Polish Oil and Gas Company (PGNiG SA)
Head Office

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Update of the PGNiG Group Strategy for 2014−2022

Current Report No. 29/2016

The Management Board of Polskie Górnictwo Naftowe i Gazownictwo SA ("PGNiG", "the Company") hereby announces that on April 4th 2016 the PGNiG Supervisory Board approved the updated "Strategy of the PGNiG Group for 2014−2022" ("the Strategy").

Given the volatility of oil prices on global markets, an updating review of the Strategy was necessary. Following a review and verification of the Strategy, its macroeconomic, market and business assumptions were updated and the strategic ambitions were redefined. Ultimately, the existing strategic initiatives were modified and new ones were developed.

The updated Strategy continues to focus on the following four key business areas:

1. Maintaining stable value (both in retail and wholesale)
2. Maximising cash flows from the infrastructure and generation area
3. Strengthening and transforming the exploration and production area
4. Laying foundations for growth along the entire value chain

As a result of the update, the number of strategic initiatives to be pursued until 2022 increased from 10 to 16. They are expected to help achieve an EBITDA of approx. PLN 7.4bn in 2022. The higher EBITDA target is underpinned by larger ambitions in the following areas: (i) transmission infrastructure (gas and heat distribution), (ii) acquisitions of foreign exploration and production assets, and (iii) the Efficiency Improvement Programme.

In the period covered by the Strategy, capital expenditure on organic growth and acquisitions is maintained at PLN 40bn−50bn. The net debt to EBITDA ratio is expected to stay below 2.0 in 2022 and the current dividend policy is to be continued.[1] In terms of operational objectives, it is of key significance that the planned rates of hydrocarbon production in Poland and abroad have been raised to approx. 55−60 million boe in 2022 (assuming that favourable market conditions supporting cost-effective acquisitions arise) and that the annual production targets in Poland are maintained at approx. 33 million boe.

[1] *In its recommendations on dividend payment, the PGNiG Management Board will each time take into account the current financial standing of the PGNiG Group and its investment plans. PGNiG will recognise net profits of its subsidiaries in the consolidated accounts net of any dividend paid by the subsidiaries, so achieving the planned level of dividend payments may be postponed by one year.*

Updated Strategy: key elements

The updated Strategy covers a detailed action plan, with the existing initiatives modified significantly and new strategic initiatives developed.

<u>The modified strategic initiatives include:</u>

Initiative 1a Optimising the natural gas portfolio management and implementing a new wholesale model − updated negotiation objectives for the long-term Yamal and Qatar contracts (due to changes in the macroeconomic environment).

Initiative 2a Developing and implementing a new retail model − to actively defend the market position of PGNiG Obrót Detaliczny.

Initiative 3b Maximising value from transmission infrastructure − heat distribution − to achieve higher EBITDA from acquired heating systems.

Initiative 4 Taking active part in creating energy market regulations − new stream of work including development of mechanisms to improve the economics of fields with declining hydrocarbon production profiles.

Initiative 7 Expanding the upstream business outside of Poland − higher production targets and cost efficiency of planned acquisitions following decline of the crude oil prices.

Initiative 8a Efficiency Improvement Programme − achieving higher sustainable savings (PLN 800m−900m (previously PLN 700m−800m) by the end of 2018).

Initiative 8b Matrix Project − divided into initiative **8b** (Disposal of non-core property) and **8c** (Disposal of non-core companies).

Initiative 10 Stepping up R&D activities and searching for innovative areas for growth − innovative technologies developed in the upstream business to be applied in other areas, particularly in order to obtain coal bed methane.

<u>Three new strategic initiatives developed:</u>

Initiative 1b − examination of new diversification projects.

Initiative 1c − assessment of feasibility of developing international LNG trading.

Initiative 2b − expansion of international sales activities of PGNiG Supply & Trading.

Strategy implementation so far

The key Strategy tasks for 2015 were accomplished despite the challenging and volatile environment.

1. <u>Maintaining stable value of sales (both in retail and wholesale)</u>

The results achieved in 2015 demonstrated that the Strategy, oriented at maintaining a stable value of sales by providing a wide range of tailored discounts, especially to business customers, has been justified. 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 originally assumed in the Strategy. Negotiations with Qatargas led to amendments to the contract with this supplier reducing the risk that PGNiG S.A. would have to cover the cost of gas uncollected due to delays in the construction of the LNG terminal in Świnoujście. Moreover, PGNiG commenced talks with Gazprom as part of the six-month negotiation window provided for in the contract. In May 2015, PGNiG S.A. also filed a motion for arbitration proceedings before the Arbitration Court in Stockholm, which however did not preclude holding commercial negotiations with Gazprom to reach an agreement.

2. Maximising cash flows from the infrastructure and generation area

The business growth in the infrastructure area in 2015 was in line with expectations. The gas distribution volumes grew faster than expected, on the back of a stronger growth in the number of new connections to the network and new customers, while the average distribution charge remained at the level assumed in the Strategy.

As part of the efforts to acquire further heat distribution assets, a detailed analysis of the heat generation market in Poland was performed. Following intensive search for and selection of acquisition targets, as well as based on discussions with owners of municipal and private district heating businesses, available acquisition opportunities offered by the sector in Poland were assessed.

In the generation area, a decision to proceed with the project to build a new 450 MWe CCGT unit at the Żerań CHP plant was made. 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. Technical parameters of the unit will meet the requirements of the Industrial Emissions Directive (IED, in force as of 2016) and BAT (Best Available Techniques). Furthermore, work on conversion of the K1 boiler at the Siekierki CHP Plant was completed in 2015. The project will help reduce air emissions, as required by the IED.

3. Strengthening and transforming the exploration and production area

2015 was a successful year for the PGNiG Group also in the exploration and production area. The Group took a number of steps with a view to increasing its both conventional and unconventional gas reserves. Its objective is to maintain stable production volumes in Poland in the coming years and to keep its leading market position in the segment. New discoveries in 2015 added about 27 mboe to the Group’s reserves, the highest amount in almost 10 years.

In the upstream area, a large number of acquisition opportunities in many parts of the world were analysed. The most attractive assets in the US and Canada were identified and shortlisted. The PGNiG Group is primarily interested in acquiring reserves which are at an advanced stage of development (producing reserves), or companies holding interests in such reserves.

4. Laying foundations for growth along the value chain

Particularly noteworthy was the achievement of planned cost savings (of PLN 602m in 2015) on enhanced organisational and process-related efficiencies across the Group. This will serve as springboard for the Group’s further growth.

A presentation of the strategic initiatives is attached to this current report.

Legal basis:
Art. 56.1.1 of the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies, dated July 29th 2005, as amended (Dz. U. No. 184, item 1539).