DIRECTORS' REPORT ON THE OPERATIONS OF THE PGNIG GROUP IN 2015

Polskie Górnictwo Naftowe i Gazownictwo SA

Warsaw, February 19th 2016

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Section I: PGNiG Group

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

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG S.A.), with its registered office in Warsaw, ul. Marcina Kasprzaka 25, was established through transformation of the state-owned enterprise Polskie Górnictwo Naftowe i Gazownictwo into a state-owned stock company. On October 30th 1996, the Company was entered in the commercial register as Polskie Górnictwo Naftowe i Gazownictwo S.A. of Warsaw, under entry No. RHB 48382. On November 14th 2001, PGNiG S.A. was entered into the Register of Entrepreneurs of the National Court Register under No. KRS 0000059492.

On May 24th 2005, the Polish Securities and Exchange Commission admitted PGNiG shares to public trading. 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. 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 PGNiG Group holds the leading position in most segments of the Polish gas sector, i.e. in oil and gas exploration and production, gas fuel storage, natural gas trading and natural gas distribution. The Group's oil and gas upstream operations, carried out primarily in Poland and on the Norwegian Continental Shelf, provide it with a competitive advantage on the liberalised gas market. The Group's trade and storage operations focus on selling natural gas imported from other countries or produced from domestic fields, and on providing gas supplies at times of peak demand. The distribution operations involve the supply of gas to customers via the distribution network, as well as extending and upgrading of the gas network. In 2012, the PGNiG Group expanded its operations to include electricity and heat generation and sale.

1. Group structure

As at December 31st 2015, the Group comprised PGNiG S.A. (the Parent), and 30 production, trade and service companies, including:

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

The list of the PGNiG Group companies as at December 31st 2015 is presented in the table below.

Companies of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	Ownership interest: 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	240,000[4)]	-	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)]
	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)] For details, see below; indirect interest through Polska Spółka Gazownictwa Sp. z o.o.
[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.

Changes in the PGNiG Group's structure in 2015:

- On February 17th 2015, Gas Assets Management Sp. z o.o. was entered in the National Court Register.
- On March 5th 2015, following the closing of the liquidation process, Polskie Elektrownie Gazowe Sp. z o.o. w likwidacji (in liquidation) was removed from the National Court Register.
- April 21st 2015 saw the establishment of PST Europe Sales GmbH, with the share capital of EUR 500,000, in which PGNiG Sales & Trading GmbH acquired 100% of shares 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 deleted from the National Court Register.

As at December 31st 2015, the consolidation included PGNiG S.A. (the Parent) and 21 subsidiaries, including three groups. The chart below presents the consolidated companies of the PGNiG Group as at December 31st 2015 (by segment).

Consolidated PGNiG Group companies

Parent		
Polskie Górnictwo Naftowe i Gazownictwo S.A.		
Segment	**Subsidiaries**	**Ownership interest held by PGNiG S.A.**
Exploration and Production	Exalo Drilling S.A.	100%
	Oil Tech International F.Z.E.	100%
	Poltava Services LLC	99%
	GEOFIZYKA Kraków S.A.	100%
	GEOFIZYKA Toruń S.A.	100%
	PGNiG Upstream International AS	100%
	Polish Oil and Gas Company - Libya B.V.	100%
Trade and Storage	PGNiG Obrót Detaliczny Sp. z o.o.	100%
	PGNiG Supply & Trading GmbH	100%
	PST Europe Sales GmbH	100%
	XOOL GmbH	100%
	Operator Systemu Magazynowania Sp. z o.o.	100%
	PGNiG Finance AB	100%
Distribution	Polska Spółka Gazownictwa Sp. z o.o.	100%
	Powiśle Park Sp. z o.o.	100%
	GAZ Sp. z o.o.	100%
Heat and Power Generation	PGNiG TERMIKA S.A.	100%
Other Activities	Geovita S.A.	100%
	PGNiG Technologie S.A.	100%
	PGNiG Serwis Sp. z o.o.	100%
	B.S. i P.G. Gazoprojekt S.A. *	75%

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

Changes in management policies

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.

2. Ownership interests in other related entities

The list of other related entities of the PGNiG Group as at December 31st 2015 is presented in the table below.

Other related entities of the PGNiG Group

	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 within the PGNiG Group 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 deleted 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 the PGNiG Group's equity interests held outside the group of related entities was PLN 35.4m. In 2015, the PGNiG Group made no material equity investments outside the group of related entities.

3. 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	8,903	10,221
Trade and Storage	3,462	3,929
Distribution	10,678	12,173
Heat and Power Generation	1,071	1,068
Other Activities	1,305	1,605
Total	25,419	28,996

Compared with December 31st 2014, the number of employees at the PGNiG Group fell by 3,577 (12%). The workforce reduction was related to the PGNiG Group’s strategy for 2014−2022, designed to improve the Group’s cost efficiency and streamline its organisational structure.

The most significant staff cuts were made in the Distribution segment, in which employment contracts with 1,495 employees (12%) were terminated. The reduction was an effect of synergies generated as a result of the consolidation of six gas distribution companies into a single company in 2013. The majority of the employees laid off from the Distribution segment benefited from the company’s voluntary redundancy programme. In the Exploration and Production and Other Activities segments, the number of employees fell by 1,318 (13%) and 300 (19%), respectively. The workforce reduction in these segments was aimed at improving their cost efficiency and streamline their organisational structure. In 2015, the number of employees in the Trade and Storage segment declined by 467 (12%). Most of the leaving employees terminated their employment contracts based on the voluntary redundancy programme.

Section II: Parent'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 qualification 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 Ms Irena Ożóg and Mr Maciej Mazurkiewicz as new Supervisory Board members.

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

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

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

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

On December 4th 2015, the Minister of State Treasury appointed Mr Piotr Woźniak as 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 Mr Andrzej Janiak, Mr Janusz Pilitowski, Mr Maciej Mazurkiewicz and Ms Irena Ożóg from the Supervisory Board of PGNiG S.A., and appointed Mr Mateusz Boznański, Mr Andrzej Gonet, Mr Krzysztof Rogala and Mr Wojciech Bieńkowski as new Supervisory Board members.

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 consolidated financial statements for the year ended December 31st 2015 (Note 36.5).

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.

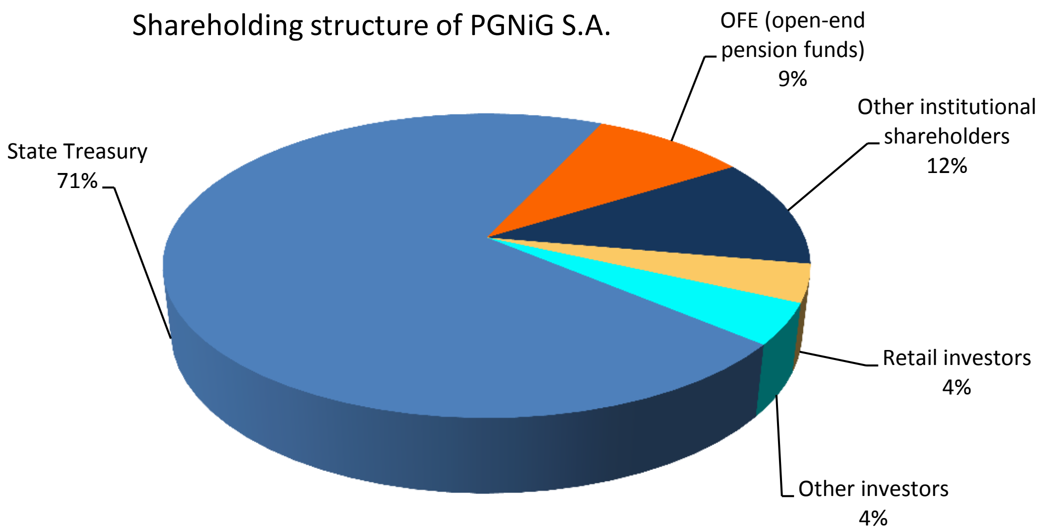
As at December 31st 2015, the share capital of PGNiG S.A. amounted to PLN 5,900,000,000 and was divided into 5,900,000,000 shares with a par value of PLN 1 per share. The Polish State Treasury was the only shareholder with a large direct holding of PGNiG shares. The shares of all series, that is Series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

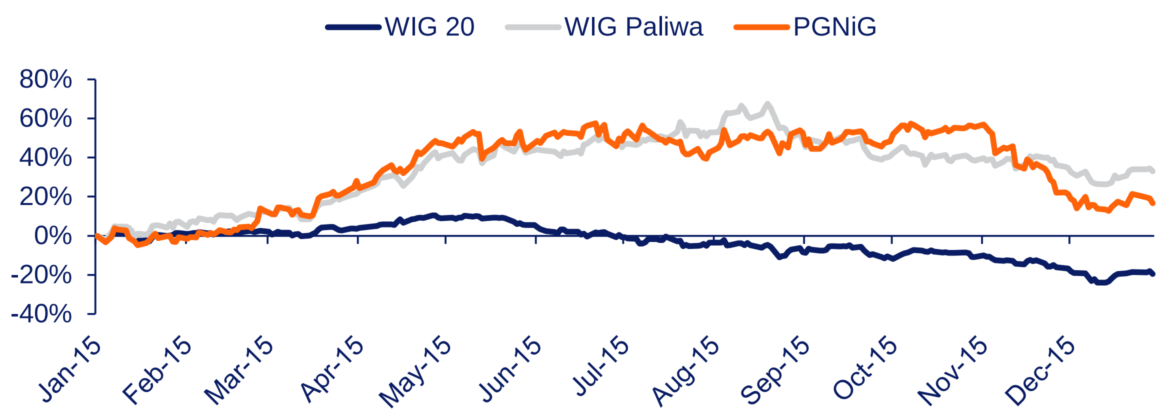
2. Share price

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: PGNiG Group's development directions

On December 29th 2014, the Supervisory Board of PGNiG S.A. approved the PGNiG Group's Strategy for 2014–2022.
The Strategy covers four business areas and ten strategic initiatives, which − if fully implemented − should allow the Group in a time horizon of eight years (by 2022) to earn EBITDA of approximately PLN 7bn, keep the net debt to EBITDA ratio below 2, and pay out dividends at 50% of the consolidated net profit (with a proviso that in its dividend recommendations, the PGNiG Management Board will always take into account the current financial standing of the PGNiG Group and its investment plans). In the period covered by the Strategy, capital expenditure on organic growth and acquisitions is expected to reach PLN 40bn-50bn. An important factor for delivery of the strategic objectives will be the expected increase in hydrocarbon production to approximately 50-55 mboe in 2022, with the annual production in Poland maintained at the current level of approximately 33 mboe.

The business areas covered by the PGNiG Group's Strategy for 2014-2022 include:

- Maintaining stable trading volumes (both in retail and wholesale)
- Maximising cash flows from the infrastructure and generation area
- Strengthening and transforming the exploration and production area
- Laying foundations for growth along the value chain

As regards the objective of maintaining stable trading volumes (both in retail and wholesale), the PGNiG Group will seek to maintain its leading position on the gas market and to remain the preferred gas supplier for all customer segments. The Group intends to achieve these objectives by developing and implementing mechanisms to improve customer service quality and encourage customers to continue their business relationships with the Group. The PGNiG Group also intends to maintain the high stability of gas supplies to end customers and to enhance its product offering through such initiatives as launch of *dual fuel* products. The priority in this area is to develop and implement mechanisms that would mitigate the risk related to the Company's long-term gas import contracts. The PGNiG Group will also seek to introduce more flexibility into its natural gas portfolio and adjust the portfolio to the changing pricing and supply/trading conditions on the market, while maintaining its ability to ensure energy security.

The PGNiG Group's grid infrastructure, gas storage, and electricity and heat generation assets are a source of predictable, stable revenue and deliver attractive rates of return relative to the risks. In the coming years, the assets will prove important in stabilising the Group's financial performance and enhancing its ability to finance new projects. In a highly competitive environment, it will be of key importance to maximise cash flows from this business area and to allocate any free cash to growth-oriented projects that will fully exploit the Group's potential and synergies available in new growth areas. The Group intends to pursue new, profitable transmission infrastructure projects (heat networks) as one of its development directions.

The Exploration and Production segment will continue to play a major role in the development of the PGNiG Group. The Group's main objective is to maintain stable production of natural gas and crude oil in Poland. In addition, to secure further meaningful growth of shareholder value, the Group intends to take active steps to build a portfolio of foreign exploration and production assets. The PGNiG Group will continue the exploration and appraisal of *shale gas* deposits in Poland within its most prospective licence areas, with a view to verifying recoverable unconventional reserves of hydrocarbons and commencing their economically-viable production in the shortest possible time.

To ensure further growth at each stage of its value chain, the PGNiG Group will take steps to improve its cost effectiveness and organisational efficiency. These measures will include cost rationalisation, development of new business areas, and focus on the Group's principal business activity. Their implementation will improve the Group's ability to finance new projects and enhance its competitive position.

Progress with the 'PGNiG Group Strategy for 2014–2022' in 2015

Key tasks planned for 2015 to support the delivery of the PGNiG Group's strategic vision were performed. This was facilitated by precisely identified and effectively monitored strategic initiatives. An important factor aiding their implementation was the achievement of the assumed cost savings on enhanced organisational and process-related efficiencies across the PGNiG Group. On December 30th 2015 (the last session day in the year), the PGNiG stock price closed at PLN 5.14, which means it went up by more than 15% compared with the last day of trading in 2014 despite the unfavourable market environment. In 2015, acting in accordance with the strategy guidelines, the Annual General Meeting of PGNiG S.A. decided to pay a dividend to the Company's shareholders. The dividend amounted to PLN 1.18bn, i.e. PLN 0.20 per share, which represented 62% of the PGNiG's net profit and 42% of the PGNiG Group's net profit for 2014. The Company had never before paid such a high dividend, which should be noted considering the current financial standing of the PGNiG Group and its investment plans.

The results achieved by the Group in 2015 with respect to maintaining a stable value of sales confirmed that its strategy to provide a wide range of dedicated discount offers, especially to business customers, was correct. At the end of 2015, the tariff price was in fact the maximum price, because customers benefited from a number of discount offers. The results achieved in wholesale were even better than targeted in the strategy. Negotiations with Qatar Liquefied Gas Company Limited (3) led to amendments to the contract with this supplier reducing the risk that PGNiG S.A. would have to cover the cost of uncollected gas due to the delayed launch of the LNG terminal in Świnoujście. Thanks to the amendments, PGNiG S.A. succeeded in eliminating the risk of having to make payments under the take or pay clause in 2015. Moreover, PGNiG S.A. entered into negotiations with OOO Gazprom Export based on the negotiation window provided for in the contract between the parties. In May 2015, PGNiG S.A. called PAO Gazprom and OOO Gazprom Export to arbitration proceedings before the Arbitration Court in Stockholm, which however did not preclude the parties from holding commercial negotiations to reach an agreement.

In line with expectations, in 2015 the Group recorded a growth in the area of its transmission and storage infrastructure. The gas transfer volumes were growing faster than expected, on the back of a faster growth in the number of new connections to the network and new customers, while the average distribution charge remained as assumed in the strategy. As part of plans to acquire heat network assets in Poland, a detailed analysis of the market was prepared, followed by an evaluation of acquisition opportunities.

In the generation area, a final building permit was obtained for the 450 MWe CCGT unit planned to be built at the Żerań CHP plant. The project will contribute to modernisation of the Żerań CHP plant in Warsaw, which will translate into improved reliability of heat and power supply in the Warsaw metropolitan area and a noticeable air quality improvement. The CCGT unit is expected to come online in 2018. The unit's parameters will meet the requirements (mandatory as of 2016) of Directive 2010/75/EU of the European Parliament and of the Council on industrial emissions (*IED*) and the requirements as to employment of the Best Available Techniques (BAT). Furthermore, work on conversion of the K1 boiler at the Siekierki CHP Plant was completed. After completion of the first stage of the boiler start-up process, it was possible to commence the last stage, i.e. connection of the boiler to the steam collector and launch of generation of electricity from biomass, scheduled for Q1 2016.

In 2015, in the area of exploration and production, the PGNiG Group took a number of steps with a view to increasing its gas reserves, both conventional and unconventional. The Group's objective is to maintain stable production volumes in Poland in the years to come and to keep its leading market position in this respect. In 2015, new discoveries added about 27m boe to the Group's recoverable reserves volume. It was the greatest increase in almost ten years, attained thanks to the Group having prepared geological and pre-engineering documentation of the hydrocarbon accumulations to which it holds rights, to be approved by the Minister of Environment in 2016. Concurrently, the Group achieved the objective provided for in its strategy as to maintaining the current rates of hydrocarbon production in Poland. As regards acquisitions in the upstream area, various offers from many parts of the world were analysed. The most attractive assets in the US and Canada were identified and shortlisted. The Company is primarily interested in acquiring reserves which are at an advanced stage of development, producing reserves, or companies holding interests in such reserves.

Section V: Operating review of the PGNiG Group

1. Operating data

Financial performance of the PGNiG Group in 2011−2015

	Unit of measure	2015	2014	2013	2012	2011
Revenue	PLNm	36,464	34,304	32,044	28,730	23,004
Operating expenses, including:	PLNm	-33,174	-30,461	-28,895	-26,190	-21,132
depreciation and amortisation	PLNm	-2,790	-2,502	-2,463	-2,069	-1,574
EBIT (operating profit)	PLNm	3,290	3,843	3,149	2,540	1,872
EBITDA (operating profit + depreciation/amortisation)	PLNm	6,080	6,345	5,612	4,609	3,446
Net profit/(loss)	PLNm	2,136	2,822	1,920	2,240	1,755
Number of shares	million shares	5,900	5,900	5,900	5,900	5,900
Earnings per share (net profit/number of shares)	PLN	0.36	0.48	0.33	0.38	0.3
Declared or paid dividend per share (dividend paid/number of shares)	PLN	0.2	0.15	0.13	-	0.12

* average share price in a given year

In 2015, the PGNiG Group reported revenue of PLN 36bn, 83% of which was derived from sales of natural gas.

Revenue (PLNm)

	2015	2014	2013	2012	2011
Natural gas, including:	29,966	27,128	24,970	23,698	20,269
- high-methane gas	28,541	25,726	23,540	22,309	19,052
- nitrogen-rich gas	1,425	1,402	1,430	1,389	1,217
Crude oil	1,945	2,654	2,757	1,263	1,100
Helium	75	120	183	161	58
Electricity	1,570	1,695	1,360	842	11
Heat	1,127	1,079	1,069	978	0
Geophysical and geological services	115	281	239	339	448
Drilling and well services	267	480	594	610	578
Construction and assembly services	129	135	243	123	132
Distribution services	363	67			
Connection charge	120	112	110	106	97
Other sales	787	553	519	610	311
Total	36,464	34,304	32,044	28,730	23,004

In 2015, the PGNiG Group sold 23 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	2011
Trade and Storage	22,236	17,808	15,465	14,189	13,595
Exploration and Production	765	801	749	723	682
Total	23,001	18,609	16,214	14,912	14,277

The PGNiG Group produced a total of 4.6 bcm of natural gas (measured as high-methane gas equivalent), of which 87% was produced from the fields in Poland, and the balance – from the fields on the Norwegian Continental Shelf and in Pakistan.

Natural gas production volume (mcm)

	2015	2014	2013	2012	2011
Poland	4,005	4,027	4,211	4,317	4,329
Abroad	624	477	371	0	0
Total	4,629	4,504	4,582	4,317	4,329

In 2015, 100% of the electricity produced by the Group's Generation segment was electricity co-generated with heat.

Electricity and heat production volumes

	Unit of measure	2015	2014	2013	2012	2011
Electricity	GWh	4,090	4,173	4,436	4,390	
Heat	TJ	36,545	36,923	40,540	40,568	

2. Events in 2015

March	PGNiG S.A. completed the project 'Construction of the surface installations of the Wierzchowice Underground Gas Storage Facility, phase: 3.5bn Nm3, sub-phase: 1.2bn Nm3'. After completion of the construction work and acceptance of the upgraded installation, the additional working capacity became available in 2014. PGNiG S.A. discovered tight gas within the Kirthar licence area in Pakistan.
April	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 of high-methane and nitrogen-rich gas was reduced by ca. 7.1% and 3.2%, respectively. PGNiG Obrót Detaliczny Sp. z o.o. introduced the 'Flexible Price' discount scheme. In the following months, PGNiG Obrót Detaliczny Sp. z o.o. launched a number of other promotional schemes for its major customers. By introducing the discounts, the company succeeded in retaining its largest customers.
May	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. The working capacities of the Husów Underground Gas Storage Facility and the Kosakowo Underground Gas Storage Cavern Facility were increased respectively to 500 mcm and 112.4 mcm. PGNiG S.A. launched the 'Price Deregulation' discount scheme for its strategic customers. The scheme proved very popular and helped the Company retain its key accounts.
July	The working capacity of the Mogilno Underground Gas Storage Cavern Facility was increased to 468.2 mcm. Operator Systemu Magazynowania Sp. z o.o. started providing storage services based on the newly expanded capacities of the Husów, Kosakowo and Mogilno underground storage sites. The President of the Energy Regulatory Office approved 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.

August	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. The joint operations relate to oil and gas exploration, appraisal and production. The President of the Energy Regulatory Office approved PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 1. The average price of gas fuel was reduced by 6.5% in the case of high-methane gas and 2.5% in the case of nitrogen-rich gas (Lw), and by 0.8% for customers receiving Ls nitrogen-rich gas (group Z-7B). The tariff change came in force on September 1st 2015 and was effective until December 31st 2015.
October	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) contract terms and eliminates the risk of PGNiG S.A. having to pay for uncollected LNG under the take or pay clause.
November	PGNiG S.A. opened a gas production facility in Pakistan (its production facility outside of Poland).
December	Polska Spółka Gazownictwa Sp. z o.o. completed the project named 'South-eastern gas supply line for the city of Gdańsk, and distribution network roll-out in Wiślinka and Wyspa Sobieszewska'. As part of the project, more than 130 km of high- and medium-pressure gas pipelines were build. In terms of the scope of work and investment expenditure, this was the largest of all the 38 projects in the distribution area which benefited from EU financing available for the years 2007–2013. The President of the Energy Regulatory Office approved 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. The President of the Energy Regulatory Office approved PGNiG Obrót Detaliczny Gas Fuel Supply Tariff No. 2, effective from January 1st 2016 to March 31st 2016. The average price of gas fuel was reduced by 3.3% in the case of high-methane gas and by 2.8% and 2.1% respectively in the case of Lw nitrogen-rich gas and Ls nitrogen-rich gas.

Section VI: Regulatory environment

The PGNiG Group'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 to liquefy natural gas and regasify LNG at LNG regasification plants.

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

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

1.2. Changes in gas fuel tariffs

In 2015, the bulk of high-methane and nitrogen-rich natural gas sold by PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. was subject to 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.

PGNiG S.A. Tariff

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.

PGNiG Obrót Detaliczny Tariff

In the period from January 1st 2015 to August 31st 2015, PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 1, approved by the President of the Energy Regulatory Office on December 17th 2014, was in effect.

On August 13th 2015, the President of the Energy Regulatory Office approved PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 1. The average prices of gas fuel (the price of gas fuel and the subscription fee) were reduced by 6.5% in the case of high-methane gas, 2.5% in the case of nitrogen-rich gas (Lw), and by 0.8% for customers receiving Ls nitrogen-rich gas (group Z-7B). Moreover, following withdrawal of decompressed propane-butane from PGNiG Obrót Detaliczny's product offering, relevant provisions were deleted from the amended tariff. The tariff change came in force on September 1st 2015 and was effective until December 31st 2015.

On December 17th 2015, the President of the Energy Regulatory Office approved new PGNiG Obrót Detaliczny Gas Fuel Supply Tariff No. 2, effective from January 1st 2016 to March 31st 2016. The average prices of gas fuel were reduced by:

- 3.3% in the case of high-methane gas, including 3.5% for households (tariff groups W-1 to W-4) and 2% for business customers (the other tariff groups)
- 2.8% in the case of nitrogen-rich gas (Lw)
- 2.1% in the case of nitrogen-rich gas (Ls).

Subscription fees for households, excluding 12T tariff groups, were reduced by 10%. Subscription fees for other customers remained unchanged.

The full text of the tariffs, prices and fees is available on www.oferta.pgnig.pl and www.ure.gov.pl.

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

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.

On July 3rd 2015, PGNiG Obrót Detaliczny Sp. z o.o. 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 (group E) traded at a virtual gas trading point (OTC market in Poland). 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 this report, the proceedings were still 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 the PGNiG Group.

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 the PGNiG Group.

Section VII: 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.

The PGNiG Group is the leader of the Polish hydrocarbon exploration and production market. As of 1990, hydrocarbon exploration in Poland is based on a licensing policy which ensures equal access to exploration licences for all market participants. As at December 31st 2015, PGNiG S.A. held 61 crude oil and natural gas exploration and appraisal licences. Over the past 25 years, a number of foreign companies have carried out exploration in Poland, including globally-known players such as Amoco, Texaco, Conoco and Exxon. At the same time, new exploration companies were established by Polish petrochemical giants PKN Orlen and Grupa LOTOS. At the end of 2015, 14 companies were engaged in hydrocarbon exploration in Poland. Despite this highly competitive environment, the PGNiG Group has maintained its leading position − no foreign company has independently made a material discovery or become the operator under a production licence. As at the end of 2015, PGNiG S.A. held 227 production licences, i.e. approximately 96% of all licences for the production of crude oil and natural gas. There are also a number of international companies - such as Schlumberger, Halliburton, Weatherford and United Oilfield Services - offering oilfield services in Poland. Despite the intense competitive pressure, companies of the PGNiG Group (GEOFIZYKA Kraków S.A., GEOFIZYKA Toruń S.A. and Exalo Drilling S.A.) enjoy a strong position in this market area.

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

PGNiG S.A. conducts exploration work in Pakistan under an agreement for hydrocarbon exploration and production in the Kirthar licence area executed between PGNiG S.A. and the government of Pakistan on May 18th 2005. Work in the Kirthar block is conducted jointly with Pakistan Petroleum Ltd., with production and expenses shared in proportion to the parties' interests in the licence: PGNiG S.A. (operator) – 70%, PPL – 30%.

In H1 2015, the drilling of the Rizq-1 borehole was completed and a fracking operation was carried out. The maximum gas-flow rate recorded during the testing of the well was 206.5 cubic metres per minute. 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.

Norway

PGNiG Upstream International AS, a PGNiG Group company, holds interests in exploratory and production licences on the Norwegian Continental Shelf, in the North Sea, in the Norwegian Sea and in the Barents Sea. Jointly with partners, the company has been producing hydrocarbons from the Skarv, Morvin, Vilje and Vale fields and working on development of the Snadd and Gina Krog fields located on the Norwegian Sea and the North Sea. In the other licence areas, the company is engaged in exploration projects.

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

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

In 2015, the company produced a total of 664 thousand tonnes of crude oil and other fractions (measured as tonnes of crude oil equivalent) and 572 mcm of natural gas from deposits on the Norwegian Continental Shelf. Production from all the deposits was higher than initially planned. The increase was achieved primarily through the use on the Skarv field of a technique of injecting natural gas into a deposit to improve oil recovery.

Based on the research and analyses carried out in 2015, field models were updated. As a result, the estimated recoverable reserves controlled by PGNiG Upstream International AS increased significantly. The company's total net reserves grew from 80.9m boe at the end of 2014 to 87.3m boe (5,101 thousand tonnes of crude oil and 7,806 mcm of natural gas) at the end of 2015.

In 2015, PGNiG Upstream International AS and its partners continued the development of the Gina Krog and Snadd fields. Maersk, a new drilling rig placed in service in October 2015, was used to drill exploration and production wells on the Gina Krog field. A steel jacket was set up over the Gina Krog field, where a production platform, currently being built in South Korea, will be placed. Most of the work to connect the Gina Krog field to the existing infrastructure was also carried out in 2015. Production from Gina Krog is scheduled to commence in 2017. In 2015, as a partner in the PL029C licence area (in the vicinity of the Gina Krog field), the company was also involved in the drilling of an exploration well on the East-3 prospect. Data from the well confirm the presence of hydrocarbons. In 2015, the results were analysed and an estimate of resources was made. In the case of the Snadd field, which is at the stage of selection of the development concept, work on selecting the optimum project scenario was under way.

Working jointly with its partners, PGNiG Upstream International AS also continued operations in its other exploration licence areas. Among other things, the company worked on the evaluation of prospectivity of the PL646, PL702, PL703, PL707, PL711, PL756 and PL799 licence areas.

In January 2015, under the *APA* 2014 licensing round, PGNiG Upstream International AS was granted the PL799 operator licence in the Norwegian Sea As the operator, the company acquired a 40% interest in the licence, while its partners – Statoil Petroleum AS, VNG Norge AS and Explora Petroleum AS – each received a 20% interest. This licence is located in the vicinity of the Skarv and Snadd fields, and is another operator licence granted to PGNiG Upstream International AS on the Norwegian Continental Shelf.

As far as the PL558, PL646 and PL711 licences are concerned, the geological and geophysical analyses performed on an ongoing basis for each of the licences led the company and its partners to the conclusion that the exploration risk was high at some of them, and as a consequence the licences were relinquished (without drilling exploration wells). In 2015, the company received a confirmation of relinquishment of its PL648S operator licence. As at December 31st 2015, PGNiG Upstream International AS held interests in 15 exploration and production licences on the Norwegian Continental Shelf, including two operator licences.

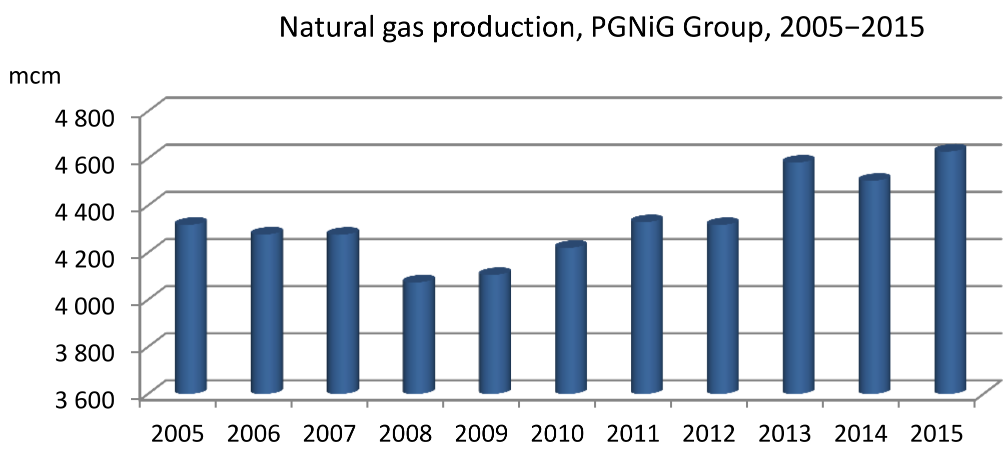
In 2015, the company filed licence applications as part of two licensing rounds: *APA* 2015 (*Awards in Predefined Areas*) and the 23rd *Licence Round*. In January 2016, the company was awarded (in the *APA* 2015 licensing round) interests in four exploration and production licences, including one operatorship. Two of the licences (PL838 and PL839) are located in the Norwegian Sea, one in the North Sea (PL813), and one in the Barents Sea (PL850). The 23rd licensing round will be resolved in 2016.

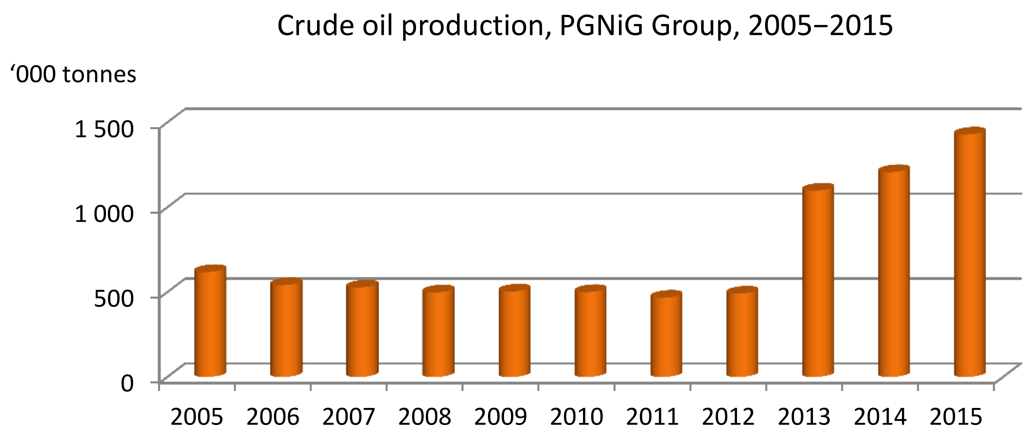
Libya

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

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

3. Production





In 2015, the PGNiG Group conducted hydrocarbon production in Poland, in the Norwegian Continental Shelf and in Pakistan. Natural gas and crude oil in Poland is extracted by two branches of PGNiG S.A.: the Zielona Góra Branch and the Sanok Branch. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 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, the PGNiG Group produced a total of 4,629 mcm of natural gas (high-methane gas equivalent), of which 4,005 mcm was produced from fields in Poland, and 624 mcm from fields abroad. Production of crude oil and NGL reached 1,429 thousand tonnes of crude oil equivalent, of which 664 thousand tonnes came from the Norwegian Continental Shelf. The increase in production at the Norwegian Continental Shelf was a result of PGNiG Upstream International AS's acquisition in 2014 of interests in producing fields (Morvin, Vale and Vilje) and the use of a new production technique on the Skarv field. 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:	50,367	4,629	49,542	4,504
high-methane gas, including:	22,236	2,030	20,634	1,876
- Zielona Góra Branch	-	-	-	-
- Sanok Branch	15,952	1,458	15,983	1,457
- Norway	6,284	572	4,651	419
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	1,429	1,207
- Zielona Góra Branch	‘000 tonnes	719	742
- Sanok Branch	‘000 tonnes	46	47
- Norway	‘000 tonnes	664	418

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).

Underground gas storage facilities

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, gas sales by the segment reached 765 mcm, of which 713 mcm was sold on the domestic market and 52 mcm on foreign markets. In addition, the segment sold 1,391 thousand tonnes of crude oil, including other fractions. 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:	8,391	765	8,886	801
- high-methane gas	892	81	768	69
- nitrogen-rich gas	7,499	684	8,118	732

Sales of crude oil

	Unit of measure	2015	2014
Poland	'000 tonnes	518	360
Foreign markets, including:	'000 tonnes	873	809
- Norway	'000 tonnes	619	389
- Germany	'000 tonnes	254	420
Total	'000 tonnes	1,391	1,169

In Poland, the largest amounts of natural gas were sold to industrial customers, accounting for about 79% of the total sales volume. PGNiG S.A. sold crude oil to Shell International Trading and Shipping Company Ltd., TOTSA TOTAL OIL TRADING S.A., BP Europa SE, Rafineria Trzebinia S.A., and Rafineria Nafty Jedlicze S.A. (in 2015, these refineries were merged to form a single entity – ORLEN Południe S.A.). Moreover, in accordance with the agreement of 2013 between PGNiG S.A. and Grupa LOTOS S.A., in January 2015 PGNiG S.A. began supplying crude oil to the 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. Service activities

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

Exploration, appraisal and core boreholes were drilled mainly in search for hydrocarbons, but also for copper. Drilling work was performed mainly abroad for external customers involved in exploration for conventional deposits of oil and gas, e.g. in Kazakhstan, Pakistan, and Egypt. The main customer in Poland was PGNiG S.A. Additionally, in Poland contracts were performed for companies exploring for: conventional oil and gas (e.g. PGNiG S.A., Rawicz Energy Sp. z o.o.), unconventional gas (for PGNiG S.A. - exploration for shale gas), and copper (for KGHM Polska Miedź S.A., Miedź Copper Sp. z o.o., Zielona Góra Copper Sp. z o.o., Przedsiębiorstwo Budowy Kopalń PeBeKa S.A., Mozów Copper Sp.z o.o., Wilcze Copper Sp. z o.o. and KGHM Kupfer A.G.).

Production well drilling was performed mainly in Poland, for PGNiG S.A. Abroad, such work was performed for external customers, mainly in Pakistan and Ukraine. Moreover, storage chamber completion work was performed for PGNiG S.A. as part of expansion of the storage capacities of the Mogilno Underground Gas Storage Cavern Facility.

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

In addition, in 2015 companies of the Exploration and Production segment performed geophysical services in the area of exploration geophysics (including acquisition, processing and interpretation of seismic data) and well logging. On the Polish market, the most important customer for those services was PGNiG S.A., followed by FX Energy Poland Sp. z o.o., Orlen Upstream Sp. z o.o., Lotos Petrobaltic S.A., PGE Górnictwo i Energetyka Konwencjonalna S.A., Przedsiębiorstwo Budowy Kopalń PeBeKa S.A., the AGH University of Science and Technology of Kraków, and the Institute of Geophysics of the Polish Academy of Sciences. For PGNiG S.A., the Exploration and Production segment companies performed mainly exploration geophysics services; for external customers, they provided both exploration geophysics and well logging services. Activities in foreign markets included primarily work performed in the area of exploration geophysics, mainly for customers from the Czech Republic, Croatia, Germany, Slovakia, and Pakistan.

6. 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.

On the Norwegian Continental Shelf, PGNiG Upstream International AS will continue, as a project partner, to produce hydrocarbons from the Skarv, Morvin, Vilje and Vale fields, develop the Gina Krog field, prepare the Snadd field for development, and make geological and formation data analyses on the Skarv field (to select locations for additional production wells). The company will also carry out exploration in the vicinity of the Skarv field. In addition, the company intends to acquire new licence areas by participating in the APA annual licensing rounds, as well as in the regular licensing rounds held every two to three years. The company does not rule out that it will acquire new licence areas through buying other oil companies’ interests in areas considered prospective (Farm in) or through exchanging its own licences for such interests (Farm Down). The company holds a diversified portfolio of exploration and production licences in the North Sea, the Norwegian Sea and the Barents Sea, and maintaining this diversification is perceived as an important factor in managing the project portfolio. In the future, the company may participate, as a partner, in drilling projects in deep-sea waters (below 1,000 metres) and in the Arctic Zone. This is connected with its interests in two licences

(PL702 and PL703) in the Vøring Basin in the Norwegian Sea shelf, where sea depth exceeds 1,000 metres, and in licence PL707 in the Barents Sea shelf.

Hydrocarbon production

In 2016, the PGNiG Group will conduct hydrocarbon production in Poland, in the Norwegian Continental Shelf, and in Pakistan. The Group is implementing an investment programme to maintain, in a long-term perspective, its natural gas production capacity. As part of the programme, the PGNiG Group 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.

Service activities

In 2016, the PGNiG Group plans to provide drilling services in Poland and abroad. In Poland, drilling services will be performed for PGNiG S.A. and for third-party customers, including Orlen Upstream Sp. z o.o., BNK Polska Sp. z o.o., San Leon Energy PLC, Shale Energy PLC, and Palomar Natural Resources LLC. Abroad, the Group will perform drilling work for its existing and new customers in Kazakhstan and Pakistan, while also seeking to expand its business onto new markets. The PGNiG Group participates in tenders for contracts in Algeria and Kuwait, has successfully completed a pre-qualification process in Saudi Arabia, and submitted bids for drilling work planned e.g. in India (42 wells), Ethiopia, Kenya, and Djibouti (geothermal drilling). The PGNiG Group also plans to resume its business in Egypt, Uganda, Mozambique, and Ukraine. Moreover, the Group is holding talks about entering, together with other companies, the Iranian market. In Europe, the segment expects to secure contracts e.g. for drilling projects in Germany, the UK, Romania, Slovakia, and Hungary.

Specialist oilfield services are planned to be performed in Poland chiefly for PGNiG S.A., but also for foreign companies that hold licences to explore for minerals (mainly hydrocarbons), and in foreign markets for external customers in Slovakia, Ukraine, Lithuania, Latvia, Germany, Romania, Serbia, Tajikistan, Belarus, and the Czech Republic (also well abandonment and workover treatments).

Moreover, the segment will perform services consisting in the acquisition, processing and interpretation of seismic data and well logging services for PGNiG S.A. and external customers. On foreign markets, the PGNiG Group plans to provide geophysical services in Pakistan, Italy, Germany, Slovakia, Spain, Egypt, Tunisia, Myanmar, Gabon, and India.

7. Risks related to exploration and production

Resource discoveries and estimates

The main risk inherent in exploration activities is the risk of failure to discover reserves, i.e. exploration risk, meaning that not all structures identified as potential hydrocarbon bearing formations actually contain a sufficient accumulation of hydrocarbons.

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

Exploration for unconventional deposits of gas

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

Delayed work

Under the applicable Polish laws and regulations, the process of obtaining a licence for exploration and appraisal of crude oil and natural gas reserves lasts from one to one and a half years. In the foreign markets, such procedures may even take up to two years from the time that the winning bid is awarded until the relevant contract is ratified. Prior to the commencement of field work, the Company is also required to make a number of arrangements, for instance to obtain legal permits and approvals for entering the area, and to meet the environmental protection requirements and, in some cases, requirements related to the protection of archaeological sites. It is also required to hold tenders to select a contractor. All this delays the execution of an agreement with a contractor by another few months. Frequently the waiting time for customs clearance of imported equipment is very long. These factors create the risk of delays in the start of exploration work.

Formal and legal hurdles beyond PGNiG S.A.'s control include:

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

These factors significantly delay implementation of investment projects and commencement of on-site construction work. Further, PGNiG S.A.'s obligation to comply with the Public Procurement Law frequently protracts the tender procedure. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing an entire project. A 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 the PGNiG Group, especially those active globally, enjoy strong market positions and have greater financial resources than those available to the Group. Thus, it is probable that such companies would submit their bids in tender procedures and be able to acquire promising licences, offering better terms than the Group could offer given its financial and human resources. This competitive advantage is particularly important on the international market.

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

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

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

Unforeseen events

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

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

Safety, environmental protection and health regulations

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

Section VIII: 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).

The PGNiG Group is the largest supplier of natural gas in Poland. In 2014, the PGNiG Group's share in gas sales to end consumers declined to 89.2%, from 94.4% in the previous year. The remaining 10.8% were gas sales by other companies trading domestically and by foreign companies selling gas to major customers that have imported the gas on their own. In 2015, natural gas was supplied to customers mostly by two PGNiG Group companies: PGNiG S.A. (the largest wholesale gas supplier) and PGNiG Obrót Detaliczny Sp. z o.o. (the largest retail gas supplier). However, due to the increase in interconnector capacities, the ongoing gas market deregulation and growing activity of other players, PGNiG's share in gas imports dropped by close to 17 pp, down to 63%, in the period from December 2014 to December 2015.

1. Purchases of natural gas

In 2015, the PGNiG Group purchased gas from foreign and domestic suppliers, chiefly on the Polish Power Exchange.

PGNiG S.A. purchased gas mainly under the following contracts:

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

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

In 2015, to fulfil its trading obligations, the PGNiG Group purchased a total of 18,378 mcm of natural gas, 60% of which was imported from foreign suppliers. The table below presents the structure of natural gas purchases from suppliers, measured as high-methane gas equivalent.

Structure of natural gas purchases

	2015			2014		
	GWh	mcm	%	GWh	mcm	%
Foreign suppliers:	121,448	11,069	60%	122,830	11,086	76%
- Gazprom Export	89,476	8,155	74%	90,733	8,097	73%
- other foreign suppliers	31,972	2,914	26%	32,097	2,989	27%
Domestic suppliers:	80,197	7,309	40%	37,849	3,445	24%
- Power exchange	78,352	7,141	98%	35,144	3,201	93%
- Other domestic suppliers	1,845	168	2%	2,705	244	7%
Total	201,645	18,378	100%	160,679	14,531	100%

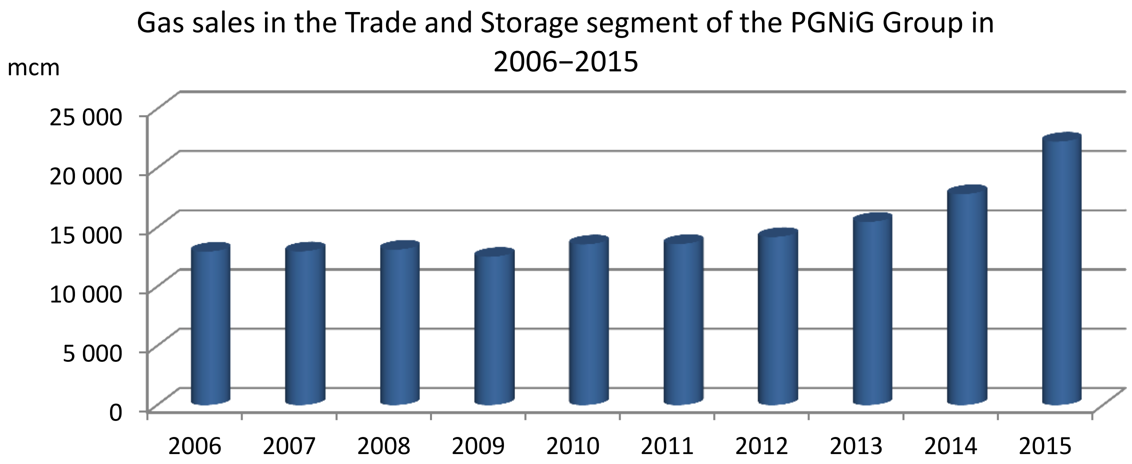
On May 13th 2015, PGNiG S.A. called PAO Gazprom and OOO Gazprom Export to arbitration proceedings before the Arbitration Court in Stockholm. The dispute relates to a change of the pricing terms under the contract for gas supply to Poland of September 25th 1996. Commencement of the arbitration proceedings 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. The PGNiG Group sold gas to customers in Poland and abroad (chiefly on the German market), and on the power exchanges in Poland and Germany.

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

In 2015, gas sales in the Trade and Storage segment reached 22,236 mcm, 20,197 mcm of which was sold on the domestic market. Compared with 2014, gas sales increased by approximately 25%. 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:	243,976	22,236	197,523	17,808
- high-methane gas	236,827	21,585	191,819	17,289
- nitrogen-rich gas	7,149	651	5,704	519

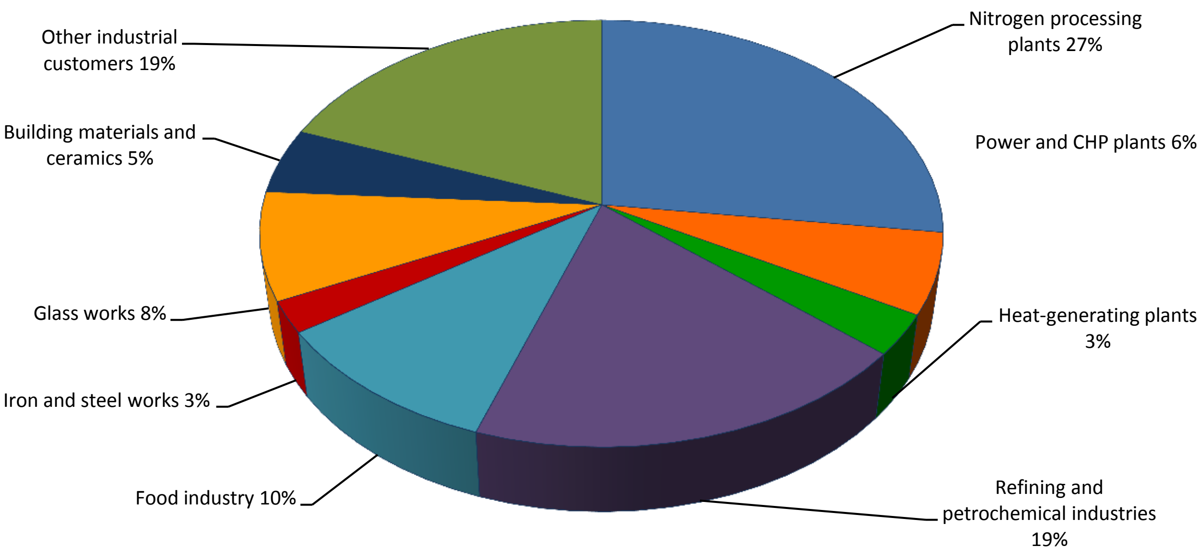
In 2015, the majority of sales took place on the Polish Power Exchange, where the PGNiG Group sold 8,951 mcm of gas – an increase of some 110% on 2014. This substantial increase was attributable to the launch of operations by PGNiG Obrót Detaliczny Sp. z o.o., which is the largest buyer of gas on the 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) and by households. The latter were the largest customer group (approximately 6.6m), accounting for 97% of the entire PGNiG Group customer base. 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	71,224	6,491	80,107	7,189
Trade and services	31,667	2,886	27,167	2,491
Households	40,837	3,722	40,854	3,672
Wholesale customers	2,039	186	2,123	197
Exchange	98,209	8,951	47,272	4,259
Total	243,976	22,236	197,523	17,808

In 2015, the PGNiG Group sold 2,039 mcm of natural gas on foreign markets, primarily in Germany, mostly to households and SMEs.

Structure of natural gas sales to industrial customers in 2015



Promotional schemes of PGNiG S.A.

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.

<u>Promotional schemes of PGNiG Obrót Detaliczny Sp. z o.o.</u>

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

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

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

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

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

In view of the considerable interest in the discount schemes, in 2015 PGNiG Obrót Detaliczny Sp. z o.o. launched new editions of the 'Flexible Price' scheme (3, 4 and 5). As in the previous editions, customers were given a discount on the tariff price of the gas fuel and the possibility to change the due dates for payment and the number of preliminary invoices. The discount amount depended on the gas fuel consumption volume, the due dates for payment, the number of advance payment invoices issued to the customer and the promotional offer term selected by the customer. An additional discount was also introduced as part of the 'Flexible Price 4 and 5' schemes, which depended on the market price of gas at the time of agreement signing. The company also launched new editions of the 'Constant Savings for Business' scheme (2 and 3), which were addressed to customers in the W-5 tariff group.

In December 2015, a new offer addressed to special customers, i.e. procurement groups, was introduced. Under the scheme, all customers forming a procurement group are offered the same pricing terms, tied to exchange quoted prices, e.g. a uniform price of gas irrespective of the tariff group where individual offtake points are located. A new product, the 'Indexed Offer', was also introduced. It is addressed to customers in the W-6A and higher tariff groups with special expectations with respect to gas consumption billing based on their own pricing formulas or specific exchange-traded products. By introducing the discounts, the company succeeded in retaining its largest customers.

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.

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

Sales of electricity

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

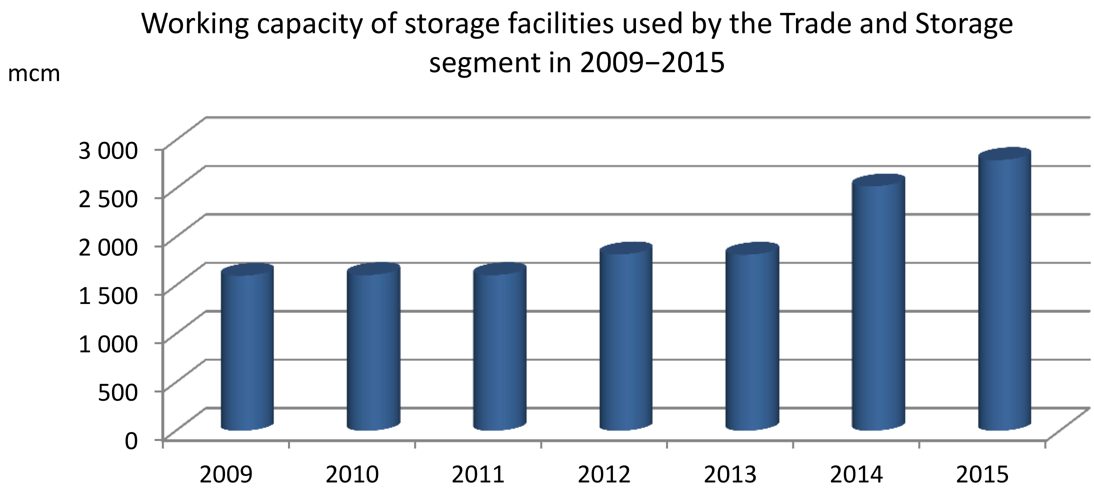
The Group also sold electricity to end users in Germany and Austria, where its customers included chiefly small and medium-sized companies, as well as households.

In 2015, electricity sales in the Trade and Storage segment reached 9,807 GWh, 5,846 GWh of which was sold on the domestic market. The table below presents sales of electricity by customer group.

Sales of electricity (GWh)

	2015	%	2014	%
End user	317	3%	259	3%
Trading companies	857	9%	3,186	31%
Balancing market	353	4%	425	4%
Exchange	8,280	84%	6,284	62%
Total	9,807	100%	10,153	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.

<u>Tariff</u>

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

Licence

On May 14th 2015, the President of the Energy Regulatory Office expanded Operator Systemu Magazynowania Sp. z o.o.'s licence to store gas fuels in storage facilities to reflect the increased working capacities of the Husów Facility (which increased to 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.

Storage capacities made available

As at December 31st 2015, the PGNiG Group held in total 2,795.6 mcm of working storage capacity, of which 2,790.5 mcm was made available to OGP GAZ-SYSTEM S.A. on TPA terms, including 2,759.0 mcm under a long-term contract and PLN 31.5 mcm under a short-term contract. 5.1 mcm of the Kawerna SFG's working capacity is allocated for the Mogilno and Kosakowo cavern facilities' own needs. The working capacities and working capacities made available as at December 31st 2015 and December 31st 2014 are presented in the table below.

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

	Working storage capacities (mcm)		Working storage capacities made available (mcm)		Working storage capacities made available (GWh)[1)]	
	2015	2014	2015	2014	2015	2014
Kawerna SFG, including:	580.6	459.1	575.5	458.5	6,314	5,031
– Mogilno underground gas storage cavern facility	468.2	407.9	464.0	407.5	5,091	4,471
– Kosakowo underground gas storage cavern facility	112.4	51.2	111.5	51.0	1,223	560
Wierzchowice underground gas storage facility	1,200.0	1,200.0	1,200.0	1,200.0	13,166	13,166
Sanok SFG, including:	1,015.0	865.0	1,015.0	865.0	11,137	9,491
– Husów underground gas storage facility	500	350	500	350	5,486	3,840
– Strachocina underground gas storage facility	360	360	360	360	3,950	3,950
– Swarzów underground gas storage facility	90	90	90	90	988	988
– Brzeźnica underground gas storage facility	65	65	65	65	713	713
Total	2,795.6	2,524.1	2,790.5	2,523.5	30,617	27,688

[1)]Converted to gas with a calorific value of 39.5 MJ/cm

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. Following the completion of caverns Z-16 and Z-17 at the Mogilno underground gas storage cavern facility, the PGNiG Group plans to make available 132.8 mcm of new working capacities.

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 the changes taking place on the natural gas market, the PGNiG Group 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.

This risk also applies to PGNiG Obrót Detaliczny Sp. z o.o. Competitors seek to boost sales of gas fuels by offering competitive prices or joint purchase of natural gas and electricity. The most active competitors in terms of sales to business customers are: DUON Marketing&TRADING S.A., Hermes Energy Group S.A., RWE Polska S.A., Energetyczne Centrum S.A., and Energa S.A. The key competitors in tariff groups 1–4 are: DUON Marketing&TRADING S.A., Energetyczne Centrum S.A., ENERGA-OBRÓT SA, Energia dla firm S.A., and Tauron Polska Energia S.A. These companies have the largest share among customers changing their gas fuel provider in 2015. The activity of the competitors, as well as the growing customer awareness, result in the increasing market pressure on PGNiG Obrót Detaliczny Sp. z o.o. to lower gas fuel prices and define contract terms by way of individual negotiations. Therefore, PGNiG Obrót Detaliczny Sp. z o.o. launched a number of flexible promotional schemes for its largest customers. These schemes allow customers to choose optimum payment terms, contract duration and gas volumes ordered.

PGNiG Obrót Detaliczny Sp. z o.o. is consistently perceived as a reliable and secure supplier. To maintain its competitive position and ability to offer attractive prices to customers, the company continues its efforts to optimise costs and reorganise internal processes, as well as roll out new products and services. In 2015 and early 2016, PGNiG Obrót Detaliczny Sp. z o.o. reduced its retail gas prices on three occasions. In total, the average gas price was brought down by over 11% (in the case of high-methane gas). From a market perspective, the price reductions improved the company's competitive edge.

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 IX: Distribution

The segment’s core business consists in the transmission of high-methane and nitrogen-rich gas, as well as of small amounts of propane-butane and coke-oven gas over the distribution network. In 2015, the segment discontinued the distribution of propane-butane-air and decompressed propane-butane, and switched over to delivering high-methane gas using the LNG technology. Also, the segment is engaged in extending and upgrading the gas network and connecting new customers to the existing network and to new sections of the network.

Gas distribution services are rendered by Polska Spółka Gazownictwa Sp. z o.o. As the Distribution System Operator, the company conducts its business activities in the Provinces of: Poznań, Szczecin, Gdańsk, Bydgoszcz, Warsaw, Łódź, Białystok, Kraków, Rzeszów, Kielce, Lublin, Katowice, Opole, Wrocław, Zielona Góra and, partially, in the Province of Olsztyn. The company holds a dominant share in the market, supplying gas to customers all over the country. PSG Sp. z o.o. owns approximately 96% of Poland’s distribution network and 98.5% of the connections. For the time being, there are no circumstances that could adversely affect the company’s competitive position and performance.

1. Segment’s operations

In 2015, all settlements of Polska Spółka Gazownictwa Sp. z o.o. with its customers were performed based on Tariff No. 3 for Gas Fuel Distribution Services and LNG Regasification Services, as approved by the President of the Energy Regulatory Office on December 17th 2014. The average rates of distribution service charges increased by 3% relative to the previous tariff. On December 16th 2015, the President of the Energy Regulatory Office approved an amendment to Tariff No. 3 for Gas Fuel Distribution Services and LNG Regasification Services, and extended its term until June 30th 2016. The amendment set out more detailed criteria for defining tariff groups and settlements related to connections to the distribution network. The rates of distribution and regasification service charges remained unchanged.

The Distribution Grid Code for Polska Spółka Gazownictwa Sp. z o.o. approved on July 29th 2014 by the President of the Energy Regulatory Office had been effective until February 28th 2015. On February 16th 2015, the President of the Energy Regulatory Office approved a new Distribution Grid Code, in effect since 6:00 am, March 1st 2015. The new code specifies the detailed rules of cooperation with operators of other distribution systems. The new code also regulates in detail the rules for managing system limitations in the event of discrepancies between gas fuel supply or offtake and transport forecasts prepared by operators of other distribution systems.

1.1. EU co-financed projects

In 2015, Polska Spółka Gazownictwa Sp. z o.o. completed all the 18 projects involving construction, extension and modernisation of its distribution networks, for which agreements for EU co-financing under the Infrastructure and Environment Operational Programme (OP I&E) had been signed for 2007−2013. As part of these projects, work on acquiring new customers, as well as designing and constructing new connections continues. In 2015, the company also completed the last two of the 20 investment projects under the Regional Operational Programmes for 2007−2013. The total value of the completed 18 projects under the Infrastructure and Environment Operational Programme is estimated at ca. PLN 500m, with EU co-financing of ca. PLN 170m. For implementation of the 20 projects financed under the Regional Operational Programmes, Polska Spółka Gazownictwa Sp. z o.o. incurred expenditure of ca. PLN 32m, with EU contribution of PLN 10m.

Upon completion of the projects, Polska Spółka Gazownictwa Sp. z o.o. constructed and modernised gas pipelines, and also rolled out the gas network in new areas located in 13 provinces: Gdańsk, Szczecin, Olsztyn, Bydgoszcz, Zielona Góra, Łódź, Białystok, Warsaw, Lublin, Kielce, Katowice, Opole, and Wrocław. More than 1,100 km of distribution gas pipelines with auxiliary infrastructure were built, including:

- 370 km of high-pressure gas pipelines
- 740 km of medium-pressure gas pipelines
- 36 gas stations
- 1 LNG regasification station.

As a result, gas infrastructure was built in areas where no such infrastructure had existed before; additionally, some gas pipelines were upgraded. In many cases, the projects eliminated the supply gap resulting from insufficient transmission capacities of the existing infrastructure managed by the company. This will increase the amount of supplied gas and improve the security of supplies. Accounting for the non-refundable grant in economic analyses for the projects improved their expected results and was the key argument in favour of their implementation. The projects further strengthened the Company's position as a leader in the gas distribution market in Poland and enhanced its brand image. It also improved the quality of life in local communities, increased the attractiveness of areas where no gas infrastructure had existed before for potential investors, and helped protect the environment. The infrastructure built as part of the projects serves mainly household and institutional customers. Following completion of the projects, approximately 5,000 new gas connections will be constructed for households and industrial customers.

Particularly noteworthy EU co-financed projects include:

- securing access to natural gas in the town of Suwałki, using the LNG technology
- south-eastern gas supply line for the city of Gdańsk, and distribution network roll-out in Wiślinka and Wyspa Sobieszewska
- gas network roll-out in the Chęciny and Sitkówka Nowiny communes.

<u>Securing access to natural gas in the town of Suwałki, using the LNG technology</u>

The purpose of the project was to roll out a gas network in the town of Suwałki by constructing an LNG regasification station, a gas pipeline network together with connections to new customers, and technical infrastructure. The project also involved conversion of the existing propane-butane gas network to a natural gas network. The project made it possible to supply natural gas to residents, institutions and industrial customers from the Suwałki area as part of a local network roll-out preceding future supplies of gas via transmission pipelines. It was the only EU co-financed project which involved a modern LNG regasification technology:

- in the first phase, LNG will be delivered to the regasification station by road tankers and stored in cryogenic tanks
- before it is fed to the distribution network, LNG will be regasified in a dedicated unit as a result of heat transfer in ambient air vaporizers, and prepared for transportation via the network
- at the gas station, the gas will be heated and, after its pressure has been reduced to that required in a medium-pressure distribution network, it will be metered and odorised
- the gas will be fed to the distribution network, consisting partly of the converted propane-butane network.

The distribution network roll-out project in Suwałki was carried out as part of the PESO project, which involved provision of access to gas supplies in Pisz, Ełk, Suwałki and Olecko. The PESO project involved primarily removal from service of the obsolete propane-butane gas production units and creating conditions for the natural gas market to develop. LNG regasification is an innovative and safe technology constantly developed around the world.

South-eastern gas supply line for the city of Gdańsk, and distribution network roll-out in Wiślinka and Wyspa Sobieszewska

The purpose of the project was to connect Wyspa Sobieszewska (an eastern district of Gdańsk), the towns and villages located in the Pruszcz Gdański, Cedry Wielkie, Suchy Dąb and Pszczółki communes, as well as a strategic institutional customer to the gas grid. As part of the project, more than 130 km of high- and medium-pressure gas pipelines were built.

In terms of the scope of work and investment expenditure, this was the largest of all the 18 projects co-financed under the Infrastructure and Environment Operational Programme for 2007−2013. The project's scope of work accounts for more than 10% of all gas pipelines constructed by Polska Spółka Gazownictwa Sp. z o.o. as part of these projects. Approximately 21% of the entire amount spent on all the 18 projects co-financed under the Infrastructure and Environment Operational Programme for 2007−2013 was incurred on this project, while the grant represents ca. 18% of the entire amount of co-financing for these projects.

Gas network roll-out in the Chęciny and Sitkówka Nowiny communes

The purpose of this project was to roll out a gas network in 18 towns and villages located in three communes of the Kielce province: Chęciny and Sitkówka-Nowiny (the Kielce county) and Sobków (the Jędrzejów county). The gas pipeline is approximately 67 km long and reaches about 6.2 thousand households and more than a dozen local government buildings and businesses. Metering stations were also constructed for the purposes of connecting institutional customers to the grid.

The project was carried out in the area which had been a "blank" on the gas network map of the region. As single-family housing is developing rapidly in the Chęciny and Sitkówka-Nowiny communes, connecting these areas to the gas network increases their value and attracts prospective buyers. Access to the gas network is one of the arguments used by local government authorities when seeking potential investors, especially those interested in using natural gas for process or manufacturing applications. Strong customer interest, reflected in the number of gas network connection agreements, shows that there was a supply gap to be filled.

The project, despite some difficulties in the execution phase, was completed as one of the first projects, in accordance with the co-financing agreement. Upon its completion the key indicators were also achieved – the output indicator, defined as the required number of gas pipeline kilometres, and the result indicator, reflecting the number of customers connected to the gas network, as assumed in the co-financing agreement.

1.2. Other projects

In addition, in 2015 there were projects financed directly by the company. Key among these were:

- Continued design work on the upgrade of a 61 km high-pressure gas pipeline from Sandomierz to Ostrowiec Świętokrzyski;
- Continued work on the upgrade of the Łódź Ring, including the upgrade of the high-pressure gas pipeline from Konstantyna to Meszcze. The project involves a series of tasks designed to improve the technical condition of the gas network, and also provides for redevelopment of ca. 52 km of gas pipelines, overhaul and upgrading work on gas stations on the gas pipelines of the Łódź Ring and the construction of high-pressure regulating stations; execution of the individual stages of the project is scheduled until 2020; in 2015, design work was completed and construction work commenced on the Łódź–Smulsko high-pressure gas station along with high- and medium-pressure gas pipelines; work on the construction of the block/bleed/connection system on the high-pressure gas pipeline from Rzgów to the Pabianice block system in Ksawerów continued; design work on the construction and conversion of high-pressure gas stations in Niewiadów and

Piotrków Trybunalski continued; design work on a gas station in Rzgów and on the block/bleed system at the pressure reduction station in Szynkielew was under way;
- Continued design work on the upgrade of a 37 km high-pressure gas pipeline from Parszów to Kielce. Development of project design documents is planned to be completed by the end of 2016; the completion of the project was delayed due to difficulties in acquiring legal titles to properties for the purposes of construction;
- Continued design work on the upgrade of a 21 km section of the high-pressure gas pipeline from Lubienia to Parszów;
- Upgrade of the high-pressure gas pipeline from Warzyce to Gorlice; in 2015, construction and assembly work was continued; by the end of 2015, the construction of 20.5 km of gas pipeline had been completed;
- Extension of high-pressure stations and gas mains fed from the Warsaw Ring. The project is designed to improve the transmission capacity and security of gas supplies within the city of Warsaw; the project involves construction of the Sękocin high-pressure station (completed in 2014), Jabłonna high-pressure station, Sokołów high-pressure station, Ząbki high-pressure station and a medium-pressure gas pipeline with a total length of ca. 11 km; in 2015, design work for the Ząbki high-pressure station was carried out;
- Extension of high- and medium-pressure gas network in Września; the project involves construction of three medium-pressure gas stations, medium-pressure gas pipelines with a total length of 31.5 km, a high-pressure gas station, and a high-pressure gas pipeline with a length of 10.2 km;
- Modernisation of the gas network in Stara Wieś and Kozietuły in the Belsk Duży commune; the project involves construction of a 11.4 km gas pipeline and a medium-pressure gas pipeline with a length of 1.4 km. In 2015, design documentation was prepared and a construction contract was signed.

PSG Sp. z o.o. also connected new customers to the gas grid. In 2015, the number of newly connected customers was 87.6 thousand. Major projects in this area included:

- Distribution network roll-out in Przasnysz and Chorzele. The project involves construction of a high-pressure reduction station, two increased medium-pressure reduction stations, a 65km increased medium-pressure pipeline and a 7km medium-pressure pipeline; in 2015 design work was completed and construction work commenced on a 30 km medium-pressure Przasnysz – Chorzele pipeline; design work on the Lekowo – Przasnysz gas pipeline was continued, construction of the Lekowo high-pressure station was under way, construction of two increased medium-pressure reduction and metering stations (Sierakowo and Brzesko Kołaki) commenced; by the end of 2015, 80% of the construction work on the Lekowo high-pressure station and the Sierakowo and Brzesko Kołaki medium-pressure stations had been completed;
- Distribution network roll-out in Bielsk Podlaski. The project involves connecting Miejskie Przedsiębiorstwo Energetyki Cieplnej S.A. of Bielsk Podlaski to the gas network; the customer has declared to accept 15 mcm of gas fuel p.a. (following modernisation of the town's central boiler house); in 2015, design documentation for the project was prepared;
- Connecting the Bydgoszcz power utility to the gas network. The project involves the construction of an 8 km high-pressure gas pipeline and a high-pressure metering station; design work related to the pipeline and the station was carried out in 2015.

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

	Dec 31 2015		Dec 31 2014	
	GWh	mcm*	GWh	mcm*
Volume of gas supplied to customers	104,803	9,552	102,858	9,327
- high-methane gas	96,423	8,788	95,027	8,610
- nitrogen-rich gas	5,587	509	4,991	458
- propane-butane-air and decompressed propane-butane	1	0	16	2
- coal gas	2,792	255	2,824	257

*mcm measured as high-methane gas equivalent

	Unit of measure	Dec 31 2015	Dec 31 2014
Length of network, excl. connections**	km	127,519	124,606
No. of customers	million shares	6.9	6.8
No. of new customers connected to the network	('000)	87.6	80

**Own and third-party networks.

2. Planned activities

In 2015, PSG Sp. z o.o. conducted work seeking to secure co-financing for its investment projects under the Infrastructure and Environment Operational Programme for 2014–2020. First, the company is planning to seek co-financing for 10 investment projects involving construction, extension and upgrade of distribution networks. In addition, the company has a portfolio of projects consistent with the objectives of the Infrastructure and Environment Operational Programme for 2014–2020, which the Company might be able to submit for co-financing if the amount of EU funds allocated to the distribution segment is increased, and if the Ministry of Development and Ministry of Energy open another round of project entries.

In 2016, the company will continue to pursue projects consisting in construction and extension of gas networks and connection of new customers, including projects based on the LNG technology.

In the coming years, the company wants to implement an investment model fostering accretion in the volumes of transferred gas and speed up its key investment projects. In order to carry out its plans, PSG sp. z o.o. intends to rely, as far as possible, on external financing available under EU programmes planned as part of the new multiannual financial framework 2014–2020. Particular emphasis will be placed on intensifying the processes aimed at finding new customers for gas, and on improving the reliability of gas networks and security of gas supplies.

PSG sp. z o.o. is also planning to develop its research, development and innovation activities (R+D+(I)). These activities will focus on research into ways of improving the reliability, ensuring safety and raising efficiency of the gas infrastructure, and will be conducted mainly through demonstration projects (promoted in the current multiannual financial framework 2014–2020), as well as based on any other model allowing the company to tap into external funds. Such approach will enable the company to optimally utilise the EU funding and take advantage of certain tax incentives introduced under the Act Amending Certain Acts to Support Innovation, which has been in effect since January 1st 2016.

Moreover, the company has been looking for opportunities to commercialise new innovative technologies and create innovative services that would enable it to evolve its core business and thus expand into new markets or increase market share. PSG sp. z o.o. has been analysing issues (both from the technological and regulatory point of view) related to broadening the functionality of its gas infrastructure to make it capable of transporting natural gas with an admixture of other gases, including biogas, synthetic natural gas (SNG), CO_2 and hydrogen. An upgrade of the gas networks to so expand their functionality would permit the company to launch new services and connect new customers from the power generation sector (stabilisation of the power system, fuel supply to portable and local electrical appliances powered by fuel cells), as well as the automotive sector and other industries where hydrogen is used in production processes.

The company also intends to consistently leverage the opportunities opening up in its business, regulatory and social environment with regard to:

- introduction of new regulations supporting the development of cogeneration and commercial power plants
- changes in the regulatory framework that would facilitate implementation of the company’s key investment projects
- growing demand for natural gas from large and medium customers (heat plants and CHP plants, manufacturing and industrial plants, service centres)
- reduction, in the medium term, of gas fuel prices due to liberalisation of the gas market and situation in the global markets, stimulating an increase in demand for gas and consequently for distribution services
- influencing the formation of the gas market (for instance through participation in regulatory consultations with the Energy Regulatory Office and the Ministry of Energy)
- obtaining EU co-financing for the company’s key investment projects and deployment of innovative technologies
- further network roll-out and connection of customers in regions characterised by poor gas supply infrastructure (e.g. central Poland, north-eastern regions of Poland), also based on the LNG technology.

3. Risks related to distribution

Legislation

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

Tariff policy

No tariff policy is published in Poland applicable to companies engaged in natural gas distribution that would include detailed rules and methodologies for determining the level of regulatory revenue acceptable to the regulator. The prevailing practice consists in determining short-term tariffs based on annual negotiations with the President of the Energy Regulatory Office. This solution gives the President of the Energy Regulatory Office much room for discretion in the process of evaluating costs incurred by the Distribution System Operator, its investment expenditure and regulatory value of its assets. This is a source of uncertainty as to the amount of revenue and profit that may be generated by the company. In order to mitigate this risk, in 2015 Polska Spółka Gazownictwa Sp. z o.o. approached the President of the Energy Regulatory Office with its proposal of a “Long-Term Strategy with respect to Regulation and Tariffs at PSG for 2016–2018”. The proposal is being analysed by the Energy Regulatory Office. Due to the lack of final solutions and regulations concerning the ‘socialisation’ of costs of the LNG terminal, any final arrangements with the Energy Regulatory Office concerning the proposal have been postponed until 2016. If an agreement is concluded with the President of the Energy Regulatory Office concerning the proposed long-term strategy, the company will have a basis for planning in a three-year time horizon based on anticipated stable levels of regulatory revenue.

Direct competition

Liberalisation of the gas market is contributing to intensified competition in the segment. Companies distributing natural gas are progressively expanding their gas networks and attracting new customers. Additionally, companies have emerged which offer LNG distribution services. The market entry barriers are significantly lower here, as LNG distribution involves much lower capital expenditure and does not require a connection to the gas system or adequate reserve capacity to be maintained in the transmission and distribution networks. Another issue which affects the segment's competitive position is the tariff policy of the Energy Regulatory Office, which makes it difficult for the PGNiG Group to operate a flexible pricing policy for some groups of customers. With the lack of flexible pricing, competitors' offers may prove to be an attractive alternative to the PGNiG Group's customers. The activity of companies competing on the local markets will not have a significant effect on the position of Polska Spółka Gazownictwa Sp. z o.o., therefore the risk of the company losing its dominant market position is low. However, the company constantly monitors the business decisions of its key competitors.

Large customers opting for reconnection to the transmission network

In view of the growing competition in the sector, there is a risk that the company's large customers may opt for reconnecting directly to the gas transmission network operated by OGP GAZ-SYSTEM S.A. Customers justify their willingness to reconnect by pointing to the need to cut costs. The departure of some customers would mean a loss of transferred gas volumes and thus also of revenue from sale of distribution services, and, as a consequence, would cause the need to cover any resulting excess of costs over revenue, for instance by increasing tariff rates.

Claims raised by property owners

More and more frequently, Polska Spółka Gazownictwa Sp. z o.o. is facing excessive financial claims raised by owners of land plots where the gas network was developed in the past. Transmission easement serves as a basis for determining the extent of the use of third-party property by a transmission company, for which relevant consideration is due to the owner. Furthermore, land owners raise compensation claims for extra-contractual use of land by the company. The owners' claims give rise to additional, frequently considerable costs, and thus may adversely affect the financial performance of the segment.

Sources of gas supply for the distribution system

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

Substitution

Continuing low prices of coal, hydrocarbons (fuel oils, heating oils) and other energy carriers used for municipal heating are hardly an incentive (in particular for retail customers) to switch to environmentally friendly gas fuel. In this situation, support to the company's plans to increase its revenue from sale of distribution services comes from local authorities, which implement various programmes aimed at reducing emissions from sources below 40m, in which financial support is offered to those willing to change their heating system. Among institutional customers, decisions to change the fuel used for heating purposes are made based on an analysis of the economics of such change, taking into consideration a possible reduction in staff costs.

Falling gas consumption

A decline in the average gas consumption by small customers is attributable to the improving energy efficiency of buildings (thermal modernisation) and reduced usage of individual gas-fired boilers for heating water. Thermal modernisation of buildings includes thermal insulation of outer walls, replacement of windows, use of condensing boilers, automatic control of heating systems, and installation of solar systems. Even though PSG Sp. z o.o. acquires more than 80 thousand new customers per year (mostly retail customers), the total volumes of gas supplied in this segment have been decreasing, causing the company to lose some of its revenue from distribution services.

Section X: Generation

The segment's principal business activity is the generation of heat and electricity. The segment's business also includes execution of major natural gas-fired projects in the power sector.

PGNiG TERMIKA S.A. is involved in the generation, distribution and sale of heat and electricity. The company also serves as the Group's competence centre for heat and electricity generation and execution of heat and power projects. The company's main revenue sources are sales of heat, electricity, system services, and certificates of energy origin. The installed capacity of the company's generating assets is 4.8 GW of achieved thermal power and 1 GW of achieved electrical power, which satisfies approximately 70% of the heat demand on the Warsaw metropolitan market. PGNiG TERMIKA S.A. is also a producer and supplier of heat and the owner of heat sources and heat networks in Pruszków, Komorów and Piastów, as well as the owner of an 8 MW gas-fired heating plant and a distribution network supplying heat to the Regaty residential estate in the Warsaw district of Białołęka.

1. Segment's operations

As at December 31st 2015, PGNiG TERMIKA S.A. held an electricity trading licence valid until December 31st 2030, as well as the following licences, each valid until December 31st 2025:

- for production of heat
- for transmission and distribution of heat
- for production of electricity.

<u>Tariffs</u>

From January 1st 2015 to August 14th 2015, the former tariff (approved by the President of the Energy Regulatory Office's decision of July 8th 2014) applicable to PGNiG TERMIKA S.A.'s sales of heat generated at the Żerań CHP, Siekierki CHP, Pruszków CHP, Wola Heating Plant and Kawęczyn Heating Plant, and to the transmission and distribution of heat via the heating network supplied from the Pruszków CHP plant, was effective until July 31st 2014. On July 29th 2015, the President of the Energy Regulatory Office approved a new tariff for heat generated by PGNiG TERMIKA S.A., effective from August 15th 2015.

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

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

<u>Production</u>

PGNiG TERMIKA S.A.'s key products are heat and electricity. In 2015, 100% of total electricity output was electricity cogenerated with heat. The table below presents PGNiG TERMIKA S.A.'s production volumes.

Electricity and heat production volumes

Product	Unit of measure	2015	2014
Electricity	GWh	4,090	4,173
Heat	TJ	36,545	36,923

The company also provided Network Constrained Generation services under an agreement with PSE Operator S.A., pursuant to which the company maintains a long-term plant margin and keeps a specific number of generating units available, so as to overcome limitations in the operation of power sources in the national power system and to ensure Warsaw's energy security. PGNiG TERMIKA S.A. is required to generate electricity whenever so instructed by the Transmission System Operator. In performance of the agreement, the company had generated 178.8 GWh of electricity by December 31st 2015.

Sales

In 2015, PGNiG TERMIKA S.A. sold 36,209 TJ of heat. PGNiG TERMIKA S.A. sold heat mainly to Veolia Energia Warszawa S.A. (formerly Dalkia Warszawa S.A.), which purchased 92.8% of the heat generated by the company. In 2015, Veolia Energia Warszawa S.A. contracted 3.3 GW of PGNiG TERMIKA's heat generation capacity. The balance of the heat output was sold to direct customers in Warsaw, Pruszków and to customers connected to the Regaty Heating Plant's network.

In 2015, PGNiG TERMIKA S.A. sold a total of 3,487 GWh of electricity generated at its plants, including 158 GWh under its Network Constrained Generation services. The key customer for electricity generated at PGNiG TERMIKA S.A.'s plants was PGNiG S.A., with an aggregate share in the company's electricity sales volume in 2015 reaching 99%. The company also sold electricity to smaller customers.

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

Construction of a CCGT unit in Stalowa Wola

In 2015, as part of the 'Construction of a CCGT Unit in Stalowa Wola' project, executed jointly with Tauron Polska Energia S.A., the Group continued the installation of the steam and gas turbines and construction and assembly work in the cold water pumping station, as well as the installation of cable ducts, cabling and wiring, conductor lines and the lightning. The Group also performed a water test of the recovery boiler and the condenser and completed construction work on the San river weir. Finishing work was also completed and cold start-ups commenced.

In September 2015, the progress of the work was significantly slowed by damage to the underground reinforced-concrete canal where the contractor was installing two parallel cooling water pipelines. Some defects in the work caused soil under the canal to be washed out, resulting in damage to the structure. The damage was discovered on April 17th 2015, when the posts supporting the pipeline trestle running above the canal sank by several centimetres. Expert opinions and a repair concept were prepared in early October. It was decided that the fastest and least expensive choice would be to construct a new canal (using the microtunneling method) next to the existing one. Given the lack of sufficient funds to finance the project, Abener Energia S.A. practically suspended all work on the unit.

Due to Abener Energia S.A.'s failure to comply with the schedule and material technical conditions of the contract, Elektrociepłownia Stalowa Wola S.A. terminated the contract on January 29th 2016. In accordance with the contract's terms, the contractor will be called on to carry out a detailed as-built survey of the project. Subsequently, Elektrociepłownia Stalowa Wola S.A., together with Tauron

Polska Energia S.A., PGNiG TERMIKA S.A. and the financing banks, will decide how the project should be continued and completed.

On April 3rd 2015, Elektrociepłownia Stalowa Wola S.A. received a summons to appear before the Court of Arbitration at the Polish Chamber of Commerce, filed by general contractor Abener Energia S.A. for confirmation of the occurrence of a force majeure event and increasing the contractor’s remuneration. On July 27th 2015, the contractor submitted a contract amendment notice, demanding that its remuneration be increased by PLN 15m and the project’s completion deadline be extended to January 27th 2017. On October 17th 2015, the Court of Arbitration at the Polish Chamber of Commerce received a petition from Abener Energia S.A. for confirmation of the occurrence of a force majeure event.

2. Planned activities

Electricity and heat sales will be the main source of revenue of PGNiG TERMIKA S.A. in 2016. The main customer for electricity generated at PGNiG TERMIKA S.A.’s plants will be PGNiG S.A., while the main customer for heat will be Veolia Energia Warszawa S.A.

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

In subsequent years, in line with the requirements of the PGNiG Group strategy, PGNiG TERMIKA S.A. will focus improving the efficiency of its existing assets and will also develop its new business area involving the acquisition of heating systems and, in economically justified cases, construction of new cogeneration units. The Company plans acquisitions of heating networks, also abroad. PGNiG TERMIKA S.A. intends to focus on projects based on gas-fired or biomass-fired generation sources, to gradually reduce its coal consumption and increase the share of low- and zero-emission fuels in its energy mix. In 2016, the company will place in service a biomass-fired unit at the Siekierki CHP plant.

On May 4th 2015, the Act on Renewable Energy Sources (RES) became effective. The Act provides for two parallel support systems: one for existing installations (certificate system), and the other for installations launched after the effective date of the Act (auction system). The provisions on the auction system will be effective as of June 30th 2016, which means that the hybrid RES system at the Siekierki CHP plant (with the K1 steam generator converted to a biomass-fired unit, scheduled to come online in the first half of 2016) will be covered by the existing certificate system for 15 years. The new auction support system provides business opportunities for the implementation of RES projects, with the level of revenues guaranteed for 15 years.

On November 12th 2015, a new Act Amending the Environmental Protection Law (the so-called anti-smog law) came into force. The new Act aims to improve the air quality in Poland by creating legal tools to combat emissions from sources below 40 m at provincial and local levels. Under the Act, replacement of heat sources and connection of buildings to the district heating network will be co-financed from domestic and EU funds. In addition, local governments will have the option to subsidise more expensive heating solutions so that low-income families can afford environmentally friendly heating. The new regulations are conducive to the development of heating networks and increased demand for district heating, which translates into better cogeneration potential.

3. Generation risks

More stringent gas and dust emission standards

Furthermore, in order to meet more stringent gas and dust emission standards to be implemented as of 2016, producers have to thoroughly modernise their power and CHP plants and may be forced to shut down a number of generation units (a total of some 4,000 to 6,000 MWe by 2020) where it is not economically viable to install expensive flue gas treatment systems.

Maintaining share in the municipal heat market

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

Marketing efforts conducted jointly with Veolia Energia Warszawa S.A., and connecting further western districts of Warsaw to the municipal heating network should significantly reduce potential future decline in the volume of energy produced at PGNiG TERMIKA S.A.'s generating plants.

Section XI: Other Activities

1. Segment's operations

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

The services offered by the segment were provided to both third-party customers and PGNiG Group companies. The key projects executed for external customers included:

- Construction of the 175.2 km DN 700 high-pressure gas pipeline from Gustorzyn to Rembelszczyzna, for OGP GAZ-SYSTEM S.A.,
- Construction of a 64 km section of the DN 700 high-pressure gas pipeline from Szczecin to Gdańsk (stage I: Płoty–Karlino section) for OGP GAZ-SYSTEM S.A.; project completed,
- Construction of the Jeleniów II Gas Compressor Station for OGP GAZ-SYSTEM S.A.,
- Assembly of HDPE pipelines, valves and hydrants, and corridor construction, under the Polish LNG Project for Saipem S.P.A. S.A., Branch in Poland; project completed
- Preparation of design documentation for the project to construct the DN 100 high-pressure Zdzieszowice–Wrocław pipeline in the following sections: Brzeg–Zębice–Kiełczów (46 km) and Zdzieszowice–Brzeg (84 km), for OGP GAZ-SYSTEM S.A.,
- Preparation of design documentation for and construction of a high-pressure gas metering station together with a compression unit in Sękocin Nowy for OGP GAZ-SYSTEM S.A.,
- Production of equipment and spare parts for drilling rigs and drillships for MHWirth AS (Norway),

Work performed by the segment's companies for external customers also included hotel, restaurant and spa centre services.

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

- Extension of the Brzeźnica underground gas storage facility,
- Completion of construction of the Wierzchowice underground gas storage facility (a project previously performed by PBG),
- Changes in the configuration of gas compressors for the Wierzchowice underground gas storage facility (reversible operation of gas compressors); project completed,
- Construction of the water-injection system for the BMB (Barnówko – Mostno – Buszewo) field,
- Development of the Połęcko field,
- Development of the Załęże-1K and 2K gas wells (Krasne gas production facility); project completed,
- Development of the Wilków-51K well; project completed,
- Development of the Draganowa-1 well,
- Development of the Gajewo crude oil deposit,
- Development of wells on the Brońsko field (hook-up of the Brońsko 26H well and expansion of the Kościan–Brońsko Central Facility),
- Development of the Rzeszów-20K well (Rzeszów Gas Production Facility).

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

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

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

In addition, the segment's work for other PGNiG Group companies included production of well desanding equipment, spare parts for surface well equipment, preparation of gas infrastructure technical and design documents, as well as provision of technical and expert consulting services.

2. Planned activities

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

3. Risks related to other activities

Legislation

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

Competition

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

Qualified personnel

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

Section XII: Investments

In 2015, capital expenditure incurred by the PGNiG Group on property, plant and equipment and intangible assets was PLN 3,324m, having gone down by ca. 15% year on year. The table below presents the Group's expenditure in the individual segments.

Capital expenditure (PLNm)

	2015	2014
Exploration and Production	1,437	2,056
Trade and Storage	233	335
Distribution	1,193	1,120
Generation	454	410
Other Activities	7	6
Total	3,324	3,927

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

Exploration and Production

The capital expenditure incurred in 2015 in the Exploration and Production Segment amounted to PLN 1,437m. 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.).

In 2015, the PGNiG Group's expenditure on gas & oil exploration and production work on the Norwegian Continental Shelf amounted to PLN 395m. the majority of which was allocated towards the development of the Gina Krog field.

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

- Completion of development of 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

The capex of the Trade and Storage segment amounted to PLN 233m. 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' (commenced in 2008) was completed. After completion of the construction work and acceptance of the upgraded installation, the additional working capacity totalling 1.2 bcm became 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.

Distribution

Capital expenditure incurred by the PGNiG Group in the Distribution segment amounted to PLN 1,193m. The capex budget was spent on upgrading and extending the gas network and on connecting new customers. For a discussion of key projects in the Distribution segment, see Section IX Distribution.

Generation

Starting from 2016, Poland will be subject to more stringent standards of gas and dust emission, for which reason the modernisation of power plants and CHP plants is necessary. In order to meet the more stringent emission requirements, PGNiG TERMIKA S.A. has gradually been modernising its generating assets. Capital expenditure of the Generation segment amounted to PLN 454m, of which approximately PLN 65.2m was spent on environmental protection projects. Furthermore, in 2015 the segment continued some of the investment projects commenced in previous years. The most important of these were:

- Construction of a 450 MW CCGT unit at the Żerań CHP plant. In 2015, a final permit for the construction of the CCGT unit at the Żerań CHP plant was obtained, construction site preparation continued, and a tendering procedure for delivery and installation of the unit was announced (bids will be accepted until March 15th 2016);
- Conversion of the K1 steam generator at the Siekierki CHP plant into a biomass-fired unit; work carried out in 2015 included construction and installation work, technical acceptance of the unit; an application was also filed to the President of the Energy Regulatory Office to amend the licence for co-generation of electricity and heat at the Siekierka CHP plant so it includes a hybrid system, and start-up work at the steam generator and biomass system was carried out;
- Conversion of the Pruszków CHP plant; work carried out in 2015 included construction and installation work on the water treatment station and launch of the facility, fitting of a cyclone filter at the K9 steam generator, and revision of the conversion concept for the Pruszków CHP plant; an agreement for the construction of a cyclone filter for the K7 steam generator was also signed and demolition and construction work began;
- Construction of a gas- and oil-fired peak-load and reserve boiler house at the Żerań CHP plant; following the cancellation of the tender procedure in 2014, a new tender procedure for the construction of the boiler house was announced in 2015;

- Bringing the K2 steam generator at the Siekierki CHP plant in line with BAT (Best Available Technique) requirements in respect of dust, SO_2 and NO_x emissions; design and construction work began in 2015.

Other Activities

In 2015, the Other Activities segment incurred capital expenditure on property, plant and equipment and intangible assets of PLN **7**m. Major investment projects included purchase of software, vehicles, buildings and structures, as well as production plant and equipment.

Section XIII: 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 TERMIKA S.A. (the Siekierki, Żerań and Pruszków CHP plants and the Kawęczyn and Wola heating plants), PGNiG S.A. Branches in Odolanów (gas compressor station, boiler house and process gas heaters), Zielona Góra (LMG oil and gas production facility, Wierzchowice underground gas storage facility, boiler house, and Dębno oil and gas production facility), and 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 5,560,537 Mg. In 2015, the PGNiG Group reviewed annual reports on its carbon dioxide emissions for 2014. Carbon emissions from the installations covered by the EU ETS scheme in 2014 totalled 5,788,782 tonnes. After reconciling its CO_2 emissions with emission rights held, and after redeeming the allowances allocated for 2014, a deficit of 2,152,777 tonnes of CO_2 free emission units was identified. The deficit was covered with reserves accumulated in the accounts of the Group installations (unused free allocations from previous years) and with allowances purchased on the Intercontinental Exchange Futures Europe.

In 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.

Environmental protection in drilling operations

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

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

In 2015, as part of the effort to limit the environmental impact of its drilling operations, Exalo Drilling S.A. completed the work to implement a mobile evaporator system (for drilling waste neutralisation), purchased water tanks (with pumping equipment), a fuel tank, and overhauled a centrifuge and three power generator motors.

Environmental impact of the Kosakowo underground gas storage cavern facility

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

Land and sea monitoring activities are carried out in the vicinity of the Kosakowo underground gas storage cavern facility to assess the project's environmental impact. These activities are conducted as part of two programmes: the environmental monitoring programme (of May 2009) and the basic and emergency control programme for the Kosakowo underground gas storage cavern facility (of April 2014). The programmes cover the monitoring of underground and surface water, soil, vertical earth surface movements, the condition and operation of the brine discharge installation at the Kosakowo underground gas storage cavern facility, and the impact of the discharged brine on waters of the Puck Bay. The storage facility's tightness is also monitored by measuring soil air at selected locations. The surveys and observations conducted so far indicate that the operations of the Kosakowo underground gas storage cavern facility do not have a negative impact on the environment. The monitoring activities are conducted by two independent bodies: the Maritime Institute of Gdańsk and the Institute of Hydroengineering of the Polish Academy of Sciences of Gdańsk, as well as by the personnel of the Kosakowo underground gas storage cavern facility.

Reclamation of the fuel ash landfill site

PGNiG TERMIKA S.A. is carrying out reclamation of the Myśliborska fuel ash landfill site for the Żerań CHP plant. The project will involve reclamation of the land as green areas (Cells No. 1 and 2) and for residential and commercial development (Cell No. 3). 2015 saw the conclusion of work on dismantling the technical infrastructure between the Żerań CHP plant and the landfill site, while macrolevelling and soil compaction continued in Cell No. 3. Macrolevelling of surge tanks also began. All of the reclamation work is scheduled to be completed in 2016.

Fulfilment of the requirements of the Industrial Emissions Directive and BAT

In 2015, in an effort to meet the environmental standards provided for in Directive 2010/75/EU of the European Parliament and of the Council on industrial emissions (IED) and future requirements related to the Best Available Techniques (BAT), PGNiG TERMIKA S.A. pursued investment projects designed to reduce atmospheric gas and dust emissions. In 2015, the company completed installation of the fourth set of spray nozzles in absorbers No. 1 and No. 2 at the Siekierki CHP plant; in environmental terms, assuming the unit operates at full capacity, the project should reduce SO_2 concentrations from ca. 200-300 mg/Nm^3 to less than 150 mg/Nm^3; total expenditure on the project was ca. PLN 20m. In 2015, PGNiG TERMIKA S.A. also continued work on:

- Conversion of coal-fired steam generator No. 1 at the Siekierki CHP plant into a biomass-fired unit; the expected annual reduction of pollutants into the atmosphere comprises reduction of CO_2 emissions by 227,000 tonnes, of SO_2 emissions − by 780 tonnes, of NO_x emissions − by 260 tonnes and of particulate matter emissions − by 20 tonnes; the converted steam generator is to be placed in service in H1 2016.

- Conversion of mazout-fired water boilers at the Siekierki CHP plant and the Wola heating plant into light oil units, including modernisation of their burners. In environmental terms, the project will reduce SO_2 concentration from 1,300–1,500 mg/Nm^3 to below 200 mg/Nm^3; the project is scheduled for completion in H1 2016.
- Provision of the fluidised bed boilers at the Żerań CHP plant with high efficiency dust collectors (bag filters) and enhancing the desulfurisation process; in environmental terms, the project will reduce dust concentration from ca. 50–100 mg/Nm^3 to below 20 mg/Nm^3 and SO_2 concentration from 500 mg/Nm^3 to below 200 mg/Nm^3; the project is scheduled for completion in H1 2016.

In 2015, the company embarked on a number of new pro-environmental projects, including:

- Upgrade of the atmosphere protection system at the Siekierki CHP plant's steam generator No. 2; under the project, the existing semi-dry flue gas desulfurisation unit will be upgraded and a NOx reduction system will be added; the project is scheduled for completion in 2017.
- Fitting of a NOx reduction system at the Siekierki CHP plant's water boilers K5, K6, K7 and K16; the project is scheduled for completion in 2017.

<u>Noise reduction project at the Siekierki CHP plant</u>

In 2015, PGNiG TERMIKA S.A. completed the construction of noise barrier walls around transformers located in the Siekierki CHP Plant switch room in the western part of the plant. The project reduce noise emissions by 9 dB. In past years, noise barrier walls along the eastern border of the Plant's premises and along coal unloading points located at the hump tracks were completed. Total expenditure on the projects amounted to approximately PLN 4.8m.

<u>Biomass supplies and consumption</u>

In performance of the requirements stipulated in Directive 2009/28/EC on the promotion of the use of energy from renewable sources, PGNiG TERMIKA S.A. acquires biomass primarily from purchases contracted on the market. The company also concludes long-term contracts for the supply of biomass from energy willow plantations. Currently, the company procures biomass from plantations with a total area of 407 ha. In 2015, the amount of biomass co-combusted or combusted at PGNiG TERMIKA S.A. was 9,393 tonnes (Żerań CHP plant) and 6,409 tonnes (Siekierki CHP plant), respectively. Thanks to the use of biomass as a fuel, in 2015 CO_2 emissions from fossil fuels were reduced by 14,420 tonnes.

Section XIV: 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 XV: Financial performance

1. Financial performance in 2015

The separate financial statements of PGNiG S.A. and the consolidated financial statements of the PGNiG Group 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 is provided in the consolidated financial statements of the PGNiG Group for 2015 (Note 36.6).

1.1. Key financial and business data

The consolidated financial statements of the PGNiG Group for 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 consolidated financial statements of the PGNiG Group for 2015 (Note 2).

In 2015, the PGNiG Group posted a net profit of PLN 2,136m, down by PLN 686m year on year.

Summary information on the PGNiG Group'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:

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

Consolidated statement of financial position (PLNm)

ASSETS	Dec 31 2015	Dec 31 2014
Total non-current assets	36,959	37,692
Property, plant and equipment	32,967	33,528
Investment property	12	9
Intangible assets	1,138	1,113
Investments in equity-accounted entities	840	856
Other financial assets	275	243
Deferred tax assets	1,575	1,783
Other non-current assets	152	160
Total current assets	12,866	11,234
Inventories	2,229	3,189
Trade and other receivables	3,372	4,236
Current tax assets	7	5
Other assets	146	132
Derivative financial instrument assets	709	567
Cash and cash equivalents	6,239	2,958
Assets held for sale	164	147
Total assets	49,825	48,926

Consolidated statement of financial position (PLNm) – contd.

LIABILITIES AND EQUITY	Dec 31 2015	Dec 31 2014
Total equity	30,741	30,169
Share capital	5,900	5,900
Share premium	1,740	1,740
Accumulated other comprehensive income	(637)	(270)
Retained earnings	23,733	22,794
Equity attributable to owners of the parent	30,736	30,164
Equity attributable to non-controlling interests	5	5
Total non-current liabilities	12,795	12,384
Borrowings and other debt instruments	5,799	5,069
Employee benefit obligations	565	604
Provisions	1,728	1,803
Deferred revenue	1,511	1,581
Deferred tax liabilities	3,090	3,250
Other non-current liabilities	102	77
Total current liabilities	6,289	6,373
Trade and other payables	3,288	3,589
Borrowings and other debt instruments	583	769
Derivative financial instrument liabilities	1,165	593
Current tax liabilities	53	191
Employee benefit obligations	352	284
Provisions	694	720
Deferred revenue	154	227
Total liabilities	19,084	18,757
Total equity and liabilities	49,825	48,926

Consolidated statement of profit or loss (PLNm)

	2015	2014
Revenue	36,464	34,304
Total operating expenses	(33,174)	(30,461)
Raw materials and consumables used	(24,216)	(21,229)
Employee benefits expense	(2,714)	(2,827)
Depreciation and amortisation expense	(2,790)	(2,502)
Services	(2,674)	(2,843)
Work performed by the entity and capitalised	953	980
Other income and expenses	(1,733)	(2,040)
Operating profit	3,290	3,843
Finance income	80	86
Finance costs	(305)	(432)
Share in net profit/(loss) of equity-accounted entities	(51)	129
Profit before tax	3,014	3,626
Income tax	(878)	(804)
Net profit	2,136	2,822
Attributable to:		
Owners of the parent	2,134	2,823
Non-controlling interests	2	(1)
Earnings and diluted earnings per share attributable to holders of ordinary shares of the parent (in PLN)	0.36	0.48

Consolidated statement of cash flows (PLNm)

	2015	2014
Net cash (used in)/generated by operating activities	7,258	6,979
Net cash (used in)/generated by investing activities	(3,147)	(3,680)
Net cash (used in)/generated by financing activities	(829)	(3,169)
Net increase/(decrease) in cash and cash equivalents	3,282	130
Cash and cash equivalents at beginning of the period	2,956	2,826
Cash and cash equivalents at end of period	6,238	2,956

Financial ratios

Profitability

	2015	2014
EBIT (PLNm) operating profit	3,290	3,843
EBITDA (PLNm) operating profit + depreciation/amortisation	6,080	6,345
ROE net profit* to equity at end of the period**	6.9%	9.4%
NET MARGIN net profit* to revenue	5.9%	8.2%
ROA net profit* to assets at end of the period	4.3%	5.8%

* Net profit attributable to owners of the parent.
** equity attributable to owners of the parent

Liquidity

	Dec 31 2015	Dec 31 2014
CURRENT RATIO current assets to current liabilities (net of employee benefit obligations, provisions and deferred income)	2.5	2.2
QUICK RATIO current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred income)	2.1	1.6

Debt

	Dec 31 2015	Dec 31 2014
DEBT RATIO total liabilities to total equity and liabilities	38.3%	38.3%
DEBT/EQUITY RATIO total liabilities to equity*	62.1%	62.2%

* Equity attributable to owners of the parent.

1.2. Financial standing

The PGNiG Group’s revenue in 2015 was PLN 36,464m, up by PLN 2,160m (6%) year on year. With costs rising by PLN 2,713m (9%), the Group earned consolidated operating profit of PLN 3,290 m in 2015. The Group’s EBITDA was down by PLN 265m, to PLN 6,080m. The decline was mainly attributable to macroeconomic factors (a drop in crude oil prices on global markets) and the ongoing deregulation of the Polish gas market.

Exploration and Production

Operating profit of the Exploration and Production segment was PLN 1,095m, down PLN 911m (45%) year on year. At PLN 2,426m, EBITDA was lower than the year before – by PLN 717m (23%).

The segment's revenue decreased by PLN 1,216m (20%) year on year, to PLN 4,855m, despite a 19% increase in the volume of crude oil sales (mainly from deposits in Norway, where sales grew by approximately 59%). The revenue decline reflected the fall in crude oil prices (in Polish zloty terms, the average price of Brent in 2015 was approximately 36% lower than in 2014). The decrease in crude oil prices, adversely affecting the profitability of exploration projects, also depressed demand for exploration services provided by the Exploration and Production segment. In 2015, revenue from geophysical and exploration services fell by PLN 416m year on year. The segment's operating expenses were down PLN 305m (8%) on the back of lower impairment losses on the segment's assets, which in 2015 lowered the segments' profit by PLN 846m (PLN 1,037m in 2014). In addition, reversal of provisions for well decommissioning costs added PLN 128m to the segment's operating profit, compared with a negative effect of PLN -38m in the same period of the previous year. The reversal was a result of the lower average decommissioning cost per well and the higher discount rate.

Trade and Storage

In 2015, the Trade and Storage segment's operating profit was down PLN 202m year on year, to PLN 381m.

The segment's revenue in 2015 was up by PLN 2,917m (or 10%) year on year, driven principally by higher revenue from gas sold on the Polish Power Exchange, whose volume was 9 bcm in 2015, relative to 4.3 bcm the year before. The segment's operating expenses in 2015 were up by PLN 3,119m (or 11%) year on year, mainly on higher costs of gas fuel purchases on the Polish Power Exchange (made by PGNiG Obrót Detaliczny Sp. z o.o.). Sale and purchase transactions carried out on the Polish Power Exchange by, respectively, PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. (which commenced operations on August 1st 2014) are not eliminated in the consolidated financial statements.

The decline in the segment's operating result is due to the ongoing deregulation of the Polish gas market, which allows the segment's largest customers to diversify their gas fuel supplies. In 2015, PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. changed their tariffs for fuel gas sales several times. As a result, the average tariff price for gas fuel in Q4 2015 was lower by ca. 10% compared with 2014. Additionally, in response to changing market conditions, the segment companies selling gas fuel in Poland launched discount schemes, making their offering more attractive to customers.

The decline in the segment's operating result was also attributable to a higher write-down on inventories of gas fuel, up by PLN 190m in 2015.

As at December 31st 2015, the Group held ca. 1.7 bcm of gas in underground storage – approximately 19% less than at the end of 2014.

Distribution

The Distribution segment's operating profit in 2015 increased 27% year on year, to PLN 1,450m, while its EBITDA came in at PLN 2,339m, up by PLN 337m on the year before. The performance improved partly on the back of a PLN 302m (7%) rise in revenue. The revenue increase was primarily driven by:

- higher tariff for gas fuel distribution services, with the average year-on-year rise of 3%,
- lower quarterly average air temperature in Q1 2015 relative to the corresponding quarter of the previous year; in Q1 and Q2 2015, the average air temperature fell, respectively, by 0.6 °C and

0.3°C year on year; in Q4 2015, the average air temperature remained virtually unchanged year on year.

Despite the PLN 302m increase in revenue, the segment's operating expenses remained virtually the same − down by PLN 10m (0.3%), which is primarily attributable to reduced employee benefits expenses following the 2015 workforce streamlining as part of the voluntary redundancy programme.

Generation

The segment's operating profit for 2015 was PLN 367m, up PLN 205m year on year. EBITDA was PLN 679m, an improvement of 47% year on year. The following factors contributed to that significant improvement:

- higher revenues from sales of heat, resulting mainly from a higher heat tariff (an increase on average of 7% in August 2014 and 5% in August 2015);
- lower procurement costs of coal, the main fuel for heat production (the average price of coal in Q1−Q3 2015 was 6% lower than in the same period of the previous year).

<u>Operating performance by segment</u>

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

2015	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to external customers	3,148	31,274	654	1,215	173	0	36,464
Inter-segment sales	1,707	468	3,931	672	152	(6,930)	0
Segment's total revenue	4,855	31,742	4,585	1,887	325	(6,930)	36,464
Segment's expenses	(3,760)	(31,361)	(3,135)	(1,520)	(331)	6,933	(33,174)
Operating profit/(loss)	1,095	381	1,450	367	(6)	3	3,290
Net finance costs							(225)
Share in net profit/(loss) of equity-accounted entities	-	(51)	-	-	-	-	(51)
Profit before tax							3,014
Income tax							(878)
Net profit							2,136

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

2014	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to external customers	4,346	28,367	280	1,149	162		34,304
Inter-segment sales	1,725	458	4,003	794	163	(7,143)	0
Segment's total revenue	6,071	28,825	4,283	1,943	325	(7,143)	34,304
Segment's expenses	(4,065)	(28,242)	(3,145)	(1,781)	(393)	7,165	(30,461)
Operating profit/(loss)	2,006	583	1,138	162	(68)	22	3,843
Net finance costs							(346)
Share in net profit/(loss) of equity-accounted entities	-	129	-	-	-	-	129
Profit before tax							3,626
Income tax							(804)
Net profit							2,822

The Group’s financial result was also affected by its net finance income, which improved by PLN 121m (35%), chiefly on the back of lower interest expense following a reduction in the average annual level of borrowings (the subsidiary PGNiG Upstream International AS’s debt rose in Q3 2015) and active participation in the *cash pooling* arrangements within the Group.

Pre-tax profit was decreased by PLN 51m on revaluation of shares in System Gazociągów Tranzytowych EUROPOL GAZ S.A.

In 2015, the PGNiG Group posted a net profit of PLN 2,136 m, down PLN 686m (24%) year on year.

Statement of financial position

As at December 31st 2015, total assets recognised in the consolidated statement of financial position were PLN 49,825m, up PLN 899m (2%) on the end of 2014.

Assets

Property, plant and equipment represents the largest component of the Group’s assets. As at the end of 2015, this item amounted to PLN 32,967m, having decreased by PLN 561m (or 2%) relative to December 31st 2014. The decrease was mainly due to recognition of impairment losses on these assets, up PLN 536m year on year.

Deferred tax assets, the second largest item of non-current assets, went down by PLN 208m (or 12%) on realisation of the tax loss in Norway by subsidiary PGNiG Upstream International AS (the tax loss has been accounted for since the launch of hydrocarbon production from the company’s fields on the Norwegian Continental Shelf).

As at the end of 2015, the Group’s current assets stood at PLN 12,866m, up PLN 1,632m (15%) relative to the end of 2014. Current assets increased mainly on the back of an increase in cash − up PLN 3,281m year on year, which was largely attributable to a change in the debt structure of Upstream International AS (a subsidiary of PGNiG). The company refinanced its intragroup financing, which in previous periods was eliminated in the consolidated financial statements, with a bank loan. Moreover, there was a significant change in inventories − down PLN 960m (30%) year on year relative to the end of 2015. The decrease was mainly attributable to lower stocks of gas in storage facilities as at the end of 2015 (1.7 bcm relative to 2.1 bcm as at the end of 2014), and a lower year-on-year price of gas injected into storage.

The value and structure of current assets held by the Group guaranteed its ability to settle all liabilities in a timely manner. The current ratio was 2.5, compared with 2.2 as at the end of December 2014, while the quick ratio rose from 1.6 to 2.1 year on year.

Equity and liabilities

Equity is the primary source of financing of the PGNiG Group’s assets. Relative to the end of 2014, the Group’s equity rose by PLN 572m (or 2%), primarily on the back of the net profit for the period of PLN 2,136m, adjusted for the PLN 1,180m dividend paid for the previous year.

As at December 31st 2015, non-current liabilities were PLN 12,795m, up PLN 411m on the end of December 2014. The increase is mainly due to increased liabilities of PGNiG Upstream International AS (a subsidiary of PGNiG) under long-term bank borrowings.

As at December 31st 2015, the Group carried current liabilities of PLN 6,289m, down PLN 84m (1%) year on year. The decrease was chiefly a result of lower trade payables, particularly liabilities related to purchases of gas (lower underground injection volumes in Q4 2015).

As the percentage rise in equity was almost identical to the increase in non-current and current liabilities, the debt to equity ratio and the debt ratio as at the end of 2015 remained almost unchanged relative to the previous period at, respectively, 62.1% and 38.3% (62.2% and 38.3% a year earlier).

Material off-balance-sheet items

As at December 31st 2015, the PGNiG Group's most important off-balance-sheet item was contingent liabilities of PLN 9,173, as disclosed in the consolidated financial statements. The key items of contingent liabilities included:

- a guarantee securing performance of the obligations of PGNiG Finance AB (a subsidiary of PGNiG S.A.) towards bondholders, in connection with the Eurobond programme (PLN 4,200m);
- a bond securing performance of the licence commitments and legal obligations of PGNiG Upstream International AS (a subsidiary of PGNiG S.A.) towards the state of Norway (PLN 2,675m);

Key equity investments and capital placements at the PGNiG Group

Key equity investments and capital placements at the PGNiG Group in 2015 included:

- issue of short-term notes offered to PGNiG Group companies; as at December 31st 2015, PGNiG S.A.'s outstanding debt under the notes was PLN 310m
- increase of the share capital of PGNiG SPV Sp. z o.o. by PLN 51m; all the shares were acquired by PGNiG S.A.
- acquisition by PGNiG S.A. of short-term notes issued by GEOFIZYKA Kraków S.A. under the note issuance programme operated within the PGNiG Group; as at December 31st 2015, the nominal value of notes acquired under the programme was PLN 40m
- equity increase of USD 4m (or PLN 15.3m) at POGC-Libya B.V., without issuing new shares.

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 and beyond, the PGNiG Group intends to pursue investment projects in:

- oil and gas exploration and production
- construction and extension of underground gas storage facilities
- construction and extension of distribution infrastructure
- development of the power generation segment.

Additionally, the PGNiG Group plans to allocate funds to mergers and acquisitions of heating networks and production assets outside of Poland.

When evaluating the feasibility of its investment plans for 2016 and beyond, the PGNiG Group 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 the PGNiG Group were found sufficient to finance its investment plans.

<u>Explanation of differences between the actual results and forecasts for 2015</u>

The PGNiG Management Board's financial forecast was published in current report No. 9/2015 of February 5th 2015. The forecast was then revised in current report No. 81/2015 of November 6th 2015. The results disclosed in the full-year report are not materially different from the forecasts published in the current report (the PGNiG Group's revenue forecast differs from actual performance for 2015 by (-1.72%) and the difference in the PGNiG Group's EBITDA is (-3.5%); the PGNiG Group's debt ratio did not exceed 2xEBITDA).

2. Financial management

2.1. Policies of financial risk management

The PGNiG Group 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 the PGNiG Group'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 Group's liabilities. As a rule, the Group concludes transactions in financial instruments with multiple entities with high creditworthiness. The key criteria applied by the Group in the selection of counterparties include their financial standing as confirmed by rating agencies, as well as their respective market shares and reputation.

The PGNiG Group is exposed to credit risk in connection with its:

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

Cash and cash equivalents

The Group 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 Group 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 Group 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 Group verifies creditworthiness of each institutional trading partner seeking trade credit from the Group. 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 Group’s policy. If payment is not received within the contractual term, appropriate steps are taken, in line with the Group’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 Group'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.

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

Guarantees issued

The Group's credit risk exposure under provided guarantees is substantially limited to the risk of insolvency of the banks which, acting on the Group's instructions, issued guarantees to other external entities. However, the banks on which the Group 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 the PGNiG Group'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 PGNiG Group's financial performance will be adversely affected by changes in the price of one currency against another.

The hedging measures implemented by the Group 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 Group uses call options, option strategies and forward transactions.

Interest rate risk

Interest rate risk is defined as the probability that the PGNiG Group's financial performance will be adversely affected by changes in interest rates.

The Group 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 n 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 the PGNiG Group's financial performance will be adversely affected by changes in commodity prices.

The Group'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 Group also executes transactions outside of regulated markets, under frame agreements. The Group 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 Group.

In 2015, the Group closely monitored and hedged the risk. To hedge against commodity price risk, the Group 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 Group. An equally serious threat is that of having excess structural liquidity, which could adversely affect the Group's profitability.

The Group monitors and plans its liquidity levels on a continuous basis. As part of its strategy to hedge against liquidity risk, in 2015 the Group 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 Group 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.

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

Assessment of financial resources management

The PGNiG Group actively manages its financial resources by optimising both its debt structure and financing costs. PGNiG Group companies adapt the form of financing to its purpose (operating or investing activity) and to its term. The forms of financing available to PGNiG Group companies include note issuance programmes, bank loans, finance leases and intra-Group loans advanced by PGNiG S.A.

An important tool improving the efficiency of financial resources management is the liquidity management system in which the balances of specified bank accounts of PGNiG S.A. and its subsidiaries can be aggregated (cash pooling). Thanks to the cash pooling system within the Group, cash of entities with excess liquidity is used to finance the operations of entities recording cash deficits. This not only increases the efficiency of cash management within the PGNiG Group, but also materially reduces interest expenses incurred by companies financing their cash deficits through the system. To finance their operations, these companies do not use other, external sources of financing, which are usually more expensive than cash pooling.

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 the PGNiG Group, the Group companies are able to timely fulfil their financial obligations.

2.2. Note issuance programmes

In 2015, the PGNiG Group 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 July 4th 2012, with notes issued by PGNiG TERMIKA S.A.,
- the Eurobond programme of August 25th 2011, with bonds issued by PGNiG Finance AB,
- 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.

In 2015, PGNiG TERMIKA S.A. placed new issues of short-term notes under its issuance programme agreement of July 4th 2012 (amended under annexes of 2014). The programme is valid until December 29th 2019, with an option of extending the validity term by another two years, until December 29th 2021. On August 18th 2015 and December 11th 2015, annexes to the programme were signed, amending the guarantee agreement and the agency and deposit agreement. As part of the programme, PGNiG TERMIKA S.A. may issue discount and coupon-bearing notes for up to PLN 1.5bn, with maturities ranging from one month to one year, underwritten by banks. The notes bear interest based on WIBOR plus a margin, depending on the net debt to EBITDA ratio. In 2015, the company carried out five issues of discount notes with a nominal value of PLN 310m. As at December 31st 2015, the nominal value of the notes was PLN 110m.

Under its five-year Eurobond programme established on August 25th 2011, PGNiG Finance AB may issue Eurobonds for up to EUR 1.2bn with maturities of up to 10 years. In 2015, the company did not issue any Eurobonds. As at December 31st 2015, PGNiG Finance AB's nominal debt outstanding under the issue of 2012 was EUR 500m.

The issue proceeds were applied to finance the PGNiG Group's day-to-day financial needs related to implementation of its strategy. PGNiG S.A. used 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, the PGNiG Group concluded credit facility agreements for total amounts of USD 400m and PLN 426.5m. The most important of them was the USD 400m credit facility agreement concluded on August 13th 2015 by PGNiG Upstream International AS with a syndicate of eight banks (Societe Generale, BNP Paribas, ING, HSBC, Citibank, CACIB, SEB and Natixis) represented by Societe Generale. The facility is a seven-year revolving loan with a grace period of 30 months, advanced as a Reserved Based Loan, i.e. a loan in which a specific oil or gas field is the basic security for the lenders. The amount of available funds is based on the value of production assets held by PGNiG Upstream International AS: Skarv (11.9175% interest), Morvin (6%), Vilje (24.243%), Vale (24.243%) and Gina Krog (8%). Proceeds from the facility were used to finance investments related to the company’s operations on the Norwegian Continental Shelf and for early repayment of its debt. The other credit facility agreements were concluded with a view to financing day-to-day operations.

The table below presents detailed information on key credit facility agreements executed by the PGNiG Group in 2015.

Key credit facility agreements executed by the PGNiG Group

Bank	Facility amount (m)	Currency	Interest rate	Type	Maturity date
Syndicate of eight banks	400.0	USD	LIBOR USD/EURIBOR*+1.55%**	working capital/ investment facility	Aug 13 2022
Bank Pekao S.A.	120.0	PLN	1M WIBOR + 1.00%	working capital facility	Apr 24 2016
HSBC Bank Polska S.A.	60.0	PLN	1M WIBOR + 0.50%	working capital facility	Jun 15 2016
Bank Zachodni WBK S.A.	50.0	PLN	1M WIBOR+2.00%	working capital facility	Jan 31 2016
Societe Generale S.A. Polish Branch,	40.0	PLN	1M WIBOR + 0.30%	working capital facility	Aug 31 2016
Bank Handlowy w Warszawie S.A.	40.0	PLN	1M WIBOR + 0.30%	working capital facility	Dec 30 2016
HSBC Bank Polska S.A.	40.0	PLN	3M WIBOR + 0.45%	working capital facility	Jul 7 2016

*Multi-currency credit facility, may be drawn in USD and EUR; provides for 1M, 3M or 6M interest periods.
** In 2016 and 2017, the interest rate will be LIBOR USD/EURIBOR+1.80%

Credit facility agreements terminated in 2015

In 2015, the PGNiG Group terminated one investment account overdraft facility agreement. The agreement was concluded by PGNiG Norway AS (currently: PGNiG Upstream International AS) with a syndicate of seven banks (Credit Agricole CIB, BNP Paribas, Societe Generale, Natixis, The Bank of Tokyo Mitsubishi UFJ, UniCredit Bank AG and KBC Bank NV) on August 31st 2010, for an amount of USD 400m, maturing on August 31st 2017 and bearing interest at the rate of LIBOR USD+2.5%. The agreement was terminated due to early repayment of the facility and contracting of a new facility on terms more favourable to the company.

Loan agreements executed in 2015

In 2015, the PGNiG Group concluded three loan agreements with a related entity for a total amount of PLN 18.5m. The loans were advanced to finance the company's day-to-day operations, including partial repayment of debt under investment credit facility agreements concluded for financing the construction of a CCGT unit in Stalowa Wola. The table below presents detailed information on the loans advanced by the PGNiG Group.

Loans advanced by the PGNiG Group

Company	Loan amount (m)	Currency	Interest rate	Type	Maturity date
Elektrociepłownia Stalowa Wola S.A.	13.5	PLN	3M WIBOR + 2.50%	working capital loan	Dec 31 2027
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, the PGNiG Group did not contract or terminate any loans.

2.4. Guarantees and sureties

In 2015, the PGNiG Group provided guarantees and sureties for a total amount of PLN 148m, disclosed in the consolidated financial statements. The guarantees and sureties primarily included: performance bond provided as security for gas supplies by PGNiG Supply &Trading GmBH, totalling PLN 143m.

In 2015, the PGNiG Group did not receive any material guarantees or sureties disclosable in the financial statements (those received totalled PLN 0.1m).

3. Projected future financial standing

Principal factors that will be affecting the financial standing of the PGNiG Group in 2016 include considerable volatility of the global prices of hydrocarbons and of currency exchange rates. The impact of these factors will be reflected particularly in the performance of the Exploration and Production and Trade and Storage segments.

Low prices of crude, which still prevail in the global markets, translate into lower revenue generated by the PGNiG Group companies engaged in crude production and sale, and into lower demand for seismic and exploration services offered by the Group companies, and in consequence have a negative effect on the results posted by the Group’s Exploration and Production segment. If crude prices remain low, the Group may have to recognise impairment losses on its exploration and production assets, which would negatively affect the performance of the Exploration and Production segment. Given the interrelation between the prices of hydrocarbons and the price of gas purchased by the Group under long-term contracts with OOO Gazprom Export and Qatar Liquefied Gas Company Limited (3), relatively low hydrocarbon prices will have a favourable effect on the cost of gas acquisition by PGNiG S.A. and consequently on the financial performance of the Group’s Trade and Storage segment.

Another factor with a bearing on the PGNiG Group’s business prospects in the coming year relates to the situation in the currency market. Any potential strengthening of the zloty against foreign currencies (primarily the US dollar) will have a positive effect on the performance of the Trade and Storage segment, by driving down the cost of gas imported by PGNiG S.A. As the Group’s performance is correlated with the exchange rates between the zloty and other currencies, the Group companies apply hedging policies to optimise the impact of foreign exchange risk on their results.

The Group expects that the growing liberalisation of the gas market in Poland will continue to put pressure on the results generated by the PGNiG Group companies engaged in the sale of gas and operating in the Trade and Storage segment. Competition for customers has prompted successive reductions in gas fuel sale tariffs and launch of discount schemes for customers of the Group companies. These factors have had a negative effect on the profitability of the Trade and Storage segment, by eroding its margins. Moreover, in response to the progressing liberalisation of the gas market and the resulting need to make the PGNiG Group’s business more competitive, the Group companies have embarked on a number of initiatives to improve the efficiency of their operations. These initiatives should have a positive effect on the performance of the PGNiG Group, thanks for instance to optimised costs of its operations.

In the case of the Generation segment, the Group’s performance will also be considerably affected by the support programmes for electricity from high-efficiency co-generation and renewable sources. Legislative changes in this area and fluctuations in the market prices of certificates of origin (both red and green) will have a bearing on the Group’s financial position in this segment. To note, a continuation of the current downward trend in coal prices should have a positive effect on the Generation segment’s performance.

In 2016, the Group intends to maintain a high level of capital expenditure. Spending will focus primarily on projects involving maintenance of hydrocarbon production rates, as well as on projects in the exploration for and appraisal of crude oil and natural gas deposits, and development of the power generation segment. Of particular importance for the PGNiG Group's long-term development will be potential acquisitions of production assets outside of Poland and of heat assets.

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	....