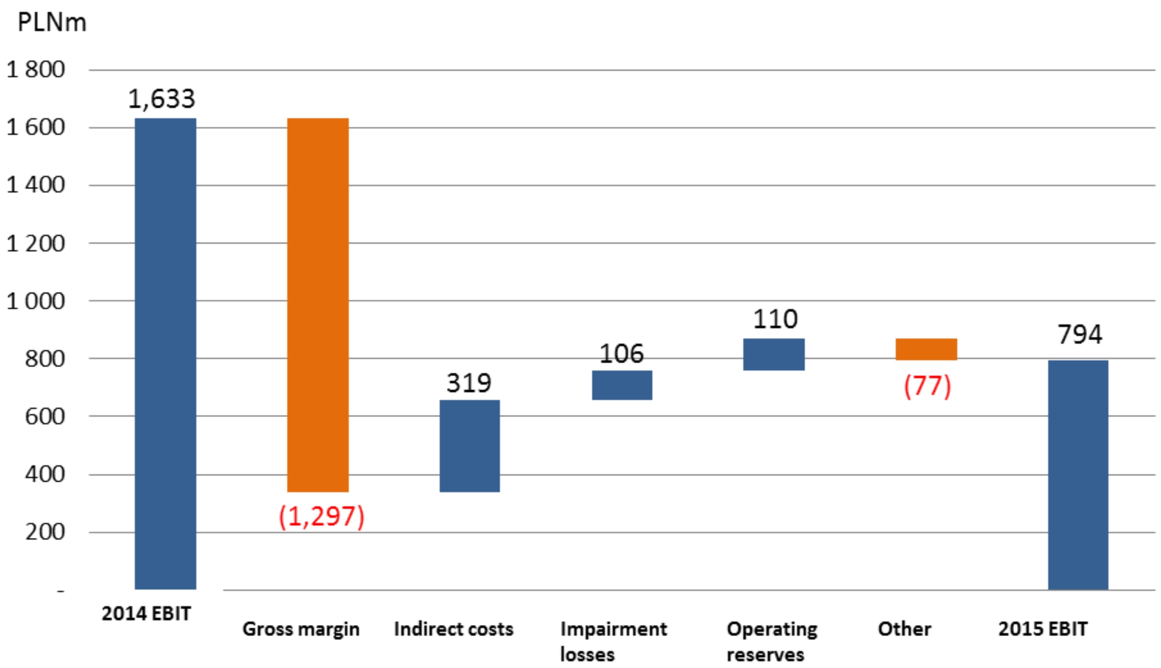
Debt

	Dec 31 2015	Dec 31 2014
DEBT RATIO total liabilities to total equity and liabilities	32.2%	32.7%
DEBT/EQUITY RATIO total liabilities to equity	47.6%	48.7%

1.2. Financial standing

In 2015, PGNiG S.A.'s operating profit (EBIT) came in at PLN 794m, down PLN 839m year on year. The chart below shows changes in EBIT from 2014 to 2015.

Change in EBIT: 2014 vs 2015



The year-on-year contraction of gross margin (the difference between revenue and direct costs) was mainly attributable to lower margins on sales of:

- crude oil (effect of ca. 55%), driven by lower average selling prices; the difference in the quoted Brent crude prices between the end of December 2014 and 2015 was approximately 33%,
- high-methane gas (effect of ca. 36%), driven by lower average selling prices of high-methane gas; the decline in average high-methane gas prices was caused by three reductions in tariff prices and the introduction of discount schemes for customers,
- other products, including helium, LPG and electricity (effect of ca. 7%), driven by lower average selling prices of these products.

The gross margin contraction was partially offset at the EBIT level by the following factors:

- decrease in indirect costs associated with the transfer of the retail business from PGNiG S.A. to PGNiG Obrót Detaliczny Sp. z o.o. in H2 2014,
- lower impairment losses on property, plant and equipment related to exploration for and evaluation of mineral resources,
- change in operating reserves (mainly due to reversal of provisions for well decommissioning costs).

In 2015, net finance income/cost was up PLN 234m 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 fell from 8.0% to 6.2%, from 5.4% to 4.2% and from 8.0% to 7.9%, respectively.

Statement of financial position

As at December 31st 2015, total assets recognised in the separate statement of financial position were PLN 35,027m, down PLN 329m on the end of December 2014.

Assets

Property, plant and equipment, of PLN 13,234m as at the end of December 2015, down PLN 286m (2%) relative to December 31st 2014, was the largest item of the Company's assets. The decrease in property, plant and equipment was driven mainly by the recognition of impairment losses on exploration assets.

Shares are another major item of assets. As at December 31st 2015, they totalled PLN 8,623m, up PLN 12m (a slight increase) on the end of December 2014.

Other financial assets stood at PLN 3,321m, down PLN 1,082m on December 31st 2014. The decline was attributable to a decrease in non-current loans advanced.

As at December 31st 2015, current assets stood at PLN 8,890m, up PLN 921m (12%) relative to December 31st 2014.

Relative to December 31st 2014, there was a decrease in inventories of PLN 868m (35%). The inventories disclosed in the statement of financial position comprise mainly gas stored in underground storage facilities. The volume of gas stored was down by 331 mcm (15%) relative to the end of 2014. At the same time, inventory write-downs were up PLN 191m.

Trade and other receivables rose by PLN 22m (2%) relative to the end of 2014.

Current financial assets stood at PLN 364m, down PLN 1,441m on December 31st 2014. The decline in current financial assets was attributable to a decrease in current loans advanced and debt securities.

Cash and cash equivalents stood at PLN 5,190m, up PLN 3,248m relative to the end of 2014. The increase was due to a failure to complete some of the investment projects planned for 2015 (including acquisitions), lower than expected cost of gas procurement, repayment of loans advanced and sale of notes.

The value and structure of current assets held by the Company guaranteed its ability to settle all liabilities in a timely manner. The current ratio was 2.5 compared with 2.2 as at the end of December 2014, while the quick ratio rose from 1.5 to 2.0.

Equity and liabilities

Equity is the primary source of financing of the Company's assets. As at the end of 2015, equity stood at PLN 23,738m, on par with the level recorded as at December 31st 2014.

As at December 31st 2015, non-current liabilities were PLN 7,205m, down PLN 180m on the end of December 2014. The decrease was due to a change in provisions for production well decommissioning costs.

Current liabilities fell slightly, by PLN 107m to PLN 4,084m, on the end of 2014.

The Company's debt was slightly lower on 2014. At the end of 2015, debt to equity fell from 48.7% to 47.6%, while the debt ratio (total liabilities to total equity and liabilities) decreased from 32.7% to 32.2%.

Transactions concluded on non-arm's length terms

In 2015, PGNiG S.A. and its subsidiaries did not enter into any material related-party transactions on non-arm's length terms.

Feasibility of investment plans

In 2016, PGNiG S.A. intends to maintain a high level of expenditure on investments, in particular on exploration and production activities in Poland and abroad. The Company also intends to continue projects to extend and upgrade its storage infrastructure.

When evaluating the feasibility of its investment plans for 2016 and beyond, PGNiG S.A. took into account its financial standing. including the available sources of external financing and cash generated by the Group's day-to-day operations. In conclusion, the funds available to PGNiG S.A. were found sufficient to finance its investment plans.

Explanation of differences between the actual results and forecasts for 2014

No financial forecasts for 2015 were published by PGNiG S.A.

2. Financial management

2.1. Policies of financial risk management

PGNiG S.A. is exposed to financial risks, including in particular:

- credit risk,
- market risk and
- liquidity risk.

To effectively manage the financial risks, PGNiG S.A. has implemented the 'Policy of Financial Risk Management at PGNiG S.A.', which defines the distribution of functions and responsibilities between the Company's organisational units in the process of managing and monitoring the financial risks. The body responsible for ensuring compliance with the policy and its periodic revisions is the risk committee, which proposes risk management procedures, monitors the policy implementation and revises the policy as needed.

2.1.1. Credit risk

Credit risk is defined as the probability of failure by PGNiG S.A.'s trading partner to meet its obligations on time or failure to meet such obligations at all. The credit risk resulting from a third party's inability to perform its obligations under a financial instruments contract is generally limited to the amounts, if any, by which the third party's liabilities exceed the Company's liabilities. As a rule, PGNiG S.A. concludes transactions in financial instruments with multiple entities with high creditworthiness. The key criteria applied by the Company in the selection of counterparties include their financial standing as confirmed by rating agencies, as well as their market shares and reputation.

PGNiG S.A. is exposed to credit risk under:

- fund placements,
- trade receivables,
- loans and other financial assets,
- hedging transactions and
- financial guarantees provided,

Cash and cash equivalents

The Company identifies, measures and minimises its credit exposure to individual banks with which it places its funds. The credit exposure was reduced through diversification of the portfolio of counterparties (mainly banks) with which the Group companies place their funds. PGNiG S.A. has also concluded framework agreements with all its relationship banks. These framework agreements stipulate detailed terms of execution and settlement of financial transactions between the parties.

The Company measures the related credit risk by regularly reviewing the banks' financial standing, as reflected in ratings assigned by rating agencies such as Fitch, Standards&Poor's and Moody's.

In 2015, the Company invested its significant long-term cash surplus in a well diversified portfolio of deposits held with reputable banks.

Trade and other receivables

Material credit risk (in value terms) is related to receivables, mainly receivables under gas fuel sales, as well as electricity and related products sales, including carbon credits, and certificates of origin for electricity.

Transactions made at the Polish Power Exchange do not generate exposure to credit risk, as the system of guaranteed settlements through the agency of the Commodity Exchange Clearing House provides each member of the Clearing House with the safety of settlements in the case of insolvency of any individual market participants. In order to minimise the risk of uncollectible receivables arising in connection with sale transactions executed outside of the PPE, uniform rules designed to secure trade receivables are in place and must be observed while concluding general supply contracts.

In line with its policy, the Company verifies creditworthiness of each institutional trading partner seeking trade credit. An adequate credit limit is determined individually for each trading partner depending on how a partner is rated. Relevant agreements with such trading partners, consistent with the provisions of the Energy Law, define appropriate payment terms and forms of security, and contain provisions governing suspension of supplies should the partner cease to meet its obligations.

Balances of receivables from customers are monitored on an ongoing basis, in line with the Company's policy. If payment is not received within the contractual term, appropriate steps are taken, in line with PGNiG S.A.'s debt collection procedures.

Loans and other financial assets

Exposure to credit risk under loans advanced arises in connection with loans advanced by PGNiG S.A. to related entities. Loans to those entities are advanced in line with an internal procedure, which stipulates detailed rules governing the conclusion and monitoring of loan agreements, thus minimising the Company's exposure to credit risk under such agreements. Loans are advanced only if the borrower meets a number of conditions and provides appropriate security.

Positive value of derivative financial instruments

The exposure to credit risk under financial derivatives is equal to the net carrying amount of the positive valuation of the derivative (at fair value). As in the case of placements, transactions in financial derivatives are executed with most reputable banks with high credit ratings. The Group companies have also concluded either framework agreements or *ISDA* Agreements with each of their relationship banks, stipulating detailed terms of service and limits of maximum exposure arising from the fair value of derivatives.

PGNiG S.A. believes that all these measures protect it from any material credit-risk-related losses.

Guarantees issued

PGNiG S.A.'s credit risk exposure under provided guarantees is substantially limited to the risk of insolvency of the banks which, acting on the Company's instructions, issued guarantees to other external entities. However, the banks on which the Company relies for provision of guarantees are reputable institutions with high ratings; therefore, both the probability of their insolvency and the associated credit risk are insignificant. As in the case of the risk related to cash deposits, the credit risk under provided guarantees is measured by regularly reviewing the financial standing of the banks issuing the guarantees.

2.1.2. Market risk

Market risk is defined as the probability that PGNiG S.A.'s financial performance or value will be adversely affected by changes in the financial and commodity markets.

The main objective of the market risk management is to identify, measure, monitor and mitigate key sources of the risk, including:

- foreign exchange risk
- interest rate risk
- commodity risk (e.g. gas fuel, crude oil, energy and related products).

Currency risk

Currency risk is defined as the probability that the Company's financial performance will be adversely affected by changes in the price of one currency against another.

The hedging measures implemented by the Company are mainly intended to provide protection against the currency risk accompanying payments settled in foreign currencies (mainly payments for gas fuel supplies). To hedge its trade payables, the Company uses call options, option strategies and forward transactions.

Interest rate risk

Interest rate risk is defined as the probability that the Company's financial performance will be adversely affected by changes in interest rates.
The Company is exposed to interest rate risk primarily in connection with its financial liabilities.

PGNiG S.A. measures its market risk (including the currency and interest rate risks) by monitoring VaR (value at risk). *VaR* means that the maximum loss arising from a change in the market (fair) value will not exceed that value over the next business days, given a specified probability level (e.g. 99%). VaR is estimated using the variance-covariance method.

Commodity price risk

Commodity price risk is defined as the probability that PGNiG S.A.'s financial performance will be adversely affected by changes in commodity prices.

The Company's exposure to commodity price risk arises mainly in connection with its contracts for gas fuel deliveries and sales contracts entered into through the process of daily bidding and sale of the fuel at the PPE. It stems from volatility of prices of gas and oil products quoted on global markets. Under some of the contracts for gas fuel deliveries, the pricing formula relies on a weighted average of the prices from previous months, which mitigates the volatility risk.

Commodity risk is also related to electricity trading, certificates of origin and carbon credits. Trade in electricity is carried out on regulated exchange markets in Poland and abroad. The Company also executes transactions outside of regulated markets, under frame agreements. The Company actively manages its exposure to commodity price risk using implemented *VaR* measures. *VaR* values are measured and *VaR* limits are set and actively monitored to limit the potential losses related to the exposure to commodity price risk assumed by the Company.

In 2015, the Company closely monitored and hedged the risk. To hedge against commodity price risk, the Company used Asian call options settled as European options, risk reversal option strategies, commodity swaps, as well as futures and forwards.

PGNiG S.A. applies cash-flow hedge accounting with respect to foreign exchange transactions and commodity transactions, as well as fair-value hedge accounting with respect to an advanced loan. The application of cash-flow hedge accounting allows the Company to charge the effective portion of the hedge to revaluation capital reserve, which results in the sustained matching of the effect of valuation of hedging instruments on profit or loss and the result on the hedged item. This eliminates the volatility of financial results by recognising the economic and accounting effects of hedging in the same period.

2.1.3. Liquidity risk

The main objective of the liquidity risk management is to monitor and plan the Company's liquidity on a continuous basis. Liquidity is monitored through at least 12-month projections of future cash flows, which are updated once a month. PGNiG S.A. reviews the actual cash flows against projections at regular intervals – an exercise which comprises an analysis of unmet cash-flow targets, as well as the related causes and effects.

The liquidity risk should not be equated exclusively with the risk of loss of liquidity by the Company. An equally serious threat is that of having excess structural liquidity, which could adversely affect the Company’s profitability.

The Company monitors and plans its liquidity position on a continuous basis. As part of its strategy to hedge against liquidity risk, in 2015 the Company had in place a number of debt issuance programmes. Any surplus cash was invested in a well diversified portfolio of deposits held with reputable banks. In addition, under the extended intra-Group note issuance programme, PGNiG S.A. was able to acquire notes issued by other Group companies.

The liquidity risk is significantly mitigated at PGNiG S.A. through the application of the PGNiG S.A. Liquidity Management Procedure. This procedure has been implemented across the Company’s organisational units. It offers a systematised set of measures designed to ensure proper liquidity management through: settlement of payments, preparation of cash-flow projections, optimum management of free cash flows, securing and restructuring of financing for day-to-day operations and investment projects, protection against the risk of temporary liquidity loss due to unforeseen disruptions, and appropriate servicing of credit agreements.

Measurement of the liquidity risk is based on an ongoing detailed monitoring of cash flows, which takes into account the probability that specific flows will materialise, as well as the planned net cash position.

In the current and comparative periods, the Company met its liabilities under borrowings in a timely manner. Further, there were no breaches of material provisions of any of its borrowing agreements that would trigger accelerated repayment.

PGNiG S.A. has not identified any other material risks inherent in its day-to-day operations.

<u>Assessment of financial resources management</u>

PGNiG S.A. pays its financial liabilities in a timely manner and the risk of failure to meet its liabilities is minimised. PGNiG S.A. maintains sufficient liquidity in the form of deposits held with various banks, with varying maturity dates. The liquidity risk is mitigated by bond/note issuance programmes under agreements with banks executed in 2015 and in previous years.

While assessing the efficiency of financial resources management, a noteworthy fact is the optimum diversification of the portfolio of financial institutions. It should also be noted that, thanks to the diversity of available financing sources and liquidity management tools at PGNiG S.A., PGNiG S.A. is able to timely fulfil its financial obligations.

2.2. Note issuance programmes

In 2015, PGNiG S.A. was able to issue notes under the following programmes:

- the note issuance programme of June 10th 2010,
- the note issuance programme of May 22nd 2012,
- the note issuance programme of October 2nd 2014,
- the note issuance programme of December 1st 2010, addressed to PGNiG Group companies.

In 2015, annexes were signed to the terms and conditions of all note issuance programmes, harmonising them with the requirements of the Act of Bonds of January 15th 2015.

Under the note issuance programme of June 10th 2010 (amended under annexes of 2011 and 2014), valid until July 31st 2020, PGNiG S.A. may issue discount or coupon-bearing notes of up to PLN 7bn with maturities ranging from one month to one year. The total nominal value of notes issued in 2015 was PLN 0.5bn. As at December 31st 2015, no outstanding debt was recognised by PGNiG S.A. under the programme.

Under the note issuance programme of May 22nd 2012, valid until May 22nd 2017, PGNiG S.A. may issue (for private placement) fixed or floating rate notes with maturities of up to 10 years, for up to PLN 4.5bn. In 2015, the Company did not issue any notes under the programme. As at December 31st 2015, the debt outstanding under notes issued in previous years amounted to PLN 2.5bn.

Under the note issuance programme of October 2nd 2014, valid until September 30th 2024, PGNiG S.A. may issue discount notes of up to PLN 1bn with maturities ranging from one year to four years. In accordance with the agreement, the issue proceeds may only be used to finance investing activities related to, among other things, maintenance of production capacity, diversification of gas supply sources, oil and gas exploration, development of the power sector and ongoing projects involving the construction of underground gas storage infrastructure. In 2015, the Company did not issue any notes under the programme, nor did it disclose any outstanding debt under the programme.

The issue proceeds were applied to finance PGNiG S.A.'s day-to-day financial needs related to implementation of its strategy. PGNiG S.A. uses the issue proceeds also to finance the exploration for conventional and unconventional oil and gas deposits, field development, construction and extension of underground gas storage capacities and the distribution network, including new connections, as well as power generation projects.

Furthermore, pursuant to the agreement of December 1st 2010 (as amended by annexes of 2011 and 2014), in 2015 the Company continued to issue short-term discount notes to PGNiG Group companies. Under an annex of August 7th 2015, the programme amount was increased from PLN 3bn to PLN 5bn. For PGNiG S.A., the maximum amount of notes in issue remained at PLN 1bn, with the balance allocated to other Group companies. The note issuance programme is designed to enable the flow of cash between companies, thus optimising the liquidity management within the Group. In 2015, PGNiG S.A. and GEOFIZYKA Kraków S.A. issued notes with a total nominal value of PLN 4,234m and PLN 40m, respectively. As at December 31st 2015, PGNiG S.A.'s outstanding debt under the notes in issue was PLN 310m, while GEOFIZYKA Kraków S.A.'s − PLN 40m.

2.3. Borrowings

Credit facility agreements executed in 2015

In 2015, PGNiG S.A. entered into overdraft facility agreements for a total amount of PLN 100m. As at December 31st 2015, no outstanding debt was recognised by the Company under the facilities. The table below presents detailed information on the credit facility agreements executed by the Company in 2015.

PGNiG S.A.'s credit facility agreements

Bank	Facility amount (PLNm)	Interest rate	Type	Maturity date
Bank Handlowy w Warszawie S.A.	40.0	1M WIBOR + 0.30%	working capital facility	Dec 30 2016
Societe Generale S.A. Polish Branch,	40.0	1M WIBOR + 0.30%	working capital facility	Aug 31 2016
mBank S.A.	20.0	ON WIBOR +0.30%	working capital facility	Sep 01 2016

Credit facility agreements terminated in 2015

In 2015, PGNiG S.A. did not terminate any credit facility agreements.

Loan agreements executed in 2015

In 2015, PGNiG S.A. advanced and novated loans to related entities only, totalling NOK 4,100m, EUR 10m and PLN 428.5m. The loans advanced by PGNiG S.A. were used to finance the investment activities on the Norwegian Continental Shelf, as well as day-to-day operations, including mainly settlements of gas purchases and repayment of liabilities. The table below presents detailed information on the loans advanced by PGNiG S.A.

Loans advanced by PGNiG S.A.

Company	Loan amount (m)	Currency	Interest rate	Type	Maturity date
PGNiG Upstream International AS	4,100.0	NOK	3M NIBOR + 2.25%	working capital loan/ investment loan	Dec 31 2026[*]
PGNiG Obrót Detaliczny Sp. z o.o.	400.0	PLN	1M WIBOR + 1.80%	working capital loan	Feb 24 2016
PGNiG Supply & Trading GmbH	10.0	EUR	3M EURIBOR +2.00%	working capital loan	Dec 31 2017[**]
Elektrociepłownia Stalowa Wola S.A.	13.5	PLN	3M WIBOR + 2.50%	working capital loan	Dec 31 2027
GEOFIZYKA Kraków S.A.	10.0	PLN	1M WIBOR +1.70%	working capital loan	Jul 26 2016
Elektrociepłownia Stalowa Wola S.A.	2.6	PLN	6M WIBOR+2.50%	working capital loan	Nov 30 2016
Elektrociepłownia Stalowa Wola S.A.	2.4	PLN	3M WIBOR + 2.50%	working capital loan	Dec 31 2027

[*] In 2015, PGNiG S.A. executed annex 5 to loan agreement no. 3 of August 27th 2010. Pursuant to the annex, the loan amount was reduced from NOK 5.05bn to NOK 4.10bn and the repayment date was extended from December 20th 2021 to December 31st 2026. The remaining terms and conditions of the loan were not amended.

[*] In 2015, PGNiG S.A. executed annex 1 to loan agreement no. 1 of April 27th 2012. The annex extended the repayment date from December 31st 2016 to December 31st 2017. The remaining terms and conditions of the loan were not amended.

In 2015, PGNiG S.A. did not contract or terminate any loans.

2.4. Guarantees and sureties

In 2015, PGNiG S.A. provided guarantees and sureties for a total amount of PLN 195m, disclosed in the separate financial statements. This amount included:

- surety for a PLN 30m loan contracted by PGNiG Technologie S.A.
- performance bond provided as security for gas supplies by PGNiG Supply &Trading GmBH, totalling PLN 165m.

In 2015, PGNiG S.A. did not receive any guarantees or sureties disclosable in the financial statements.

3. Projected future financial standing

The most important factors affecting the financial standing of PGNiG S.A. in 2016 will be the considerable volatility of global hydrocarbons prices and currency exchange rates, which add to the uncertainty regarding revenues and the future carrying amounts of production assets, as well as the cost of gas procurement under long-term contracts with OOO Gazprom Export and Qatar Liquefied Gas Company Limited (3).

The prices of crude oil, petroleum products and gas are an essential factor determining PGNiG S.A.’s financial position. As at the end of 2015, the prices of Brent crude were below USD 40 per barrel. In 2016, the oversupply of crude oil is expected to continue, which will keep the prices down. The long-term prospect of growing demand for crude oil with a 50% lower growth in supply warrants the expectation that in 2017 demand will finally outstrip supply, driving up the prices. As an ultimate result, in 2016 it will be possible to keep oil margins on the 2015 level, with rises expected in the following years. In 2016, the cost of gas procurement is expected to remain low. Since the agreement with OOO Gazprom Export is based on a 9-month pricing formula, the sensitivity of the cost of procuring gas fuel to the volatility of hydrocarbon prices will be deferred.

Another significant factor behind the Company’s financial performance are conditions prevailing on the currency markets. Since PGNiG S.A.’s financial performance is strongly correlated with the PLN/USD exchange rate, the Company will pursue its hedging policy to optimise the exchange rate’s effect on the cost of gas imports.

The progressing deregulation of the Polish gas market and the resulting diversification of supplies by PGNiG S.A.’s key customers may force the Company to export its surplus gas at prices which fail to cover the actual cost of procurement under long-term contracts. In response to that threat, in 2015 PGNiG S.A. rolled out discount schemes addressed to its strategic customers. They represented active response to the customer expectations and new conditions brought on by the liberalisation of the market. PGNiG S.A. is also implementing a number of projects designed to improve efficiency and cut operating costs. These efforts, which target both the market and the Company’s internal structure, should have a positive bearing on future performance.

Other drivers of PGNiG S.A.’s performance are the rates and charges provided for in the gas fuel tariffs, quoted gas prices, and new discount schemes for customers. The tariffs were reduced three times in 2015, impairing the performance of the Trade and Storage segment. On January 1st 2016, another tariff reduction became effective (approved by the President of the Energy Regulatory Office on December 16th 2015). The price war for customers manifested in additional discounts will further squeeze margins, potentially leading even to temporary losses.

Starting from 2016, the Company’s performance will also be adversely affected by the increase in royalty rates compared with 2015 – 33% for crude oil and a nearly fourfold increase for high-methane gas.

In the coming years, natural gas and crude oil output is expected to remain relatively stable. Production from the fields will support PGNiG’s future performance.

In 2016, the Company intends to maintain a high level of capital expenditure. Most funds will be allocated to financial investments as well as exploration and production of hydrocarbons. PGNiG S.A. will spend nearly PLN 1bn on the drilling of research, exploration, evaluation and production wells, and more than PLN 0.3bn on wellsite development and on extension, and modernisation of oil and gas production facilities.

Members of the Management Board

President of the Management Board	Piotr Woźniak	....
Vice-President of the Management Board	Janusz Kowalski	....
Vice-President of the Management Board	Łukasz Kroplewski	....
Vice-President of the Management Board	Bogusław Marzec	....
Vice-President of the Management Board	Maciej Woźniak	....
Vice-President of the Management Board	Waldemar Wójcik	....