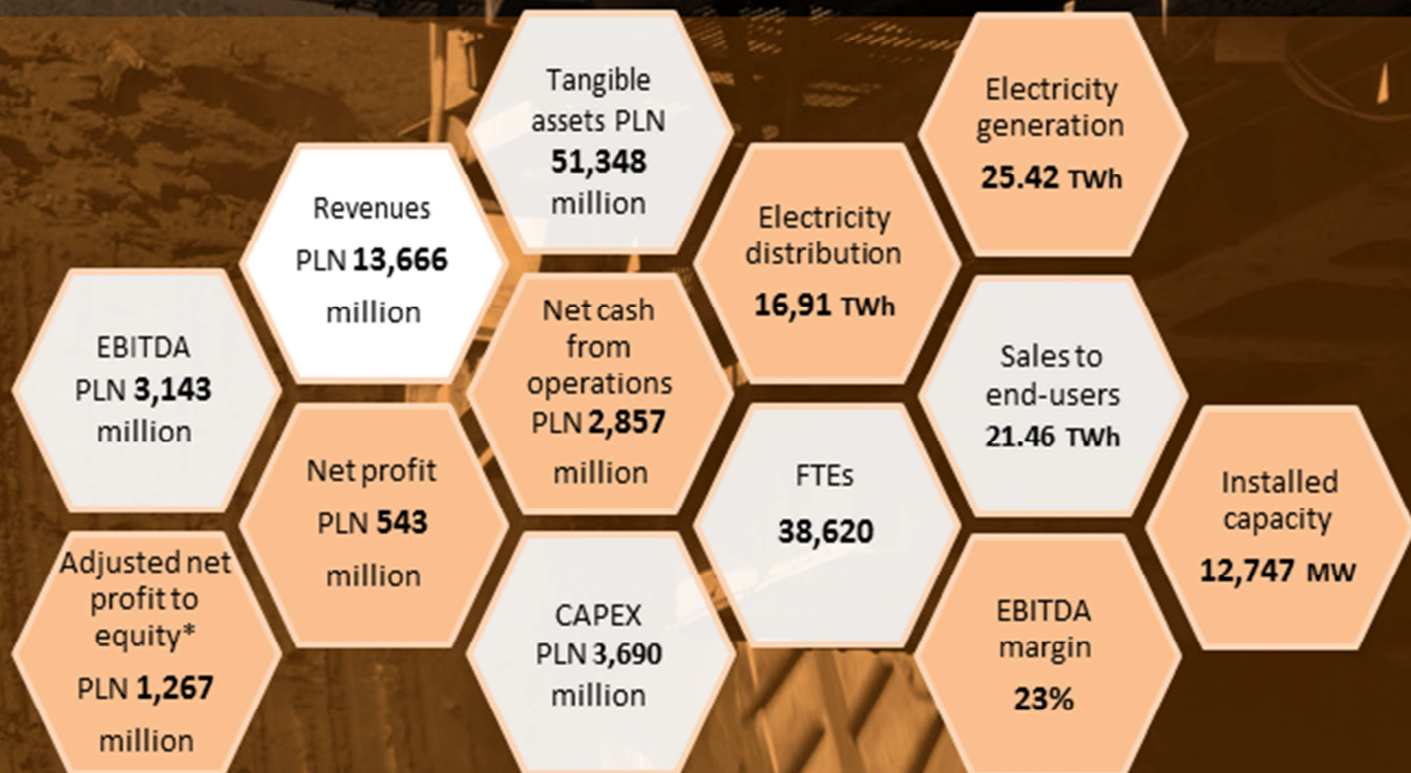


**Management Board's report on  
activities of the Capital Group of  
PGE Polska Grupa Energetyczna S.A.  
for the 6-month period**

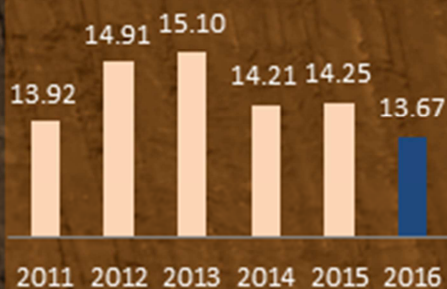
**ended June 30, 2016**

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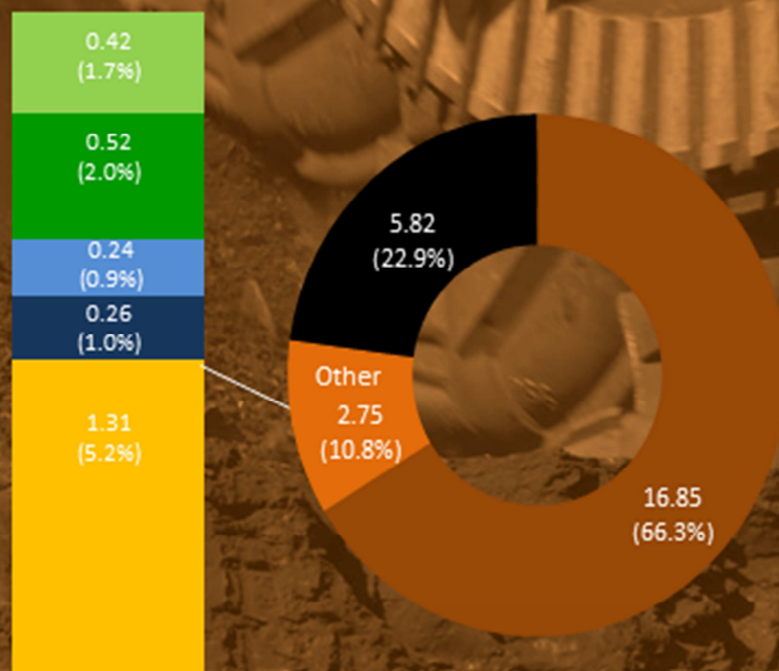
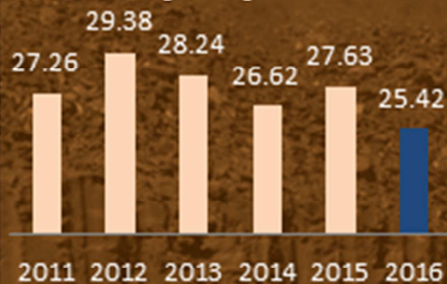


### REVENUES [PLN BN] H1



### ELECTRICITY GENERATION STRUCTURE

### NET ELECTRICITY PRODUCTION [TWh] H1



Legend for Electricity Generation Structure:

- Lignite
- Hard coal
- Gas
- Pumped-storage
- Hydro
- Wind
- Biomass

\* net profit adjusted by impairment of property, plant and equipment

## CONVENTIONAL GENERATION



## RENEWABLE ENERGY



### Operations

Extraction of lignite and generation of electricity and heat from conventional sources and distribution of heat and supporting operations in this respect

Electricity generation from renewable sources and in pumped storage power plants

### Key assets of the segment

4 conventional power plants  
8 CHPs  
2 lignite mines

14 wind power plants  
1 photovoltaic plant  
29 run-of-river hydro power plants  
4 pumped storage power plants,  
including 2 with natural flow

### Energy volumes

Generation in H1 2016  
24.4 TWh

Generation in H1 2016  
1.02 TWh

### Market position

PGE is a leader in lignite mining

PGE is the leading producer of energy from renewable sources

Revenues [PLNm]

5,652

370

EBITDA [PLNm]

1,568

205

Share in EBITDA of the group

50%

7%

Capital expenditures  
[PLNm]

2,855

95

Assets [PLNm]

33,603

3,849

Installed capacity [MW]

10,613

2,134

## SUPPLY

## DISTRIBUTION



**Operations**

**SUPPLY:** Wholesale trading of electricity on domestic and international market and trading of related products, fuels and CO2 emission allowances

**DISTRIBUTION:** Supply of electricity to final off-takers through the grid and HV, MV and LV power infrastructure

**Key assets of the segment**

-

284,603 kms.  
of distribution lines

**Energy volumes**

Sales to end-users in H1 2016  
21.43 TWh

Electricity distributed in H1 2016  
16.91 TWh

**Market position**

One of the leaders in wholesale trading and retail supply in Poland

Second energy distributor with regard to number of customers

**Revenues [PLNm]**

8,047

2,922

**EBITDA [PLNm]**

208

1,117

**Share in EBITDA of the group**

7%

36%

**Capital expenditures [PLNm]**

7

713

**Assets [PLNm]**

4,651

16,814

## 1 Description of activity of the Capital Group

Capital Group of PGE Polska Grupa Energetyczna S.A. ("PGE Capital Group", the "Group", the "Capital Group", "PGE Group") is the largest vertically integrated company in energy sector in Poland in terms of revenues, installed capacity and electricity produced.

The parent company of PGE Capital Group is PGE Polska Grupa Energetyczna S.A. ("PGE S.A.", the "Company").

PGE Group currently organizes its activities in the following business segments:

- Conventional Generation includes search and extraction of lignite and production of energy in power plants and CHP plants as well as supporting operations in this respect.
- Renewable Energy Includes electricity generation from renewable sources and in pumped-storage power plants.
- Supply includes sale and purchase of electricity and gas on wholesale market, trading of CO<sub>2</sub> allowances and energy certificates and purchase and supply of fuels, as well as sale of electricity and provision of services to end users.
- Distribution includes management of local distribution grids and distribution of electricity.
- Other Operations include provision of services by the subsidiaries to the Capital Group, for example obtaining of financing, IT services, telecommunication services, accounting and HR services. Additionally, Other Operations include a subsidiary, whose main activities are preparation and execution of nuclear power plant construction project.

## 1.1 Factors important for the development of the PGE Capital Group

In the opinion of the Company's Management Board, the following factors will influence the Company's and the Group's results and performance within at least next quarter:

Market environment	Description in p.
<b>Demand</b>	1.2.1
<ul style="list-style-type: none"> <li>● demand for electricity and heat</li> <li>● seasonality and weather conditions</li> </ul>	
<b>Electricity market</b>	1.2.4
<ul style="list-style-type: none"> <li>● wholesale electricity prices</li> <li>● prices and tariffs on electricity and heat retail sale markets</li> <li>● tariffs for transmission and distribution of heat and tariffs for electricity distribution</li> </ul>	1.2.3
<b>Related markets</b>	1.2.5
<ul style="list-style-type: none"> <li>● prices of property rights (certificates of origin of electricity)</li> <li>● availability and prices of fuels used in generation of electricity and heat, in particular prices of hard coal, fuel gas and biomass, as well as costs of fuels transportation to the generating units</li> <li>● prices of CO<sub>2</sub> emission rights</li> </ul>	1.2.2
<b>Power infrastructure</b>	1.2.4
<ul style="list-style-type: none"> <li>● availability of cross-border transmission capacities</li> <li>● growth of generating capacity in national electro-energy system, including renewable energy and cogeneration</li> <li>● development and modernisation of energy grid</li> </ul>	1.2.4
<b>Macroeconomic environment</b>	1.2.1
<ul style="list-style-type: none"> <li>● GDP dynamics, particularly in industrial production</li> <li>● interest rates and exchange rates, values of which affect evaluation of assets and liabilities shown by the Group</li> </ul>	
<b>Regulatory environment</b>	
<b>Domestic</b>	
<ul style="list-style-type: none"> <li>● possible changes to the Poland's energy policy as a result of new Energy Policy of Poland until 2050</li> <li>● changes in scope of services like: <ul style="list-style-type: none"> <li>▪ modification of current Operational Reserve mechanism</li> <li>▪ modification of cold reserve mechanism</li> <li>▪ implementation of further packages for demand reduction services</li> </ul> </li> <li>● implementation of capacity market</li> <li>● further amendments to the Law on Renewable Energy Sources, defining support scheme for energy generation in renewables</li> <li>● obligation to redeem certificates of energy origin in next years</li> <li>● parameters and auction schedule for RES installations</li> <li>● results of proceeding of the European Commission on notification of cogeneration and renewable energy sources support schemes</li> <li>● results of explanatory proceedings before the ERO President and court disputes in cases of issue of certificates of origin of energy produced from biomass for some of the branches of PGE Górnictwo i Energetyka Konwencjonalna S.A. ("PGE GiEK S.A.")</li> <li>● matter of implementation of quality tariff in distribution, that will make regulated income dependant on SAIDI and SAIFI ratios and connection time, among others</li> <li>● possible different decision in law disputes, from which most relevant were presented in note 21.4 to the consolidated financial statements</li> <li>● draft Water Law Act changing the way of collecting water charges</li> </ul>	
<b>International</b>	
<ul style="list-style-type: none"> <li>● regulations of 2030 climate and energy package – including EU climate summit decisions from October 2014 particularly: at least 40% CO<sub>2</sub> reduction targets, 27% RES share target in total energy consumption, 27% efficiency improvement target, including: <ul style="list-style-type: none"> <li>▪ draft revision of the EU Emission Trading System (EU ETS) Directive – formula for compensation mechanisms – Modernisation Fund and free allocation of CO<sub>2</sub> emission allowances</li> <li>▪ appeal by Poland to the European Court of Justice regarding a decision to establish a Market Stability Reserve for the CO<sub>2</sub> emission allowance market – possible impact on CO<sub>2</sub> prices and procedure for determining climate policy</li> </ul> </li> </ul>	

- draft revision of the Renewable Energy (REDII) Directive, including setting out the means by which Poland is to contribute to the 27% share of renewable energy in the energy mix at EU level by 2030
  - draft revision of the Energy Efficiency Directive (EED), including setting out the means by which Poland is to contribute to the 27% improvement in energy efficiency at EU level by 2030
  - regulations connected with the reduction of emissions of other pollutants, including:
    - process of revising the Best Available Techniques (BAT) – uncertainty regarding the final date for publication of the BAT conclusions and, therefore, the date for adapting production assets to the new requirements. A preferred deadline for adapting to the requirements stemming from the BAT conclusions is 2024, meaning that publication of the BAT conclusions ought to be delayed to the end of 2019
    - draft National Emission Ceilings (NEC) Directive regarding national limits for the emission of certain pollutants into the air and its impact on the electricity sector, including establishing the final content of provisions regulating the emission ceilings and the means by which national authorities are to implement these
  - implementation of the Energy Union concept, including:
    - process of European markets connection, works on standardized model of electricity market, unified trading areas and the trading rules between them. Currently, works are being pursued on connection of Poland to market coupling mechanisms, which is based on combining of energy sale and energy purchase offers from two or more markets, taking into account the transmission capacity available on the connections of these markets and determining the price of electricity based on a common algorithm.
    - a new directive aiming to ensure the security of supply, which might include a legally binding requirement to expand interconnectors to 10% by 2020 and to 15% by 2030;
    - harmonisation of capacity mechanisms in the EU.
- 

## 1.2 Factors and events affecting results

### 1.2.1 Macroeconomic situation

PGE Group's main operating area is Poland, and the domestic macroeconomic backdrop has a substantial impact on Group's results. At the same time, the condition of Poland's economy remains largely tied to the situation across the European Union and in global markets. The Group's financial results are affected by both the situation in specific segments of the economy and the financial markets, which affect the terms of PGE Group's debt financing.

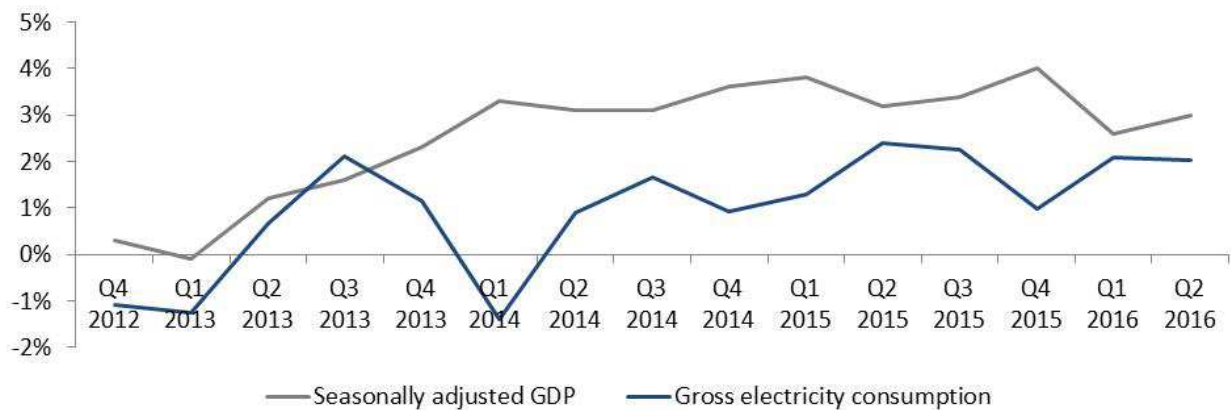
As a rule of thumb, there is a historical correlation between rising electricity demand and economic growth in Poland. Historical data over the long term shows that this link is weakened because of the economy becoming less energy-intensive. In the past ten years, Poland's gross domestic product grew by about four times faster than gross electricity demand. Considering PGE Group's position on the Polish power generation market, as well as its substantial share in the electricity sales and distribution market, changes in power and heat demand may have a significant impact on the Group's results.

In the first half of 2016, gross electricity consumption went up 2.1% compared to the first quarter of 2015. The increase was higher than in the previous year, when consumption went up 1.8% from the analogical period of 2014.

Economic trends in the first half of 2016 largely remained positive. According to the forecasts available as at the publication date, seasonally adjusted GDP in the second quarter of 2016 was higher by 3.0%\* in real terms than in the previous year.



Diagram: Seasonally adjusted GDP change vs. change in gross electricity consumption.



\* GDP for the Q2 2016 estimated according to analysts' forecasts, dynamics of gross electricity consumption according to PSE  
Source: Central Statistical Office of Poland, PSE

Economic growth and rising electricity consumption were accompanied by moderately optimistic condition of Polish industry, which is responsible for approx. 45% of domestic electricity consumption. The Purchasing Managers' Index (PMI) for industry averaged 54.3 points in the first half of 2015, and 52.1 points in the first half of 2016. This is above the 50-point threshold, which means the respondents expect the sector's situation to improve. The positive result stems mainly from growing production and employment. The results of the Polish industrial sector should be further strengthened by the Eurozone, whose PMI for the first half of 2015 remained at an average level of 51.8 points, and 51.9 points in the first half of 2016.

Diagram: Manufacturing PMI in Poland and Eurozone (in points).



Source: Markit Economics

From PGE Group's perspective, another positive development is the stronger growth in overall industrial production. In the first half of 2016, it went up by 5.7% y-o-y, compared to 3.9% in the analogical period of previous year. The change resulted from substantial growth in industrial production (7.3% y-o-y in the first half of 2016 versus 4.5% in the first half of 2015). Production in the whole energy sector decreased again (-3.8% y-o-y in the first half of 2016 vs -5.5% in the first half of 2015). The value of industrial manufacturing depends on volumes of goods produced and prices. PPI's dynamics remains negative for more than three years. In the first half of 2016 PPI decreased by 1.1% due to low prices of fossil fuels, particularly crude oil and hard coal.

CPI reading has remained negative since July 2014. In the analysed period CPI amounted to -0.8% y-o-y.

Table: Key economic indicators for Poland.

<b>Key economic indicators</b> (% change y-o-y)	<b>H1 2016</b>	<b>H1 2015</b>
GDP <sup>1</sup>	3.0	3.2
CPI <sup>2</sup>	-0.8	-0.8
PPI <sup>2</sup>	-1.1	-2.4
Sold industrial production <sup>2</sup>	5.7	3.9
Sold production – manufacturing <sup>2</sup>	7.3	4.5
Sold production – energy <sup>3</sup>	-3.8	-5.5
Dynamics of domestic electricity consumption <sup>4</sup>	2.1	1.8
Gross domestic electricity consumption (TWh) <sup>4</sup>	81.6	79.9
EUR/PLN <sup>5</sup>	4.37	4.14

*Source: <sup>1</sup> Central Statistical Office of Poland, GDP seasonally adjusted for the second quarter of 2016 estimated on the basis of analysts' forecasts, <sup>2</sup> Central Statistical Office of Poland – data for the second quarter of 2016 estimated on the basis of monthly figures, <sup>3</sup> Central Statistical Office of Poland - Energy generation and supply of electricity, gas, steam and hot water supply, <sup>4</sup> PSE S.A., <sup>5</sup> National Bank of Poland*

### 1.2.2 Fuel purchase costs

Table: Volume and cost of purchase of fuels for generation needs from third party suppliers in the first half of 2016 and 2015.

Type of fuel	H1 2016		H1 2015	
	Volume (tons ths)	Cost (PLNm)	Volume (tons ths)	Cost (PLNm)
Hard coal	2,338	504	2,367	571
Gas (cubic metres ths)	353,887	256	300,182	273
Biomass	501	111	696	198
Fuel oil	20	18	14	19
<b>TOTAL</b>		<b>889</b>		<b>1,061</b>

In the first half of 2016 the costs of purchasing primary fuels for generation needs from providers outside the Group amounted to PLN 889 million and were lower by PLN 172 million compared to the first half of 2015.

Costs of purchase of the main fuels in PGE Capital Group were impacted mostly by:

#### Biomass

- Lower volume of biomass purchase by 28% (PLN -55 million)  
Lower volume of biomass purchase is a result of lower electricity production in co-combustion with biomass due to the decreased profitability of energy production in that technology (the impact of new regulations of RES law and low prices of green certificates).
- Average price lower by o 22% (PLN -32 million)

#### Hard coal

- Lower purchase volume by 1% (PLN -7 million)  
Lower volume of hard coal purchase results mainly from lower purchase volume at Dolna Odra power plant, which used coal stock to a greater extent.
- Lower average price by 11% (PLN -60 million)  
Lower hard coal price results chiefly from the situation on the mining market, both domestic and international. It allowed for negotiation of lower contractual prices of hard coal than in 2015.

#### Gas

- Higher purchase volume by 18% (PLN +49 million)  
Increased purchase volume in the first half of 2016 in relation to the first half of 2015 resulted from higher demand for gas fuel at branches of PGE GiEK S.A.
- Lower average price by 20% (PLN -66 million)  
Lower average purchase price is connected with liberalisation of Polish gas market and decline of gas prices on the exchanges.

#### Fuel oil

- Purchase volume higher by 43% (PLN +8 million)  
Higher purchase volume results from higher use of fuel oil for the needs of trial run of units after overhauls and modernisations in Bełchatów power plant.
- Lower average price by 34% (PLN -9 million)  
Lower global prices of crude oil and refinery products attributed to the decrease of average purchase price of fuel oil.

In the first half of 2016 approximately 66% of the electricity was produced from internally sourced lignite, whose extraction price is fully controlled by PGE Capital Group.

### 1.2.3 Tariffs

PGE Group companies earn part of their income based on tariffs approved by the President of the Energy Regulatory Office:

- tariffs for the sale of electricity to households (G tariff group);
- tariffs of the distribution companies;
- tariffs for heat.

#### Sales of electricity

In 2016 tariffs for sales of energy to the corporate customers (key and business) and to individuals (other than G tariff customers connected to the distribution network of PGE Dystrybucja S.A.) were not subject to approval of the President of the Energy Regulatory Office.

In 2016 sales of electricity to off-takers from the G tariff group, connected to the distribution network of PGE Dystrybucja S.A., was conducted on the basis of electricity Tariff for PGE Obrót S.A. approved by the decision of the President of the Energy Regulatory Office for the period till December 31, 2016. In comparison to the analogical period of 2015 tariffs in G tariff group decreased by approximately 0.8%.

#### Distribution of electricity

Methodology of and assumptions for tariffs determination were published in the document "Tariffs for the DSO for the year 2016", which was prepared and published by the President of the Energy Regulatory Office.

On December 17, 2015 the ERO President approved the Tariff of PGE Dystrybucja S.A. for electricity distribution services for the period until December 31, 2016.

Tariff came into force on January 1, 2016.

Distribution tariffs for 2016 approved by the President of the Energy Regulatory Office, contributed to changes in average tariff in particular tariff groups (calculated for revenues and volume in a given tariff year) in comparison to year 2015:

- A tariff group – decrease by 1.31%;
- B tariff group – decrease by 1.96%;
- C+R tariff group – decrease by 5.90%;
- G tariff group – decrease by 1.96%.

Decrease of distribution tariffs takes into account 12% increase in quality fee transferred from the Transmission System Operator tariff that increases regulated revenue but does not affect the result of Distribution segment.

The most important change is implementation in tariff for 2016 of quality parameters. It has been settled that the ratios directly impacting the regulated revenue will be following key performance indicators:

- SAIDI – System Average Interruption Duration Index;
- SAIFI – System Average Interruption Frequency Index;
- Connection time;
- Transfer time of metering and billing data („CPD”), which will be included in the quality regulations as of 2018.

Not meeting the levels of ratios indicated by the ERO President will result in penalty of decreasing the regulated revenue through reduction of amount of return on capital in year t+2. In the initial period no rewards are anticipated for achieving better indicators than the required ones.

Impact of quality parameters realized in 2016 will be included in tariff for 2018. In accordance with the assumptions adopted by the ERO, a penalty may not exceed 2% of regulated revenue and value of 15% of return on capital in a given year.

For the first time in line with the ERO guidelines, it has been possible to include in the tariff costs related to construction of energy infrastructure in the traffic lane, or costs related to the permanent exclusion of land from agricultural production and forestry.

In the tariff of PGE Dystrybucja S.A. RES fee was also introduced. That fee – due to the amendments to the RES Law – came into force as from July 1, 2016.

#### Tariff for heat

Pursuant to the Energy Law, Energy companies holding concessions set tariffs for heat and propose their duration. Tariff is subject to approval of the President of the Energy Regulatory Office, if it is consistent with rules and regulations. Detailed rules for tariffs determination are defined in the Regulation of the Polish Minister of Economy on detailed rules for

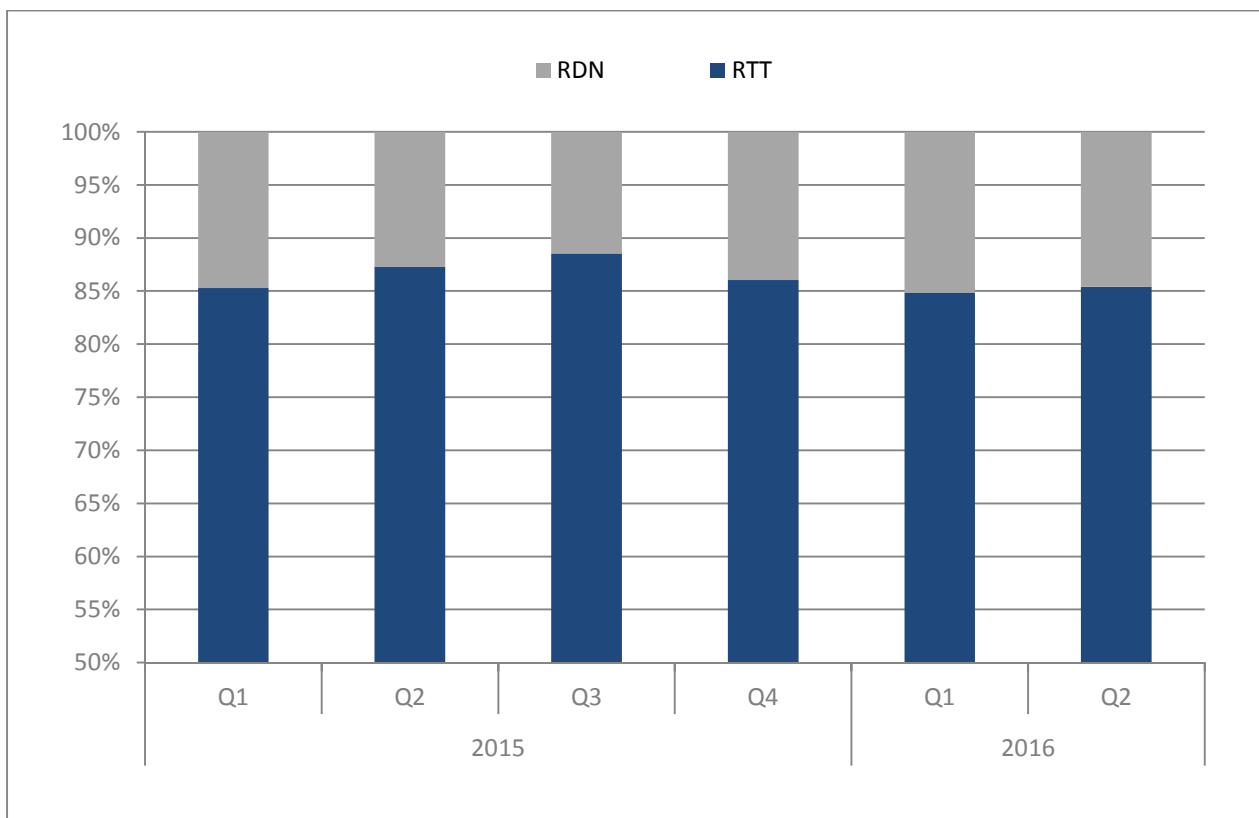
calculation of tariffs and on settlements with regard to heat supply. Conduction of proceedings concerning heat tariffs approval lies within the competence of regional Branches of the Energy Regulatory Office.

#### 1.2.4 Electricity prices

##### Domestic market – trading volumes

Trading volume on electricity on the day-ahead market of Towarowa Giełda Energii S.A. (TGE – Polish Power Exchange) in the first half of 2016 increased by 10% y-o-y. The trading volumes on the futures market (RTT) increased by 0.5% compared to the first half of 2015. Total combined trading volume for the day-ahead market and RTT increased by 2 % compared to the first half of 2015, reaching 95.5 TWh. This means that TGE trading volumes exceeded domestic electricity consumption, which amounted to 81.6 TWh - according to PSE S.A.

Chart: Quarterly trading volumes on the day ahead market (RDN) and futures market (RTT) in 2015-2016.



Source: TGE

##### Domestic market - Prices

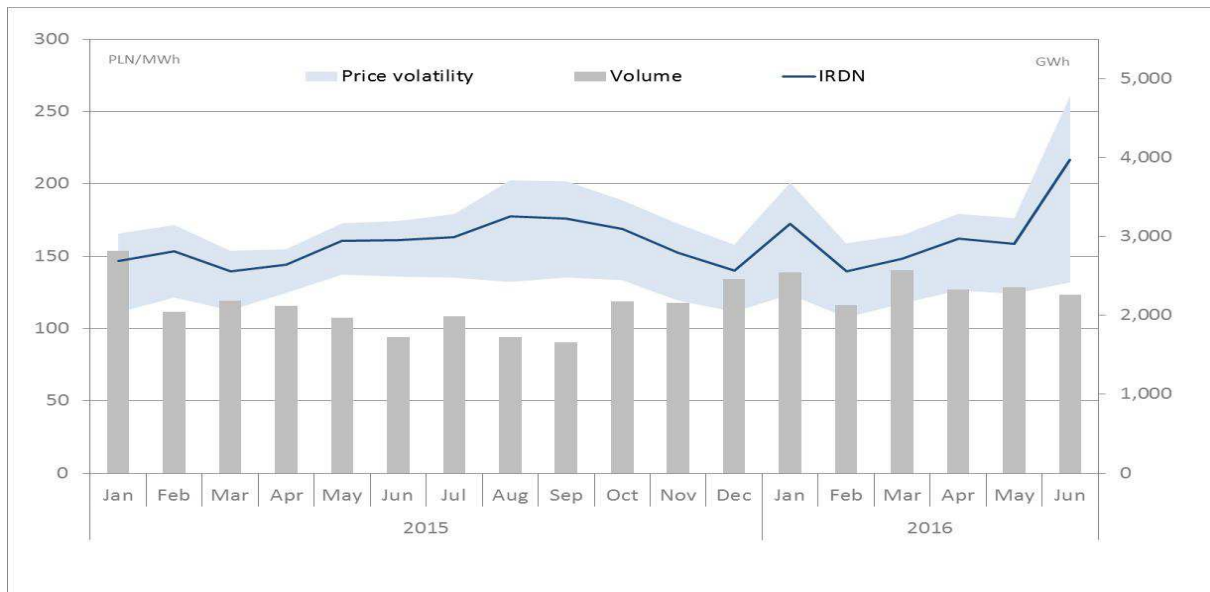
###### Day-ahead market

In the first half of 2016, prices on the day-ahead market showed a rising tendency. The average price in the first half of 2016 on the day-ahead market ("IRDN index") was PLN 166/MWh, compared to PLN 150/MWh in the previous year. The higher average price for the whole half-year resulted mainly from:

- Changes in the structure of supply resulting from a lower availability of lignite-fired units that caused a rise in production from units with higher variable cost and therefore a higher market price.
- Increase in domestic consumption of energy in the first half of 2016 by 2.1% y/y.

The uptrend in electricity prices on the day-ahead market in the first half of 2016 was also caused by a seasonal factor – lower wind generation in springtime compared to wintertime.

Chart: Monthly prices and price volatility at the day ahead market in 2015–2016 (TGE)\*.

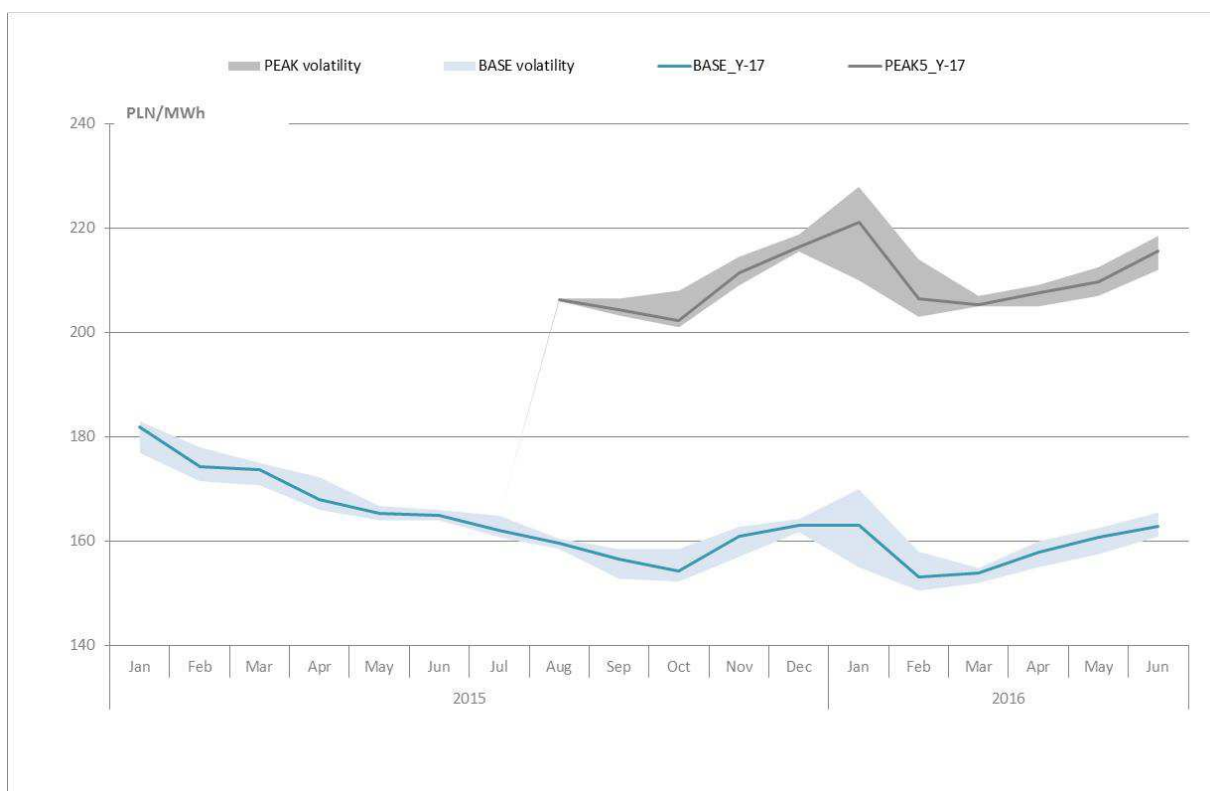


\* arithmetic average monthly price from all power exchange transactions concluded at the session (IRDN) and prices spread (comparison of average monthly price of peak contracts sIRDN and off-peak offIRDN).

### Futures market

In the first half of 2016, the average price of annual contracts BASE Y-17 was PLN 159/MWh, down 6% from the same period last year. From February to June 2016, the futures market was trending up, which was correlated with higher indexes of fossil fuel prices globally – particularly higher indexes of ARA coal prices. The average price for the BASE Y-17 contract in the second quarter of 2016 was PLN 161/MWh, compared with PLN 157/MWh in the first quarter of 2016. In year-on-year terms, the average price in the second quarter of 2016 was 3% lower. Average peak contract price (PEAK Y-17) was PLN 210/MWh in the first half of 2016 and was by 2% lower compared to the first half of 2015.

Chart: Monthly prices and price volatility on the futures market in 2015-2016 (TGE)\*.



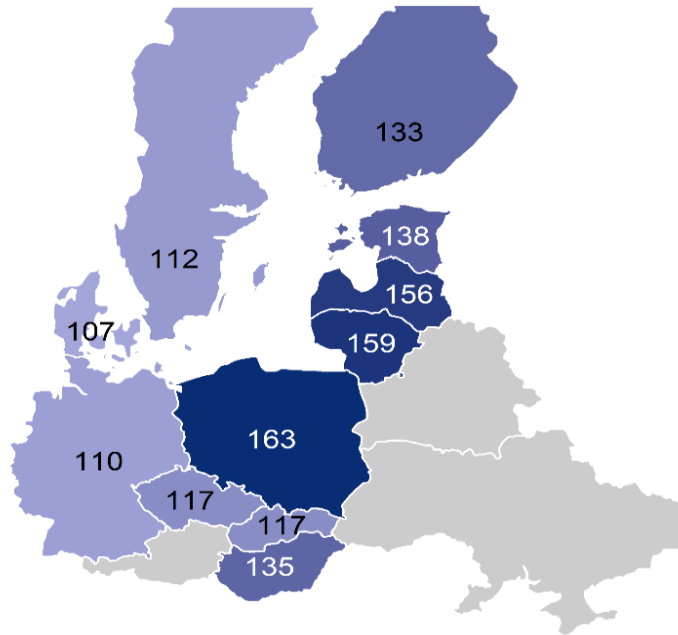
\* arithmetic average monthly price from all transactions ( PEAK volatility – difference between maximum and minimum price in a given month in peak contracts, BASE volatility – difference between maximum and minimum price in a given month in base contracts).

### International markets

#### Wholesale market

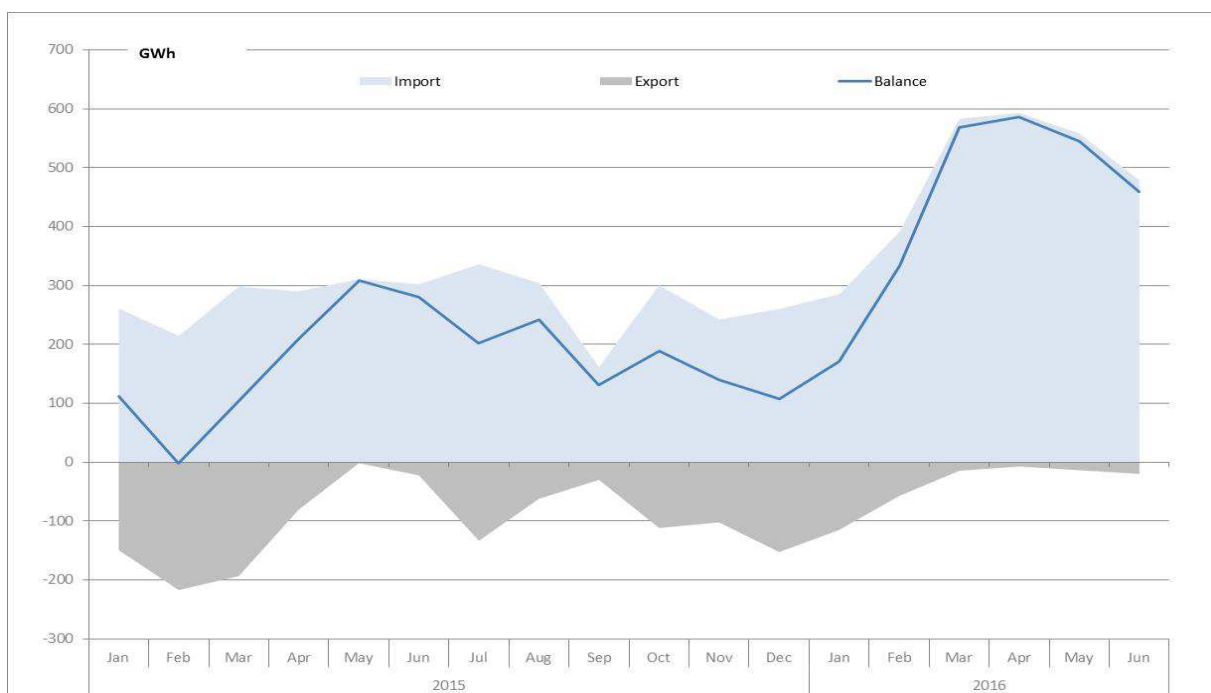
In the first half of 2016, wholesale energy prices in Poland were some of the highest in Europe, resulting in a substantial excess of imports over exports.

Chart: Comparison of average prices on Polish market and on selected European markets in the first half of 2016 (prices in PLN/MWh).



Source: TGE, EEX, EPEX, Nordpool, OTE a.s., PXE

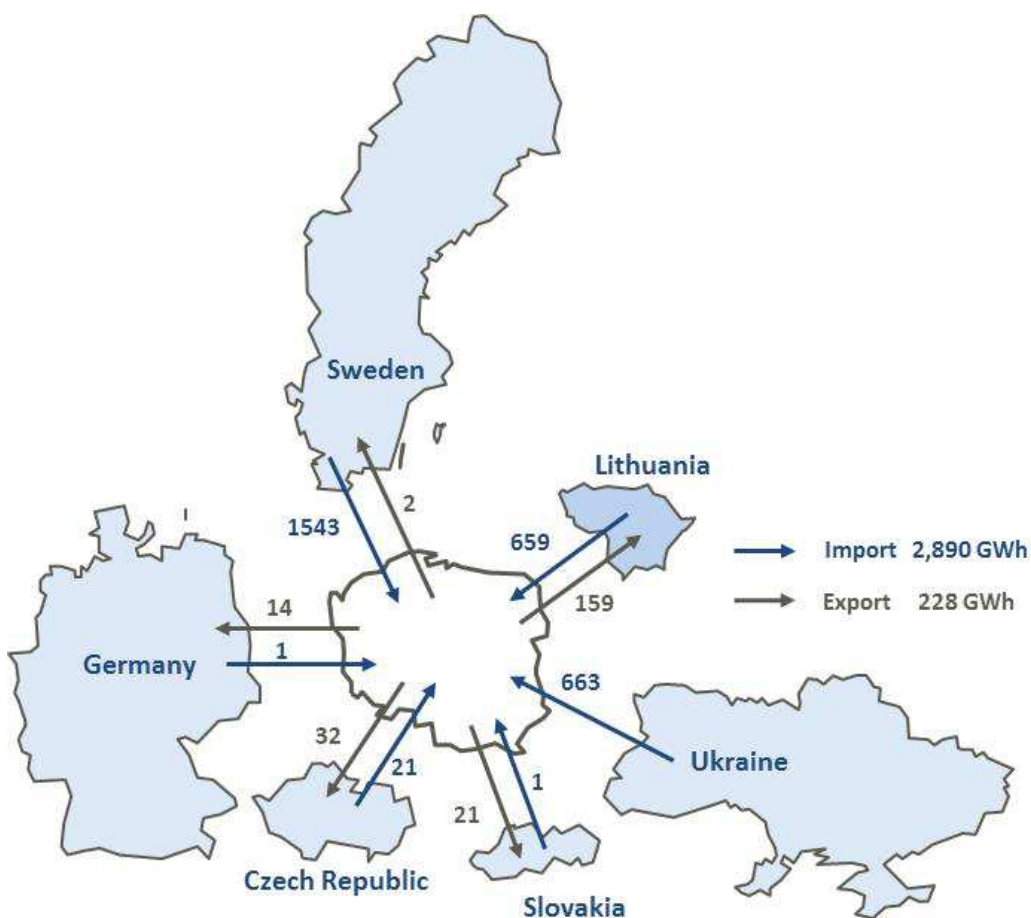
Chart: Monthly imports, exports and cross-border exchange balance in 2015-2016.



Source: own work based on PSE data.

The balance of commercial cross-border exchange in the first half of 2016 was 2.66 TWh, denoting growth by 163% from the same period last year. During this period, net imports covered 3.3% of national energy consumption. The total import volume in the first half of 2016 was 2.89 TWh, nearly 13 times the export volume, which reached 0.23 TWh. Poland's commercial exchange balance in the first half of 2016 was mainly affected by connections with three countries which were net import sources: Sweden 1.54 TWh, Ukraine 0.66 TWh and Lithuania 0.50 TWh. The flow of energy from the east and northeast was of key importance on year-on-year dynamics (in the first half of 2015, no flows were recorded from Ukraine and Lithuania, while net import from Sweden remained at a similar level, reaching 1.65 TWh). Net energy exports to Germany, Czech Republic and Slovakia in the first half of 2016 reached a total of 0.04 TWh, compared with 0.64 TWh in the same period last year – the year-on-year decline resulted from a loss of pricing advantage in morning and evening hours, which the Polish market enjoyed in the first half of last year.

Diagram: Geographical structure of commercial exchange in the first half of 2016 (GWh).



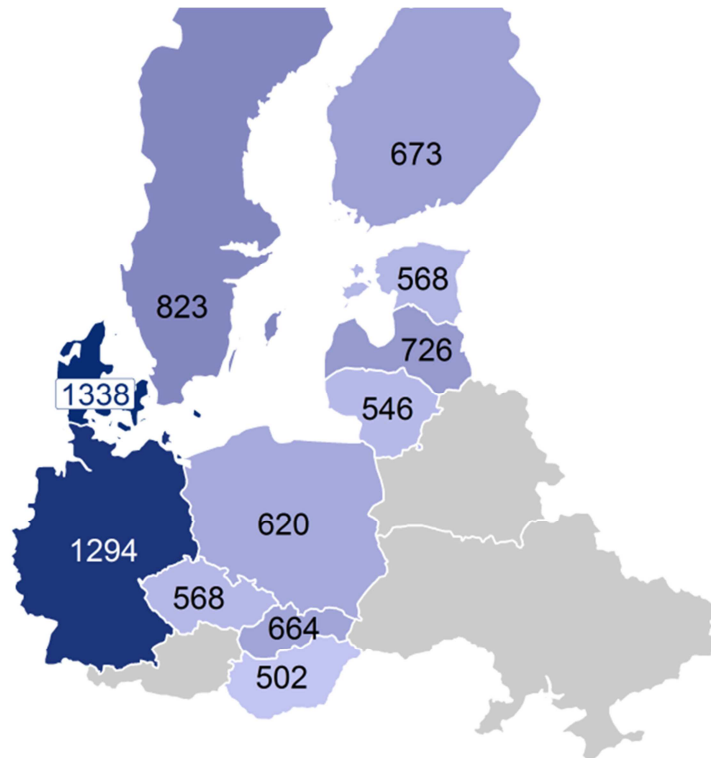
Source: own work based on PSE data

### Retail market

The diversity of electricity prices for retail customers in the European Union depends not only on the level of the wholesale prices of electricity. The fiscal system, regulation mechanisms and support schemes in particular countries all have significant impact on the final price of electricity. In Poland in the second half of 2015, an additional burden for individual customers accounted for 22% of the electricity price, compared to the EU average of 29%. In Denmark and Germany the proportion of additional charges in the price of electricity exceeded 50%.

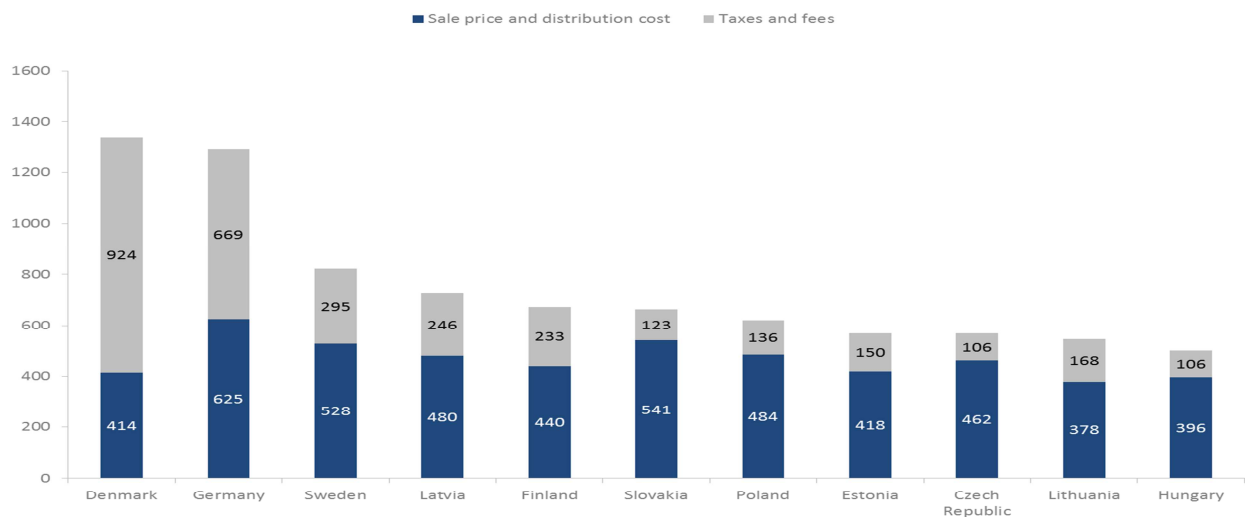


Diagram: Comparison of average electricity prices for individual customers in selected EU countries in the second half <sup>1</sup> of 2015 (prices in PLN/MWh). Prices include the costs of electricity distribution.



Source: own work based on Energy prices in the EU. Eurostat, the statistical office of the European Union. EUR/PLN 4.40

Diagram: The share of additional charges in electricity prices for the individual customers in selected EU countries in the second half of 2015 (prices in PLN/MWh, calculated with average quarterly exchange rate EUR/PLN 4.40)



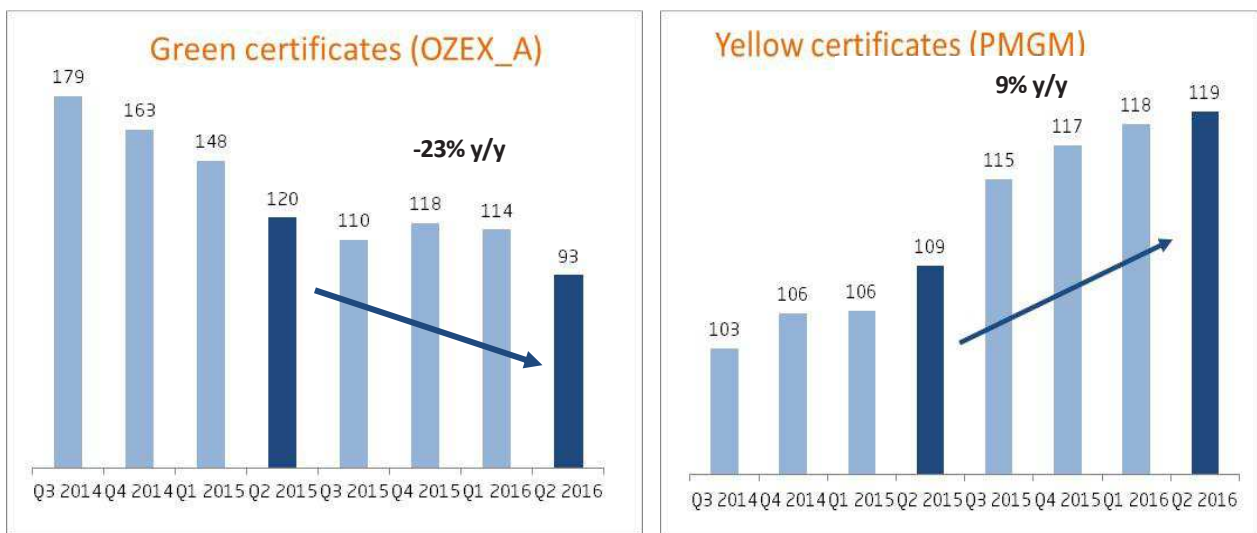
<sup>1</sup> Eurostat data are published after the end of the half-year. During preparation of this report, the second half of 2015 was the latest period in the Eurostat database.

### 1.2.5 Prices of property rights

Of key significance to PGE Group's financial results are property rights from renewable energy sources (OZEX\_A) and yellow cogeneration property rights (PMGM). In the first half of 2016, the average price of green certificates reached PLN 103/MWh and was 23% lower y-o-y, reflecting higher electricity production from renewable sources and therefore a growing supply of green certificates. Over the first half of 2016 a downward trend was observed: average price in the second quarter of 2016 amounted to PLN 93/MWh, and was lower by PLN 21/MWh in comparison to the first quarter of a current year. The prices of green certificates remained at a substantially lower level than the substitute fee established for 2016 at PLN 300/MWh.

The average price of yellow certificates grew by 9% y-o-y to PLN 119/MWh (substitute fee: PLN 125/MWh).

Chart: Average quarterly prices green and yellow certificates (in PLN/MWh).



Source: Own work based on TGE quotations

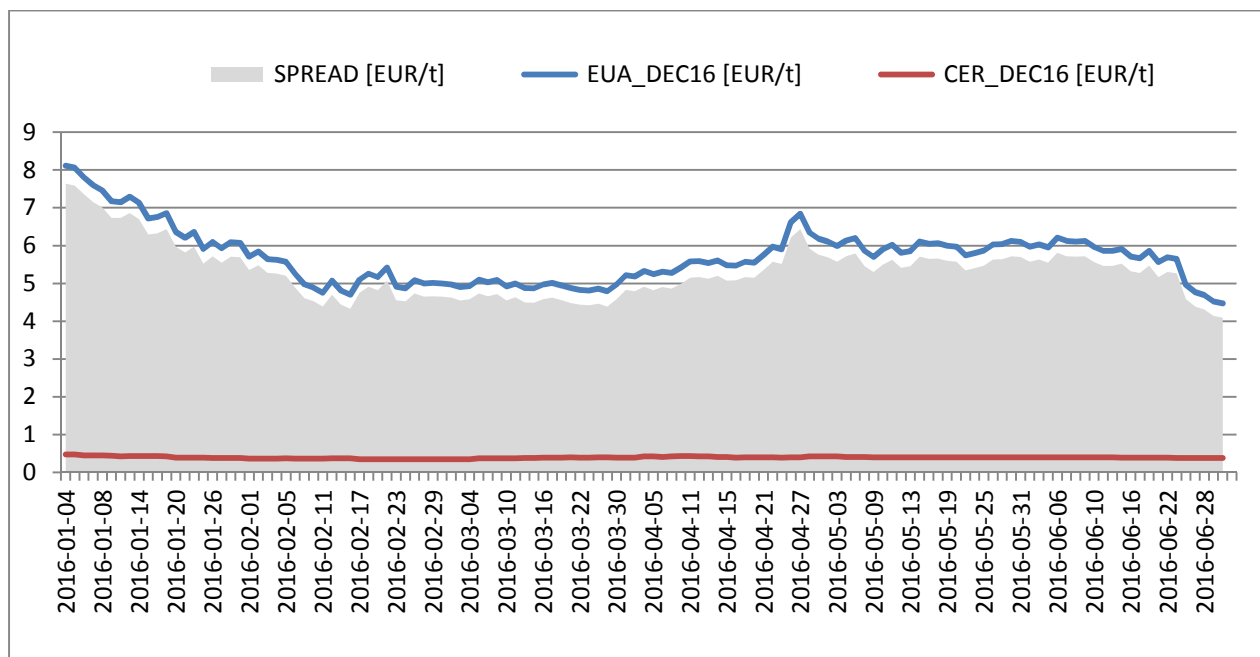
### 1.2.6 Prices of CO<sub>2</sub> emission rights

Two types of emission rights are available on the market – European Union Allowances (EUA) and Certified Emission Reductions (CER). CER-type rights may be redeemed by business operators only to a limited extent, in settlement period 2013-2020 up to 11% of the allocations granted under the National Allocation Plan for years 2008-2012.

In the first half of 2016, the prices of EUAs were priced at average of EUR 5.71/t, including the substantial decline in the first quarter, mainly as a result of lower commodity prices on highly correlated markets, i.e. crude oil, gas, coal and electricity in Germany and increasing of volume intended for auctions in 2016. The first half of 2016 saw allocation of free-of-charge CO<sub>2</sub> emission allowances for 2015 and publication by the European Commission of data regarding levels of greenhouse gas emissions from installations covered by the EU ETS. In the second quarter, a trend reversal was observed along with a slight increase in prices as well as a rebound on commodity markets.

At the end of June 2016, a record price decline took place. This was accompanied by turbulence in financial markets following the Brexit referendum in the U.K.

Chart: Prices of CO<sub>2</sub> emission rights in the first half of 2016.



Source: own work based on the data from Intercontinental Exchange (ICE) - settlement prices

In the first half of 2016, future EUA prices for December 2016 were priced in range EUR 4.47-8.11/tonne. In the same period, CERs in future contracts with delivery in December 2016 were priced in range EUR 0.35-0.47/tonne.

Work on revision of the EU Emissions Trading System (EU ETS) directive is on-going. The new legal regulations concern the next settlement period, i.e. after 2020. The final version of the directive is to be published at the beginning of 2017.

### 1.2.7 Emission rights granted free of charge for years 2013-2020

The Regulation of the Council of Ministers, that sets the allocation of allowances for particular units of electricity producers in period 2013-2020, was adopted on April 8, 2014. Analogically, allocations of allowances for heat producers were set by the Regulation of the Council of Ministers of March 31, 2014.

PGE's installations accounts were credited with free allowances for heat for 2016 and energy for 2015, while free allowances for electricity for 2016 will be received by the Group by the end of April 2017, after verification of reports from investments submitted to the National Investment Plan.

At the same time, redemption of emission rights resulting from CO<sub>2</sub> emissions in 2015 was completed in April 2016.

The table below presents data on Emission of CO<sub>2</sub> from major Group installations in the first half of 2016 in comparison to allocation of CO<sub>2</sub> emission rights for 2016.

Table: Emission of CO<sub>2</sub> from major Group installations in the first half of 2016 in comparison to allocation of CO<sub>2</sub> emission rights for 2016 (in tonnes).

Operator	CO <sub>2</sub> emissions in H1 2016*	Allocation of CO <sub>2</sub> emission rights for 2016**
Bełchatów Power Plant	15,682,875	10,282,843
Turów Power Plant	3,766,405	4,137,453
Opole Power Plant	2,998,641	2,377,219
ZEDO	2,453,975	1,949,023
Bydgoszcz CHPs	409,619	442,383
Lublin Wrotków CHP	320,894	257,020
Gorzów CHP	226,069	201,665
Rzeszów CHP	170,876	107,381
Kielce CHP	105,378	83,196
Zgierz CHP	90,112	32,763
<b>TOTAL</b>	<b>26,224,844</b>	<b>19,870,946</b>

\* estimates, emissions not verified - the data will be settled and certified by the authorised verifier of CO<sub>2</sub> emission on the ground of yearly reports of volume of CO<sub>2</sub> emissions

\*\* amount of granted CO<sub>2</sub> emission rights will be confirmed in the Regulation of the Council of Ministers in the first quarter of 2017

### 1.2.8 Termination of long-term contracts (LTC)

Due to the termination of LTCs in accordance with the LTC Act, the producers being earlier the parties to such contracts obtained a right to receive compensations for the coverage of so called stranded costs. Stranded costs were capital expenditures resulting from investments in generating assets made by the generator before May 1, 2004 that a generator is not able to recoup from revenues obtained from sales of generated electricity, spare capacity and ancillary services in a competitive environment after early termination of LTC. The LTC Act limits the total amount of funds that may be paid to all generators to cover stranded costs, discounted as at January 1, 2007, to PLN 11.6 billion, including PLN 6.3 billion for PGE.

Table: Key data relating to PGE Group generators subject to the LTC Act.

<b>Generator</b>	<b>LTC maturity</b>	<b>Maximum amount of stranded and additional costs (in PLN million)</b>
Turów Power Plant	2016	2,571
Opole Power Plant	2012	1,966
ZEDO	2010	633
Lublin Wrotków CHP	2010	617
Rzeszów CHP	2012	422
Gorzów CHP	2009	108
<b>TOTAL</b>		<b>6,317</b>

In the period provided for by the LTC Act, i.e. till December 31, 2007, PGE S.A. signed LTC termination agreements with generators being parties to the then applicable LTCs. Therefore generators obtained a right to receive funds to cover their stranded costs.

The impact of LTC compensations on results achieved by the PGE Group is described in note 24.1 to the consolidated financial statements and in p. 6.9 of this report.

## 2 Strategy of the PGE Capital Group for years 2014 - 2020 and key activities in the first half of 2016

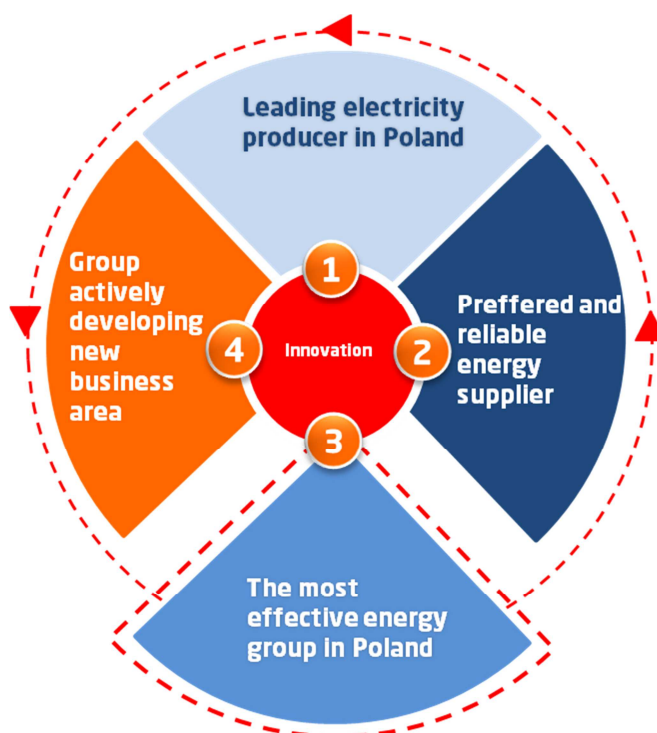
Market and regulatory environment is currently subject to constant changes, which require PGE Group to verify its strategy through prioritisation and potential correction of key aspirations and strategic activities.

In particular, it is required to accelerate restructuring initiatives and efficiency improvement in operations of the whole organisation that are necessary for faster diversification of the Group's generation fleet. The Company analyses its development plans in the context of the market situation and maximization of the CAPEX and OPEX efficiency.

Main areas of analyses are:

- Investment and modernization program
- M&A activities and restructuring
- Optimising of organizational structure and efficiency improvement programs

Diagram: Strategic aspirations of PGE Capital Group.



### Leading electricity producer in Poland

In order to strengthen the leading position in electricity generation in Poland, PGE Group strategy assumes significant spending in 2016-2020 for replacement, modernisation and construction of new generation assets. Review of the investment and modernization program is one of the key elements in the process of updating aspirations and strategic actions of the PGE Capital Group.

#### Key actions in this field include:

- Modernisation and construction of highly efficient conventional units based on domestic fuel resources. By 2019 commissioning of two new highly efficient hard coal units in Opole power plant and by 2020 lignite-fired unit Turów power plant with a total capacity of approx. 2,290 MW.
- Development of cogeneration in connection with the long-term support scheme. Currently, PGE Group is at the advanced stage of execution of 138 MWe co-generation project of CCGT unit in Gorzów CHP and started realisation of the waste incineration plant in Rzeszów CHP (Notice to Proceed issued in April 2016). Development of further projects is conditional upon long-term support system implementation.
- Diversification of generation portfolio through implementation of zero-carbon investments (nuclear, RES) in business models ensuring their economic predictability. PGE Group intends to continue developing project of construction of first Polish nuclear power plant and developing new capacities in wind power plants. Construction of the first nuclear power plant is the key investment lowering the carbon intensity of generation portfolio of PGE Group, however development of the long-term support system is necessary for

further project development with account taken to project financing and interest of the off-takers. Application for the "fundamental decision" to be issued will be possible at the break of 2019 and 2020 based on the form of support system and results of the integrated proceeding. In 2015 PGE finished construction of wind farms Karwice, Gniewino Lotnisko, Resko II and Kisielice II and thanks to that, currently has 529 MW installed capacity in wind farms. Construction or acquisition of other RES projects will be dependent on the shape of RES support system i.e. detailed regulations, which will be included in the implementing regulation to the RES Law of February 20, 2015 and will have significant impact on potential for creating the PGE Group's value in the Renewable Energy segment.

- Maintaining a position of leading operator of the regulatory assets. PGE expands and modernises regulatory assets to fully utilise their potential of cooperation with PSE S.A. Further investments are planned until 2020 to assure highest operating standards and uninterrupted availability of assets.
- Provision of resource base for conventional generation as a strategic option for future growth depending on the direction of EU climate policy. Projects for obtaining concession for lignite extraction from Żłoczew deposit and obtaining concession for lignite extraction from Gubin deposit are currently at the stage of obtaining the required administrative permits. Exploitation of lignite deposits will be considered within the development strategy of the whole generation portfolio.

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### Key projects in the first half of 2016

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Construction of new units in Opole power plant	<ul style="list-style-type: none"> <li>● construction of two power units of 900 MW each</li> <li>● budget: approx. PLN 11 billion (net, without costs of financing)</li> <li>● capital expenditures incurred: approx. PLN 5.0 billion</li> <li>● <b>fuel:</b> hard coal</li> <li>● <b>net efficiency:</b> 45.5%</li> <li>● <b>contractor:</b> syndicate of companies: Rafako, Polimex-Mostostal and Mostostal Warszawa; main subcontractor: Alstom</li> <li>● commissioning: unit 5 – H2 2018; unit 6 – H1 2019</li> <li>● January 31, 2014 – issue of Notice to Proceed</li> <li>● status: continuing construction of pressure parts of boiler no. 5 and steel structure of turbine halls of boiler and unit no. 6, concrete coating for cooling tower no. 6 is progressing; Overall progress of the works as of the end of June 2016 exceeded 50%</li> </ul>
Construction of new unit in Turów power plant	<ul style="list-style-type: none"> <li>● construction of power unit with a capacity of 490 MW</li> <li>● budget: approx. PLN 4 billion (net, without costs of financing)</li> <li>● capital expenditures incurred: approx. PLN 0.14 billion</li> <li>● <b>fuel:</b> lignite</li> <li>● <b>net efficiency:</b> 43.1%</li> <li>● <b>contractor:</b> syndicate of companies: Mitsubishi-Hitachi Power Systems Europe, Budimex and Tecnicas Reunidas</li> <li>● commissioning: H1 2020</li> <li>● December 1, 2014 - issue of Notice to Proceed</li> <li>● status: project documentation development stage; reinforce, foundation and excavation works, including strengthening of soil among others</li> </ul>
Construction of new unit in Gorzów CHP	<ul style="list-style-type: none"> <li>● construction of cogeneration CCGT unit with a capacity of 138 MWe and 88 MWt</li> <li>● budget: approx. PLN 607 million (net, without costs of financing)</li> <li>● capital expenditures incurred: approx. PLN 310 million</li> <li>● <b>fuel:</b> local nitrogen-rich gas or methane-rich gas (Group E)</li> <li>● <b>overall net efficiency:</b> 84%</li> <li>● <b>contractor:</b> Siemens</li> <li>● commissioning: H2 2016</li> <li>● October 3, 2013 - issue of Notice to Proceed</li> <li>● status: project in advanced stage; finishing works are carried out, reception of equipment and technological systems and commissioning works are ongoing</li> </ul>

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Construction of a Thermal Processing Installation with Energy Recovery at Rzeszów CHP

- construction of a thermal processing installation with energy recovery at Rzeszów CHP with capacity of approx. 8 MWe in condensation (approx. 4.6 MWe +16.5 MWt in co-generation)
- budget: approx. PLN 293 million (net, without costs of financing)
- capital expenditures incurred: approx. PLN 3.5 million
- **fuel:** municipal waste
- **boiler's efficiency:** 86%
- **contractor:** Aster Resovia TM.E.S.p.A. Termomeccanica Ecologia
- commissioning: H1 2018
- Agreement with the Contractor signed on December 22, 2015, Notice to Proceed issued on April 8, 2016
  
- status: stage of project works, completed demolition of cubature buildings, excavation works for the main unit's elements are ongoing

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Investments in renewable energy sources

**Gniewino Lotnisko wind farm**

- budget: approx. PLN 516 million (net, without costs of financing)
- capacity: 90 MW (30 turbines with a capacity of 3 MW)
- June 2014 – contract for supply of wind turbines (Alstom)
- August 2014 – contract for construction works (CJR)
- status: investment completed, occupancy permit obtained in December 2015, concession for electricity generation obtained in January 2016

**Kisielice II wind farm**

- budget: approx. PLN 79 million (net, without costs of financing)
  - capacity: 12 MW (6 turbines with a capacity of 2 MW)
  - January 2015 – turnkey contract for construction of the wind farm (Mega)
  
  - status: investment completed, occupancy permit obtained in December 2015, concession for electricity generation obtained in February 2016
- 

Total installed capacity in PGE Group's wind farms currently amounts to **529 MW**.



Modernisation and  
replacement  
projects

**Comprehensive modernization of units 7-12 - Bełchatów power plant**

- **Project's objective:** to extend the life-time of the units up to 320 ths. hours which enables utilization of existing lignite resources
- boosting the efficiency of the units by approx. 2 p.p.
- budget: approx. PLN 4.6 billion (net, without costs of financing)
- work progress: units no. 7, 8, 11 and 12 commissioned, trial run of unit no. 9 completed, unit no. 10 – synchronised with NPS, adjustment operation commenced
- fuel: lignite
- Completion: 2017

**Modernization of desulphurization installations for units 3-12 - Bełchatów power plant**

- **project's objective:** to decrease the SO<sub>2</sub> emission level to the level required in IED ( $\leq 200$  mg/Nm<sup>3</sup>)
- budget: ca. PLN 156 million (net, without costs of financing)
- work progress: completion of all on-site works
- fuel: lignite
- completion: 2016

**Change in technology of furnace waste storage for units 1-12 – Bełchatów power plant and construction of installation to transport ash; production and transport of sludge from unit 14 in Bełchatów power plant**

- **project's objective:** to provide the capability for storage of furnace waste produced during the operation of units 1-12 of Bełchatów power plant until exhaustion of lignite resources. In the course of the project, the requirement to fit out unit 14 with new technology for the transport and storage of combustion waste was identified.
- budget for units 1-12: ca. PLN 456 million (net, without costs of financing)
- budget for unit 14: ca. PLN 91 million (net, without costs of financing)
- completion: 2018

**Reduction of NO<sub>x</sub> emission - units 1, 2 and 4 Opole power plant**

- **project's objective:** to decrease the NO<sub>x</sub> emission level from boilers of units no. 1, 2 and 4 to standard required in IED ( $\leq 200$  mg/Nm<sup>3</sup>).
- work progress: completed works connected with construction of NO<sub>x</sub> reduction installation and commissioning of installation. Optimisation of installation on unit no. 2 is ongoing.
- budget: ca. PLN 148 million (net, without costs of financing)
- fuel: hard coal
- completion: 2016

**Construction of desulphurization installations for units 4-6 – Turów power plant**

- **project's objective:** to decrease the SO<sub>2</sub> emission level to standard required in IED ( $\leq 200$  mg/Nm<sup>3</sup>).
- work progress: commissioning of FGD installation
- budget: ca. PLN 530 million (net, without costs of financing)
- fuel: lignite
- completion: 2016

**Construction of overburden line in Bełchatów Lignite Mine (Szczerców Field)**

- **project's objective:** to increase the mine extraction capacity enabling to cover lignite needs of Bełchatów power plant
- budget: ca. PLN 100 million (net, without costs of financing)
- fuel: lignite
- completion: 2016

**Construction of flue gas denitrification installation and flue-gas desulphurisation for OP-230 boilers no. 3 and 4 in Bydgoszcz CHPs**

- **Aim of the project:** Reduction of NO<sub>x</sub> and SO<sub>x</sub> emissions from boilers no. 3 and 4 to a level allowing for further use after 2017
- budget to be determined, tender procedure ongoing
- fuel: hard coal
- completion: 2018

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#### Modernisation of the Pomorzany power plant

- **Aim of the project:** Reduction of NO<sub>x</sub> and SO<sub>x</sub> emissions from Benson OP-206 boilers to a level allowing to meet the requirements of the IED Directive and BAT conclusions as well as to ensure that the plant remains in operation until about 2040
- budget to be determined, tender procedure ongoing
- fuel: hard coal
- completion: 2019

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#### Comprehensive reconstruction and modernisation of units no. 1-3 at Turów power plant

- **Aim of the project:** Adaptation to BAT Conclusions requirements regarding permissible emissions, increase of availability and efficiency, as well as expansion of each turboset's nominal capacity by 15 MW.
- budget: PLN 826 million
- work progress: handover of main project documentation for each island by contractors
- fuel: lignite
- completion: 2020

#### Construction of flue gas desulphurisation and denitrification installations for WP-70 boilers at Lublin-Wrotków CHP

- **Aim of the project:** Adaptation of WP-70 water boilers to emission standards as per BAT Conclusions requirements for units smaller than 300 MWt.
- budget to be determined, tender procedure ongoing
- fuel: hard coal
- completion: 2018

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#### Preferred and reliable energy supplier

PGE Group reorganises the sales process based on effective trading strategy. In every customer segment the PGE Group focuses on understanding the needs of the customers and improvement of customer service quality. In particular it includes:

- corporate customers segment, PGE Group focuses on effective margin management at the Group level and on securing optimal contracts of generating units of PGE Capital Group;
- SME segment, PGE Group focuses on retention of historical customers while maintaining the margin levels, acquisition of new customers through improved customer service and expansion of product offering;
- households segment, PGE Group acquires new customers, expands product offering, lowers the service and sales costs and builds modern IT tools supporting sale processes.

In the Distribution segment, assuring reliability of supply through operational and investment efficiency is the main goal. PGE Group is committed to improve grid reliability - we intend to achieve a goal of 50% SAIDI reduction by 2020 mainly by refocusing the investment outlays on projects to the largest extent limiting the level of undelivered energy and by increasing operational performance.

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Project of  
network losses  
reduction

- **the project is intended to** reduce electricity procurement costs for balancing differences
- **activities undertaken:**
  - replacement of transformers with low-loss units
  - grid conversion and modernisation: construction of HV/MV and MV/LV stations, increase of cable cross-sections for HV, MV and LV lines, reduction of MV and LV lines
  - maintenance of optimal grid workload, elimination of adverse energy transit in HV lines, optimisation of MV line partitions, reduction of load asymmetries in LV lines.
- **the results of the project:** lowering of the balancing difference in 2015 to 5.91% (in 2014 it amounted to 6.32%); volume of balancing difference in 2015 amounted to 2.38 TWh and was lower than in 2014 by 4.4% with the simultaneous increase of volumes of energy delivered to off-takers by 2.6% in comparison to the previous year.
- **activities initiated in the first half of 2016:** project assumptions for 2016-2020 were updated in March 2016. Pursuant to the revision, activities aimed at reducing balancing differences at PGE Dystrybucja S.A. are to be continued. Level of balancing differences expected in 2016 – 5.90%.

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CRM Billing

- **the aim of the project is deployment of support systems** for settlements and customer service in PGE Obrót S.A. and PGE Dystrybucja S.A.
  - **the project will yield:**
    - improved operational performance and support tools for processes dealing with settlements and customer service
    - stronger competitive position on the back of an expanded product offering
    - improved customer service quality
  - the above objectives will be attained through the **deployment of IT tools** that support billing and settlement processes, debt collection, sales, post-sales services, CRM, customer service, exchange of metering data and information concerning technical operations
  - **activities initiated in the first half of 2016:** A procurement proceeding under public procurement law was initiated to deliver and implement a system for customer service and settlements at PGE Obrót S.A. and PGE Dystrybucja S.A. 11 requests to participate in the proceeding were received. Currently, PGE S.A. is in the final stage of evaluating the submitted applications and selecting a short list of entities which will be invited to submit proposals. The short list will be published once the tendering committee completes all of its activities. Moreover, implementation of a new eBOK/mBOK system for PGE Group clients was completed. The solution received a PayU Lab Award in the “eCustomer Experience – Energy” category.
- 

### The most effective energy group in Poland

PGE Group ambition is to be the most efficient power utility in Poland. It includes improvement of operational efficiency, dialogue with the stakeholders concerning the regulatory environment and implementation of best corporate governance practices. Key actions in this field include:

- Organisation restructuring allowing for costs reduction and revenues increase. Effects of continuation of activities relating to efficiency improvement will have a sustainable influence on EBIT of ca. PLN 1.5 billion after 2016. The target will be achieved through implementation of operational effectiveness improvement programmes in Conventional Generation and Distribution segments, reduction of grid losses and interruptions in supply in distribution and rationalization of fixed costs in Renewable Energy segment.
- Active dialogue with the stakeholders concerning the regulatory environment. In particular PGE Group will strive to guarantee economic predictability of investment projects and to create agreements with the key stakeholders who shape the regulatory environment in Poland and in the European Union.
- Implementation of best corporate governance practices regarding human resources management, business decisions support and efficiency management as well as optimization and standardisation of supporting processes.

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Human Capital  
Management  
Strategy („HCM  
Strategy”)

- **the aim of this project is supporting the business strategy goals through:**
    - **enhancing the effectiveness of human resources management**
    - **reinforcing strategic HR management**
    - **optimisation and standardisation of HR processes in terms of:** maximising the benefits through operational scale and specialisation (integration of IT tools and systems), harmonised operating standards, optimal use of resources.
  - **Activities in the first half of 2016:** works in specific business lines were completed, aimed at adopting corporate rules. During this time, works were also on-going aimed at adapting each company's lower-tier procedures and instructions to comply with the corporate rules. In the second quarter, works were also on-going on preparing HR tools in the second group of strategic initiatives. Of key importance were works connected with preparing SAP HRM, which models HR processes. In addition to that, communications activities, including change management, were continued throughout the second quarter. In June, the first editions of HR Business Partner Academy and HR and Payroll Process Management Academy were completed, with over 80 participants from the HR areas from across all business lines. The aim of these programmes was to support the development of competences of HR staff within the HR Business Partner model.
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Program SAP

● **the aim of the project is:**

- **improved operational efficiency through:** standardisation of processes within the Group, the aim of the project, optimisation of the technical assets efficiency, more efficient maintenance and development of the system
- **improved transparency through:** creation of uniform records of economic events, access to the ongoing and compact of management information, streamlining and accelerating of decision making process
- **base creation for:** creation of Shared Services Centre within PGE Group, integration of procurement system, retention of market leadership in face of stiffening competition

Within PGE Group's SAP Programme, an ERP system is being implemented in the areas of accounting, controlling, logistics ("RiL"), procurement invoice workflow („OFZ”), electronic workflow of documents („EOD”), standard audit file („JPK”), Business Process Improvement („BPI”), asset management (“AM”), human capital management (“HCM”), financial consolidation (“FC”) and SAP Fiori.

- **activities initiated in the first half of 2016:** implementation works were completed in areas of RiL, and AM in companies Ramb sp. z o.o., MegaSerwis sp. z o.o., Bestgum Polska sp. z o.o., Eltur-Serwis sp. z o.o., Elbis sp. z o.o., Betrans sp. z o.o. In July OFZ implementation for the above companies was completed and in HCM area implementation by the end of August. Implementation works for project HCM HRM Career and Development for the Group companies are carried out in HCM area, including implementation in subsidiaries of PGE S.A. and PGE GiEK S.A. In May works were commenced in EOD project in PGE Group companies, JPK project in companies PGE S.A., PGE GiEK S.A., PGE Dystrybucja S.A., PGE Energia Odnawialna S.A., PGE Obrót S.A., PGE Systemy S.A., PTS Betrans sp. z o.o., Bestgum Polska sp. z o.o., Eltur-Serwis sp. z o.o., MegaSerwis sp. z o.o., Ramb sp. z o.o., PGE Dom Maklerski S.A., Exatel S.A. A BPI pilot is being conducted at seven PGE Group companies – these are tools supporting comprehensive effectiveness management for business processes carried out via SAP. So far, implementation of SAP system encompassed 20 thousand users in areas RiL, HCM, AM, FC in all companies of PGE Group.
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### Group actively developing new business areas

PGE Group's Development and Innovation Strategy 2015-2020, adopted by the Management Board of PGE S.A. in June 2015, defines Strategic Research and Development and New Business Areas ("SOBiR+NB"), within which the Group intends to carry out R&D and innovation projects concerning, among others, the supply of new products or services. The SOBiR+NB areas are aligned with the Group's most important challenges and are identified for each element of the value chain (see the graph below). In addition, in order to scope out the technologies that are available on global markets, three working groups have been established within PGE S.A., dedicated to coal gasification technology, use of waste for electricity and heat production as well as coal enrichment technology. Characterisations and assessments of technology, carried out by teams, are currently the basis and are used for the defining of expansion projects or projects aimed at implementing solutions that are of most significance to PGE Group. Projects are launched gradually, taking into consideration their potential impact on the business and the capacity for executing them within the production environment.

MANAGEMENT BOARD'S REPORT ON ACTIVITIES OF THE CAPITAL GROUP  
OF PGE POLSKA GRUPA ENERGETYCZNA S.A. FOR THE 6-MONTH PERIOD ENDED JUNE 30, 2016



Optimisation of the mining process	Utilisation of carbon dioxide (CCU)	Prosumer photovoltaics	Smart Grid	Management of information about customers (Big Data)
Raw material treatment	Reduction of emissions (NOx, SOx, Hg, etc.),	Wind energy	Smart Meters	Smart Facility
	Improvement of generation effectiveness		Energy storage	E-mobility
	Fuel gasification			Demand management
	Micro-cogeneration			
	Nuclear energy			

## Innovation

PGE focuses on initiating and executing R&D projects that fall within the SOBiR+NB areas. In the first half of 2016, 51 projects were continued within these areas.

### Key projects in the first half of 2016

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„Power-to-Gas” concept	<ul style="list-style-type: none"><li>● <b>Aim of the project: development of energy storage technology in a “Power-to-Gas” installation,</b> consisting of the conversion of electricity surpluses, produced mainly by wind farms, into hydrogen via an electrolysis process, with potential for further use in different technological configurations. The feasibility study of construction of Power to Gas installation was developed on joint request of PGE S.A. and gas transmission operator Gaz-System S.A. Activities are currently being undertaken to develop a concept for executing a potential Power to Gas project at a selected location and in a hydrogen use scenario.</li></ul>
Cooperation with the National Centre for Research and Development ("NCBR")	<ul style="list-style-type: none"><li>● one of the <b>key assumptions</b> of the project is the use by PGE Group of public funds available in the Intelligent Development Operational Programme (POIR), where NCBR is the implementing authority</li><li>● <b>main activities:</b><ul style="list-style-type: none"><li>■ As part of works so far in 2016 intended to sign the Joint Venture Agreement, a version of the PGE – NCBR Agreement was adjusted to the new guidelines of the Operational Programme Intelligent Development, which is a financing source for part of the Joint Venture’s budget (public funds). A draft of the PGE – Contractor Agreement has been prepared, which secures the interests of both of the Parties as regards intellectual property rights concerning R&amp;D project results and establishes rules for the commercialisation of these projects’ results. Furthermore, given the changing market environment, the proposed research agenda has been modified and it will be finally verified and approved by the National Centre for Research and Development (NCBR) in the nearest future. The aim of the joint undertaking is to address the challenges facing PGE Group as the sector’s largest entity, thus increasing the level of innovativeness in PGE Group and the Polish energy sector. Agenda is being drafted on the basis of subject areas proposed by PGE S.A., which are aligned with the SOBiR+NB areas and is assumed to complement synergically with the Sectoral Program for the power sector.</li></ul></li></ul>

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### 3 Results achieved in PGE Capital Group

#### 3.1 Financial results of PGE Capital Group

Key financial data	Unit	H1 2016	H1 2015 <i>data restated</i>	% change
Sales revenues	PLN million	13,666	14,245	-4%
<b>EBIT</b>	<b>PLN million</b>	<b>952</b>	<b>-6,174</b>	-
<b>EBITDA</b>	<b>PLN million</b>	<b>3,143</b>	<b>4,228</b>	<b>-26%</b>
Net profit/loss attributable to equity holders of the parent company	PLN million	546	-5,055	-
Adjusted net profit attributable to equity holders of the parent company *	PLN million	1,267	2,144	-41%
LTC compensations	PLN million	401	301	33%
<i>Revenues from LTC compensations</i>	<i>PLN million</i>	<i>253</i>	<i>301</i>	<i>-16%</i>
<i>Adjustment of LTC settlements (other operating revenues)</i>	<i>PLN million</i>	<i>148</i>	<i>0</i>	<i>-</i>
<b>Capital expenditures</b>	<b>PLN million</b>	<b>3,690</b>	<b>3,332</b>	<b>11%</b>
Net cash from operating activities	PLN million	2,857	3,069	-7%
Net cash from investing activities	PLN million	-4,601	-4,066	-13%
Net cash from financial activities	PLN million	354	-273	-
Adjusted net earnings per share	PLN	0.68	1.15	-41%
<b>EBITDA margin</b>	<b>%</b>	<b>23%</b>	<b>30%</b>	

Key financial data	Unit	As at June 30, 2016	As at December 31, 2015	% change
Working capital	PLN million	3,036	4,126	-26%
<b>Net debt/LTM EBITDA **</b>	<b>x</b>	<b>0.62</b>	<b>0.32</b>	

\* Net profit adjusted by impairment loss

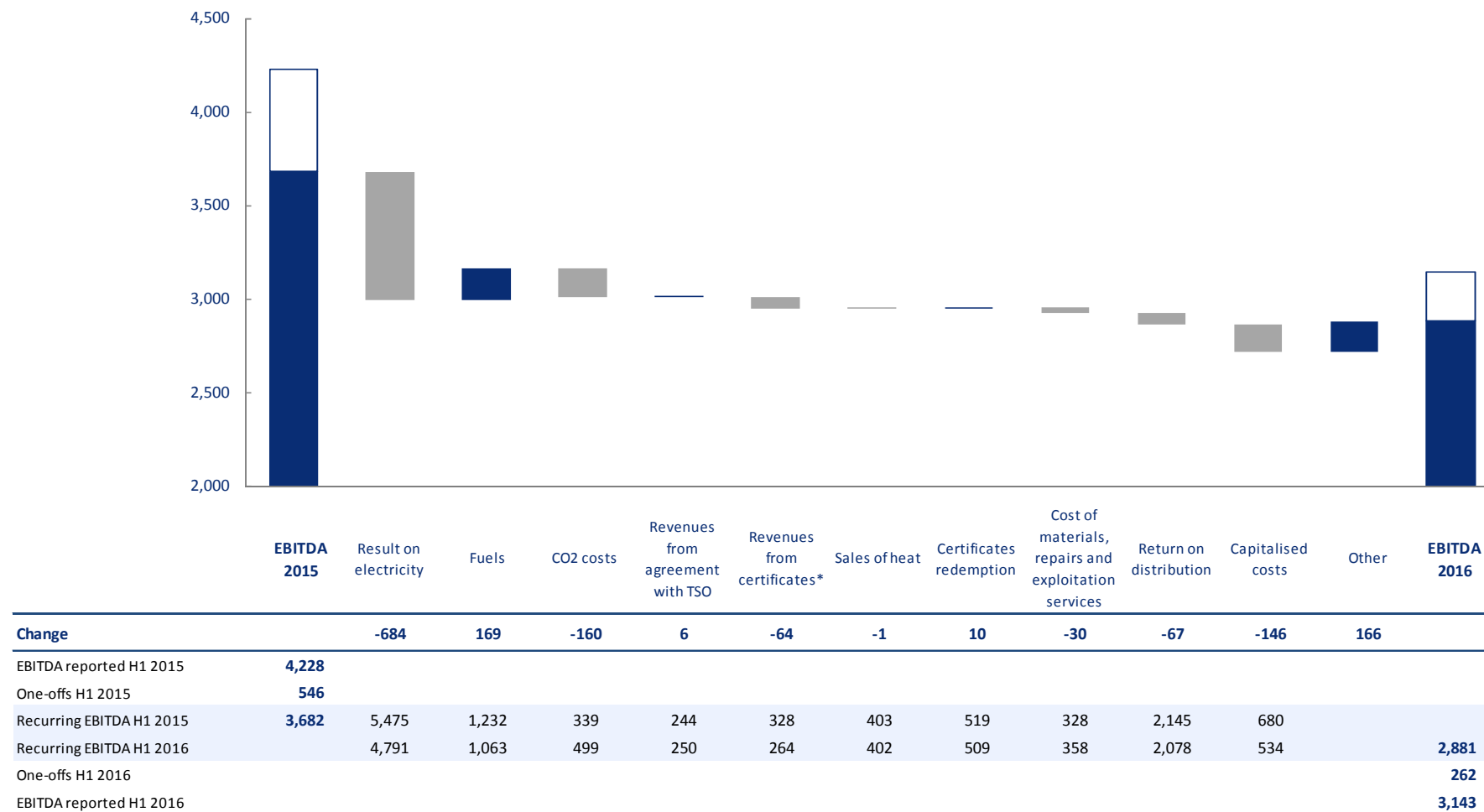
\*\* LTM EBITDA - Last Twelve Months EBITDA

Table: Impact of one-offs on EBITDA [in PLN million].

One-offs	H1 2016	H1 2015	% change
LTC compensations	401	301	33%
Change in reclamation provision	0	193	-
Change in actuarial provision	0	52	-
Revaluation of balance sheet value of property rights	-118	0	-
Voluntary Leave Program	-21	0	-
<b>Total</b>	<b>262</b>	<b>546</b>	<b>-52%</b>

### 3.1.1 Consolidated statement of comprehensive income

Chart: Key changes of recurring EBITDA in PGE Capital Group [in PLN million].

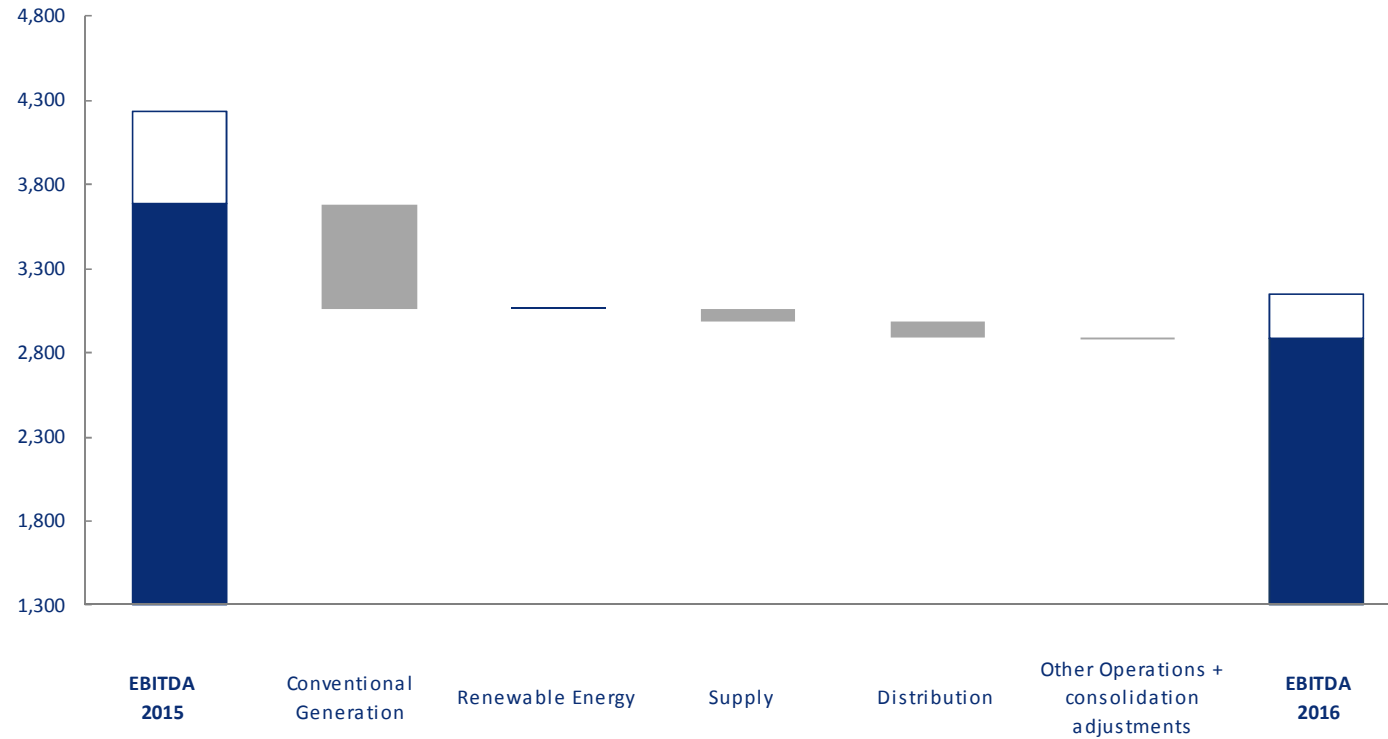


□ one-offs

\*Adjusted by the value of revaluation of certificates stock in Szczecin CHP



Chart: Key changes of recurring EBITDA by segments [in PLN million].



Change	Conventional Generation	Renewable Energy	Supply	Distribution	Other Operations + consolidation adjustments	EBITDA 2016
EBITDA reported H1 2015	2,459	202	279	1,235	53	
One-offs H1 2015	527	0	2	18	0	
Recurring EBITDA H1 2015	1,932	202	277	1,217	53	
Recurring EBITDA H1 2016	1,306	205	208	1,117	45	2,881
One-offs H1 2016	262	0	0	0	0	262
EBITDA reported H1 2016	1,568	205	208	1,117	45	3,143

□ one-offs

### 3.1.2 Consolidated statement of financial position

Chart: Key changes in Assets [in PLN million].

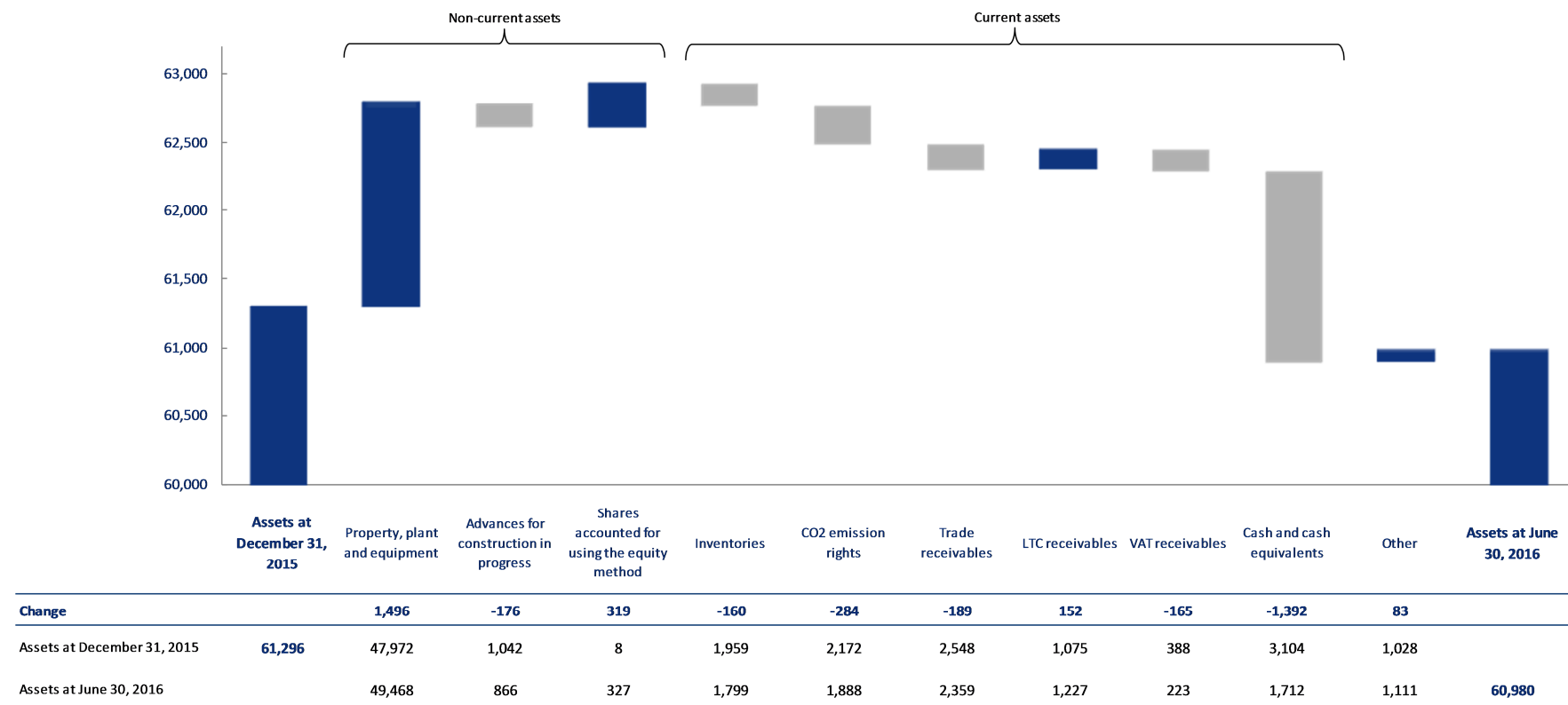
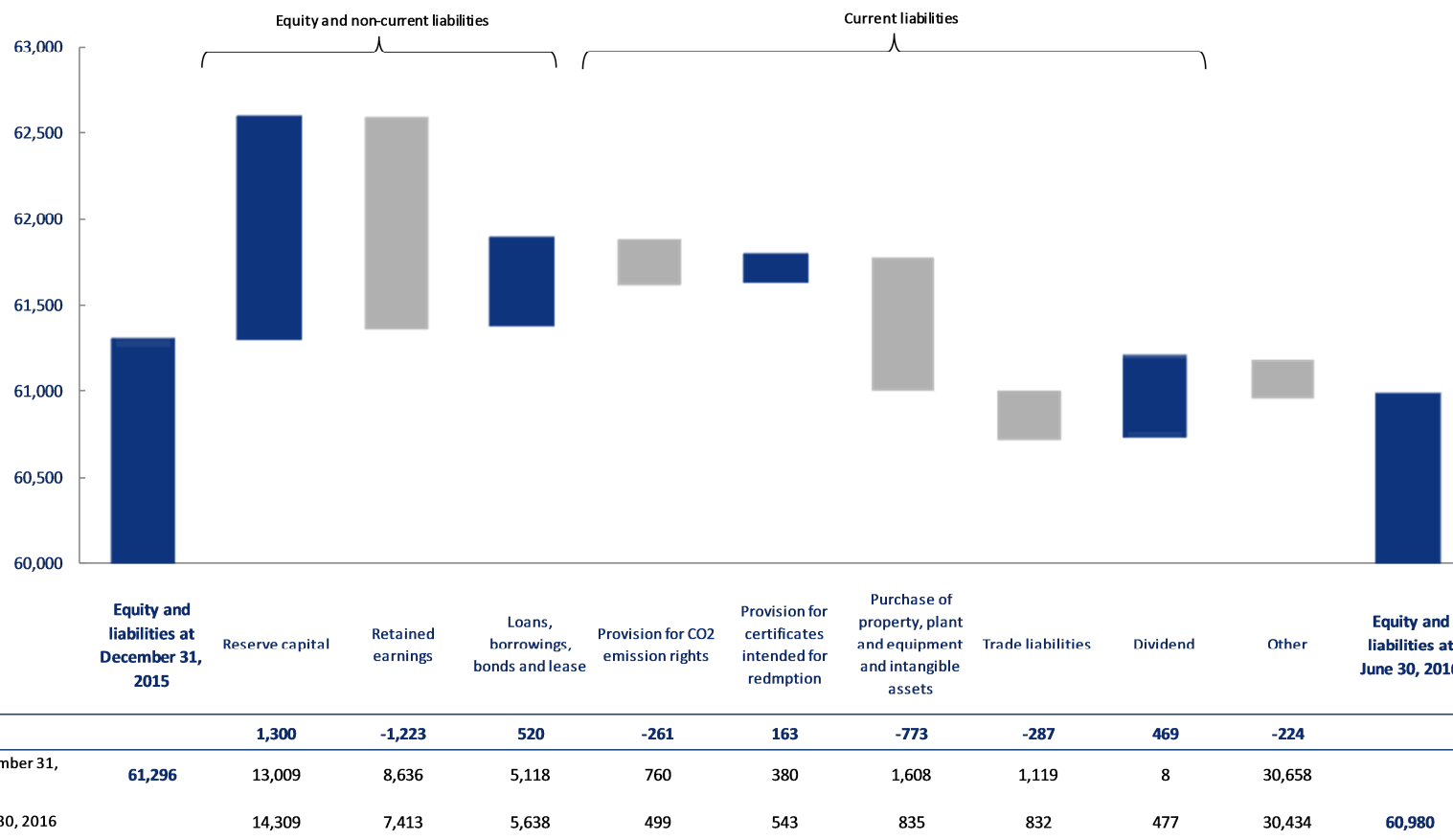
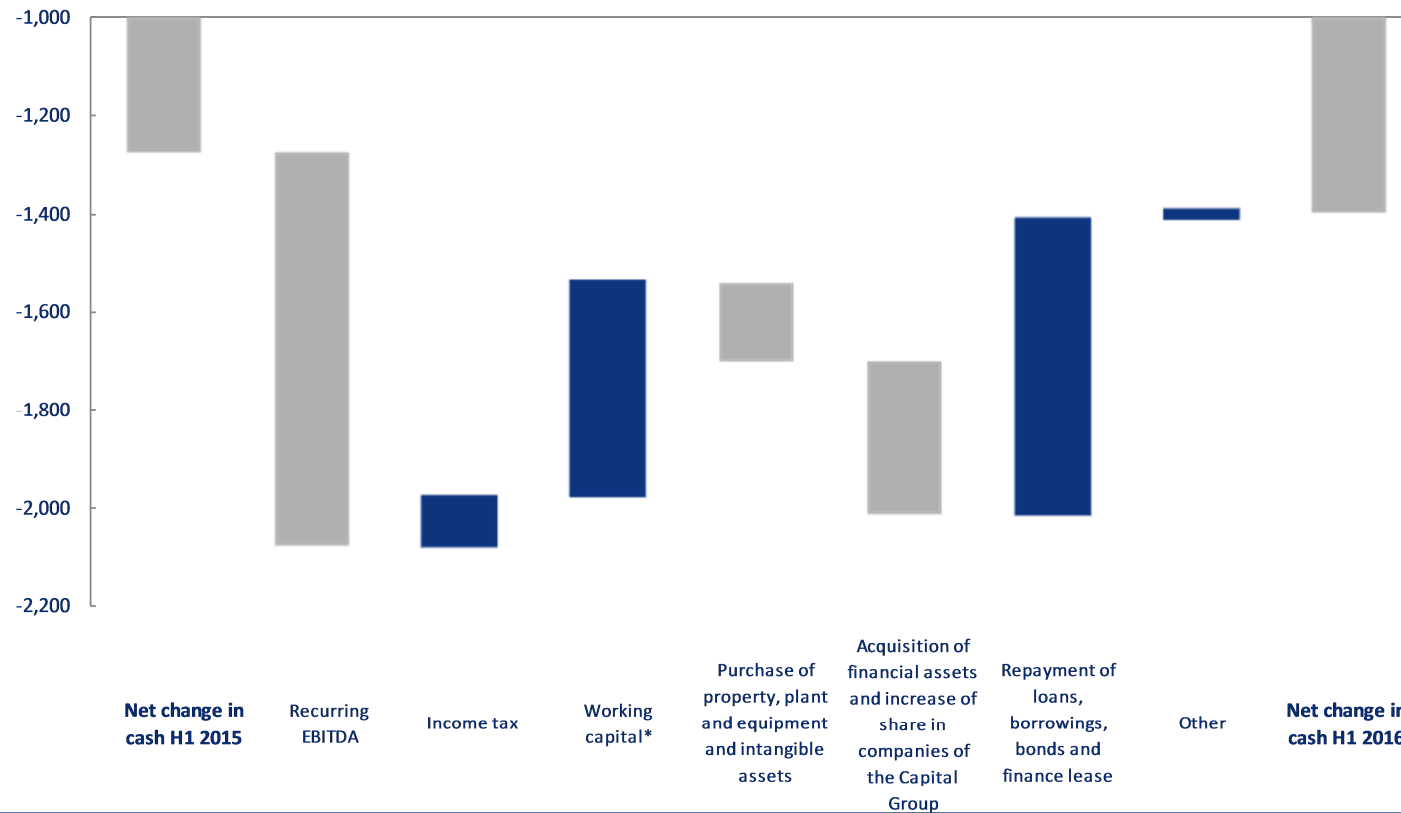


Chart: Key changes in Equity and Liabilities [in PLN million].



### 3.1.3 Consolidated statement of cash flows

Chart: Net change in cash [in PLN million].



	Net change in cash H1 2015	Recurring EBITDA	Income tax	Working capital*	Purchase of property, plant and equipment and intangible assets	Acquisition of financial assets and increase of share in companies of the Capital Group	Repayment of loans, borrowings, bonds and finance lease	Other	Net change in cash H1 2016
<b>Change</b>	<b>-1,270</b>	<b>-801</b>	<b>103</b>	<b>433</b>	<b>-162</b>	<b>-307</b>	<b>595</b>	<b>19</b>	<b>-1,390</b>
Net change in cash H1 2015	-1,270	3,682	-232	-596	-4,066	-75	-183	200	
Net change in cash H1 2016		2,881	-129	-163	-4,228	-382	412	219	-1,390

\*Part of the working capital adjusting the cash flows from operating activities

### 3.2 Operational figures of PGE Capital Group

Table: Key operational figures.

Key figures	Unit	H1 2016	H1 2015	% change	2015
Lignite extraction	Tons m	21.68	25.02	-13%	49.40
Net electricity production	TWh	25.42	27.63	-8%	55.58
Heat sales	GJ m	10.18	10.60	-4%	18.19
Sales to final customers*	TWh	21.43	19.26	11%	39.00
Distribution of electricity**	TWh	16.91	16.45	3%	33.38

\* sales by PGE Obrót S.A. with additional estimation and with taking into account the sales within PGE Group

\*\* with additional estimation

#### 3.2.1 Balance of energy of PGE Capital Group

##### Sales of electricity

Table: Sales of electricity outside the PGE Capital Group (in TWh).

Sales volume	H1 2016	H1 2015	% change	2015
<b>SALES IN TWh, including:</b>	<b>50.63</b>	<b>50.22</b>	<b>1%</b>	<b>101.70</b>
Sales to end-users*	21.46	19.27	11%	39.05
Sales on the wholesale market, including:	28.12	30.15	-7%	60.89
<i>Sales on the domestic wholesale market - power exchange</i>	25.22	28.57	-12%	57.71
<i>Other sales on the domestic wholesale market</i>	2.85	1.54	85%	3.07
<i>Sales to foreign customers</i>	0.05	0.04	25%	0.11
Sales on the Balancing Market	1.05	0.80	31%	1.76

\* after elimination of internal sales within PGE Group

The growth in sales volumes to end customers resulted mainly from having contracted additional volumes in the corporate client segment in A and C2x tariff groups. The decline in volumes sold via the power exchange is connected with decreased generation due to lower availability of the Bełchatów power plant (see p. Production of electricity). A higher sales volume on other wholesale markets was driven by performance of contracts for PSE S.A. and Enea Operator S.A. in the Conventional Generation segment. Higher sales volumes on the balancing market were due to sales under the Cold Intervention Reserve Service („IRZ”).

## Purchases of electricity

Table: Purchases of electricity from outside of the PGE Capital Group (in TWh).

Purchases volume	H1	H1	% change	2015
	2016	2015		
<b>PURCHASES IN TWh, including:</b>	<b>27.69</b>	<b>24.96</b>	<b>11%</b>	<b>50.92</b>
Purchases on the domestic wholesale market – power exchange	21.21	19.92	6%	40.54
Purchases on the domestic wholesale market, other	2.39	1.96	22%	3.99
Purchases from abroad	0.04	0.02	100%	0.03
Purchases from Balancing Market	4.05	3.06	32%	6.36

Increased purchases on the domestic wholesale market – power exchange was caused by increased purchases pursued by Supply segment in order to sell to the final customers. Higher purchase volume was also recorded on other wholesale market what is a result of increased purchase on local market from Połaniec power plant executed by PGE Obrót S.A. Higher purchase volume on the balancing market is a consequence of balancing the contracted sale, purchase and generation.

## Production of electricity

Generation volume	H1	H1	% change	2015
	2016	2015		
<b>ENERGY GENERATION IN TWh, including:</b>	<b>25.42</b>	<b>27.63</b>	<b>-8%</b>	<b>55.58</b>
Lignite-fired power plants	16.85	19.61	-14%	38.98
<i>including co-combustion of biomass</i>	0.00	0.21	-	0.34
Coal-fired power plants	5.47	5.14	6%	11.04
<i>including co-combustion of biomass</i>	0.18	0.22	-18%	0.43
Coal-fired CHP plants	0.53	0.67	-21%	1.30
Gas-fired CHP plants	1.31	1.10	19%	2.05
Biomass-fired CHP plants	0.24	0.23	4%	0.46
Pumped storage power plants	0.26	0.22	18%	0.57
Hydroelectric plants	0.24	0.27	-11%	0.36
Wind power plants	0.52	0.39	33%	0.82

Generation level in the first half of 2016 in comparison to the first half of 2015 was mainly affected by **lower generation in lignite-fired power plant**. Decline in production in Bełchatów power plant results from working time of unit no. 1 limited to 1,500 h in 2016 because of not meeting the EU emission standards as well as from longer by 5,664 h period of overhauls mainly:

- Unit no. 3 – medium overhaul from February 15, 2016 till July 1, 2016;
- Unit no. 10 – modernisation from August 15, 2015 till May 7, 2016;
- Unit no. 6 – medium overhaul from March 28, 2016 till May 23, 2016.

Decrease of production in Turów power plant results mainly from average capacity load lower by 10 MW.

Decrease of production coal-fired CHP plants is a result of **lower production of electricity in Pomorzany CHP** what is a consequence of limitation of working time to 17,500 h in years 2016-2023 because of not meeting the EU emission standards. Additionally, **lower electricity generation in Bydgoszcz CHP** is a consequence of technological restrictions of the desulphurisation installation.

An increase in production of electricity at coal - fired power plants was caused by **higher generation in Opole power plant and in Dolna Odra power plant** what is a consequence of higher utilisation of units by PSE S.A. In addition, in the comparable period of 2015 units in Dolna Odra power plant were in overhauls for longer periods: unit no. 5 from April 25 till May 20, 2015 and unit 7 from April 11, 2015 till May 2, 2015.

**Increased production in gas-fired CHP plants** results mainly from continuation of electricity production in co-generation with heat after the heating season in Lublin Wrotków CHP due to favourable prices of gas fuel.

**Higher production in wind farms** results mainly from increased installed capacity by 218 MW in wind farms commissioned in the second half of 2015 and first quarter of 2016 i.e.:

- FW Lotnisko – 90 MW;
- FW Resko II – 76 MW;
- FW Karwice – 40 MW;
- FW Kisielice II – 12 MW;

with the lower generation from other wind farms due to unfavourable wind conditions.

**A decrease of production in hydroelectric power plants** is a consequence of unfavourable hydrological conditions.

**Higher production in pumped storage power plants** results from the nature of these generation units, which in the first half of 2016 were used to a higher extent by PSE S.A.

### 3.2.2 Sales of heat

In the first half of 2016 the heat sales in PGE Capital Group totalled 10.18 GJ million and were lower by 0.42 GJ million than in the first half of 2015. Lower sales of heat resulted from lower demand for heat due to higher average outdoor temperatures. Lower sales also resulted from limitation of working time of Pomorzany CHP to 17,500 h in years 2016-2023 as the CHP fails to meet the EU emission standards. Additionally, a lower sale by ZEC Bydgoszcz is a result of new heat generator in Bydgoszcz that started operations in January 2016.

### 3.3 Business segments – financial data

Table: Breakdown of the Group's revenues by business segments in the first half of 2016 and 2015.

in PLN million	Total revenues		
	H1 2016	H1 2015*	% change
Conventional Generation	5,652	6,426	-12%
Renewable Energy	370	378	-2%
Supply	8,047	7,268	11%
Distribution	2,922	3,002	-3%
Other operations	333	340	-2%
<b>TOTAL</b>	<b>17,324</b>	<b>17,414</b>	<b>-1%</b>
<b>Consolidation adjustments</b>	<b>-3,658</b>	<b>-3,169</b>	<b>-15%</b>
<b>TOTAL AFTER ADJUSTMENTS</b>	<b>13,666</b>	<b>14,245</b>	<b>-4%</b>

\* data restated

Table: Key figures for each business segment in the first half of 2016.

in PLN million	EBITDA	EBIT	Capital expenditures	Assets of the segment*
			H1 2016	
Conventional Generation	1,568	915	2,855	33,603
Renewable Energy	205	-720	95	3,849
Supply	208	195	7	4,651
Distribution	1,117	557	713	16,814
Other operations	33	-29	68	1,042
<b>TOTAL</b>	<b>3,131</b>	<b>918</b>	<b>3,738</b>	<b>59,959</b>
<b>Consolidation adjustments</b>	<b>12</b>	<b>34</b>	<b>-48</b>	<b>-3,032</b>
<b>TOTAL AFTER ADJUSTMENTS</b>	<b>3,143</b>	<b>952</b>	<b>3,690</b>	<b>56,927</b>

\* see note 6 to the consolidated financial statements

Table: Key figures for each business segment in the first half of 2015.

in PLN million	EBITDA	EBIT	Capital expenditures	Assets of the segment*
			H1 2015**	
Conventional Generation	2,459	-7,260	2,358	27,383
Renewable Energy	202	88	219	4,252
Supply	279	267	13	4,969
Distribution	1,235	709	688	15,857
Other operations	33	-20	80	958
<b>TOTAL</b>	<b>4,208</b>	<b>-6,216</b>	<b>3,358</b>	<b>53,419</b>
<b>Consolidation adjustments</b>	<b>20</b>	<b>42</b>	<b>-26</b>	<b>-2,777</b>
<b>TOTAL AFTER ADJUSTMENTS</b>	<b>4,228</b>	<b>-6,174</b>	<b>3,332</b>	<b>50,642</b>

\* see note 6 to the consolidated financial statements

\*\* data restated



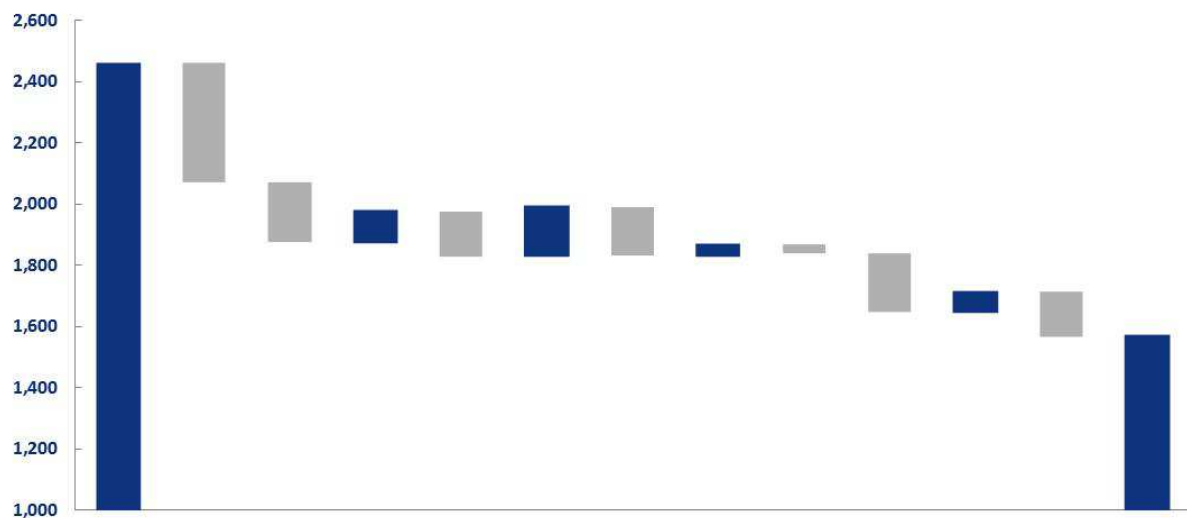
### 3.3.1 Conventional Generation

Table: Key figures for Conventional Generation.

PLN million	H1 2016	H1 2015*	% change
Sales revenues	5,652	6,426	-12%
EBIT	915	-7,260	-
EBITDA	1,568	2,459	-36%
Capital expenditures	2,855	2,358	21%

\* data restated

Chart: Key changes of EBITDA in Conventional Generation [in PLN million].



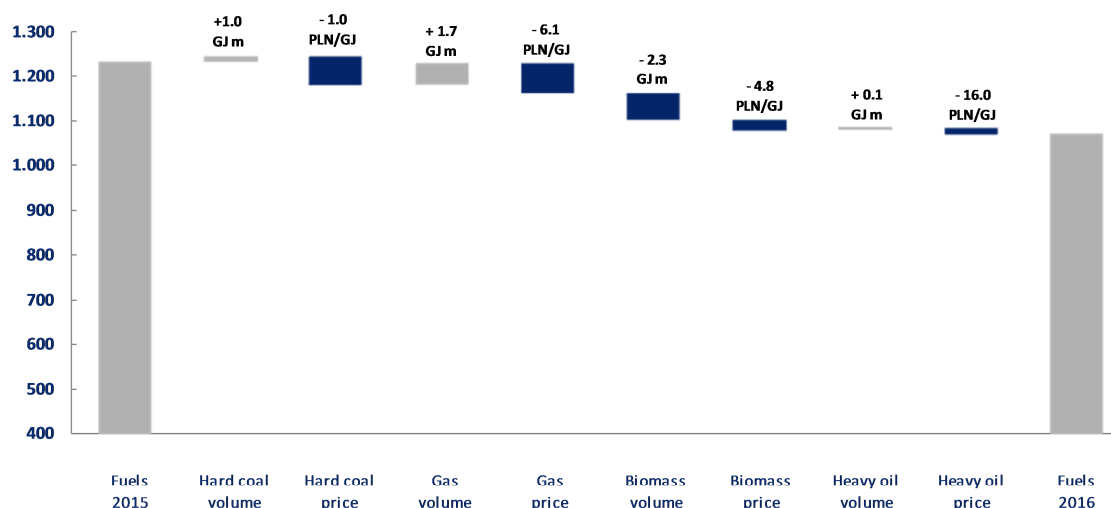
Change	EBITDA 2015	Sale of electricity difference in volume	Sale of electricity difference in price	Revenues from LTC	Sale of property rights	Fuel	CO2	Environmental costs	Personnel costs	Change in provision for reclamation of land	Other	Capitalized costs	EBITDA 2016
Change		-388	-196	100	-147	162	-160	37	-27	-193	66	-145	
EBITDA H1'15	2 459	4 748	301	222	1 236	339	173	1 329	193	638			
EBITDA H1'16		4 164	401	75	1 074	499	136	1 356	0	493			1 568

Key factors affecting the results of Conventional Generation in the first half of 2016 compared to the first half of 2015 were:

- Decreased sales volume of electricity** mainly as a result of lower production in Bełchatów power plant due to working time of unit no. 1 limited to 1,500 h in 2016 because of not complying with the EU emission standards. Additionally, in comparison to the first half of 2015, units 3, 6 and 10 in Bełchatów power plant were in overhaul and modernization for longer period.
- Decrease of electricity prices**, what attributed to the relevant decrease of revenues from sales. Average sale price of electricity realised by the Conventional generation segment in the first half of 2016 amounted to PLN 166/MWh, while it amounted to PLN 173/MWh in the first half of 2015.
- Higher LTC compensations** as a result of recognition in 2016 of LTC adjustment in amount of PLN 148 million in connection with the verdicts in court disputes: (i) favourable verdict of the Court of Appeal relating to adjustment of stranded costs for 2010 due to Opole power plant (PLN +173 million); (ii) unfavourable verdict of the Supreme Court in scope of gas adjustment for 2009 for Lublin Wrotków CHP and rejection of cassation appeal in case of gas adjustment for 2010 for Lublin Wrotków CHP and Rzeszów CHP (PLN -25 million).
- Lower revenues from certificates** mainly due to revaluation of certificates in Szczecin CHP (PLN -118 million).
- Lower costs of fuels used**, including mainly hard coal and biomass. It is effect of lower hard coal prices and lower generation of electricity from co-combustion of biomass due to decreased profitability of electricity production in that technology (the impact of provisions of RES law and low prices of green certificates). Main changes on different types of fuel are presented on the chart below.

- **Higher CO<sub>2</sub> costs** as a result of higher cost per unit of CO<sub>2</sub> emission and lower amount of allowances granted free of charge.
- **Lower fees for use of environment** mainly resulting from lower electricity generation and as a consequence lower emissions (SO<sub>2</sub>, NO<sub>x</sub>).
- **Higher personnel expenses** mainly as a result of provision raised for Voluntary Leave Program in amount of PLN 21 million due to newly submitted applications.
- **Recognition of change in reclamation provision in 2015** in amount of PLN 193 million due to change of discount rate from 2.6% to 3.3%.
- **Lower capitalised costs**, among other, as a result of lower volume of overburden removal in mines and recognition of lower removal costs as asset.

Chart: Costs of fuels consumption (including transport) in Conventional Generation [in PLN million].



Change	12	-66	50	-67	-59	-24	5	-13	
Fuels H1 2015	1,236	736	273	193	28				
Fuels H1 2016		682	256	110	20				1,074

## Capital expenditures

Table: Capital expenditures incurred in Conventional Generation segment in the first half of 2016 and 2015, by particular investment tasks.

in PLN million	Capital expenditures		
	H1 2016	H1 2015	% change
Investments in generating capacities, including:	2,541	1,892	34%
▪ Development	1,798	1,058	70%
▪ Modernisation and replacement	743	834	-11%
Purchase of finished capital goods	29	28	4%
Vehicles	4	12	-67%
Other	12	33	-64%
<b>TOTAL</b>	<b>2,586</b>	<b>1,965</b>	<b>32%</b>
Capitalized costs of overburden removal in mines	269	393	-32%
<b>TOTAL with capitalized costs of overburden removal</b>	<b>2,855</b>	<b>2,358</b>	<b>21%</b>

Highest capital expenditures in the first half of 2016 were incurred for the following projects:

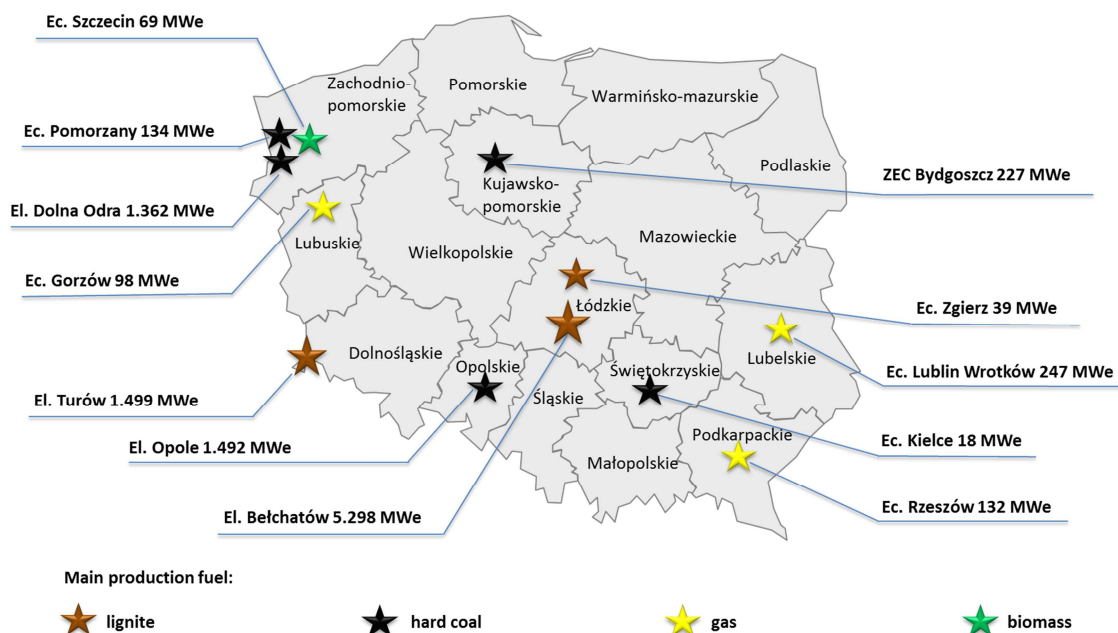
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|--|--------------------|
| ■ construction of units 5 and 6 in Opole power plant                                 | PLN 1.716 million; |
| ■ comprehensive modernization of units 7-12 - Bełchatów power plant                  | PLN 439 million;   |
| ■ construction of overburden line GD 1 in Bełchatów lignite mine                     | PLN 30 million;    |
| ■ construction of CCGT unit in Gorzów CHP  | PLN 29 million;    |
| ■ construction of desulphurization installations of units 4 - 6 in Turów power plant | PLN 25 million;    |
| ■ construction of unit no. 11 in Turów power plant                                   | PLN 17 million.    |

Key developments in the first half of 2016 in Conventional Generation:

- A contract to modernise generators 1-3 at Turów power plant was signed in January, and a contract to modernise electrostatic precipitators at Turów's units 1-3 was signed in March; as these contracts were signed, contractors for the specific modernisation "islands" at units 1-3 were issued declarations on the contracts' entry into force as of March 14, 2016;
- In March works connected with the construction of NOx reduction installation on units no. 1, 2 and 4 in Opole power plant were completed, the last installation on unit no. 2 was commissioned on March 18, 2016;
- In April, a notice to proceed was issued for the contractor in the task "Construction of a Thermal Processing Installation with Energy Recovery at Rzeszów CHP";
- In May modernised unit no. 10 in Bełchatów power plant was synchronised with the National Power System, adjustment operation commenced;
- In June modernised unit no. 10 in Bełchatów power plant was commissioned;
- In June FGD installations on units no. 4, 5 and 6 in Turów power plant were commissioned.

Key investments being pursued within the Conventional Generation segment are described in p. 2 of this report.

Diagram: Main assets of the Conventional Generation segment.



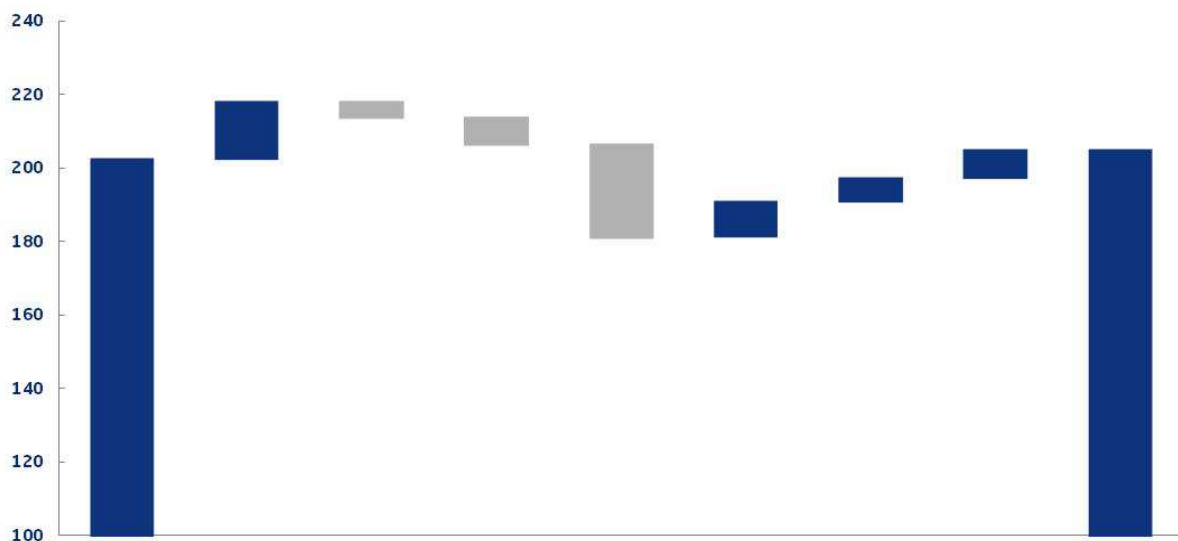
### 3.3.2 Renewable Energy

Table: Key figures for Renewable Energy.

PLN million	H1 2016	H1 2015*	% change
Sales revenues	370	378	-2%
EBIT	-720	88	-
EBITDA	205	202	1%
Capital expenditures	95	219	-57%

\* data restated

Chart: Key changes of EBITDA in Renewable Energy [in PLN million].



Change	EBITDA 2015	Sale of electricity - wind	Sale of property rights - wind	Sale of electricity - water	Sale of property rights - water	Revenues from agreement with TSO*	Personnel costs	Other	EBITDA 2016
Change		16	-4	-7	-25	9	6	8	
EBITDA H1'15	202	65	59	49	31	115	43		
EBITDA H1'16		81	55	42	6	124	37		205

\* Excluding revenues and costs relating to balancing market not affecting EBITDA result

Key factors affecting the results of Renewable Energy in the first half of 2016 compared to the results of the first half of 2015 included:

- **The decline of revenues from sales of certificates**, resulting from lower realized average sale price in the first half of 2016 compared to the first half of 2015 by approx. PLN 15/MWh. Of significant impact was also lower electricity generation volume from hydro power plants (by approx. 11%) and volume of certificates associated therewith due to adverse weather conditions, as well as loss of supports with regard to property rights for the hydro power plants with capacity exceeding 5MW as from January 1, 2016.
- **The increase of sales of electricity from wind power plants** was caused mainly by the increased volumes generated what is connected with increased installed capacity in wind farms by 218 MW (see p. 3.2.1). The above compensated lower production from other wind farms due to unfavourable wind conditions in the first half of 2016.
- **Higher sales revenues from ancillary control services** (agreement with PSE S.A.) mainly due to higher rate for intervention reserve of active power and higher volume.
- **Change in item Other** was caused mainly by one-off settlement resulting from recognised impairment loss. Higher operational expenses connected with the new wind farms (FW Karwice, FW Resko II, FW Kisielice II, FW Lotnisko) also had negative impact on result.

In the first half of 2016 an impairment loss recognised in amount of PLN 732 million. Total impairment loss on wind assets at consolidated level amounted to PLN 783 million. Impairment was recognized in item amortization and depreciation without impact on EBITDA (see p. 6.8 and note 3.2 to the consolidated financial statements).

**Capital expenditures**

Table: Capital expenditures incurred in Renewable Energy segment in the first half of 2016 and 2015.

in PLN million	Capital expenditures		
	H1 2016	H1 2015	% change
Investments in generating capacities, including:	94	218	-57%
▪ Development	73	203	-64%
▪ Modernization and replacement	21	15	40%
Other	1	1	-
<b>TOTAL</b>	<b>95</b>	<b>219</b>	<b>-57%</b>

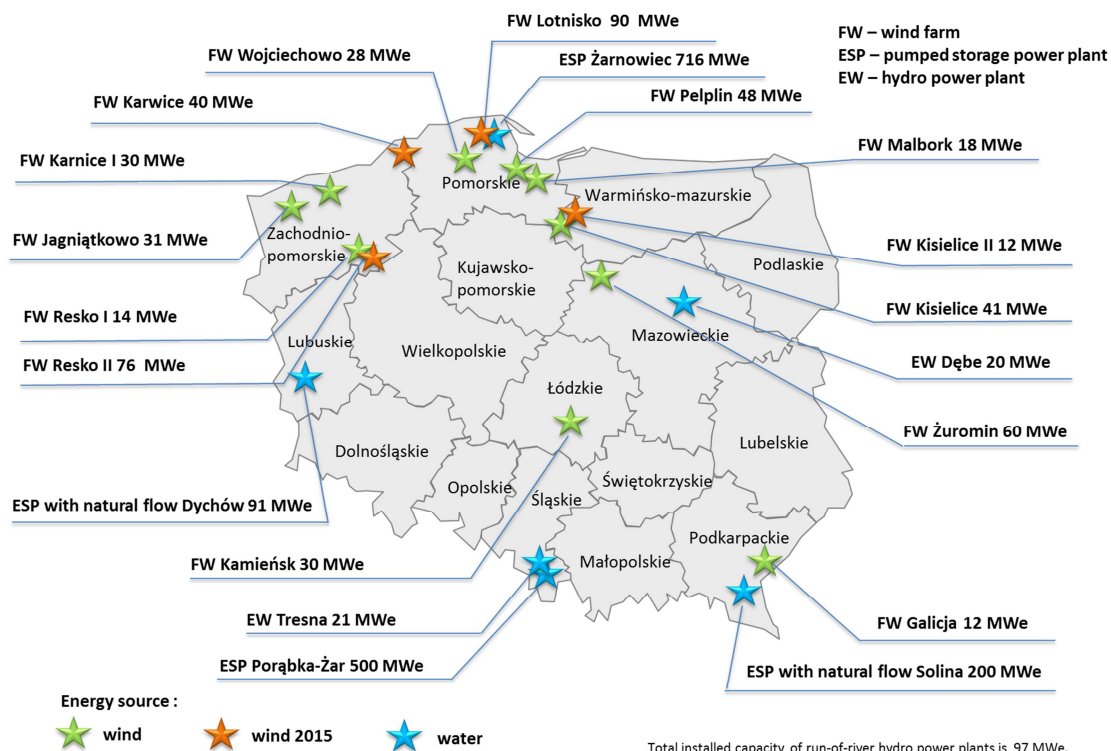
In the first quarter of 2016 the highest capital expenditures were incurred for construction of Lotnisko wind farm with capacity of 90 MW (final settlement of the contract) PLN 69 million.

Key conclusions in Renewable Energy segment in the first half of 2016 included:

- concession for electricity generation in Lotnisko wind farm (90 MW) obtained in January 2016;
- concession for electricity generation in Kisielice II (12 MW) obtained in February 2016.

Key investments being pursued within the Renewable Energy segment are described in p. 2 of this report.

Diagram: Main assets of the Renewable Energy segment.



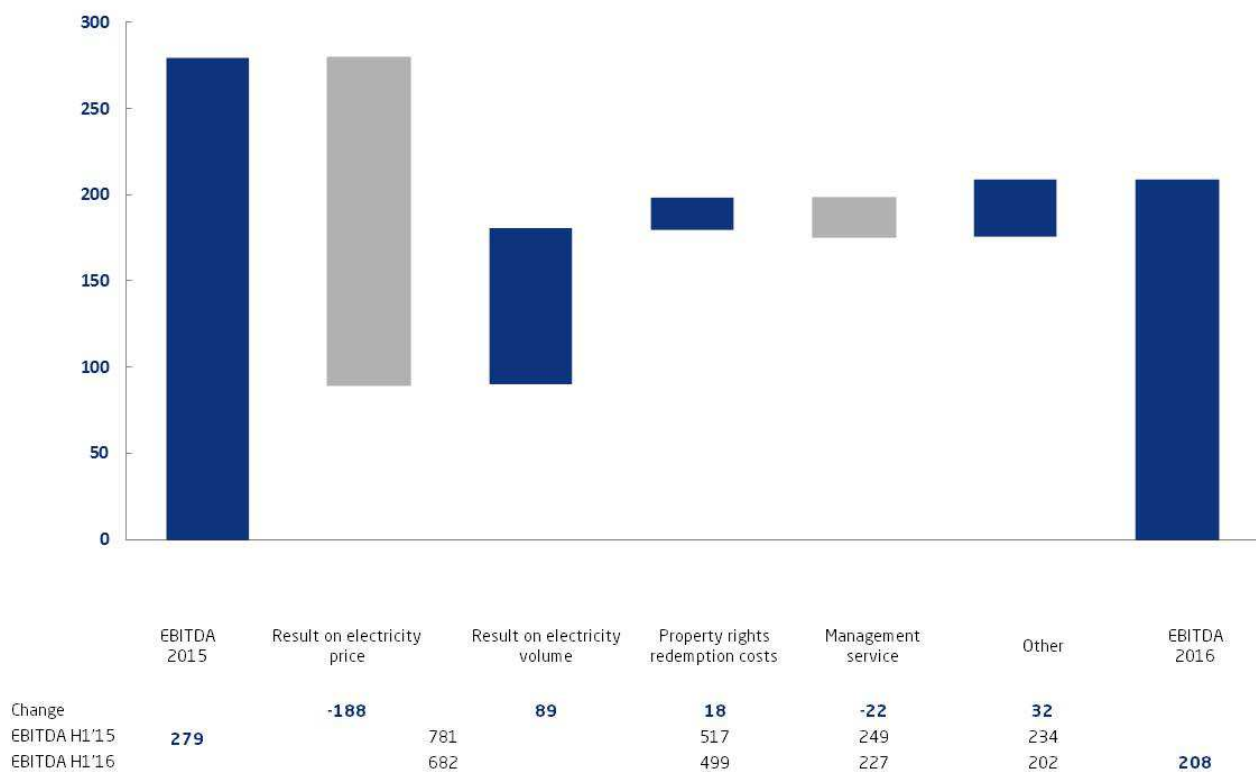
### 3.3.3 Supply

Table: Key figures for Supply.

PLN million	H1 2016	H1 2015*	% change
Sales revenues	8,047	7,268	11%
EBIT	195	267	-27%
EBITDA	208	279	-25%
Capital expenditures	7	13	-46%

\* data restated

Chart: Key changes of EBITDA in Supply [in PLN million].



Key changes in Supply segment in the first half of 2016 compared to the results of the analogous period of 2015 included:

- **Decrease of results from electricity** by PLN 99 million due to lower margin per unit on energy sale due to less favourable spread between the average price of sale (decrease by PLN 10/MWh) and average price of purchase of electricity (decrease by PLN 2/MWh). Increase in volume of electricity traded by 11% partly compensated negative impact of lower price on the segment's results.
- **Decreased costs of certificates redemption** resulting mainly from the falling prices on the green certificates.
- **Decrease of revenues from the Agreement for Commercial Management of Generation Capacities ("ZHZZ")** due to lower trading volume by 1.7 TWh under management and lower prices of sale under so called power exchange obligation. Revenues of PGE S.A. from PGE GiEK S.A. decreased by PLN 26 million, while revenues from PGE EO increased by PLN 4 million.
- **Increased revenues from other services** by PLN 25 million, mainly provided by the Corporate Centre to the companies from other segments of the PGE Capital Group.
- Fixed costs lower by PLN 4 million.

### 3.3.4 Distribution

Table: Key figures for Distribution.

PLN million	H1 2016	H1 2015*	% change
Sales revenues	2,922	3,002	-3%
EBIT	557	709	-21%
EBITDA	1,117	1,235	-10%
Capital expenditures	713	688	4%

\* data restated

Chart: Key changes of EBITDA in Distribution [in PLN million].



Change	EBITDA 2015	Volume of distributed energy	Change of distribution tariff*	Other distribution related revenues**	Network losses	Transmission services*	Personnel costs	Other	EBITDA 2016
EBITDA H1'15	1 235	2 742	-130	207	207	668	536	-16	
EBITDA H1'16		2 690		177	225	686	520		1 117

\* Increase of transmission costs with no impact on result, offset by the increased revenues from distribution services

\*\* Other revenues (reactive power, excess capacity, additional services), revenues from connection fee, sale of transit services

Key factors affecting the results of Distribution in the first half of 2016 compared to the results of the first half of 2015 included:

- **Increased volume of distributed energy** by 469.1 GWh, resulting from – inter alia – higher number of customers measured by power take-off points (by approx. 43.6 thousand) in comparison to the first half of 2015.
- **Decreased revenues from distribution services** results mainly from lower distribution tariffs for 2016 in comparison to the approved tariffs for 2015.
- **Decrease in other revenues** resulting mainly from lower revenues from connection fees. In the first half of 2016 2 wind farms and special economic zone were connected to the grid.
- **Higher costs of balancing differences** resulted mainly from a higher volume of balancing differences connected with: (i) higher demand for electricity and (ii) change of supply structure. A decline in supplies was recorded in 2016 to customers in tariff A group, where transmission is characterised by lower technical losses than in other tariff groups.
- **Lower personnel costs result mainly from:** (i) reduction in employment, and (ii) recognition of a provision in 2015 for the regulation of salaries.
- **Change in other** results mainly from: (i) higher costs incurred for repairs and exploitation of the grid assets and (ii) higher property tax in connection with the increased value of grid assets.

## Capital expenditures

Table: Capital expenditures incurred in Distribution segment in the first half of 2016 and 2015.

in PLN million	Capital expenditures		
	H1 2016	H1 2015	% change
MV and LV power networks	227	210	8%
110/ MV and MV/MV power stations	61	63	-3%
110 kV power lines	18	11	64%
Connection of new off-takers	268	254	6%
Purchase of transformers and energy counters	61	65	-6%
IT, telemechanics and communication	57	63	-10%
Other	21	22	-5%
<b>TOTAL</b>	<b>713</b>	<b>688</b>	<b>4%</b>

In the first half of 2016 in Distribution segment the highest capital expenditures were incurred for implementation of tasks from group: „Connection of new off-takers” and „MV and LV power networks”.



### 3.3.5 Other operations

Table: Key figures for Other operations.

PLN million	H1 2016	H1 2015*	% change
Sales revenues	333	340	-2%
EBIT	-29	-20	-45%
EBITDA	33	33	0%
Capital expenditures	68	80	-15%

\* data restated

EBITDA of Other operations segment was at the same level as in the comparable period of the previous year.

#### Capital expenditures

Capital expenditures in Other Operations in the first half of 2016 amounted to PLN 68 million compared to PLN 80 million in the first half of 2015.

Within the above amount, the highest capital expenditures in the first half of 2016 were incurred by the following companies:

- PGE Systemy S.A. – for IT infrastructure and software development PLN 30 million;
- PGE EJ 1 sp. z o.o. – for nuclear project development PLN 21 million;
- Exatel S.A. – for telecommunication infrastructure development PLN 17 million.

### 3.4 Transactions with related entities

Information about transactions with related entities is presented in note 23 to the consolidated financial statements.

### 3.5 Publication of financial forecasts

PGE S.A. did not publish financial forecasts.

On July 27, 2016 PGE S.A. published current report no. 40/2016, in which disclosed EBITDA and net profit attributable to equity holders of the parent company for the first half of 2016. Consolidated EBITDA and net profit attributable to equity holders of the parent company in the first half of 2016 were achieved at the estimated level and amounted respectively to PLN 3.1 billion and PLN 0.5 billion.

### 3.6 Information about shares and other securities

#### 3.6.1 Shares of the parent company owned by the members of management and supervisory authorities

According to the best knowledge of the Management Board of the Company, members of management and supervisory authorities of the Company as of the date of submission of this report and as of the date of publishing of the consolidated report for the first quarter of 2016 held following number of shares:

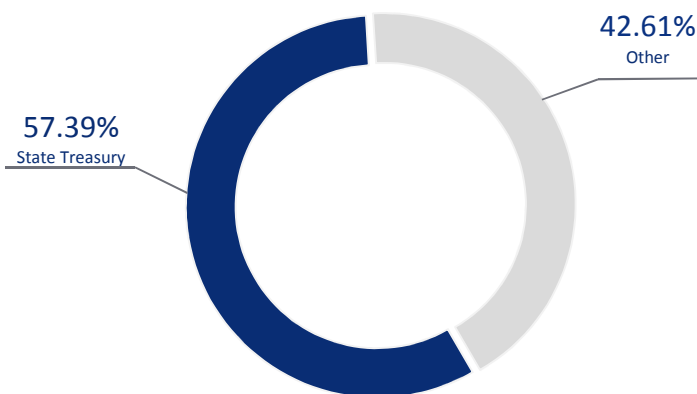
Table: PGE S.A. shares held and managed directly by the members of management and supervisory authorities of the Company.

Shareholder	Number of shares as of submission date of the quarterly report for Q1 2016 (i.e. May 11, 2016)	Change in number of owned shares	Number of shares as of submission date of the half-year report	Nominal value of shares as of submission date of the half-year report (PLN)
<b>The Management Board</b>	-	-	-	-
<b>The Supervisory Board</b>	<b>7</b>	-	<b>7</b>	<b>70</b>
Jarosław Głowacki*	7	-	7	70

\* Mr. Jarosław Głowacki was appointed to the Supervisory Board of PGE S.A. by the resolution no. 13 of the Extraordinary General Meeting of PGE S.A. on March 1, 2016.

#### 3.6.2 Shareholders holding directly or indirectly by subsidiaries at least 5% of the total votes at Company's General Meeting as at the date of the half-year report.

The State Treasury holds 1,072,984,098 ordinary shares of the Company with a nominal value of PLN 10 each, representing 57.39% of the share capital of the Company and entitling to exercise 1,072,984,098 votes at the General Meeting of the Company, constituting 57.39% of the total number of votes.

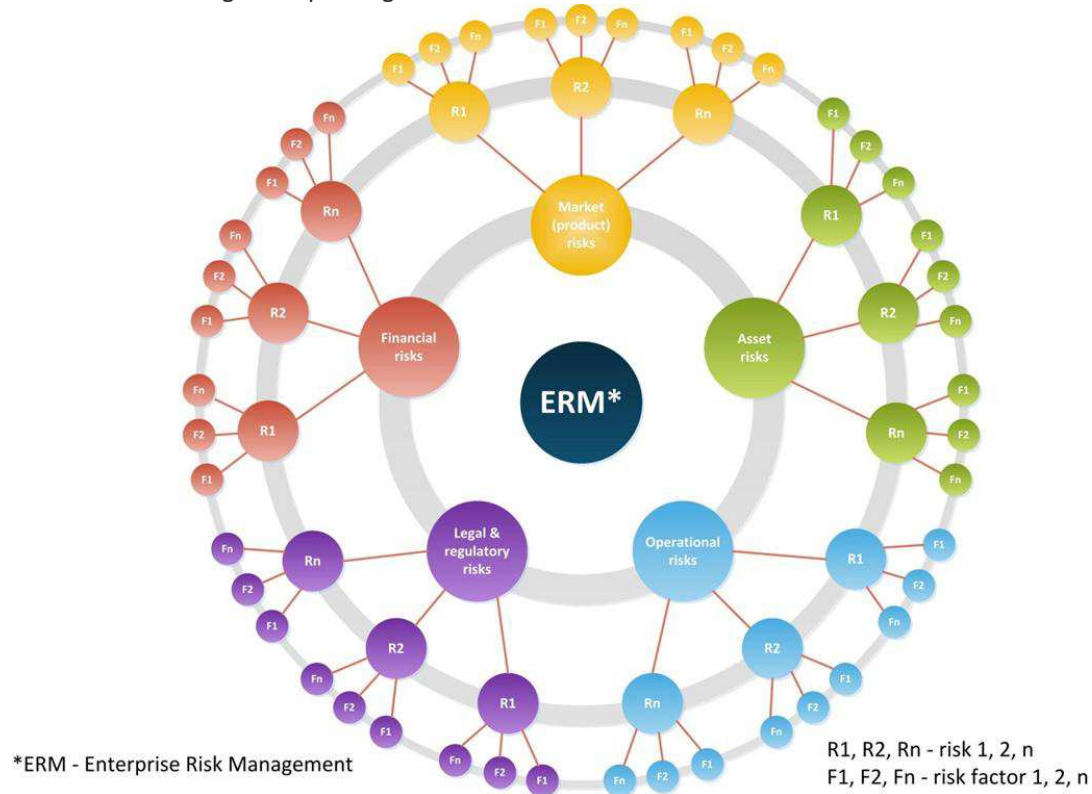


Shareholder	Number of shares	Number of votes	% in total votes on General Meeting
State Treasury	1,072,984,098	1,072,984,098	57.39%
Others	796,776,731	796,776,731	42.61%
<b>Total</b>	<b>1,869,760,829</b>	<b>1,869,760,829</b>	<b>100.00%</b>

## 4 Risks and threats of the PGE Capital Group

### Risk management

The activity of PGE Capital Group companies, as well as other entities operating in the electrical and power sector, is exposed to a number of external risks and threats connected with market, regulatory and legal environment and internal risks and threats resulting from operating activities.



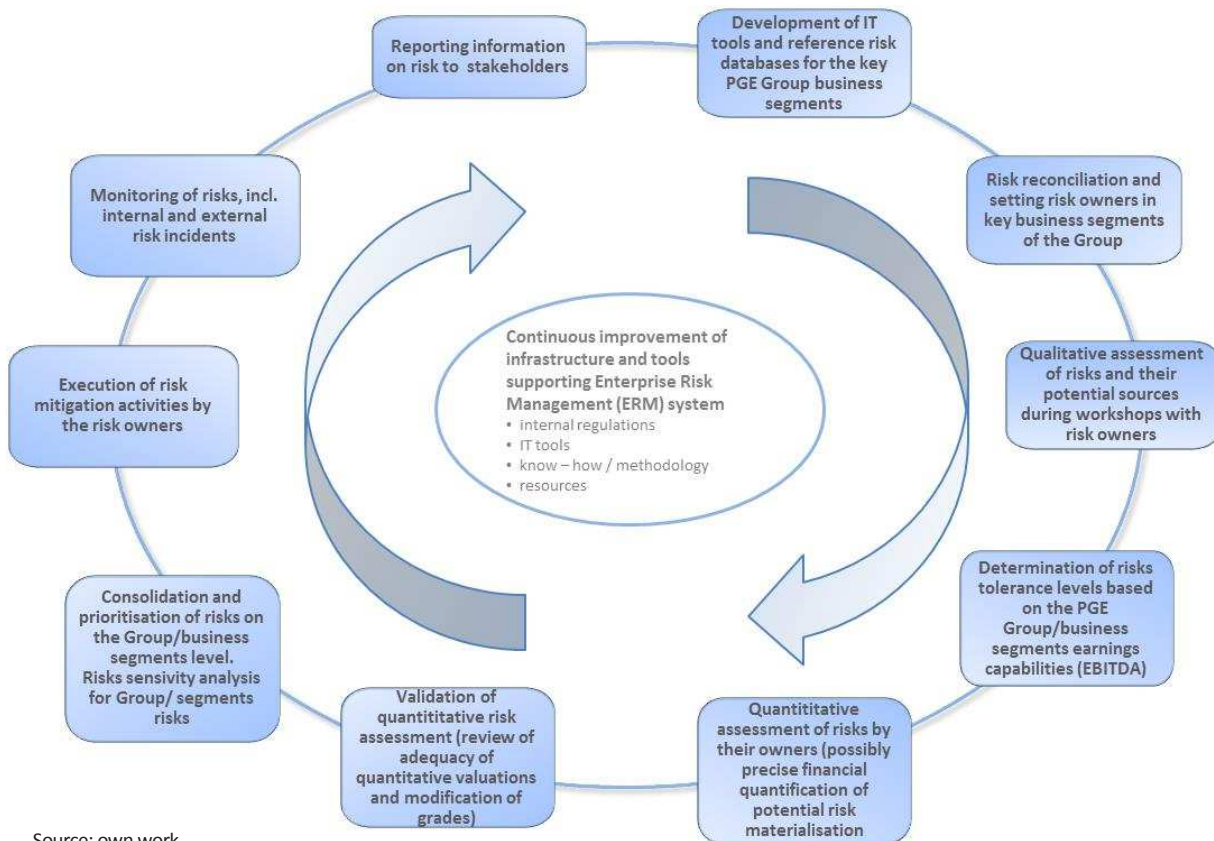
In PGE Group risk management process is pursued based on the GRC (Governance - Risk - Compliance) model, which allows adaptation and integration of each of the Group's operational areas at all levels of management. Having established a top-level Risk Committee, which reports directly to the Management Board, supervision over the effectiveness of risk management processes is ensured across the entire Group. Function definition within corporate risk management enables an independent assessment of specific risks and their impact on PGE Group as well as limiting and controlling major risks using the economic capital concept via risk management instruments. Formation of a separate compliance function within the Group guarantees that PGE Group's activities are in line with legal conditions and ensures observance of the adopted internal standards, at the same time reinforcing the monitoring of regulatory environment and increasing the effectiveness of identifying potential gaps and initiating adaptive changes.



Source: own work

The PGE Capital Group has consequently developed and improves a comprehensive risk management system so that risks involved in its operations and having a significant impact on the value of the Company are maintained at sustainable levels in relation to assumed business objectives. Further mechanisms are being introduced to improve both the measurement of risk levels and the effectiveness of identifying exposure areas.

The PGE Capital Group risks concerning various areas of operations are identified and kept within the assumed limits by reducing negative effects of such risks and by taking preventive or corrective measures, in accordance with the applied cycle.



































Source: own work

1

The main risks and threats, to which activity of the PGE Group is exposed, are presented below along with their assessment and outlook in the horizon of the next year.

Risk level	low	medi-um	high	Risk outlook	decrease	growth	stable
<b>low level</b>	Risk does not pose a threat and may be tolerated,						
<b>medium level</b>	Risk which needs preparation of the proper reaction based on analysis of costs and benefits,						
<b>high level</b>	Intolerable risk, which needs immediate and active reaction, leading simultaneously to limitation of possible consequences and of probability of occurrence thereof						
<b>Market (product) risks</b>	Prices of electricity and related products – resulting from a lack of certainty with regard to the future levels and volatility of commodity prices relative to open contract positions - this particularly concerns electricity and associated products (property rights, CO <sub>2</sub> emission allowances). <span style="float: right;">■ ▲</span>						
<b>Related to prices and volumes of offered products and services</b>	Electricity sales volumes – this risk derives from a lack of certainty with regard to the conditions determining the demand and supply of electricity, directly affecting the volume of market sales by PGE Group. <span style="float: right;">■ ◀▶</span>						
	Tariffs (regulated prices) – resulting from the requirement to approve rates for distribution services and electricity and heat prices for particular groups of entities. <span style="float: right;">■ ◀▶</span>						
	<b>Property risks</b>						
<b>Related to development and maintenance of the assets</b>	Failures – connected with the operation and degradation over time of energy equipment and facilities (maintenance and repair work, diagnostics) <span style="float: right;">■ ◀▶</span>						
	Damage to property – connected with the physical protection of energy equipment and facilities against destructive external factors (including fire, flood and intentional damage). <span style="float: right;">■ ◀▶</span>						
	Investment and development – connected with strategic plans for expanding the generation, distribution and sales potential as well as on-going investments. <span style="float: right;">■ ◀▶</span>						

<b>Operational risks</b>  Related to pursuing of ongoing economic processes	Production costs – connected with the growing costs of fuel procurement, operational works, wage factors, etc.		
	Electricity and heat production – connected with production planning and impact of the factors that determine production capacities.		
	Fuel management – connected with uncertainty regarding the quality, timeliness and volumes of fuel supply (mainly coal) and the effectiveness of inventory management processes.		
	HR – pertaining to provision of employees with the relevant experience and competences, who are capable of performing specific tasks.		
	Social dialogue – connected with a failure in achieving agreement between the Group's management and employees, what could lead to strikes/collective labour disputes.		
<b>Regulatory and legal risks</b>  Related to compliance with external and internal legal provisions	Legal changes in support systems – connected with uncertainty as to the future shape of the support system (or a lack thereof) for production of certified energy.		
	Costs of purchase of certificates and CO <sub>2</sub> allowances - resulting from the possible changes to the statutory requirement for electricity sellers to purchase a specified quantity of property rights and to uncertainty with regard to volume of CO <sub>2</sub> emission rights granted free of charge in future.		
	Compensation for the termination of long-term contracts (LTCs) – there is a possibility that the level of adjustments to advances collected for stranded costs, as calculated by the Group, will be questioned by the President of the Energy Regulatory Office (URE), as a result of which the Group will be obligated to return advances received for terminating the LTCs.		
	Environmental protection – resulting from industry regulations specifying which "environmental" requirements energy installations should meet and what the principles for using the natural environment are. The future, yet unknown, environmental regulations and uncertainty concerning the final shape of the projected regulations (in particular with regard to the revision of BAT / BREF) may translate into a change in the level of capital expenditures of the PGE Group.		
	Unresolved legal status – connected with difficulties in respect of land acquisition or access to land in the course of new investments (particularly in the Distribution segment).		
	Concessions – resulting from the statutory requirement to hold concessions for coal mining as well as for the production and distribution of electricity and heat.		
	Discriminatory activities – connected with application by the Group of practices that limit or eliminate competition and infringe on legal regulations or consumer interests.		
<b>Financial risks</b>  Related to finance management	Credit risk – connected with the potential occurrence of a credit event (e.g. counterparty default, partial and/or late payment of receivables or a different type of breach of contractual conditions, for example failure to deliver/collect goods or failure to pay for any associated damages or contractual penalties).		
	Liquidity risk – connected with the possibility of losing the ability to meet current liabilities and obtaining financing sources for business operations.		
	Interest rate risk – resulting in particular from the negative impact of changes in market interest rates on PGE Group's cash flows generated by floating-rate financial assets and liabilities.		
	Foreign exchange risk – understood in particular as risk that PGE Group's cash flows denominated in currencies other than the functional currency are exposed to due to negative exchange rate movements.		

## Risk mitigation measures

### Market (product) risks

Market risks impact the revenue side and product and service offerings

**Measures:** PGE Group has drafted and implemented internal procedures for managing foreign exchange risk (price- and volume-related), which include a global risk appetite measure, VaR-based position limits, as well as management of consolidated exposure to commodity pricing risk through mechanisms for protection against risk exceeding acceptable levels. Currency risk management procedures provide consistent guidance for significant PGE Group companies in respect of process organisation in the context of commercial strategy and mid-term planning. PGE Group has devised and followed in it business practice rules pertaining to a strategy for hedging key exposures in the area of electricity and related product trading that correspond to the adopted risk appetite in the mid-term (up to five years, assuming that the necessary market liquidity is available). Position hedging levels are established with consideration given to the results of analysing pricing risk in respect of electricity and related products. When specifying the target hedging levels, PGE Group takes into consideration its financial standing, including in particular its strategic objectives.

PGE Group researches, monitors and analyses the electricity and related products markets in order to optimally use its generation and selling capacities. New products are introduced on the retail market and actively promoted through nationwide marketing campaigns. Maintaining a diverse product portfolio and focusing efforts on tailoring its offering to the market (historic as well as national), the Group diversifies channels used to reach the end-customers (own sales channel, agency sales channel) and diversifies target groups with account take to client's volume potential. Efforts aimed at current clients retention are based on a model consisting of a diversified portfolio of customer loyalty schemes and client-acquisition activities. Portfolio includes also special offers dedicated to former clients who moved over to the competitors, as well as industry offerings dedicated to specific types of economic activity. PGE Group also introduces bundled offers. Particular attention is paid to ensuring a high level of customer service by developing employees' competences and building relations with business and retail clients. Having implemented tools to support these processes, the Group effectively manages information flows, which directly translates into comfortable client relations as well as better sales planning and organisation.

### Regulatory and legal risks

Regulatory and legal risks mainly impact the compliance area

**Measures:** PGE Group's operations are subject to a host of national, European and international laws and regulations. Monitoring of the changes being introduced or proposed assures minimization of their negative impact on our operations in key business segments, i.e. production of electricity and heat, lignite mining and distribution and sale of electricity and heat as well as purchase of related products (fuels, property rights and CO<sub>2</sub>). PGE S.A. is one of the members of the Polish Electricity Committee that opened its office in Brussels. Through the Committee's operations, PGE S.A. actively influences proceeding and shaping of EU law and engages a dialogue with the EU institutions. PGE S.A. adapts its internal regulations and practices to make sure that the Group's activities are in compliance with the power sector regulations, environmental protection regulations and other binding legislation.

### Property risks

Property risks  
affect assets

**Measures:** PGE Group effectively pursues a strategy for building up and modernization of its production capacities. The Group diversifies current structure of the production sources due to energy generation technology. Currently PGE Group is running two key investments (Opole, Turów) alongside a number of grid investments, RES investments as well as modernisation and development projects. We are continuously carrying out maintenance and repair work. The reliability of the power supply to the end users has been systematically improved. Our main generation assets were insured against failure and damage to property. Companies from the PGE Group joined the Mutual Insurance Company PZUW. Insurance covers approximately 70% of generation assets of PGE GiEK S.A. helping to optimise the insurance process. Other Group companies' assets will be successively insured on analogical conditions, as the existing insurance policies expire.

### Operational risks

Operational risks  
impact the cost  
side

**Measures:** PGE Group's results are to a large extent dependent on the costs incurred in the course of operations. The Company optimises costs inter alia through monitoring of fuel prices and reserves and securing supply through long-term contracts with suppliers and through price fixing formulas. In turn, inspections, repairs and modernisation of the existing assets translate into ensuring optimal equipment lifecycles and required availability of key components of those assets. Moreover, level of costs is affected by securing CO<sub>2</sub> emission allowances partly free of charge and purchase of lacking allowance with the assumption of securing the margin on sales. An intensive dialogue is also carried out in order to work out the most favourable solutions with regard to employment and optimization of employment costs within PGE Capital Group.

### Financial risks

Financial risks  
have an impact on  
finances

**Measures:** PGE Group manages credit risk stemming from commercial transactions that can generate losses if a counterparty were to default. Prior to executing a transaction, a counterparty assessment is carried out, which involves, among other factors, financial analysis, internal ratings and credit limits that are regularly updated and monitored. Exposures that exceed established limits are hedged in accordance with the Group's credit risk management policy. PGE Group applies a central financing model, which is generally used by PGE S.A. when raising external capital. PGE Group subsidiaries use a variety of intra-group financing sources such as: loans, bonds, bank account consolidation agreements (cash pooling). Liquidity risk is monitored using periodic liquidity planning, i.e. cash flow moving forecasts for operating, investing and financing activities. As regards currency risk and interest rate risk, PGE Group has implemented internal management procedures. PGE Group companies execute derivative transactions involving interest rate- and/or currency-based instruments (IRS, CCIRS) only in order to hedge identified risk exposures.

## 5 Description of the organisation of the PGE Capital Group

Companies comprising the main business segments of PGE Group as at June 30, 2016.

Segment	Company
<b>CONVENTIONAL GENERATION</b>	1. PGE Górnictwo i Energetyka Konwencjonalna S.A.
	2. Przedsiębiorstwo Energetyki Ciepłej sp. z o.o.
	3. MegaSerwis sp. z o.o.
	4. ELBIS sp. z o.o.
	5. PUP ELTUR SERWIS sp. z o.o.
	6. TOP SERWIS sp. z o.o.
	7. ELMEN sp. z o.o.
	8. MEGAZEC sp. z o.o.
	9. EPORE sp. z o.o.
	10. RAMB sp. z o.o.
	11. PTS BETRANS sp. z o.o.
	12. BESTGUM POLSKA sp. z o.o.
	13. Energoserwis Kleszczów sp. z o.o.
<b>RENEWABLE ENERGY</b>	14. PGE Energia Odnawialna S.A.
	15. Elektrownia Wiatrowa Baltica-1 sp. z o.o.
	16. Elektrownia Wiatrowa Baltica-2 sp. z o.o.
	17. Elektrownia Wiatrowa Baltica-3 sp. z o.o.
	18. PGE Energia Natury sp. z o.o.
	19. PGE Energia Natury Omikron sp. z o.o.
	20. PGE Energia Natury PEW sp. z o.o.
<b>SUPPLY</b>	21. PGE Polska Grupa Energetyczna S.A.
	22. PGE Dom Maklerski S.A.
	23. PGE Trading GmbH
	24. PGE Obrót S.A.
	25. Enesta sp. z o.o.
<b>DISTRIBUTION</b>	26. PGE Dystrybucja S.A.



## 5.1 Changes in organisation of the Capital Group

### 5.1.1 Changes in organisation of the Capital Group in the first half of 2016

The changes, which occurred in the PGE Capital Group's structure in the first half of 2016 are presented in note 1.3 to consolidated financial statements and described below.

#### Shares in subsidiaries and associates

In the first half of 2016 PGE S.A. changed its equity interest in the following entities:

- On February 2, 2016 the Extraordinary Assembly of Partners of PGE Trading GmbH with its seat in Berlin adopted a resolution on increase of the company's share capital from EUR 3,350,000 to EUR 5,350,000, i.e. by EUR 2,000,000, through the creation of 1 new share with nominal value of EUR 2,000,000. The increase of the share capital was acquired by PGE S.A. in exchange for a cash contribution. On March 7, 2016 the increase of the share capital was registered with the German commercial register.
- On March 10, 2016 PGE S.A. and PGE GiEK S.A. signed an agreement for sale of 6,812 shares in RAMB sp. z o.o. with its registered office in Piaski (Kleszczów commune), owned by PGE GiEK S.A., constituting 100% of the share capital of that company. Ownership of the shares was transferred to PGE S.A. as of the agreement date. Currently PGE S.A. is the sole partner of the company.
- On April 26, 2016 an agreement on initiation of Polska Grupa Górnicza sp. z o.o. ("PGG") was signed. On April 29, 2016 the Extraordinary Assembly of Partners of PGG adopted resolution in the increase of the share capital by PLN 1,805,557,200 to PLN 2,305,607,200, through issue of new shares taken up by: PGE GiEK S.A. with its seat in Bełchatów, ENERGA Kogeneracja sp. z o.o. with its seat in Elbląg, PGNiG TERMIKA S.A. with its seat in Warsaw, Fundusz Inwestycji Polskich Przedsiębiorstw Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych with its seat in Warsaw, Towarzystwo Finansowe Silesia sp. z o.o. with its seat in Katowice, WĘGLOKOKS S.A. with its seat in Katowice who submitted appropriate declarations on acquisition of new shares in PGG and accession to the company. PGE GiEK S.A. took up 3,611,111 shares with a nominal value of PLN 361,111,100, representing 15.7% in the increased share capital of PGG. On July 25, 2016 the increase of the share capital was registered with the National Court Register.
- On June 13, 2016 PGE S.A. and PGE Inwest 2 sp. z o.o. (100% subsidiary of PGE S.A.) signed an agreement for sale of 220,000 shares of Telewizja Familijna S.A. in bankruptcy with its seat in Warsaw, held by PGE S.A., representing 11.96% of the share capital of the company. As at the agreement date, the ownership of shares was transferred to PGE Inwest 2 sp. z o.o.
- On June 22, 2016 PGE Energia Odnawialna S.A. („PGE EO”) and Bank Ochrony Środowiska S.A. with its seat in Warsaw („BOŚ”) signed an agreement for subscription of new shares in the increased share capital of BOŚ (the "Agreement"). In accordance with the Agreement, BOŚ offered PGE EO to acquire 2,000,000 ordinary bearer shares with a nominal value of PLN 10 each total nominal value of PLN 20,000,000. Submission of subscription offer took place through private placement (addressed only to certain investors). PGE EO accepted the offer and on June 23, 2016 paid the total issue price to BOŚ. On July 12, 2016 the increase of the share capital of BOŚ was registered with the National Court Register. Currently there's no information about the registration of the new shares of BOŚ by the National Depository for Securities. As a result of the above transaction, PGE EO currently holds shares constituting 3.18% in the share capital of BOŚ.
- On June 22, 2016 the Ordinary Assemblies of Partners of PGE Inwest 5 sp. z o.o., PGE Inwest 6 sp. z o.o., PGE Inwest 7 sp. z o.o., PGE Inwest 8 sp. z o.o., PGE Inwest 9 sp. z o.o., PGE Inwest 10 sp. z o.o., PGE Inwest 11 sp. z o.o., PGE Inwest 12 sp. z o.o., PGE Inwest 13 sp. z o.o., PGE Inwest 14 sp. z o.o. and PGE Inwest 15 sp. z o.o. (the "Companies") adopted resolutions on the increase of the share capitals of those Companies in each case from PLN 10,000 to PLN 20,000, i.e. by PLN 10,000 PLN, through issue of new 10 shares in each of the Companies with a nominal value of PLN 1,000 each. The increase of the share capitals were acquired by the sole partner of the Companies, i.e. by PGE Polska Grupa Energetyczna S.A., in exchange for the cash contribution. The increase of the share capital was registered with the National Court Register: in PGE Inwest 5 sp. z o.o. on July 19, 2016, in PGE Inwest 6 sp. z o.o. on July 20, 2016, in PGE Inwest 7 sp. z o.o. on July 25, 2016, in PGE Inwest 8 sp. z o.o. on July 18, 2016, in PGE Inwest 11 sp. z o.o. on July 19, 2016, in PGE Inwest 13 sp. z o.o. on July 21, 2016, in PGE Inwest 14 sp. z o.o. on July 19, 2016, in PGE Inwest 15 sp. z o.o. on July 26, 2016. As at the preparation date of this report, there's no information about the registration of the increase of the share capital: PGE Inwest 9 sp. z o.o., PGE Inwest 10 sp. z o.o. and PGE Inwest 12 sp. z o.o.
- In the period from January 1, 2016 to June 30, 2016, PGE S.A. purchased from minority shareholders of PGE GiEK S.A., as a result of a mandatory buyback in accordance with art. 418 of the Polish Commercial Companies' Code, a total of 77,134 shares in PGE GiEK S.A. (constituting 0.01% of PGE GiEK S.A.'s share capital). Currently PGE S.A. holds shares representing 99.972% of the share capital of PGE GiEK S.A.

In the first half of 2016 PGE Group companies changed their capital exposure in the following entities:

- On December 9, 2015 PGE Dystrybucja S.A. and ENEA Operator sp. z o.o. with its seat in Poznań signed a conditional agreement for sale of 4 shares in Centralny System Wymiany Informacji sp. o.o. with its seat in Poznań to PGE Dystrybucja S.A. (the Agreement”), constituting 20% of the share capital of the company. According to the Agreement and annex no. 1 to the Agreement, Condition precedent for the transfer of ownership of shares to PGE Dystrybucja S.A. is the obtaining of the approval for concentration of the Office for Competition and Consumer Protection, wherein the transfer of shares will take place no earlier than December 31, 2016. On June 8, 2016 the Office for Competition and Consumer Protection issued its approval – condition precedent according to the Agreement.
- On February 16, 2016, an Extraordinary Assembly of Partners of BIO – ENERGIA sp. z o.o., based in Warsaw, passed a resolution on voluntary cancellation, for payment, of some of the company’s shares, held by PGE EO S.A., i.e. 130,000 shares. In connection with the share cancellation, the Extraordinary Assembly of Partners passed a resolution on a reduction in the company’s share capital by PLN 13,000,000, i.e. from PLN 22,597,800 to PLN 9,597,800. In connection with the above, PGE EO S.A. and BIO – Energia sp. z o.o. executed an agreement on February 16, 2016 for the sale to the company of the shares being subject to voluntary cancellation. Payment for the shares will take place after the reduction in the company’s share capital is registered by the National Court Register. Pursuant to art. 456 § 1 of the Polish Commercial Companies Code, a creditor notification procedure with regard to the share capital reduction lasted until June 10, 2016. As at the preparation date of this report, there’s no information about the registration of the decrease of the share capital by the register court.
- On May 25, 2016 Pensjonat Dychów sp. z o.o. in liquidation, with its seat in Dychów, was deleted from the National Court Register as a result of the liquidation proceedings. PGE Energia Odnawialna S.A. held 100% shares in the share capital of the company.

In the first half of 2016 PGE Capital Group did not discontinue any of its substantial operations.

## 5.2 Branches of the companies of the PGE Capital Group

As at June 30, 2016 the following PGE Group companies had their branches:

<b>PGE Górnictwo i Energetyka Konwencjonalna S.A.</b> with its registered office in Bełchatów	<ul style="list-style-type: none"> <li>● Branch Bełchatów power plant</li> <li>● Branch Opole power plant</li> <li>● Branch Turów power plant</li> <li>● Branch ZEDO</li> <li>● Branch Bełchatów lignite mine</li> <li>● Branch Turów lignite mine</li> <li>● Branch Gorzów CHP</li> <li>● Branch Bydgoszcz CHPs</li> <li>● Branch Rzeszów CHP</li> <li>● Branch Kielce CHP</li> <li>● Branch Lublin Wrotków CHP</li> <li>● Branch Zgierz CHP</li> </ul>
<b>PGE Energia Odnawialna S.A.</b> with its registered office in Warsaw	<ul style="list-style-type: none"> <li>● Branch ZEW Solina - Myczkowce in Solina</li> <li>● Branch ZEW Porąbka - Żar in Międzybrodzie Bialskie</li> <li>● Branch ZEW Dychów in Dychów</li> <li>● Branch EW Żarnowiec in Czymanów</li> </ul>
<b>PGE Energia Natury sp. z o.o.</b> with its registered office in Warsaw	<ul style="list-style-type: none"> <li>● Branch „Galicja” with seat in Orzechowce</li> </ul>
<b>PGE Trading GmbH</b> with its registered office in Berlin	<ul style="list-style-type: none"> <li>● Branch in Prague</li> </ul>
<b>PGE Dystrybucja S.A.</b> with its registered office in Lublin	<ul style="list-style-type: none"> <li>● Branch Lublin</li> <li>● Branch Łódź-Miasto</li> <li>● Branch Łódź-Teren</li> <li>● Branch Warszawa</li> <li>● Branch Rzeszów</li> <li>● Branch Białystok</li> <li>● Branch Zamość</li> <li>● Branch Skarżysko-Kamienna</li> </ul>
<b>PGE Obrót S.A.</b> with its registered office in Rzeszów	<ul style="list-style-type: none"> <li>● Branch with seat in Lublin</li> <li>● Branch with seat in Łódź</li> <li>● Branch with seat in Warsaw</li> <li>● Branch with seat in Białystok</li> <li>● Branch with seat in Zamość</li> <li>● Branch with seat in Skarżysko-Kamienna</li> </ul>
<b>Elbest sp. z o.o.</b> with its registered office in Bełchatów	<ul style="list-style-type: none"> <li>● Branch Bogatynia</li> <li>● Branch Wawrzkowizna</li> <li>● Branch Krasnobród</li> <li>● Branch Iwonicz-Zdrój</li> </ul>
<b>Elbest Security sp. z o.o.</b> with its registered office in Bełchatów	<ul style="list-style-type: none"> <li>● Branch Rogowiec I</li> <li>● Branch Rogowiec II</li> </ul>
<b>Przedsiębiorstwo Transportowo - Sprzętowe „Betrans” sp. z o.o.</b> with its registered office in Bełchatów	<ul style="list-style-type: none"> <li>● Branch ELTUR-TRANS with seat in Bogatynia</li> <li>● Branch Rogowiec with seat in Rogowiec</li> </ul>
<b>Przedsiębiorstwo Usługowo-Produkcyjne „ELTUR-SERWIS” sp. z o.o.</b> with its registered office in Bogatynia	<ul style="list-style-type: none"> <li>● Branch in Brzezine near Opole</li> </ul>
<b>EPORE sp. z o.o.</b> with its registered office in Bogatynia	<ul style="list-style-type: none"> <li>● Branch Bogatynia</li> <li>● Branch Bełchatów</li> <li>● Branch in Brzezine</li> <li>● Branch Żarska Wieś</li> </ul>
<b>ELBIS sp. z o.o.</b> with its registered office in Bogatynia	<ul style="list-style-type: none"> <li>● I Branch with seat in Warsaw</li> </ul>
PGE S.A. and other Group companies do not have branches.	

## 6 Other significant events of the reporting period and subsequent events

### 6.1 Investment Agreement on the financial investment in Polska Grupa Górnicza sp. z o.o.

On April 28, 2016, PGE Górnictwo i Energetyka Konwencjonalna S.A. signed the Investment Agreement determining the conditions of the financial investment (the "Investment") in Polska Grupa Górnicza sp. z o.o. (the „Agreement”). The parties of the Agreement are: PGE Górnictwo i Energetyka Konwencjonalna, ENERGA Kogeneracja, PGNiG TERMIKA S.A., Węglkoks S.A., Towarzystwo Finansowe „Silesia” Sp. z o.o., Fundusz Inwestycji Polskich Przedsiębiorstw FIZAN (jointly referred later to as the „Investors”) and Polska Grupa Górnicza Sp. z o.o. („PGG”). PGG operates on the basis of selected mining assets, acquired from Kompania Węglowa S.A. (“KW”) (including 11 hard coal mines, 4 operational units and support, managing and supervisory functions of KW headquarters transferred therewith).

The Agreement specifies the Investment conditions, including inter alia, conditions of PGG recapitalisation by the Investors, operating rules of PGG and corporate governance rules, including method of Investors’ supervision over PGG.

Recapitalisation of PGG in total amount of PLN 2,417 million, was divided into 3 stages, within which PGE GiEK S.A. will pay a total of PLN 500 million, including:

- PLN 361 million within the first stage. The result was acquisition of 15.7% in the share capital of PGG by PGE GiEK S.A. on April 29, 2016;
- PLN 83 million within the second stage (up to November 3, 2016). As a result of the second payment, PGE GiEK’s share in the share capital of PGG will increase to 16.6%;
- PLN 56 million within the third stage (up to February 1, 2017). As a result of the third payment, PGE GiEK’s share in the share capital of PGG will increase to 17.1%.

The particular tranches will be released, on the condition, inter alia, that terms of PGG bonds issue are not breached.

PGG operates on the basis of the business plan, which aims at optimisation of coal production costs and achieving defined profitability levels. Business Plan assumes that in 2017 PGG will generate positive cash flows for the Investors. The Agreement foresees several mechanisms allowing for on-going monitoring of the financial standing of PGG, including execution of Business Plan and taking further optimization measures, among others, in case of adverse changes in market conditions. The Agreement assumes that each shareholder of PGG is entitled to appoint, recall and suspend one member of the Supervisory Board (individual rights). Moreover, key decisions of the Assembly of Partners of PGG regarding the capital management and restructuring require the Investors’ approval.

In view of the powers indicated above that PGE GiEK S.A. is entitled to, in the consolidated financial statements investment in PGG is treated as associate and accounted for using the equity method.

### 6.2 Changes in the Management Board

Until January 28, 2016 the Management Board consisted of:

Name and surname of the Management Board member	Position
Marek Woszczyk	President of the Management Board
Jacek Drozd	Vice-President of the Management Board for Corporate Affairs
Dariusz Marzec	Vice-President of the Management Board for Development
Grzegorz Krystek	Vice-President of the Management Board for Operations and Trading

On January 29, 2016 the Supervisory Board dismissed Mr. Jacek Drozd and Mr. Dariusz Marzec from the Management Board and delegated Mr. Marek Pastuszko, appointed to the Supervisory Board by the statement of the Minister of the State Treasury on January 28, 2016, to temporarily perform the duties of the Vice-President of the Management Board for the 3-month period.

On February 25, 2016 the Supervisory Board cancelled delegation of Mr. Marek Pastuszko to temporarily perform the duties of the Member of the Management Board and the Supervisory Board appointed him as a member of the PGE’s Management Board entrusting him the position of the Vice-President for Corporate Affairs.

On February 26, 2016 the Supervisory Board appointed Mr. Emil Wojtowicz to the Management Board as from March 15, 2016 entrusting him the position of the Vice-President for Finance and appointed Mr. Ryszard Wasilek to the Management Board of office as from March 7, 2016 entrusting him the position of the Vice-President for Development.

On March 2, 2016 Mr. Marek Woszczyk and Mr. Grzegorz Krystek submitted resignations from their positions in the Management Board as from March 30, 2016.

On March 22, 2016 Mr. Paweł Śliwa submitted his resignation from the Supervisory Board and the Supervisory Board appointed four members of the Management Board as from March 31, 2016:

- Mr. Henryk Baranowski, entrusting him the position of the President of the Management Board;
- Ms. Marta Gajęcka, entrusting her the position of the Vice-President for Market Development and International Relations;
- Mr. Bolesław Jankowski, entrusting him the position of the Vice-President for Trading;
- Mr. Paweł Śliwa, entrusting him the position of the Vice-President for Innovations.

As at the publication date of this report, the Management Board of the Company consists of:

<b>Name and surname of the Management Board member</b>	<b>Position</b>
Henryk Baranowski	President of the Management Board
Marta Gajęcka	Vice-President of the Management Board for Market Development and International Relations
Bolesław Jankowski	Vice-President of the Management Board for Trading
Marek Pastuszko	Vice-President of the Management Board for Corporate Affairs
Paweł Śliwa	Vice-President of the Management Board for Innovations
Ryszard Wasilek	Vice-President of the Management Board for Development
Emil Wojtowicz	Vice-President of the Management Board for Finance

### **6.3 Changes in the Supervisory Board**

Until January 28, 2016 the Supervisory Board consisted of:

<b>Name and surname of the Supervisory Board member</b>	<b>Position</b>
Anna Kowalik	Chairman of the Supervisory Board
Jacek Barylski	Vice-Chairman of the Supervisory Board – independent (statement of July 11, 2016)
Małgorzata Molas	Secretary of the Supervisory Board
Małgorzata Mika – Bryska	Supervisory Board Member
Jarosław Gołębiowski	Supervisory Board Member - independent
Piotr Machnikowski	Supervisory Board Member - independent
Marek Ściążko	Supervisory Board Member - independent
Jacek Fotek	Supervisory Board Member - independent

On January 28, 2016 the State Treasury appointed Mr. Marek Pastuszko as a member of the Supervisory Board of the Company by way of a written declaration submitted to the Management Board of the Company. On January 29, 2016 Mr. Marek Pastuszko was delegated by the Supervisory Board to temporarily perform the duties of the Member of the Management Board - Vice-President for Corporate Affairs. Then, on February 25, 2016 Mr. Marek Pastuszko submitted his resignation from the Supervisory Board and the Supervisory Board appointed Mr. Marek Pastuszko for the position of the Vice-President of the Management Board for Corporate Affairs.

On February 5, 2016 the Company received a resignation from Mr. Piotr Machnikowski from the Supervisory Board.

On March 1, 2016 the Extraordinary General Meeting of the Company adopted resolutions on:

- dismissal of Mr. Jacek Barylski, Ms. Małgorzata Molas, Mr. Jarosław Gołębiowski, Mr. Jacek Fotek and Mr. Marek Ściążko from the Supervisory Board;
- appointment of Mr. Jarosław Głowacki, Ms. Janina Goss, Mr. Mateusz Gramza, Mr. Mieczysław Sawaryn, Mr. Artur Składanek and Mr. Grzegorz Kuczyński to the Supervisory Board.

Moreover, on March 1, 2016 the State Treasury appointed Mr. Paweł Śliwa as a member of the Supervisory Board of the Company by way of a written declaration submitted to the Management Board of the Company. On March 22, 2016 Mr. Paweł Śliwa submitted his resignation from the Supervisory Board and the Supervisory Board appointed Mr. Paweł Śliwa for the position of the Vice-President of the Management Board for Innovations as from March 31, 2016.

As at the publication date of this report, the Supervisory Board of the Company consists of:

<b>Name and surname of the Supervisory Board member</b>	<b>Position</b>
Anna Kowalik	Chairman of the Supervisory Board
Małgorzata Mika-Bryska	Vice-Chairman of the Supervisory Board
Grzegorz Kuczyński	Secretary of the Supervisory Board - independent
Jarosław Głowacki	Supervisory Board Member - independent
Janina Goss	Supervisory Board Member - independent
Mateusz Gramza	Supervisory Board Member - independent
Mieczysław Sawaryn	Supervisory Board Member - independent
Artur Składanek	Supervisory Board Member - independent

Table: Composition of the standing committees of the Supervisory Board in the first half of 2016:

<b>Name and surname of the Supervisory Board member</b>	<b>Audit Committee</b>	<b>Corporate Gov- ernance Commit- tee</b>	<b>Strategy and De- velopment Com- mittee</b>	<b>Appointment and Remuneration Committee</b>
<b>Janina Goss</b>	Member from March 2, 2016			Member from March 2, 2016
<b>Jacek Barylski</b>		Member until March 1, 2016		Chairman until March 1, 2016
<b>Jacek Fotek</b>	Member until March 1, 2016			
<b>Jarosław Głowacki</b>		Member from March 2, 2016	Member from March 2, 2016	
<b>Jarosław Gołębiewski</b>	Chairman until March 1, 2016		Member until March 1, 2016	
<b>Mateusz Gramza</b>	Member from March 7, 2016	Member from March 2, 2016 until March 7, 2016		Member from March 2, 2016
<b>Anna Kowalik</b>	Member			Member
<b>Piotr Machnikowski</b>		Chairman until February 5, 2016		Member until February 5, 2016
<b>Małgorzata Mika-Bryska</b>		Member	Member	
<b>Małgorzata Molas</b>			Member until March 1, 2016	Member until March 1, 2016
<b>Grzegorz Kuczyński</b>	Member from March 2, 2016 Chairman from March 18, 2016	Member from March 2, 2016		
<b>Mieczysław Sawaryn</b>			Member from March 2, 2016	Member from March 2, 2016
<b>Artur Składanek</b>		Member from March 7, 2016	Member from March 2, 2016	
<b>Paweł Śliwa</b>		Member from March 2, 2016 until March 22, 2016		Member from March 2, 2016 until March 22, 2016
<b>Marek Ściążko</b>			Member until March 1, 2016	

## 6.4 Activities related to nuclear energy

### Business partnership

As a result of the sale of shares to the Business Partners (TAURON Polska Energia S.A., ENEA S.A. and KGHM Polska Miedź S.A.) by PGE S.A., PGE S.A. holds 70% in the share capital of PGE EJ 1 sp. z o.o., and each of the Business Partners holds 10% in the share capital of PGE EJ 1 sp. z o.o.

According to the Partners' Agreement, concluded on September 3, 2014, the Parties jointly undertook to finance operations under the initial phase of the Program (the "Development Stage"), proportionally to their shareholdings. The funds for the Program are paid to PGE EJ 1 sp. z o.o. in form of the increase of the share capital. PGE's financial commitment in the Development Stage will not exceed amount of approx. PLN 700 million.

### Financing

In the first half of 2016, the works were continued (for the needs of the integrated proceeding) on financing structure of the Program based on updated assumptions regarding capital expenditures and operating costs for the nuclear power plant and revised financing model for the investment. Preparatory works for the selection of financial and insurance advisor were also conducted.

Works in those areas are assumed to be continued in the third quarter of 2016.

### Support schemes

In the first half of 2016, dialogue with the Polish government continued in the area of laying down the conditions for the Polish nuclear power project, taking into consideration the potential support mechanisms dedicated to nuclear power, including the contract for difference, among others.

In the third quarter of 2016, further work is planned together with the government, aiming to develop detailed proposals for economic, organisational and legal solutions relating to the execution of the Polish nuclear project, together with allocation of risks and a cost estimate for implementing such solutions.

### Integrated proceeding

The objective of the integrated proceeding is to select concurrently, within a single procedure, all of the key contractors to build the first Polish nuclear plant (i.e. an integrated investment and capital package combined with delivery of technology and related services, supplies and construction work (in the EPC formula), fuel supply as well as related services and O&M support services).

In the first half of 2016 preparations for the invitation to the integrated proceeding were completed.

### Selection of nuclear plant location, including site and environmental decisions

In the first quarter of 2016, the approach to site and environment surveys was updated and the three potential sites for Poland's first nuclear plant, i.e. Lubiatowo-Kopalino, Choczewo and Żarnowiec, were verified in terms of hydrogeological, natural, infrastructural, social and economic conditions. Analysis was carried out regarding impact on the integrity, cohesiveness and subject of protection of Natura 2000 areas. Based on the results of the analysis and the verification procedure, a decision was made to select two locations, i.e. Lubiatowo-Kopalino and Żarnowiec, for the needs of environmental and site surveys for the purposes of preparing an environmental impact assessment and site report.

In the second quarter of 2016 the General Director for Environment Protection issued a decision regarding the scope of the environmental impact assessment, taking into consideration the two potential sites: Lubiatowo-Kopalino and Żarnowiec.

### Planning and preparing related infrastructure

Studies were being carried out in the first quarter of 2016 regarding preparations for potential access routes to construction sites at the locations being considered. These constitute the basis for designating environmental ground survey areas.

In the second quarter of 2016, PGE EJ 1 sp. z o.o. participates in public consultations for the "Pomeranian voivodship development plan" and the "Gdańsk-Gdynia-Sopot metropolitan area plan" in order to include in said plans infrastructure tasks related to the nuclear plant.

Works in those areas are assumed to be continued in the third quarter of 2016.

### **Decision in principle from the Minister of Energy (including general opinion from the President of the National Atomic Energy Agency)**

Consultations were carried out with the President of the National Atomic Energy Agency (PAA) in the first quarter of 2016 regarding the processing of applications and schedule for issuing decisions by the PAA's President for nuclear technologies that are to be qualified for participating in the integrated procedure as well as the scope of application for issue of a general opinion and the type of documents required and the scope of information in the application expected by the PAA President. The second quarter of 2016 brought further arrangements with the PAA.

#### **Social acceptance**

The main objective of activities in this area is garnering and maintaining a high level of social support at the potential nuclear plant locations (eventually, at the selected location), allowing to implement the programme to build Poland's first nuclear plant and provide knowledge about nuclear power and the programme to specific stakeholder groups at national and local level.

From the first quarter of 2016, applications can be submitted under the Programme to Support the Development of Site Municipalities („PWRGL”). Program's aim is to strengthen partnership-based relations between PGE EJ 1 sp. z o.o. and the local communities and authorities of the three municipalities by providing support to initiatives that are of significance to the residents and development of the region. Contracts with qualified applicants under the PWRGL programme were signed in the second quarter of 2016.

On national level, the third edition of the Atom for Science programme was initiated. As in the previous years, two competitions were part of the programme: for students and for academics.

## **6.5 Legal aspects**

### **Claims for annulment of the resolutions of the General Meetings of PGE S.A.**

On April 1, 2014 PGE S.A. received a copy of lawsuit filed to the District Court in Warsaw by one of the shareholders. In the lawsuit, the shareholder is seeking for annulment of the resolutions 1, 2 and 4 of the Extraordinary General Meeting of the Company held on February 6, 2014. The Company filed response to the claim. On June 22, 2015 the District Court in Warsaw dismissed in full the shareholder's claim. On July 28, 2015 the shareholder appealed against that verdict. The Company filed reply to that appeal.

On September 17, 2014 PGE S.A. received a copy of lawsuit filed to the District Court in Warsaw by one of the shareholders. In the lawsuit, the shareholder is seeking for annulment of the resolution 4 of the Ordinary General Meeting of the Company held on June 6, 2014. The Company filed response to the claim.

On August 13, 2015 the District Court in Warsaw dismissed in full the shareholder's claim. The verdict is not final and binding. On December 7, 2015 PGE S.A. received copy of the appeal by the Claimant. On December 21, 2015 the Company filed response to the appeal.

On August 21, 2015 PGE S.A. received a copy of lawsuit filed to the District Court in Warsaw by one of the shareholders. In the lawsuit, the shareholder is seeking for annulment of the resolution 5 of the Ordinary General Meeting of the Company held on June 24, 2015. On September 21, 2015 the Company filed response to the claim. The District Court in Warsaw dismissed the shareholder's claim in the verdict published on April 26, 2016.

On October 23, 2015 PGE S.A. received a copy of lawsuit filed to the District Court in Warsaw by one of the shareholders. In the lawsuit, the shareholder is seeking for annulment of the resolution 1 of the Extraordinary General Meeting of the Company held on September 14, 2015. On November 23, 2015 the Company filed response to the claim.

On May 20, 2016 PGE S.A. received a copy of lawsuit filed to the District Court in Warsaw by one of the shareholders. In the lawsuit, the shareholder is seeking for annulment of the resolution 1 of the Extraordinary General Meeting of the Company held on March 1, 2016. On June 2, 2016 the Company filed response to the claim.

### **The issue of compensation regarding the conversion of shares**

Former shareholders of PGE Górnictwo i Energetyka S.A. filed petitions calling PGE S.A. for a pre-trial settlement with respect of the payment of damages for incorrectly set – as they claim – share exchange ratio of PGE Górnictwo i Energetyka S.A. shares for the shares of PGE S.A. in the consolidation process which took place in 2010. The total value of claims resulting from petitions for pre-trial settlements by former shareholders of PGE Górnictwo i Energetyka S.A. is over PLN 10 million.

Notwithstanding the foregoing, on November 12, 2014 Socrates Investment S.A. (the purchaser of the liabilities from former shareholders of PGE Górnictwo i Energetyka S.A.) filed a lawsuit for compensation in total amount exceeding PLN 493 million



(plus interests) for the damage resulting from incorrectly (in opinion of the Socrates Investment S.A.) set share exchange ratio in the consolidation process of PGE Górnictwo i Energetyka S.A. with PGE S.A.

The Company filed its reply to the lawsuit on March 28, 2015. In September 2015 Socrates Investment S.A. presented its letter constituting a response to the Company's reply to the lawsuit.

The court hearing took place on April 27, 2016. Both of the parties upheld their previous motions and statements, and Socrates Investment also filed a motion to dismiss PGE's motions from a letter dated April 10, 2016. The court scheduled the next hearing for August 10, 2016.

PGE S.A. does not accept the claims of Socrates Investment S.A. and of the other shareholders filing for a pre-trial settlement. The claims are unsubstantiated. In the opinion of PGE S.A. the whole consolidation process was executed in fair and proper manner. The value of the shares of companies subject to the mergers was assessed by the independent company - PwC Polska sp. z o.o. Additionally, plan of the companies' merger, including the exchange ratio with respect to shares of the acquired company for the shares of the acquiring company were examined for accuracy and reliability by an expert appointed by the registration court; no irregularities were found. Then, the court registered the merger of the companies.

### **Compensations from WorleyParsons**

In 2013, PGE EJ 1 sp. z o.o. signed an agreement for environmental studies, site characterisation and services related to obtaining permits and permissions necessary in the investment process associated with the construction of a nuclear power plant with a consortium of WorleyParsons Nuclear Services JSC, WorleyParsons International Inc. and WorleyParsons Group Inc. ("WorleyParsons", the "Contractor"), in the amount of PLN 253 million net (including basic range of PLN 167 million). Due to delays in the implementation of the agreement, in 2013 the company accrued to WorleyParsons a contractual penalty in the amount of PLN 7 million. In addition, in connection with a further improper execution of services in 2014, the company accrued contractual penalties in the total amount of PLN 43 million. On December 23, 2014, PGE EJ 1 sp. z o.o. terminated the contract for reasons attributable to the Contractor.

Contractual penalties of 2013 were deducted from the remuneration payable to WorleyParsons in 2014. Penalties for 2014 in the total amount of PLN 30 million were deducted from the remuneration payable to WorleyParsons and the bank guarantee. After all deductions and amounts received by the company from the bank guarantee, the company is entitled to claim towards WorleyParsons for payment of PLN 14 million as a penalty by way of delay.

On August 7, 2015 PGE EJ 1 sp. z o.o. filed with the District Court in Warsaw, Commercial Division a claim against WorleyParsons for the payment of nearly PLN 15 million plus statutory interest for late payment of the amount due. The claimed amount includes the amount of the outstanding contractual penalties and interest for delay capitalized as at the date of filing the claim.

On January 8, 2016, PGE EJ 1 sp. z o.o. received a statement of defence from WorleyParsons International Inc. and WorleyParsons Group Inc.

On April 20, 2016 PGE EJ 1 sp. z o.o. received a statement of defence from WorleyParsons Nuclear Services JSC. A hearing in this matter has been scheduled for September 27, 2016. This will be a closed-door meeting pursuant to art. 207 § 4 of the Polish Civil Procedure Code.

Furthermore, on November 13, 2015, PGE EJ 1 sp. z o.o. received a payment demand from WorleyParsons for PLN 59 million due for, according to the claimant, remuneration and cost reimbursement that were incorrectly, according to the claimant, collected by the company from the bank guarantee. The court obligated PGE EJ 1 sp. z o.o. to submit a statement of defence within three months from receipt.

On February 13, 2016 PGE EJ 1 sp. z o.o. filed with the District Court in Warsaw a reply to the claim by WorleyParsons.

Furthermore, on May 20, 2016, PGE EJ 1 sp. z o.o. filed a motion with the Regional Court for the Capital City of Warsaw in Warsaw to commit WorleyParsons Nuclear Services JSC, WorleyParsons International Inc. and WorleyParsons Group Inc. ("Defendants") to attempt reaching a settlement concerning the Company's claims for compensation, i.e. payment to the company of PLN 40.6 million together with statutory interest for delays from the due date for payment of the above amount until the payment date for compensation for undue performance by the Defendants of obligations arising under agreement no. PGE/EJ1/08/2013 concerning environment surveys, site characterization and services connected with obtaining permits and authorisations for an investment process connected with the construction by PGE EJ sp. z o.o. of Poland's first nuclear plant with capacity of approx. 3000 MW, executed by the Defendants as contractor and the company as contracting entity on February 7, 2013.

## 6.6 Description of material agreements

No material agreements occurred in the first half of 2016.

## 6.7 Information on granting by the Company or its subsidiary of loan securities or guarantees

Within the Group, in the 6-month period ended June 30, 2016 PGE S.A. and its subsidiaries did not grant any loan securities or guarantees to another entity or its subsidiary, where the value of securities and guarantees constituted at least 10% of the Company's equity.

## 6.8 Impairment of the power generating assets of Renewable energy segment

In the first half of 2016 the PGE Group identified impairment indications that could significantly influence the value of the power generating assets and goodwill of Renewables segment. In the PGE Group's opinion the most important factors influencing the recoverable amount of assets are:

- Changes in the market environment

The delayed entry into force of the new support system for the production of electricity from renewable energy sources causes that new units are involved in the current system of support. Although, since the beginning of 2016 support for large hydropower and biomass co-firing with coal technologies was limited, the delayed entry into force of the provisions of section 4 of the Act on Renewable Energy Sources dated February 20, 2015 contributed to even higher increase of a large surplus of green certificates. Additionally, expected changes of the support system contributed to the intensification of construction works, the consequence of which was a large number of wind power plants that were put into use in 2015 and in the first half of 2016. As a result, there have been further declines of prices of energy origin rights and worsening future forecasts.

- Changes in the legal environment

On May 20, 2016 act on investments in wind farms was passed. Among other things, it amends the definition of construction in the construction law. Changed definition of construction causes that the tax base of real estate tax will be expanded to wind farms.

Consequently the PGE Group forecasts a decrease in future cash flows and recognizes the risk of impairment of power generating assets of Renewables segment in the area of wind farms.

The impairment tests of cash-generating units ("CGU") were carried out as at June 30, 2016 in order to determine their recoverable amount. The recoverable amount was determined based on estimated value in use of the tested assets calculated using the discounted cash flow method on the basis of financial projections for assumed economic useful life of the particular CGU. According to the PGE Group, adoption of the financial projections longer than five years is reasonable due to the fact that property, plant and equipment used by the Group have significantly longer economic useful lives and due to the significant and long-term impact of projected changes in the regulatory environment.

### The assumptions

The key assumptions influencing the recoverable amount of tested CGUs were as follows:

- recognition as a single CGU of:
  - pumped-storage power plants,
  - other hydro power plants,
  - wind farms.
- the production of electricity and energy origin rights based on historical data and expert estimates made for the investment needs and taking into consideration the availability of particular units.
- electricity prices forecasts for the years 2016-2030 assuming an increase in the wholesale market price by more than 20% till 2020 and a smaller increase in the following years (in fixed prices),
- energy origin rights prices assuming an increase in prices for the years 2017-2019 in relation to current prices and a significant decrease in the following years (with an exception that for the production of covered by binding contracts prices resulting from these contracts were assumed),
- increase of property tax,
- maintenance of production capacities at the current level, as a result of replacement investments,
- adoption of weighted average cost of capital after tax (WACC) at the level of 7.56%.

Forecasted electricity and energy origin rights prices are derived from the study prepared by an independent expert. The forecast of energy prices defined as the most likely was considered, with an exception that for the part covered by binding contracts, prices resulting from these contracts during their validity were assumed.

#### **Impairment of the power generating assets of Renewable energy segment**

he tests conducted indicate impairment of some of the wind farms and goodwill allocated to this CGU.

As at June 30, 2016 PLN million	Value before impairment	Impairment loss	Value after impairment
<b>Power generating assets of Renewable energy segment</b>			
Pumped-storage power plants	800	-	800
Other hydropower plants	349	-	349
Wind farms	2,636	479	2,157
Investment projects	220	32	188
Goodwill	284	272	12
<b>TOTAL</b>	<b>4,289</b>	<b>783</b>	<b>3,506</b>

#### **Sensitivity analysis**

The results of the sensitivity analysis show that changes in estimates regarding the sales prices of energy origin rights and electricity as well as weighted average cost of capital have the most significant impact on the recoverable amount of the measured assets. The table below presents the estimated impact of changes in key assumption on changes in impairment loss of Renewables segment assets as at June 30, 2016.

Parameter	Change	Impact on impairment loss	
		Increase in impairment loss	Decrease in impairment loss
Change in electricity prices throughout the forecast period	+ 1%	-	20.6
	- 1%	20.6	-
Change in WACC	+ 0.5 p.p.	75.7	-
	- 0.5 p.p.	-	72.2
Change in energy origin rights prices throughout the forecast period	+ 1%	-	9.6
	- 1%	9.6	-

## **6.9 Decisions of the President of the Energy Regulatory Office related to realisation of LTC Act**

Some generating entities, currently branches of PGE GiEK, became entitled to receive funds to cover stranded costs (so-called "LTC compensation") pursuant to the LTC Act. The LTC Act is ambiguous in many points and raise important questions of interpretation. The calculation of the estimated results of each entity and resulting compensations, annual adjustments of stranded costs and final adjustments as well as resulting revenues recognized in the statement of comprehensive income was performed by the company with the best of its knowledge in this area and with support of external experts.

Until the preparation date of this report, producers from PGE Group (branches of PGE GiEK) received decisions on annual adjustments of stranded costs and costs related to natural gas fired entities for 2008-2014. The part of these decisions were disadvantageous for the particular entities and the company believes that they were issued in violation of the Long-Term Contracts Act. As a consequence, since 2009, a number of proceedings have been pending before the Regional Court in Warsaw - Competition and Consumer Protection Court ("CCP Court") and before the Court of Appeal. As at the preparation date of this report, majority of the proceedings are conducted before the Supreme Court.

In the first half of 2016:

- A hearing before the Court of Justice of the European Union (CJEU) took place on January 27, 2016 regarding preliminary questions from the Supreme Court to the CJEU, where each of the parties presented their position. The Company is awaiting a ruling by the CJEU. On April 14 the Advocate General presented written opinion on that matter.
- On April 7, 2016 the court case was conducted before the Supreme Court, during which a cassation appeal of the ERO President was examined in case of the annual adjustment of costs arising in gas-fired units at PGE GiEK S.A. Branch Elektrociepłownia Lublin Wrotków for 2009. The Supreme Court repealed the contested judgment

of the Court of Appeal in Warsaw in full and dismissed the appeal of PGE GiEK S.A. Claim value in this case amounts to nearly PLN 7 million. As a consequence of the verdict, the company paid that amount to the account of Zarządca Rozliczeń S.A.

- On April 7, 2016 the Supreme Court refused to accept the cassation appeal for examination in case of the annual adjustment of costs arising in gas-fired units at PGE GiEK S.A. Branch Elektrociepłownia Lublin and Branch Elektrociepłownia Rzeszów for 2010. The ruling ends the proceedings, meaning that rulings by the CCP Court and the Court of Appeal are binding. Claim value in this case amounts to PLN 4 million.
- On April 14, 2016 the court case was conducted before the Court of Appeal on determining the annual adjustment for stranded costs due to GiEK S.A. Branch Elektrownia Opole for 2010. The court allowed the appeal of PGE GiEK S.A. and at the same time dismissed the appeal of the ERO President. The above means that the court changed the contested decision as requested by the appeal of PGE GiEK S.A. The judgement is final and binding. The ERO President is entitled to file a cassation appeal with the Supreme Court. Claim value in this case amounts to approx. PLN 142 million. Zarządca Rozliczeń S.A. transferred that amount to the company's account.
- On May 12, 2016 the court case was conducted before the Court of Appeal on determining the annual adjustment of costs arising in gas-fired units at PGE GiEK S.A. Branch Elektrociepłownia Rzeszów for 2012. The Court of Appeal issued verdict in which it changed the verdict of the CCP Court in full and rejected the company's appeal. Claim value in this case amounts to approx. PLN 7 million.
- On May 12, 2016 the Supreme Court refused to hear the cassation appeal of the company in case of the annual adjustment of costs arising in gas-fired units at PGE GiEK S.A. Branch Elektrociepłownia Rzeszów for 2009 and 2011. Claim value in both cases amounts to approx. PLN 10 million.
- On August 8, 2016 PGE GiEK S.A. received administrative decision of the ERO President regarding the annual adjustment of the stranded costs for the year 2015. The amount of the annual adjustment of stranded costs in generating units: Branch Elektrownia Turów and Branch Elektrownia Opole for 2015 amounts to approx. PLN (+) 326 million. The company does not dispute this amount. The amount of advances collected in 2015 amounted to PLN 251 million.

#### **Impact on the financial statements for the period ended June 30, 2016**

In the financial statements for the period ended June 30, 2016, the Group recognized LTC revenue in sales revenue in the amount of PLN 253 million.

The verdict of the Court of Appeal on determining the annual adjustment for stranded costs due to GiEK S.A. Branch Elektrownia Opole for 2010 caused an adjustment of LTC settlements of approx. PLN (+) 173 million in the financial statements for the period ended June 30, 2016.

Moreover, refusal to accept the cassation appeal for examination in case of the annual adjustment of costs arising in gas-fired units at PGE GiEK S.A. Branch Elektrociepłownia Lublin and Branch Elektrociepłownia Rzeszów for 2010 and unfavourable ruling of the Supreme Court in case of the annual adjustment of costs arising in gas-fired units at PGE GiEK S.A. Branch Elektrociepłownia Lublin Wrotków for 2009 caused an adjustment of LTC settlements of PLN (-) 25 million in the financial statements for the period ended June 30, 2016.

Above adjustments are presented after compensation in the statement of the comprehensive income in other operating revenues.

The value of disputes in all matters relating to the years 2008 – 2012 amounts to PLN 1,660 million, including the value of disputes favourably resolved for PGE Group by the Court of Appeal and a favourable final judgment by the CCP Court in the amount of PLN 1,563 million.

In the period 2008 – June 30, 2016 the PGE Capital Group recognised LTC revenues in total amount of PLN 7,488 million.

#### **6.10 Information concerning proceedings in front of court, body appropriate for arbitration proceedings or in front of public administration authorities**

As at June 30, 2016 PGE S.A. and its subsidiaries were not a party of any proceedings concerning payables or debts whose total value would constitute at least 10% of the Company's equity.

Significant proceedings pending in front of courts, competent arbitration authority or public administration authority are described in note 21.4 to the consolidated financial statements.

### **6.11 Information on issue, redemption and repayment of debt securities and other securities**

Information on issue, redemption and repayment of debt securities and other securities were described in p. 5.1. of the foregoing report.

### **6.12 Information concerning the payment of dividend for 2015**

The Ordinary General Meeting of the Company of June 28, 2016 adopted the resolution on distribution of net profit for the financial year 2015 in amount of PLN 1,768 million. PLN 467 was allocated for a dividend pay-out to the Company shareholders, what gives a dividend of 0.25 per one share of the Company. The remaining amount, i.e. PLN 1,301 million, was allocated for the reserve capital.

### **6.13 Information concerning the potential disposal of shares of Exatel S.A. to Polska Grupa Zbrojeniowa**

On May 31, 2016 PGE S.A. and Polska Grupa Zbrojeniowa (PGZ) signed a letter of intent in which they express their willingness to cooperate in order to conclude a sale of Exatel from PGE to PGZ. Currently PGE Group holds 100% shares of Exatel S.A., which is telecommunication operator providing solutions for business and public administration.

### **6.14 Information concerning the dispute between Exatel S.A. and Taifun Real sp. z o.o.**

Since 2005 Exatel S.A. (Exatel) and Taifun Real sp. z o.o. (Taifun Real) have been in a dispute regarding lease agreement for the previous office of Exatel.

On June 23, 2016, the Court of Arbitration at the Polish Chamber of Commerce in Warsaw issued a verdict in a case claimed by Taifun Real sp. z o.o. against Exatel S.A. and ordered Exatel S.A. to pay PLN 51 million together with statutory interest from the date of July 2, 2013 to Taifun Real sp. z o.o. (total amount payable – PLN 67 million). On July 29, 2016, after the Court of Appeal ascertained enforceability of the arbitration award, the amount awarded by the Court of Arbitration was paid to Taifun Real, together with accrued interest and costs of the proceeding.

### **6.15 Rating**

In the first half of 2016, rating agencies Moody's Investors Service and Fitch Ratings affirmed long-term ratings for PGE S.A. On May 25, 2016 Moody's affirmed its rating at Baa1 with stable outlook. Fitch affirmed PGE's long-term foreign and local currency Issuer Default Ratings at 'BBB+' with a stable outlook on August 5, 2016.

Moody's, in its release of May 25, 2016 appreciates strong position of PGE Group as an integrated power group dominant on the electricity market in Poland, including regulated distribution segment which is characterized by a low level of operational risk. At the same time Moody's indicates the significant fuel concentration of the generation assets posing a high exposure to carbon as well as weak electricity prices and substantial investment program. In addition Moody's indicates that prudent financial policies that balance shareholders and creditors needs will be key in preserving the current ratings. The assigned rating further takes into account an expected increase in leverage due to negative free cash flows arising from a significant capital expenditure programme.

According to Fitch's opinion, affirmation of the rating results from PGE's strong market position in the Polish electricity sector and conservative financial profile. This rating is constrained by the fairly low portion of the regulated business (distribution of electricity) in EBITDA and significant investment plans. Fitch also expects a decline in margins of PGE's core business of conventional generation. In Fitch's opinion, the large capital expenditure plans will increase funds from operations adjusted net leverage to approximately 2x by 2017 and close to 3x by 2020 from 0.3x net leverage at the end of December 2015.

On August 3, 2016 Fitch Ratings upgraded National Long-Term rating and National senior unsecured rating of PGE from "AA-(pol)" to "AA(pol)". The change of national rating follow the recalibration of the Polish National rating scale driven by the downgrade of Poland's long-term local currency Issuer Default Rating.

## 6.16 Amendment to the half-year report issued on August 9, 2016

Condensed interim consolidated financial statements (note 3.2) and management board's report on activities (chapter 6.8) issued on August 9, 2016 contained obvious typographical error in the table being part of the paragraph Impairment of the power generating assets of Renewables segment.

Previous content:

■ Wind farms / Value before impairment	636
■ Wind farms / Value after impairment	157
■ TOTAL / Value before impairment	2,289
■ TOTAL / Value after impairment	1,506

Amended as follows:

■ Wind farms / Value before impairment	2,636
■ Wind farms / Value after impairment	2,157
■ TOTAL / Value before impairment	4,289
■ TOTAL / Value after impairment	3,506

## 7 Statements of the Management Board

### 7.1 Statement on the reliable preparation of the financial statements

To the best knowledge of the Management Board of PGE S.A., the half-year consolidated financial statements and comparable data were prepared in accordance with the governing accounting principles, present a fair, true and reliable view of the material and financial situation of PGE Capital Group and its financial result.

The report of the Management Board on the activities of PGE Capital Group presents a true view of the development, achievements and situation of the Capital Group.

### 7.2 Statement on the entity authorised to audit the financial statements

The Management Board of PGE S.A. declares that the entity authorised to audit the financial statements, which reviews the interim consolidated financial statements and audits the interim separate financial statements, has been appointed in accordance with provisions of the law. The entity and the statutory auditors, who performed the review and audit, fulfilled all the requirements for issuing an unbiased and independent report on the review and audit, in accordance with the governing provisions and professional standards.

## 8 Approval of the Management Board's Report

The foregoing Management Board's Report on activities of the Capital Group of PGE Polska Grupa Energetyczna S.A. was approved for publication by the Management Board of the parent company on August 9, 2016.

Warsaw, August 9, 2016

Signatures of Members of the Management Board of PGE Polska Grupa Energetyczna S.A.

**President of the Management  
Board**

**Henryk Baranowski**

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**Vice-President of the Management  
Board**

**Marta Gajęcka**

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**Vice-President of the Management  
Board**

**Bolesław Jankowski**

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**Vice-President of the Management  
Board**

**Marek Pastuszko**

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**Vice-President of the Management  
Board**

**Paweł Śliwa**

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**Vice-President of the Management  
Board**

**Ryszard Wasilek**

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**Vice-President of the Management  
Board**

**Emil Wojtowicz**

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## **GLOSSARY**

Ancillary control services (ACS)	services provided to the transmission system operator, which are indispensable for the proper functioning of the national power system and ensure the keeping of required reliability and quality standards.
Achievable capacity	the maximum sustained capacity of a generating unit or generator, maintained continuously by a thermal generator for at least 15 hours or by a hydroelectric generator for at least five hours, at standardized operating conditions, as confirmed by tests.
Balancing market	a technical platform for balancing electricity supply and demand on the market. The differences between the planned (announced supply schedules) and the actually delivered/off-taken volumes of electricity are settled here. The purpose of the balancing market is to balance transactions concluded between individual market participants and actual electricity demand. The participants of the balancing market can be the generators, customers for electricity understood as entities connected to a network located in the balancing market area (including off-takers and network customers), trading companies, electricity exchanges and the TSO as the balancing company.
Base, baseload	standard product on the electricity market: a constant hourly power supply per day in a given period, for example week, month, quarter or year.
Best Practices	Document „Best Practice for GPW Listed Companies 2016” adopted by the resolution of the GPW Supervisory Board of October 13, 2015 and effective from January 1, 2016.
Biomass	solid or liquid substances of plant or animal origin, subject to biodegradation, obtained from agricultural or forestry products, waste and remains or industries processing their products as well as certain other biodegradable waste in particular agricultural raw materials.
Black energy	popular name for energy generated as a result of combustion of black coal or lignite.
CCS	Carbon Capture and Storage Technology used to capture CO <sub>2</sub> from the emissions of fossil fuel power plants followed by its underground storage.
CDM	Clean Development Mechanisms, one of the flexible mechanisms introduced under Article 12 of the Kyoto Protocol.
CER	Certified Emission Reduction.
Co-combustion	the generation of electricity or heat based on a process of combined, simultaneous combustion in one device of biomass or biogas together with other fuels; part of the energy thus generated can be deemed to be energy generated with the use of renewable sources.
Co-generation	the simultaneous generation of heat and electricity or mechanical energy in the course of one and the same technological process.
Constrained generation	the generation of electricity to ensure the quality and reliability of the national power system; this applies to generating units in which generation must continue due to the technical limitations of the operation of the power system and the necessity of ensuring its adequate reliability.
Distribution	transport of energy through distribution grid of high (110 kV), medium (15kV) and low (400V) voltage in order to supply the customers.
Distribution System Operator (DSO)	a power company engaging in the distribution of gaseous fuels or electricity, responsible for traffic in the gas or electricity distribution systems, current and long-term security of operation of the system, the operation, maintenance, repairs and indispensable expansion of the distribution network, including connections to other gas or power systems.
ERO	Energy Regulatory Office (pol. URE).
ERU	Emission Reduction Units.
EUA	European Union Allowances: transferable CO <sub>2</sub> emission allowances; one EUA allows an operator to release one tonne of CO <sub>2</sub> .
EU ETS	European Union Greenhouse Gas Emission Trading Scheme) EU emission trading scheme. Its operating rules are set out in the ETS Directive, amended by the Directive 2009/29/EC of the European Parliament and of the Council of April 23, 2009 (OJ EU L. of 2009, No. 140, p. 63—87).
Generating unit	a technically and commercially defined set of equipment belonging to a power company and used to generate electricity or heat and to transmit power.
GJ	Gigajoule, a unit of work/heat in the SI system, 1 GJ = 1000/3.6 kWh = approximately 278 kWh.
GPZ	main power supply point, a type of transformer station used for the processing or distribution of electricity or solely for the distribution of electricity.
Green certificate	popular name for energy generated from renewable energy sources.
GW	gigawatt, a unit of capacity in the SI system, 1 GW = 109 W.
Gwe	one gigawatt of electric capacity.
GWt	one gigawatt of heat capacity.
HICP	Harmonised Index of Consumer Prices
High Voltage Network (HV)	a network with a nominal voltage of 110 kV.



**MANAGEMENT BOARD'S REPORT ON ACTIVITIES OF THE CAPITAL GROUP  
OF PGE POLSKA GRUPA ENERGETYCZNA S.A. FOR THE 6-MONTH PERIOD ENDED JUNE 30, 2016**

Highly efficient co-generation	the generation of electric or mechanical power and useful heat through co-generation, in such a way as to ensure savings of primary energy used in: (i) a co-generation unit in the amount not lower than 10 per cent. as compared to generation of electric power and heat in separated systems with reference efficiency for separated generation; or (ii) co-generation unit with an installed capacity under 1 MW as compared to generation of electric power and heat in separated systems with reference efficiency for separated generation.
IGCC	Integrated Gasification Combined Cycle.
Installed capacity	the formal value of active power recorded in the design documentation of a generating system as being the maximum achievable capacity of that system, confirmed by the acceptance protocols of that system (a historical value, it does not change over time).
IRIESP	the Transmission Network Operation and Maintenance Manual required to be prepared by a transmission system operator pursuant to the Energy Law; instructions prepared for power networks that specify in detail the terms and conditions of using these networks by system users as well as terms and conditions for traffic handling, operation and planning the development of these networks; sections on transmission system balancing and system limitation management, including information on comments received from system users and their consideration, are submitted to the ERO President for approval by way of a decision.
IRZ	Cold Intervention Reserve Service – service consisting of maintaining power units ready for energy production. Energy is produced on request of PSE S.A.
JI	Joint Implementation: one of the flexibility mechanisms introduced under Article 6 of the Kyoto Protocol.
Kyoto Protocol	the Kyoto Protocol to the United Nations Framework Convention on Climate Change of December 11, 1997 (Dz.U. of 2005, No. 203, Item 1684), in force since February 16, 2005.
KSE	the National Power System, a set of equipment for the distribution, transmission and generation of electricity, forming a system to allow the supply of electricity in the territory of Poland.
KSP	the National Transmission System, a set of equipment for the transmission of electricity in the territory of Poland.
kV	kilo volt, an SI unit of electric potential difference, current and electromotive force; 1kV= 103 V.
kWh	kilowatt-hour, a unit of electric energy in the SI system defined as the volume of electricity used by the 1 kW equipment over one hour. 1 kWh = 3,600,000 J = 3.6 MJ.
Low Voltage Network (LV)	a network with a nominal voltage not exceeding 1 kV.
LTC	Long-term contracts on the purchase of capacity and electricity entered into between Polskie Sieci Elektroenergetyczne S.A. and electricity generators in the years 1994-2001.
Medium-voltage network (MV)	an energy network with a nominal voltage higher than 1 kV but lower than 110 kV.
MEV	Minimum Energy Volumes.
MSR	Market Stability Reserve (relating to CO <sub>2</sub> )
MW	a unit of capacity in the SI system, 1 MW = 106 W.
Mwe	one megawatt of electric power.
MWt	one megawatt of heat power.
NAP	National emissions Allocation Plan, prepared separately for the national emission trading system and for the EU emission trading system by the National Administrator of the Emission Trading System.
NAP II	National CO <sub>2</sub> emissions Allocation Plan for the years 2008-2012 prepared for the EU emission trading system adopted by the Ordinance of the Council of Ministers of July 1, 2008 (Dz. U. of 2008, No. 202, item 1248).
Nm <sup>3</sup>	normal cubic meter; a unit of volume from outside the SI system signifying the quantity of dry gas in 1 m <sup>3</sup> of space at a pressure of 101.325 Pa and a temperature of 0°C.
NO <sub>x</sub>	nitrogen oxides.
Peak, peakload	a standard product on the electricity market; a constant power supply from Monday to Friday, each hour between 7:00 a.m. and 10:00 p.m. (15-hour standard for the Polish market) or between 8:00 a.m. and 8:00 p.m. (12-hour standard for the German market) in a given period, for example week, month, quarter or year.
Peak power pumped storage plants	a special kind of hydroelectric power plants. In addition to river flow and the difference in the water table levels they need two bodies of water connected with a channel or a pipeline. The power station is situated next to the lower lake or at the dam of the upper lake. The pumped storage facilities provide ancillary control services for the national power system. Their functions are to secure stability, provide passive energy, store excessive power in the system and supply power to the system in peak time. The pumped storage plants that have a natural inflow of water to the upper lake also generate electricity from renewable sources. The main off-taker of electricity produced by the peak power pumped storage power stations and their services is TSO
Property rights	negotiable exchange-traded rights under green and co-generation certificates
RAB	Regulatory Asset Base.
Red certificate	a certificate confirming generation of electricity in co-generation with heat.
Red energy	popular name for electricity co-generated with heat.

**MANAGEMENT BOARD'S REPORT ON ACTIVITIES OF THE CAPITAL GROUP  
OF PGE POLSKA GRUPA ENERGETYCZNA S.A. FOR THE 6-MONTH PERIOD ENDED JUNE 30, 2016**

Regulator	the President of ERO, fulfilling the tasks assigned to him in the energy law. The regulator is responsible for, among others, giving out licenses for energy companies, approval of energy tariffs, appointing Transmission System Operators and Distribution System Operators.
Renewable Energy Source (RES)	a source of generation using wind power, solar radiation, geothermal energy, waves, sea currents and tides, flow of rivers and energy obtained from biomass, landfill biogas as well as biogas generated in sewage collection or treatment processes or the disintegration of stored plant or animal remains.
Tariff	the list of prices and rates and terms of application of the same, devised by an energy enterprise and introduced as binding on the customers specified therein in the manner defined by an act of parliament.
Tariff group	a group of customers off-taking electricity or heat or using services related to electricity or heat supply to whom a single set of prices or charges and terms are applied.
TFS	Tradition Financial Services, an electricity trading platform used for concluding various transactions, purchase and sale of conventional energy, property rights, renewable energy and CO <sub>2</sub> emission allowances.
TGE	Towarowa Giełda Energii S.A. (Polish Power Exchange), a commodity exchange on which trading can take place in electricity, liquid or gas fuels, extraction gas, emission allowances and property rights whose price depends directly or indirectly on electric energy, liquid or gas fuels and emission allowances, admitted to commodity exchange trading.
TPA, TPA rule	Third Party Access, the owner or operator of the network infrastructure to third parties in order to supply goods/services to third party customers.
Transmission	transport of electricity through high voltage (220 and 400 kV) transmission network from generators to distributors.
Transmission System Operator (TSO)	a power company engaging in the transmission of gaseous fuels or electric energy, responsible for traffic in a gas or power transmission system, current and long-term security of operation of that system, the operation, maintenance, repair and indispensable expansion of the transmission system, including connections with other gas or power systems. In Poland, for the period from July 2, 2014 till December 31, 2030 Polskie Sieci Elektroenergetyczne S.A. was chosen as a TSO in the field of energy transmission.
TWh	terawatt hour, a multiple unit for measuring of electricity unit in the system SI. 1 TWh is 109 kWh.
Ultra-high-voltage network (UHV)	an energy network with a voltage equal to 220 kV or higher.
V (volt)	electrical potential unit, electric voltage and electromotive force in the International System of Units (SI), $1 \text{ V} = 1 \text{ J} / 1 \text{ C} = (1 \text{ kg} \times \text{m}^2) / (\text{A} \times \text{s}^3)$ .
W (watt)	a unit of power in the International Systems of Units (SI), $1 \text{ W} = 1 \text{ J} / 1 \text{ s} = 1 \text{ kg} \times \text{m}^2 \times \text{s}^{-3}$ .
Yellow certificate	a certificate confirming generation of energy in gas-fired power plants and CCGT power plants.
Yellow energy	popular name for energy generated in gas-fired power plants and CCGT power plants.