Polskie Górnictwo Naftowe i Gazownictwo S.A.

Directors’ Report on the operations of PGNiG S.A and the PGNiG Group

in the first half of 2017

Definitions

Whenever any of the following acronyms and terms appear in this Directors' Report and nothing to the contrary is stated herein, these acronyms and terms should be interpreted as follows: **PGNiG** or the **Issuer** – PGNiG S.A. as the parent of the group; **PGNiG Group**, **Group** – the PGNiG Group, which includes PGNiG S.A. as the parent, and subsidiaries; **PGNiG UN** – PGNiG Upstream Norway AS; **POGC Libya** – Polish Oil and Gas Company – Libya B.V.; **PSG** – Polska Spółka Gazownictwa Sp. z o.o.; **PST** – PGNiG Supply & Trading GmbH; **PGNiG OD** – PGNiG Obrót Detaliczny Sp. z o.o.; **GSP** – Gas Storage Poland Sp. z o.o.; **PGNiG TERMIKA** – PGNiG TERMIKA S.A.; **PGNiG Technologie** – PGNiG Technologie Sp. z o.o.; **GEOFIZYKA Kraków** – GEOFIZYKA Kraków Sp. z o.o. w likwidacji; **GEOFIZYKA Toruń** – GEOFIZYKA Toruń Sp. z o.o.; **GEOVITA** – GEOVITA S.A.; **Gazoprojekt** – Biuro Studiów i Projektów Gazownictwa Gazoprojekt S.A.; **EXALO** – EXALO Drilling S.A.; **PEC** – Przedsiębiorstwo Energetyki Cieplnej S.A. w Jastrzębiu Zdroju; **PGNiG TERMIKA EP** – PGNiG TERMIKA Energetyka Przemysłowa S.A.; **CLPB** – Oddział Centralne Laboratorium Pomiarowo-Badawcze PGNiG S.A.; **PGG** – Polska Grupa Górnicza Sp. z o.o.; **ECSW** – Elektrociepłownia Stalowa Wola S.A.; **URE** – Energy Regulatory Office; **TTF** – Title Transfer Facility; **PPX** – Towarowa Giełda Energii S.A. (Polish Power Exchange) **UGSF** – Underground gas storage facilities; **CGSF** – Cavern gas storage facility; **CHPP** – combined heat and power plant; **HP** – heat plant; **SF** − storage facilities; **SFG** – Storage Facilities Group; **EGM** − Extraordinary General Meeting; **GM** − General Meeting; **AGM** – Annual General Meeting; **National Court Register** – National Court Register; With respect to currency and other units: amounts expressed in the złoty are designated with the acronym **PLN**; amounts expressed in the euro are designated with the acronym **EUR**; amounts expressed in the US dollars are designated with the acronym **USD**; amounts expressed in the Norwegian crown are designated with the acronym **NOK**; amounts expressed in the Swedish crown are designated with the acronym **SEK**; and the acronym **boe** is used to designate barrel of oil equivalent.

Converters

Converters	1bn m^3 of natural gas	1m tonnes of crude oil	1m tonnes of LNG	1 PJ	1m boe	1 TWh
1bn m^3 of natural gas	1	0.90	0.73	38	6.45	10.97
1m tonnes of crude oil	1.113	1	0.81	42.7	7.33	11.65
1m tonnes of LNG	1.38	1.23	1	55	8.68	14.34
1 PJ	0.026	0.23	0.019	1	0.17	0.28
1m boe	0.16	0.14	0.12	6.04	1	1.70
1 TWh	0.091	0.086	0.07	3.6	0.59	1

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1. PGNiG Group in the first half of 2017

1.1. Key financial and operating metrics

PLN 18.8bn
Revenue

PLN 4.2bn
EBITDA

PLN 2.8bn
EBIT

PLN 2.1bn
Net profit

PLN 45.1bn
Total assets

4th
Largest company listed on the WSE

PLN 36.5bn
Market capitalisation

24.9 thousand
Number of employees

6.4%
ROE

4.7%
ROA

8.4%
EV/EBITDA

17.4
P/E

1.1
P/BV

PLN 24.1m
Average daily value of trading

0.6 m tonnes
Production of crude oil, condensate, and NGL

2.2bn m^3
Production of natural gas

14.5bn m^3
Volume of gas sold

3.0bn m^3
Gas storage capacities

4.8bn m^3
Volume of gas sold on PPX

6.6bn m^3
Volume of imported gas

6.4bn m^3
Volume of distributed gas

132 thousand km
Length of gas distribution network, excluding service line

24.4 PJ
Heat output

2.2 Twh
Electricity output

1.2. Calendar of corporate events

January 2017

- On January 20th, PGNiG Technologie accepted invitation from the Polimex-Mostostal Management Board to participate in a private placement of and subscribe for 37,500,000 Series T ordinary bearer shares with a par value of PLN 2 per share, at the issue price of PLN 2 per share and the total issue price of PLN 75,000,000. Also, in the performance of an agreement with SPV Operator Sp. z o.o. and following satisfaction of the conditions precedent set out in the investment agreement of January 18th 2017, PGNiG Technologie acquired 1,500,000 Polimex shares from SPV Operator in OTC block transactions. › For more information, see section 6.2
- On January 27th, PGNiG Termika, PGE Polska Grupa Energetyczna S.A., ENEA S.A. and Energa S.A. signed a Memorandum of Understanding with EDF to negotiate terms of potential acquisition of EDF's Polish assets and of the related due diligence. In March 2017, PGNiG withdrew from the negotiations.

February 2017

- On February 13th, PGNiG made a timely repayment of a EUR 500m loan from PGNiG Finance AB, including interest. On February 14th, PGNiG Finance AB redeemed its EUR 500m Eurobonds (ISIN code: XS0746259323), and paid due interest.

March 2017

- On March 2nd, the District Court for the capital city of Warsaw in Warsaw, 12th Commercial Division of the National Court Register, approved share cancellation, reduction of PGNiG's share capital, and the amendments to the PGNiG Articles of Association made by the PGNiG Extraordinary General Meeting held on November 24th 2016. › For more information, see section 7.1
- At a meeting held on March 6th, the PGNiG Supervisory Board removed Mr Waldemar Wójcik from the Management Board and appointed Ms Magdalena Zegarska as Management Board Member elected by the PGNiG employees.
- On March 13th, the 'PGNiG Group Strategy for 2017−2022 with an Outlook Until 2026' was announced. The key objective of the new strategy is to increase the Group's value and ensure its financial stability through sustainable development. › For more information, see section 2
- On March 14th, PGNiG, concluded a supplementary agreement to the long-term contract with Qatargas whereby Qatargas will deliver additional volumes of LNG to the Group. The total volume of LNG to be supplied under the long-term contracts with Qatargas will increase to 2.17m tonnes (equivalent to about 2.7bn m^3 of gas) a year in 2018–2020, and then to 2m tonnes a year (equivalent to about 2.7bn m^3 of grid gas).
- On March 15th, PGNiG TERMIKA withdrew from negotiations concerning the acquisition of EDF's Polish assets.
- On March 29th, the Management Board approved the acquisition by PGNiG TERMIKA of a further interest in the share capital of Polska Grupa Górnicza Sp. z o.o. with a total par value of PLN 300m. On March 31st, PGNiG TERMIKA signed an investment agreement setting out the terms of the investment. › For more information, see 5.4.6

April 2017

- On April 20th, Fitch Ratings announced Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) of BBB- with Stable Outlooks and a foreign currency senior unsecured rating of BBB- assigned to PGNiG. Fitch also assigned to PGNiG the National Long-Term rating of A (pol), with a stable outlook.
- The PGNiG Group adopted its 'Sustainable Development Strategy for 2017–2022'.

May 2017

- Moody's upheld PGNiG's rating at Baa3 with a stable outlook.
- Mr Ryszard Wąsowicz resigned as Member of the PGNiG Supervisory Board, with effect as of May 30th.

June 2017

- On June 1st, the PGNiG Management Board recommended that the Company will pay dividend of PLN 0.20 per share from the 2016 profit.
- On June 21st, Individual Contracts were signed with the Azoty Group under the Framework Agreement of April 13th 2016.
- On June 28th, the PGNiG AGM approved the dividend payment from the 2016 profit in line with the Management Board's recommendation, resolved to amend the Articles of Association, and changed the composition of the PGNiG Supervisory Board. › For more information, see section 7.2
- On June 30th, production was launched in the Gina Krog licence area. PGNiG UN holds an 8% interest in the licence.

1.3. Events subsequent to the reporting date

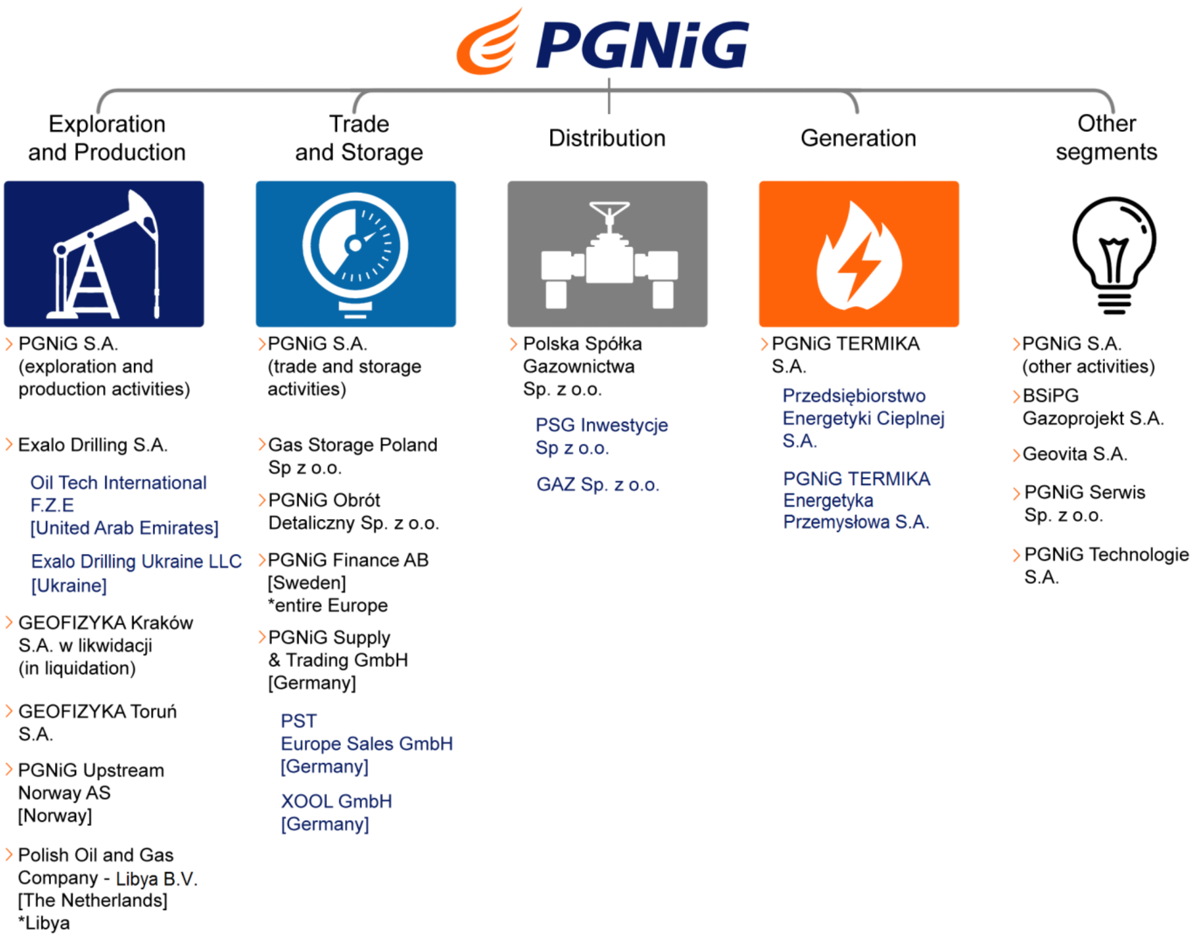
July 2017

- PGNiG submitted an application as part of the first phase of the procedure for transmission capacity reservation in gas pipelines which are to connect, via Denmark, gas fields in the Norwegian Continental Shelf with Poland. The procedure was announced by the transmission pipeline operators in Poland and in Denmark. The operators declare that the connection (including the section from Denmark to Poland) will enable delivery of approximately 10bn m^3 of natural gas a year. The route will be launched in late 2022.
- On July 27th, PGNiG and KGHM Polska Miedź S.A. signed a new gas fuel supply contract. Under the framework agreement and individual contracts, PGNiG will supply nitrogen-rich gas to KGHM Polska Miedź S.A. until 2033.

1.4. Companies of the PGNiG Group

As at June 30th 2017, the consolidated companies were PGNiG (the Parent) and 23 subsidiaries.

Consolidated companies of the PGNiG Group



Company name – PGNiG's indirect subsidiary
[country] – country of registration (if other than Poland)
** Principal place of business (if other than country of registration)*

2. Strategy of the PGNiG Group

2.1. Mission, vision, overriding objective

Mission statement: We are a trusted supplier of energy for households and businesses.

Vision: We deliver innovative energy solutions in a responsible and efficient manner.

Overriding objective: Increase the PGNiG Group's value and ensure its financial stability.

2.2. Challenges

The PGNiG Group's activities are impacted by external factors. The key challenges facing the PGNiG Group include:

- Developments in the global fuel and energy markets, including in particular **depressed oil and gas prices** and **rapid expansion of the LNG market**;

  The recent changes on the Polish gas market have been accompanied by significant price declines elsewhere in Europe, with gas prices on European markets becoming increasingly detached from prices of oil products. With spot prices of gas in Germany and other European markets having declined by over 40%, prices of gas imported to Poland became much more attractive than gas prices in the PGNiG tariff.

  The fall of crude oil prices also had major implications for the Group − the unwanted concomitant of lower gas procurement costs under long-term contracts, which made imports a more attractive source of supply, was deteriorated economics of foreign upstream projects with a predominant share of oil in total reserves, leading to a downward revaluation of the E&P segment's foreign operations.

  LNG infrastructure has been expanding rapidly on global markets in recent years, with new projects built to increase both export capacities (liquefaction plants), mainly in North America and Australia, and import capacities (regasification terminals), mainly in Europe. This has also created an excessive supply in global LNG markets, leading to decline in prices and global price convergence.

  As a participant of the global LNG market, PGNiG will be able to take advantage of the favourable pricing conditions and to secure additional gas supplies to Poland. With the abundant LNG supply, the importance of trading in gas on the spot market and under short- and medium-term contracts is growing, as destination clauses are being increasingly abandoned, the number of market participants increases, and access to the global fleet of LNG vessels is becoming easier.

- **Progressing market deregulation**
  As the requirement to sell certain amounts of gas on the exchange market has come into force, PGNiG is required to sell high-methane gas on commodity exchanges or other regulated markets. In this context requirement, the deregulation process poses a risk of significant customer attrition and revenue decline in the storage segment.

  PGNiG also faced the need to liberalize customer contracts in terms of contracted capacity, offtake amounts, and the procedure for switching suppliers.

- **Need to change the mix of imported gas sources**
  The Group's current mix of gas supply sources was structured to cover the whole of demand for natural gas in Poland. Considering the risk of losing a part of the Group's market share and given the insufficient diversification of supplies, there was a risk of imbalance in the Group's gas portfolio. Currently, the PGNiG Group's gas supply mix is largely made up of contracts priced partly by reference to prices of oil products (Yamal and Qatar contracts), while differences between the pricing formulas applied by PGNiG and its competitors entail a risk of price pressures.

  Therefore, it has become imperative that the Group explore opportunities for diversifying its gas supply sources and analyse the feasibility of related projects. With the Yamal contract nearing expiry, a need arises to build a flexible portfolio of supply sources for Poland beyond 2022.

- **Policy and regulatory changes**
  Significant changes are taking place in PGNiG's regulatory environment, particularly with respect to taxation of hydrocarbon production, the exchange sale requirement, and uncertainty surrounding the support model for gas-fired cogeneration, all of which may adversely affect revenues of the Group's segments.

2.3. Strategy of the PGNiG Group

On March 13th 2017, the PGNiG Supervisory Board approved the new 'PGNiG Group Strategy for 2017−2022 with an Outlook Until 2026'.

The new Strategy was developed in response to the changes taking place in the Group's external and internal environments. The key external changes were of macroeconomic nature (e.g. falling prices of crude oil and natural gas), but they also included other market developments, such as the rapidly accelerating competition on the Polish gas market, the need to diversify gas imports from 2022 onwards (expiry of the Yamal contract), and changes in the regulatory regime (gradual withdrawal of the tarrif regime, unpredictable future of the support mechanism for power generation beyond 2018). Following analytical reviews, key macroeconomic assumptions underlying the strategic forecasts were updated, including those related to gas, oil and electricity prices. Also, new strategic objectives and ambitions for the Group until 2022 were formulated.

A major internal change associated with the adoption of the new Strategy is a novel approach to strategic management at the PGNiG Group based on implementation of the Balanced Scorecard (BSC) methodology, which enables the balancing of the Group's financial, operating and development objectives based on four key BSC 'perspectives' (finances, customers, processes, and resources and growth).

The result is a new way of defining main strategic objectives, where targets and ambitions are set at the Group level and then cascaded down to the Group's key business areas.

Objectives of the Strategy at the Group level

The Strategy defines a new primary objective for the PGNiG Group, which is to increase the Group's value and to ensure its financial stability. It will be pursued through sustainable development of the Group driven by parallel investments in riskier business areas yielding relatively high rates of return (upstream projects – ca. 45% of total planned capex) and in regulated areas offering considerable safety of the investments (gas distribution, power and heat generation – ca. 42% of total capex). Additionally, ca. PLN 4bn of capex will be allocated to other growth projects, primarily in distribution, trading, power and heat generation.

The total capex has been assumed to exceed PLN 34bn in 2017−2022. The investment programme should deliver cumulative 2017−2022 EBITDA of ca. PLN 33.7bn, driving long-term growth of the Group's EBITDA in 2023−2026 to the annual average of ca. PLN 9.2bn. At the same time, the net debt to EBITDA ratio should stay below 2.0 over the Strategy term, with the current dividend policy providing for distribution of up to 50% of the Group's consolidated net profit upheld.

The new Strategy identifies seven key business areas, with the following strategic objectives and ambitions for 2017−2022 defined for them:

1. Exploration and Production – increase the current base of documented hydrocarbon reserves by ca. 35%, increase hydrocarbon production by ca. 41%, significantly reduce unit costs of exploration and appraisal of deposits, and maintain unit cost of field development and hydrocarbon production;
2. Wholesale – build a diversified and competitive gas supply portfolio beyond 2022 and increase the overall volume of natural gas sales by ca. 7%;
3. Retail – maximise retail margins, while maintaining the total volume of retail gas sales at ca. 67–69 TWh/year;
4. Storage – secure access to storage capacities adjusted to actual demand and improve storage efficiency;
5. Distribution – build more than 300 thousand new service lines and increase the volume of distributed gas by ca. 16%;
6. Power and Heat Generation – increase power and heat sales volumes by ca. 20%;
7. Corporate Centre – increase involvement in and effective execution of R&D&I projects (target outlay of ca. PLN 680m), improve operational efficiency across the PGNiG Group and enhance the Group's image.

For further information on the strategic objectives in the individual business areas and review of their implementation in the reporting period, see sections 5.1–5.4.

2.4. Risks

In the first half of 2017, there were no material changes in the nature, magnitude or probability of materialization of the risks affecting the PGNiG Group's business. For further information on the risks affecting the individual segments, see section 8 of the Directors' Report on the operations of PGNiG and the PGNiG Group in 2016.

2.5. Research and development

On January 30th 2017, the Scientific Advisory Group of the second term held its first meeting. The current activities of the PGNiG Group's Research and Development Department, as well as the strategic intentions and proposed work programme for the Scientific Advisory Group were presented.

The third edition of the 'Innovative Youth for PGNiG' competition was launched, with 20 research institutions submitting 69 entries. The winners will be named in the second half of 2017.

The implementation phase was completed for 10 projects financed by the National Centre for Research and Development (NCRD) under the Blue Gas I programme. In the second half of 2017, the largest research programme in the history of the PGNiG Group – INGA (Innovative Gas) – is planned to be launched in the form of a joint venture with the NCRD. Such project structure will involve a dedicated mechanism for the financing of R&D efforts, whereby the NCRD and selected industrial partners support pursuit of the country's Research Agenda. The Research Agenda includes R&D themes that are most relevant for the PGNiG Group in the areas of hydrocarbon exploration and production, gas storage, gas networks, use and new applications of gas fuels, and environmental protection.

3. Regulatory and market environment

3.1. Regulatory environment

Except as discussed below, there were no significant changes in the regulatory environment of the PGNiG Group in the first half of 2017. A detailed description of the regulatory environment is presented in section 4.1 of the Directors' Report on the operations of PGNiG and the PGNiG Group in 2016.

3.1.1. Regulatory environment in Poland

Energy Law

In the first half of 2017, there were no amendments to the Energy Law. However, in June 2017 a government-sponsored bill to amend the Act on Mandatory Stocks was submitted to the Sejm. Its provisions amend certain aspects of the Energy Law. The proposed amendments aim to clarify the rules for granting licences to trade natural gas with foreign companies. These amendments will not affect the Company's business.

Act on Mandatory Stocks

In June 2017, a government-sponsored bill was submitted to the Sejm; it introduces changes in the supply security system. The bill aims to remove doubts concerning integration reported by market participants, and introduces a number of administrative improvements. Major changes include clarifications as to the principles of providing the ticketing service; introduction of transparent rules for release of mandatory stocks, including related settlements; and further clarifications as to the extent of data and information exchanged between the transmission system operator and the storage system operator. The bill also confirms that the volume of mandatory gas stocks is calculated based on net imports. The proposed amendments will have a positive effect on PGNiG's business as they clarify interpretation doubts concerning certain provisions of the Act and reduce administrative burdens.

Geological and Mining Law

On May 25th 2017, the Polish parliament enacted the Act amending the Geological Law and certain other acts, which implements into the Polish legal order Directive 2013/30/EU of the European Parliament and of the Council of June 12th 2013 on safety of offshore oil and gas operations and amending Directive 2004/35/EC (OJ L 178 of June 28th 2013). The amendment is neutral to the Group's business as the Group does not conduct operations which would be affected by the new act.

Diversification regulation

On April 24th 2017, the Council of Ministers issued a new regulation on the minimum amount of gas supply from imports (Dz.U. item 902). The solutions provided in the regulation enable the Group to enter into long-term import contracts. The change has a positive effect on the Company's business.

Tariff regulation

In the first half of 2017, PGNiG applied the following tariffs:

- from January 1st to March 31st 2017 – PGNiG Gas Fuel Supply Tariff No. 13/2017, approved on December 16th 2016; the tariff increased the average prices of high-methane gas and nitrogen-rich gas by 12.2% and 13.4%, respectively;
- from April 1st – PGNiG Gas Fuel Supply Tariff No. 14/2017, approved on March 17th 2017. The average prices of high-methane gas and nitrogen-rich gas were increased by 8.0% and 7.9%, respectively.

In the first half of 2017, PGNiG OD applied the following tariffs:

- from January 1st to February 18th 2017 – PGNiG OD Gas Fuel Trading Tariff No. 4;
- from February 18th – PGNiG OD Gas Fuel Trading Tariff No. 5. Relative to the previous tariff, Tariff No. 5 reduced gas fuel prices by 7% on average for all tariff groups, including:
    - for consumers in tariff groups with gas fuel consumption rates up to 110 kWh/h – the price of gas fuel was reduced by 6.0%,

- for consumers in tariff groups with gas fuel consumption rates above 110 kWh/h – the price of gas fuel was reduced by 8.6% on average.

In the first half of 2017, GSP applied the following tariffs:

- from January 1st to May 31st 2017 – Gas Fuel Storage Tariff No. 1/2016, approved by the President of URE on April 22nd 2016;
- as of June 1st – Gas Fuel Storage Tariff No. 1/2017. In Tariff No. 1/2017, the average charge for storage services was reduced by -0.3% relative to No. Tariff 1/2016. The amount of the reduction was determined based on the average charges, taking account of the amount of storage capacity reservations for the 2017/2018 storage year.

In the first half of 2017, PSG applied Tariff No. 3 for Gas Fuel Distribution Services and LNG Regasification Services, approved on December 17th 2014.

In the first of 2017, the tariffs applied by PGNiG TERMIKA included:

- from January 1st to March 16th 2017 – the tariff applicable to heat generated by PGNiG TERMIKA's generating assets, i.e. the Żerań CHP plant, Siekierki CHP plant, Pruszków CHP plant, Wola heating plant, and Kawęczyn heating plant; and to the transmission and distribution of heat via the heating network supplied from the Pruszków CHP plant, approved on July 29th 2015;
- the tariff for the Regaty heating plant, effective until the disposal of that heating system to NYSAGAZ, approved on May 13th 2015;
- the tariffs for transmission of heat via heating networks in the areas of Marsa Park, Annopol, Marynarska, Chełmżyńska and Jana Kazimierza, approved on November 18th 2014;
- from March 17th – PGNiG THERMIKA Tariff applicable to heat generated by PGNiG TERMIKA's generating assets, i.e. Żerań CHP plant, Siekierki CHP plant, Pruszków CHP plant, Wola heating plant and Kawęczyn heating plant. In addition, the tariff sets the rates of fees for heat transmission and distribution through district heating networks in Pruszków, Piastów, Michałowice, and for the following streets in Warsaw: Marsa (Marsa Park complex), Annopol, Marynarska, Chełmżyńska and Jana Kazimierza. In the new approved tariff, the average combined selling price of heat (generation plus distribution) was reduced by -0.26%.

In the first half of 2017, PEC applied the heat transmission and distribution tariff approved on November 15th 2016. Compared with the previous tariff, the average prices and charges for heat generation increased by 1.7%, and for heat transmission and distribution – by 1.6%. Overall, the prices and fee rates increased by 1.7% on average.

In the first half of 2017, PGNiG TERMIKA Energetyka Przemysłowa (formerly SEJ) applied heat generation and distribution tariffs approved on October 10th 2016. On average, the weighted increase in rates and charges for heat generation and distribution was 0.7% on the previous tariff.

In June 2017, legislative work was initiated to amend the Regulation on detailed rules for determining and calculating gas fuel tariffs and on settlement of transactions in gas fuel trading. The PGNiG Group actively participates in the legislative process to protect the interests of its customers.

3.1.2. European regulatory environment

Third Energy Package

In the second quarter of 2017, reports and opinions of selected European Parliament Committees on draft legislative acts forming the Clean Energy for All Europeans package were published. PGNiG presented its key proposals to selected MPs individually and through the International Association of Oil & Gas Producers (IOGP). The Company also closely follows debates in the European Parliament.

In addition, a preliminary Quo vadis study report was published in June 2017. In the report, the consultants outlined three main and several side scenarios for the gas market in the European Union. Early in July 2017, PGNiG submitted its position on the presented draft report.

SoS Regulation

At the end of May 2017, an interinstitutional agreement was reached on the contents of the Regulation concerning measures to safeguard security of gas supply (SoS Regulation). The final shape of the transparency mechanism – i.e. the obligation of gas undertakings to submit information on gas contracts – remained the longest-standing contentious issue. The final debate on the Regulation and the vote on its adoption were scheduled in the European Parliament for September 12th 2017. No changes in the Regulation are expected.

TAR NC Regulation

At the end of June 2017, public consultations on the ENTSO-G (European Network of Transmission System Operators for Gas) document were concluded. The document proposes an interpretation of Commission Regulation (EU) 2017/460 of March 16th 2017 establishing a network code on harmonised transmission tariff structures for gas (TAR NC). Following an analysis of the ENTSO-G document, PGNiG decided not to present its opinion on this matter as the Company's most important proposals were included in the final version of the Regulation.

NC CAM Regulation

In the first half of 2017, a new grid code came into force. Work is currently underway to adapt the existing national regulatory frameworks to the requirements of the new European Commission regulation. In 2017 and in early 2018, work will continue on the implementation of the new grid code and on documents related to the application of NC CAM. PGNiG will take part in the consultations.

EU ETS

In the first quarter of 2017, the European Parliament and the EU Council reconciled their positions on the reform of the EU ETS. Interinstitutional negotiations (trilogue) are currently underway: the European Parliament, the EU Council and the European Commission are working on the final shape of the reform. At present, the institutions agree, among other thigs, on increasing the EU ETS linear reduction factor to 2.2%, and setting the share of auction allowances at 57% (of which no more than 2% is to be allocated to industries at risk of carbon leakage). PGNiG monitors the negotiations as part of its work at the IOGP.

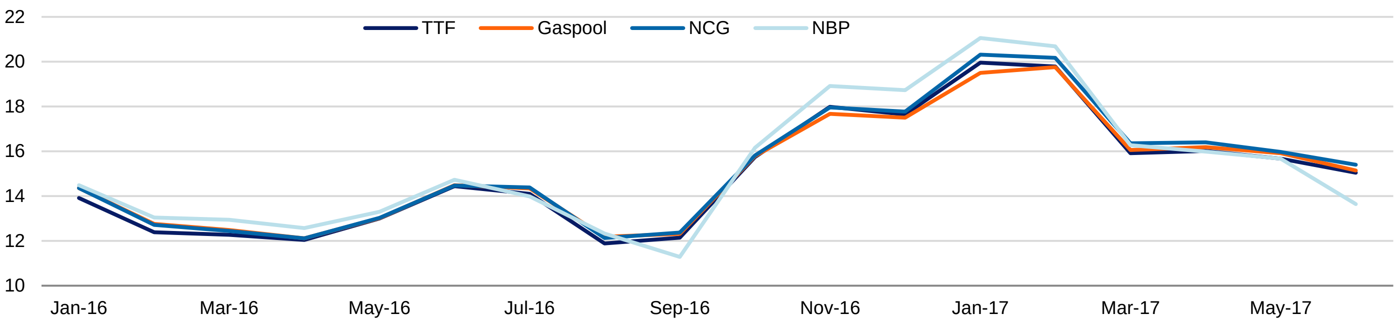
3.2. Fuel prices and currency exchange rates

3.2.1. Trends on natural gas market

Natural gas in Europe

In the first half of 2017, prices of natural gas increased on average by 30% year on year, with the largest increase of 32% reported at Germany's NCG hub. The smallest growth (27% on average) among the monitored markets was seen on the Polish Power Exchange. The average price of gas on key European markets was EUR 17.46/MWh, compared with EUR 13.50/MWh a year before. The first months of 2017 saw a number of disruptions in the supply of gas from the North. Reduced flows were due to unforeseen technical failures in the Kollsness and Troll fields in Norway. A failure also affected the Gronningen field in the Netherlands. The price increase at the NBP hub in October 2016–February 2017 was caused by operational problems at the Rough storage facility. Reversal of the spread between the NBP and hubs in the continental part of Europe seen at the end of the analysed period was a consequence of maintenance and repair works on the Interconnector pipeline – the only link allowing gas to be transmitted from Great Britain to the continent.

Average monthly spot prices of natural gas at selected European hubs (EUR/MWh)



In-house analysis based on ICE and EEX data.

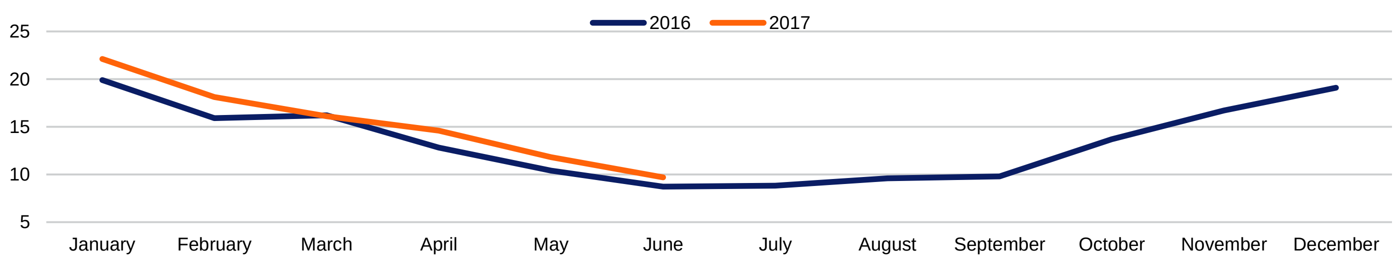
LNG

The forecast surplus of supply on the LNG market did not materialize in the first half of 2017, with several factors at play, including in particular the increased demand for LNG in North-East Asia in the first quarter of 2017 due to cold winter, and unplanned shutdowns at several LNG condensation lines (e.g. the Gorgon plant in Australia). LNG deliveries to Europe increased slightly, primarily to importers in southern parts of the continent. The demand for LNG in South America fell, however. LNG prices on the Asian spot markets rose to as much as USD 9–10 per MMBtu in January 2017, while the spread between prices in Europe and Asia, which recently reflects only differences in transport costs between Europe and Asia, increased to USD 2.5–3 per MMBtu. In the second quarter of 2017, prices returned to levels seen a year before (approx. USD 4.5–5.5 per MMBtu). The rise of LNG prices was limited by new liquefaction capacities coming on stream, especially in Australia and the US. Nigeria, Peru, and Equatorial Guinea also increased exports. LNG from the US (currently only from Sabine Pass, though Cove Point is expected to start exports towards the end of 2017, with more liquefaction plants joining in 2018 and 2019), available on flexible port-of-destination terms, was bought mainly by customers in Asia and Latin America, although several shipments were also exported to Europe (mainly the southern part of the continent). Stabilization of crude prices, followed by a further decline worldwide (Brent oil at USD 55–45 per bbl), dragged on price increases in oil-indexed LNG import contracts in the first half of 2017. Current forecasts indicate a surplus of supply in the LNG market in 2018–2022.

Poland

In Poland, the first half of 2017 saw a year-on-year increase in consumption of high-methane grid gas, largely due to weather conditions: all months except March were colder than in 2016. However, the increase was also driven by fundamental factors.

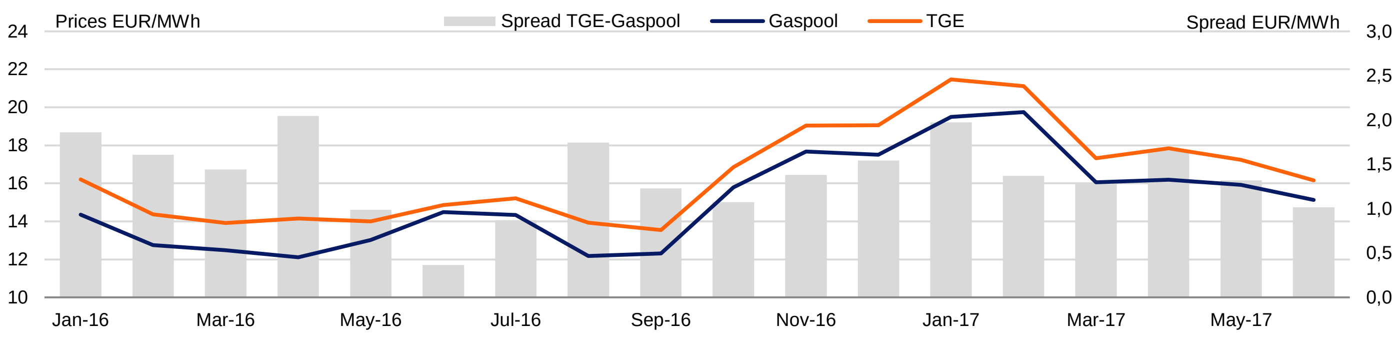
Consumption of high-methane grid gas in Poland in the first half of 2016 and 2017 (TWh)



In-house analysis based on OGP GAZ-SYSTEM high-methane gas transmission data at exit points to end customers.

Prices of gas in Poland were strongly correlated with prices in Germany and, more generally, on European gas markets. In the first half of 2017, the average spot price of gas in Poland was PLN 79.19/MWh, which represented an increase of 24% year on year, while the average spot price at the German Gaspool hub increased by 27%, to PLN 73.05/MWh. At the same time, the spread, as measured by reference to prices on the PPX, shrank from 9.5% in the first half of 2016 to 7.7% in the first half of 2017.

Average monthly natural gas spot prices in Poland and Germany (Gaspool)

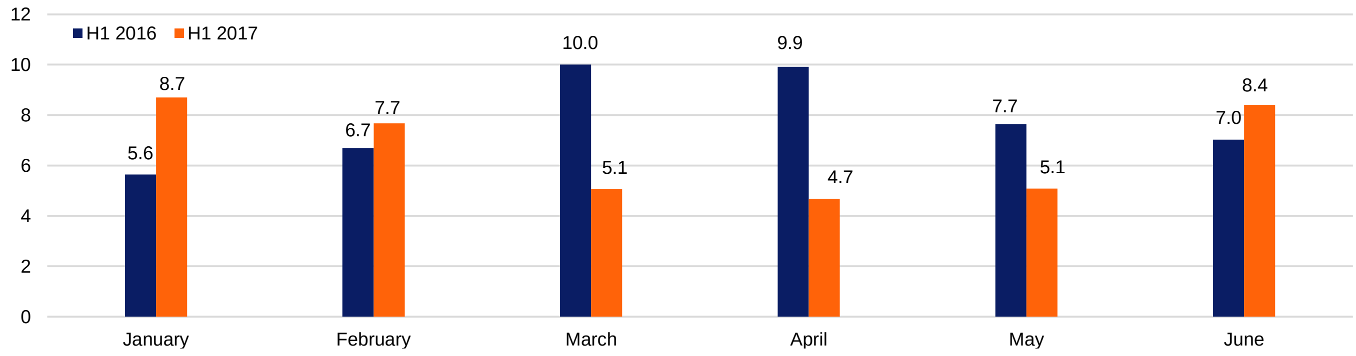


In-house analysis based on ICE and EEX data.

Polish Power Exchange

PGNiG is the leader of gas trading on the Polish Power Exchange. According to PPX data, in the first half of 2017 the total gas trading volume was 54.3 TWh, of which 39.6 TWh was traded on the Commodity Futures Market (CFIM). It means that almost 75% of gas trades in the first half of the year were executed under contracts with maturities of a year, season (summer, winter), quarter, month, and week.

Futures trading volume (RTT) on the PPX in H1 2016 and H1 2017 (TWh)

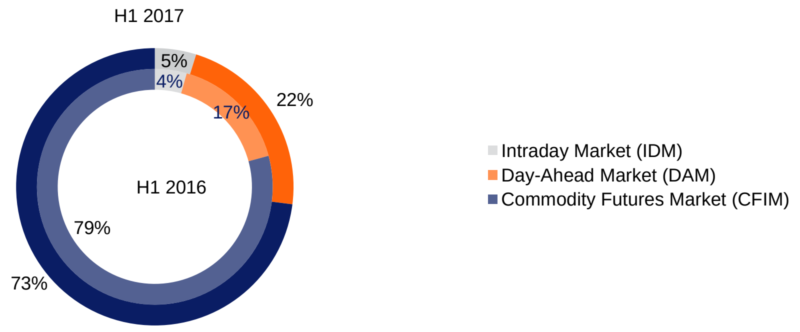


In-house analysis based on PPX data.

In the reporting period, there was an approximately 16% year-on-year decline in the futures trading volume. On the other hand, the number of transactions on the CFIM market increased: in total, 39.6 thousand transactions were executed in the six months to June 2017 (H1 2016: 23.1 transactions). The total trading volume, including both futures and spot trading (the Day-Ahead Market – DAM and the Intraday Market – IDM), also declined, from 59.3 TWh in the first half of 2016 to 54.3 TWh a year later, i.e. by over 8% year on year.

At the same time, there was an increased demand for short-term contracts, particularly on the Day-Ahead Market. In the first half of 2017, the number of transactions in these instruments rose by 24% year on year, which represented a significant change in the number of spot contracts on the PPX (up 6 pp. in total).

Contracts traded on the PPX in H1 2016 and H1 2017



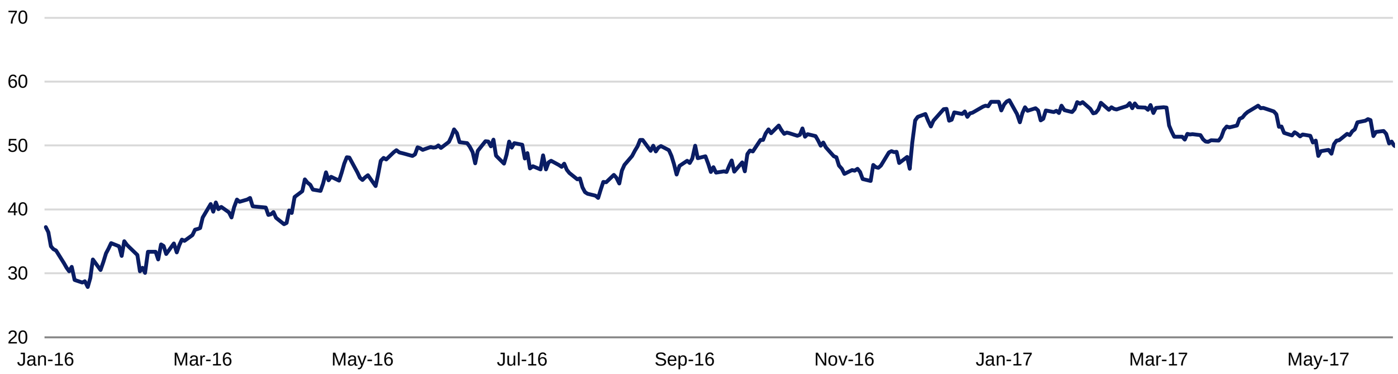
In-house analysis based on PPX data.

Gas storage facilities

As at June 30th 2017, volumes of gas stored in European gas storage facilities rose to 63% of the capacity. In the corresponding period of 2016, the facilities were 61% full. In Poland, storage facilities were filled to 57% of the capacity.

3.2.2. Trends on the crude oil market

Brent oil price, month ahead contract (USD/bbl)



Source: ICE – Intercontinental Exchange.

In early 2017, prices of crude oil remained stable. The high prices seen in December 2016 continued throughout the first quarter of 2017 as the oil producers participating in the agreement to reduce crude oil output (OPEC countries, Russia and other non-OPEC producers) gradually delivered on their commitments. The highest price recorded in the period was USD 57.10 per barrel. In March 2017, crude prices fell on investors' growing concerns that output cuts would not be fully carried out. Saudi Arabia, Kuwait and Angola fully complied with their commitments, while the United Arab Emirates and Venezuela were nowhere near their targets. Eventually, crude oil output declined to 90% of the total agreed limit of 1.8m barrels per day. However, investors argued that the deal may not be a lasting one given the lack of solidarity between the countries involved. What is more, the increasingly fast-growing production of shale oil in North America and a gradual increase in oil stocks in the US mitigated the effect of the lower oil supply from OPEC. Oil price rebounded temporarily in April when the US Department of Energy announced the first weekly decline in oil stocks since the beginning of the year. Despite this, stockpiles were still record-high and the price of oil began to fall again.

Although oil production cuts fell short of the agreement participants' plans and despite the lack of solidarity between the countries declaring output curbs, OPEC and its partner countries agreed to extend oil production cuts for another nine months, i.e. until March 2018. As a result, oil prices rose sharply. However, only a few days later the increase was halted by the news of growing crude output in Libya and Nigeria. For the first time in four years, daily production in Libya exceeded 1m barrels. Libya and Nigeria were both exempt from the cuts as production in those countries was heavily and adversely affected by civil war. The production growth rates reported by the two countries, combined with record-high stockpiles in the US, gave the decision to extend the cuts for another nine months a rather cold welcome from the market. As a consequence, the price of crude fell to the year's low, i.e. USD 44.82 per barrel, on June 21st.

Despite the downward trend in the second quarter, the average price of oil in the six months to June 2017 was up 31% year on year.

3.2.3. Outlook for crude oil and natural gas market

OPEC members and non-OPEC countries agreed to extend oil production cuts by a total of 1.8m barrels a day from the beginning of July 2017 until the end of March 2018. However, the growing production levels in Libya and Nigeria cast doubt on whether such scenario will materialise. Besides, reduced oil output by OPEC is effectively offset by production from alternative sources, in particular from shale oil deposits in the US, where a record number of wells have been drilled.

It should further be noted that inventories of crude oil are very high. To make any meaningful change, a supply shortage would have to continue for a very long time. It is clear, however, that the market has been regaining equilibrium after a long period of oversupply. Accordingly, prices of crude oil in the second half of 2017 should remain close to or slightly below the level recorded in in the six months to June, at USD 40−50 per barrel. Oil stocks are likely to gradually increase in the period.

From 2018 onwards, the inventories will be used to balance demand. The price of crude is expected to rise over the next 3−4 years on the back of lower supply on the global market, with the increase driven by lower capital expenditure in the upstream sector.

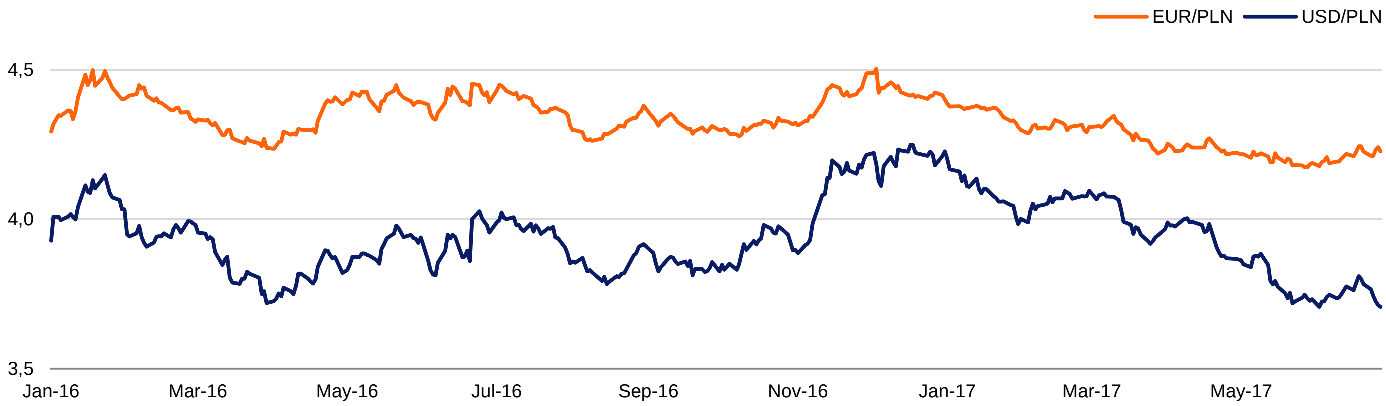
The price of natural gas in Europe will gradually decline in the coming years due to excessive supply of LNG on the global market, supported by increased production of shale gas in North America and Australia and launch of new liquefaction plants. Accordingly, competition on the LNG market is expected to intensify. The strongest growth in demand for LNG will be seen in Asia, while Europe will become a balancing market with steadily growing demand.

3.2.4. EUR/PLN and USD/PLN exchange rates

In the first half of 2017, the Polish złoty steadily appreciated against the euro and the dollar, with the latter having fallen by 12% against the złoty by the end of the secend quarter in relation to early 2017, and the former – by moderate 4% in the same period. Market analysts attribute the appreciation of the Polish currency to a relatively strong rebound of the Polish economy and more bullish market sentiment towards riskier assets, which continue to include instruments traded in Poland.

The uptrend of the złoty against the euro may, however, be reversed in the near future as the European Central Bank is expected to tighten its monetary policy in the second half of 2017, which is likely to add strength to the European currency. Since U.S. President planned policies continue to be viewed with caution, market analyses offer no definitive predictions as to the performance of the dollar against the złoty in the second half of the year. Given the very strong depreciation of the US currency in the six months to June, Polish assets may be under pressure through the end of the year.

EUR/PLN and USD/PLN exchange rates in H1 2016 and H1 2017.



Source: National Bank of Poland

(in PLN million, unless stated otherwise)

4. Financial results for the first half of 2017

Summary information on the financial results of the PGNiG Group and the Parent in the first half of 2017 is presented below.

4.1. Separate financial data of the Parent

4.1.1. Financial highlights (PLNm)

	H1 2017	H1 2016
Revenue	9,645	8,864
Total operating expenses, including	(8,786)	(8,419)
Depreciation and amortisation	(374)	(396)
Operating profit (EBIT)	859	445
Profit before tax	2,033	2,080
Net profit	1,827	1,974
Net cash flows from operating activities	689	1011
Net cash flows from investing activities	(942)	(859)
Net cash flows from financing activities	(4,399)	599
Net increase/(decrease) in cash and cash equivalents	(4,652)	751
	June 30th 2017	**December 31st 2016**
Total assets	33,338	35,769
Non-current assets	26,136	25,759
Current assets, including	7,202	10,010
Inventories	1,652	1,942
Other assets	595	578
Total equity	25,784	25,228
Total non-current liabilities	2,188	2,144
Total current liabilities	5,366	8,397
Total liabilities	7,554	10,541
Total equity and liabilities	33,338	35,769

4.1.2. Financial indicators of PGNiG S.A.

Profitability

	H1 2017	December 31st 2016
EBIT (PLNm) operating profit	859	1,281
EBITDA (PLNm) operating profit + depreciation/amortisation	1,233	2,048
ROE net profit to equity at end of period	7.1%	10.2%
Net margin net profit to revenue	18.9%	15.0%
ROA net profit to assets at end of period	5.5%	7.2%

Liquidity

	H1 2017	December 31st 2016
Current ratio current ratio current assets to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.5	1.3
Quick ratio current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.1	1.0

Debt

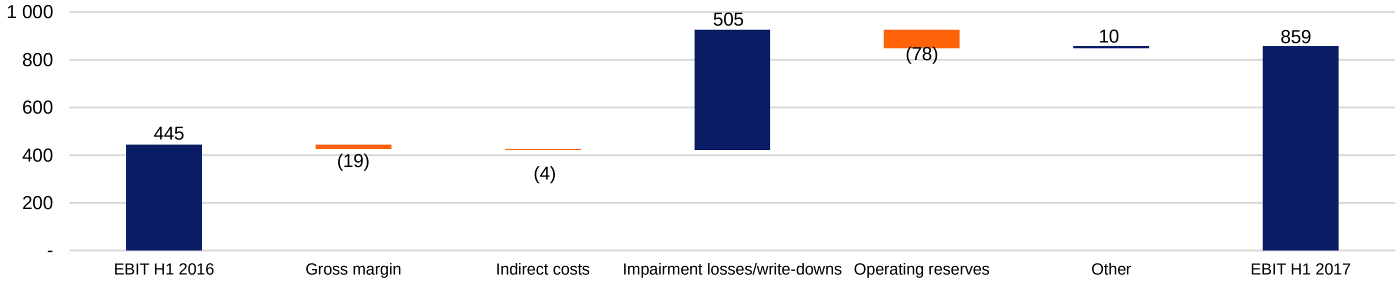
	H1 2017	December 31st 2016
Debt ratio total liabilities to total equity and liabilities	22.7%	29.5%
Debt to equity ratio total liabilities to equity	29.3%	41.8%

(in PLN million, unless stated otherwise)

4.1.3. Financial results of PGNiG S.A.

In the first half of 2017, PGNiG's operating profit (EBIT) came in at PLN 859m, up PLN 414m year on year. The chart below presents the EBIT bridge between the first half of 2016 and the first half of 2017.

EBIT bridge from H1 2016 to H1 2017



The PLN 414m year-on-year increase in operating profit (EBIT) came primarily as a result of a PLN 505m decrease in impairment losses:

- recognised particularly on property, plant and equipment and property, plant and equipment under construction,
- and partly offset by inventory write-downs.

Improved EBIT was to some extent balanced out by higher operating reserves. The decline in gross margin (difference between revenue and direct costs) was mainly attributable to lower gross margin on sales of high-methane gas, resulting primarily form higher costs of procurement of imported gas. The margin's increase was partially offset by:

- higher gross margin on sales of crude oil driven by higher average selling prices; the difference in the average Brent crude prices between H1 2016 and H1 2017 was 31%;
- higher margin on sales of nitrogen-rich gas, delivered mainly on higher sales volumes.

Changes in indirect costs and other expenses had little effect on EBIT. In the first half of 2017, net finance income/(costs) fell by PLN 461m year on year as a result of a PLN 432m decrease in dividends received from subsidiaries.

4.2. Consolidated financial data of the PGNiG Group

4.2.1. Financial highlights of the PGNiG Group

	H1 2017	H1 2016
Revenue	18,817	17,349
Total operating expenses, including	(15,975)	(15,555)
Depreciation and amortisation expense	(1,335)	(1,337)
Operating profit (EBIT)	2,842	1,794
Profit before tax	2,859	1,733
Net profit	2,098	1,271
Net cash flows from operating activities	3,932	3,776
Net cash flows from investing activities	(2,076)	(1,821)
Net cash flows from financing activities	(4,976)	(65)
Net increase/(decrease) in cash and cash equivalents	(3,120)	1,890
	June 30th 2017	**December 31st 2016**
Total assets	45,083	49,672
Non-current assets	36,265	36,236
Current assets, including	8,818	13,436
Inventories	2,101	2,510
Other assets	838	679
Total equity	32,811	32,016
Total non-current liabilities	7,037	7,303
Total current liabilities	5,235	10,353
Total liabilities	12,272	17,656
Total equity and liabilities	45,083	49,672

(in PLN million, unless stated otherwise)

4.2.2. Financial indicators of the PGNiG Group

Profitability

	H1 2017	2016
EBIT (PLNm) operating profit	2,842	3,360
EBITDA (PLNm) operating profit + depreciation/amortisation	4,177	5,974
ROE net profit* to equity at end of period**	6.4%	7.3%
Net margin net profit* to revenue	11.1%	7.1%
ROA net profit* to assets at end of period	4.7%	4.7%

**Net profit attributable to owners of the parent*
***Equity attributable to owners of the parent*

Liquidity

	June 30th 2017	December 31st 2016
Current ratio current ratio current assets to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	2.14	1.45
Quick ratio current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.63	1.18

Debt

	June 30th 2017	December 31st 2016
Debt ratio total liabilities to total equity and liabilities	27.2%	35.6%
Debt to equity ratio total liabilities to equity*	37.4%	55.1%

**Equity attributable to owners of the parent*

4.2.3. Financial results of the PGNiG Group

In the first half of 2017, the PGNiG Group posted revenue of PLN 18,817m, up by PLN 1,468m (or 8.5%) on the corresponding period of the previous year, when revenue was at PLN 17,349m. With a 2.7% increase in operating expenses, to PLN 15,975m, the Group earned consolidated operating profit (EBIT) of PLN 2,842m (up 58.4% year on year). Operating profit before depreciation and amortisation (EBITDA) came in at PLN 4,177m, which represents an increase of 1,046m (33.4%) on the previous year. A similar increase was seen in net profit, which amounted to PLN 2,098m and was higher by PLN 827m (65%) year on year. The result was achieved against the backdrop of growing prices of crude oil on global markets, low prices of natural gas in Central Europe, and the ongoing deregulation of the Polish gas market.

The combination of marketing efforts and lower temperatures drove the gas volumes sold by the PGNiG Group up from 148.2 TWh in the six months to June 2016 to 171.9 TWh a year later. This translated into revenue growth in the Group's two key business areas: Exploration and Production, and Trade and Storage. The first segment recorded a year-on-year increase in gas sales by PLN 285m (19%), while in the other segment's revenue increased by 8% year on year.

There was a nearly 32% increase in revenue from sales of crude oil and condensate, mainly due to the rising prices of crude oil in the Polish currency (31% year on year). The sales volume was 705 thousand tonnes in the first half of 2017, down 29 thousand tonnes year on year. In the Distribution segment revenues increased by 6% year on year, to PLN 2,610m, on higher volumes (up 15%). Revenue from sales also rose in the Generation segment, by PLN 1,267m (13%) year on year, on increase in volumes of heat and electricity sold (own production) year on year.

For further information of the segments' financial results, see sections 5.1–5.4.

Statement of financial position

As at June 30th 2017, total assets were PLN 45,083m, down PLN 4,589m (9.2%) year on year.

Assets

Property, plant and equipment represented the largest item of the PGNiG Group's assets. As at the end of the first half of 2017, they amounted to PLN 32,747m, having decreased by PLN 402m (or 1.2%) relative to December 31st 2016, mainly due to impairment losses. A significant increase in non-current assets, of PLN 356m (28.9%), was reported for equity-accounted investees, which came as a result of acquisition of further shares in PGG and the investment in Polimex-Mostostal S.A. (in January 2017).

At the end of the first half of 2017, the Group's current assets were PLN 8,818m, down PLN 4,618m (34.4%) relative to the end of 2016. Receivables were the largest contributing item, having decreased by PLN 1,016m (or 23.7%) on year-end 2016, chiefly due to lower receivables from sales of seasonal products, i.e. mainly gas for heating purposes. In addition, a decrease was reported in cash and cash equivalents (down by PLN 3,124m, or 53.6%) in the first half of 2017, which resulted mainly from partial repayment of the Group's debt under bonds and bank borrowings (as disclosed in the statement of cash flows under decrease in debt, which stood at PLN 5,139m as at the end of June 2017).

Equity and liabilities

Equity was the main source of financing of the PGNiG Group's assets. At the end of the first half of 2017, the Group's equity was PLN 32,811m, which marked a PLN 795m (or 2.5%) increase relative to the end of 2016. The change in equity was primarily attributable to net profit earned in the reporting period, of PLN 2,098m, adjusted for the PLN 1,156m dividend to be paid for the previous year (in accordance with the AGM resolution). For the remaining part, the change in equity was due to net other comprehensive income, which in the first half of 2017 was negative at PLN 147m. As at June 30th 2017, non-current liabilities were PLN 7,037m, remaining largely flat on the end of the first half of 2016, when they amounted to PLN 7,303m (down 3.6%). As at June 30th 2017, the Group carried current liabilities of PLN 5,235m, down PLN 5,118m (49.4%) on the end of 2016. The decrease was due to the partial repayment of debt under bonds and bank borrowings, as referred to above.

Given that current liabilities decreased, while equity and non-current liabilities remained largely unchanged, the Group saw an improvement in its debt-to-equity and debt ratios, which fell from 55.1% to 37.4% and from 35.6% to 27.2%, respectively.

The decrease in current liabilities (relatively larger than decrease in current assets which determine the level of liquidity ratios) resulted in the following improvements of the liquidity ratios: the current ratio increased to 2.14, from 1.45 at the end of December 2016, and the quick ratio was 1.63 in the reporting period, compared with 1.18 at the end of the previous year.

Transactions on non-arm's length terms

In the first half of 2017, no transactions were concluded on non-arm's length terms between companies of the PGNiG Group.

Group's ability to deliver forecast results

The PGNiG Management Board has not published any forecasts of the PGNiG Group's results for 2017.

Guarantees and sureties

In the first half of 2017, neither PGNiG nor any of its subsidiaries issued any sureties with respect to borrowings or any guarantees where the total amount of such sureties or guarantees provided for the benefit of a single entity would represent 10% or more of the provider's equity.

4.3. Change in presentation of the PGNiG Group's segments

In 2017, the Group has made significant changes in its segment reporting, including in particular:

1. For the purposes of transferring domestically produced gas from the Exploration and Production segment to the Trade and Storage segment, the applied settlement price is determined as the average monthly price quoted on the PPX Day-Ahead Market, less a discount for the Trade and Storage segment to cover justified costs of high-methane gas storage, plus a margin. The settlement price applied in gas transfers between other segments (especially for gas used for own consumption) was also changed and is now determined as the average monthly price quoted on the PPX Day-Ahead Market.
   Previously, the gas produced in Poland was transferred for sale by the Trade and Storage segment at technical cost of production.
2. Other items of operating expenses were also reclassified, based on the type of business activity.
3. The PGNiG Corporate Centre and PGNiG Finance AB were separated from the Trade and Storage segment and are now presented in Other Segments. The PGNiG Management Board resolved to adjust the financial results of the Trade and Storage segment for the income and expenses generated by the PGNiG Head Office and PGNiG Finance AB, which perform support functions for other segments of the PGNiG Group.

4.4. Expected financial standing of the Group

In the coming periods, the financial condition of the PGNiG Group will be affected by such external factors as changes in prices of hydrocarbons on global commodity markets, fluctuations in foreign exchange rates, and weather conditions. Internal factors will include implementation of the PGNiG Group's strategic objectives, which is expected to contribute to the improvement of the Group's financial results in the long run.

Recent changes in crude oil prices have affected revenues earned by the PGNiG Group companies from crude production and sale, as well as from the provision of seismic and exploration services, and in consequence have a negative effect on financial results of the Exploration and Production segment. Material decline in crude oil prices may also necessitate recognition of impairment losses on production assets. On the other hand, the fact that prices of natural gas purchased by the Group under the long-term contracts with OOO Gazprom Export and Qatar Liquefied Gas Company Limited (3) are linked to prices of oil products has a positive effect on the PGNiG Group's gas procurement costs and, as a consequence, on financial results of the Trade and Storage segment.

The situation on the domestic currency market will also have a seignificant effect on financial results of the PGNiG Group. Any strengthening of the złoty against foreign currencies (primarily the US dollar) will have a positive effect on results of the Trade and Storage segment by driving down PGNiG's gas procurement costs. The PGNiG Group has in place a hedging policy to mitigate the effects of exchange rate fluctuations.

The PGNiG Group's financial results will also be affected by the President of URE's position on gas fuel sale and distribution tariffs and heat sale tariffs. In addition, the progressing deregulation of the gas market in Poland will continue to put pressure on financial results reported by the PGNiG Group's Trade and Storage companies. The discount schemes offered by the Group and increasingly flexibile price plans adversely affect margins and thus the segment's profitability.

Weather conditions also have an impact on the results of the Distribution and Generation segments. Lower temperatures have a positive effect on gas distribution volumes and heat generation. In the Generation segment, financial results will also be considerably affected by the support programmes for electricity produced from high-efficiency cogeneration sources and renewable sources. Another key factor affecting the segment's performance are prices of the fuels used to produce heat and electricity.

In the coming quarters, the Group intends to maintain a high level of capital expenditure. Spending will focus primarily on implementation of strategic objectives: building production capacities, projects in the exploration for and appraisal of crude oil and natural gas deposits, expansion of gas distribution networks, and potential acquisitions in the Exploration and Production segment and the Generation segment. However, the PGNiG Group companies have put in place a number of initiatives to improve efficiency. These initiatives focus, among other things, on optimisation of the cost base and are expected to have a positive effect on the PGNiG Group's financial results.

5. Results of the PGNiG Group by segments

5.1. Exploration and Production

The segment's principal business activity is extraction of hydrocarbons from deposits and preparation of produced hydrocarbons for sale. This involves exploring for and extracting natural gas and crude oil from deposits, and includes geological surveys, geophysical research, drilling, and development of and production of hydrocarbons from gas and oil fields. The work is conducted by the segment on its own or jointly with partners, under joint operations agreements. Most of the segment's operations are located in Poland, Norway and Pakistan.

5.1.1. Segment's strategy

Increase proved hydrocarbon reserves

One of the segment's key objectives is to increase its proved hydrocarbon reserves by 35% by taking appropriate measures in Poland and abroad, despite the fact that in 2010–2015 the PGNiG Group's total hydrocarbon reserves shrunk at an average annual rate of 2%.

Hydrocarbon exploration in Poland is planned to be intensified in 2017–2022, to maintain the high rate of new discoveries. The 2016 breakthrough in exploration efficiency led to a surge in newly discovered hydrocarbon reserves (increase of approximately 35m boe in 2016 vs approximately 16m boe in 2015). In 2017–2022, the gross annual growth in Polish hydrocarbon reserves (including production) is expected to continue at a rate close to the 2016 levels, ranging from approximately 27m boe to 34m boe annually.

To this end, the following steps will be taken:

- review of the granted licences to evaluate whether exploration and/or production can be continued efficiently, and sale of unpromising licences,
- review of exploration plans in Poland to maximise the probability of new discoveries and prove new hydrocarbon reserves,
- review of field development plans to accelerate completion of investment projects,
- new approach to preparing field development plans and carrying out preparatory works (e.g. obtaining preliminary/conditional consents from land owners) prior to exploration drilling,
- standardization of technical requirements for the construction of onshore infrastructure and their adaptation to actual technological and operational needs.

Given the limited capacity for growth in discoveries of new hydrocarbon reserves and little prospects of proving unconventional reserves in Poland, the Group is also looking for ways to increase its hydrocarbon reserves and step up production abroad (total gross increase in reserves expected to reach approximately 442m boe in 2017–2022). The Group is also committed to carrying out production projects which yield equity gas on the Norwegian Continental Shelf and thus enable gas to be 'physically' transported to Poland.

Increase annual hydrocarbon production volumes

Another of the segment's strategic objectives is to increase the volume of annual hydrocarbon production from approximately 39m boe in 2017 to close to 55m boe in 2022 (+15.9m boe, CAGR 6%) by keeping up the annual output in Poland at 30–33m boe and considerably stepping up production abroad, i.e. in Pakistan and Norway, to 22m boe annually.

To achieve that, the following measures will be taken:

1. in Poland: increasing output from producing fields;
2. abroad:
   - participation in licensing proceedings in priority regions/countries;
   - execution of M&A projects in priority regions/countries;
   - implementation of an accelerated field development programme in the license areas in Pakistan.

Improve profitability of the exploration and production business

For years, especially in 2013–2015, PGNiG's unit exploration and evaluation costs were above the global average, largely as a result of the low exploration success rate and inefficient project execution. It is the segment's strategically-motivated ambition to considerably reduce unit exploration costs in Poland. Exploration efforts are to be focused on projects offering the highest potential for commercial success. In addition, the average time for exploration and development of deposits is assumed to be shortened.

Delivery of the PGNiG Group's exploration and production strategy will lead to an increase in EBITDA until 2022 as a result of taking the strategic measures outlined above; to optimisation of operating costs of service companies and expansion of field services offered to third parties, including in new markets; to optimisation of the portfolio of foreign upstream assets; to stepping up exploration projects abroad (Norway and Pakistan); and to enhancing business processes with innovative technologies (e.g. in management of hydrocarbon production operations).

5.1.2. Segment's volumes

Natural gas production by the PGNiG Group mln m^3	**H1 2017**	**H1 2016**	**2016**	**2015**	**2014**	**2013**
High-methane gas (E)	944	992	1,918	2,027	1,876	1,890
in Poland	656	708	1,401	1,454	1,457	1,550
in Norway	288	284	517	573	419	340
Nitrogen-rich gas (Ls/Lw as E equivalent)	1,279	1,266	2,540	2,564	2,627	2,692
in Poland	1,213	1,241	2,481	2,513	2,569	2,667
in Pakistan − PGNiG Pakistan Branch	66	25	59	52	58	25
TOTAL (measured as E equivalent)	2,222	2,258	4,458	4,591	4,503	4,582

Segment's sales of natural gas outside the PGNiG Group mln m^3	**H1 2017**	**H1 2016**	**2016**	**2015**	**2014**	**2013**
High-methane gas (E)	18	51	77	54	33	36
in Poland	18	29	53	52	33	36
in Norway	-	22	24	1	-	-
Nitrogen-rich gas (Ls/Lw as E equivalent)	385	371	703	684	738	683
in Poland	320	348	645	633	682	658
in Pakistan	65	23	58	51	56	25
TOTAL (measured as E equivalent)	403	422	780	737	771	719

Crude oil* at the PGNiG Group thousand tonnes	**H1 2017**	**H1 2016**	**2016**	**2015**	**2014**	**2013**
Crude oil production*	616	676	1,318	1,428	1,207	1,099
in Poland	365	379	763	765	789	815
in Norway	251	297	555	664	418	283
Sales of crude oil*	705	734	1,347	1,391	1,169	1,106
including oil produced in Poland	379	377	754	772	780	809
including oil produced in Norway	326	357	593	619	389	297

** including condensate and NGL*

Production of other products	**H1 2017**	**H1 2016**	**2016**	**2015**	**2014**	**2013**
thousand tonnes						
Propane-butane	17	19	37	35	32	30
LNG	11	14	26	25	30	32
mln m^3						
Helium	2	1	3	3	3	3

5.1.3. Segment's financial results

Financial highlights	**H1 2017**	**H1 2016** restated	**2016** restated	**2016***	**2015***	**2014***	**2013***
Total revenue	3,146	2,583	5,289	4,291	4,855	6,071	6,185
Revenue from sales outside the Group, including:	1,637	1,378	2,776	2,776	3,148	4,346	4,580
- high-methane and nitrogen-rich gas,	281	298	517	517	553	573	577
- crude oil, condensate, and NGL	1,032	784	1,606	1,606	1,945	2,654	2,757
- geophysical, geological and drilling services	200	193	429	429	382	761	833
Inter-segment revenue	1,509	1,205	2,513	1,515	1,707	1,725	1,605
EBITDA	2,239	896	2,206	1,285	2,426	3,143	3,381
EBITDA adjusted for impairment losses on property, plant and equipment	2,254	1,635	2,977	2,056	2,980	3,812	3,908

** Reported data, does not reflect changes in the presentation of reporting segments discussed in section 4.3, introduced in 2017.*

In the first half of 2017, the Exploration and Production segment's operating profit was PLN 1,690m, having increased by PLN 1,370m (428%) year on year, largely due to lower impairment losses on property, plant and equipment and on intangible assets, and an increase in revenue from sales. Impairment losses in the reporting period were PLN 15m, down by PLN 724m (98%) year on year. Revenue from sales amounted to PLN 3,146m, up by PLN 563m (22%) year on year. The increase in the segment's revenue was mainly attributable to:

- higher price of domestically produced gas transferred from the Exploration and Production segment to the Trade and Storage segment – the average price of gas sold in the first half of 2017 was 26% higher year on year (the price was calculated as the average for the six months to June 2017, weighted by the volume of gas produced in Poland and transferred to the Trade and Storage segment for sale). The increase in the price of domestically produced gas transferred between the segments follows directly from the fact that the price is based on gas prices quoted on the PPX, which in the first quarter of 2017 grew by 24% on average;
- higher revenue from the segment's sales of crude oil, condensate and NGL. Although the volume of these products sold in the first half of 2017 was slightly lower year on year (down 3.8%), higher prices of the products drove the revenue by 31% (in the first quarter of the year, the average price of Brent crude in zloty-terms grew by 31% on the year before).

5.1.4. Segment's activities in Poland

As at January 1st 2017, PGNiG held 46 licences for exploration and appraisal of crude oil and natural gas deposits, three 'suspended' licences (pending conversion procedure), and four combined licences for oil and gas exploration, appraisal and production. In the first half of 2017, PGNiG submitted six applications to relinquish a licence and acquired two licence areas in a tender.

As at June 30th 2017, PGNiG held 29 exploration and appraisal licences, 18 combined licences and two suspended licences (pending conversion procedure). It held a total of 224 production licences in Poland. In the reporting period no new licences were granted to PGNiG, eight licences were amended, and one licence expired. The number of licences for storage of gas in underground gas storage facilities (9) and licences for storage of waste (3) remained unchanged.

Recoverable reserves as at June 30th 2017 were 16,986 thousand tonnes of crude oil and 76,238m m^3 of natural gas (at high-methane gas equivalent).

In the first half of 2017, PGNiG was involved in crude oil and natural gas exploration and appraisal projects in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands, both on its own and jointly with partners. Drilling work in PGNiG's licence areas was performed on 15 boreholes with a total depth of 26,707 linear metres, including 10 exploration, three appraisal and two production wells. To compare, in the whole of 2016, drilling work was performed on 19 boreholes, including 12 exploration and seven appraisal wells.

Out of the 15 boreholes, 13 (nine exploration, two appraisal and two production wells) reached their target depth. As at the end of June 2017, formation test results were obtained from 12 boreholes (nine exploration and three appraisal wells), including from three boreholes where drilling works were completed in 2016. Of the total, five exploration and two appraisal wells yielded positive results. Five exploration wells failed to yield a commercial flow of hydrocarbons and were abandoned.

In total, the following eight wells were put on stream: Siedleczka-4, Siedleczka-5K, Siedleczka-6K, Przeworsk-17, Przeworsk-18, Przeworsk-19K, Przeworsk-21 K, Przeworsk-22, Brońsko-23, Brońsko-27, Brońsko-28.

In the first half of 2017, 287.77 km of 2D seismic surveys and 172.5 km^2 of 3D seismic surveys were carried out.

The volume of PGNiG's natural gas production in Poland was 1.87bn m^3. PGNiG's crude oil and condensate output in Poland reported in the first half of 2017 was 365 thousand tonnes, with sales volume of 274 thousand tonnes. In the same period, the average gas price on the PPX was PLN 185.65/1,000 m^3, while the average price of Brent crude was PLN 205.68/bbl.

5.1.5. Segment's activities abroad

Norway

Jointly with partners, PGNiG UN produces hydrocarbons from the Skarv, Morvin, Vilje and Vale fields and is working on the development of the Snadd and Gina Krog fields. As at June 30th 2017, PGNiG UN held interests in 18 exploration and production licences on the Norwegian Continental Shelf, in two of them as the operator.

In 2017, another APA 2016 round (Awards in Pre-defined Areas) was concluded, with PGNiG UN awarded interests in two new exploration licences:

- a 40% interest (as the operator) in the PL887 licence area in the Norwegian Sea. The awarded acreage is located next to the Åsgard field; the licence partners are Concedo ASA, Skagen44 AS and Petrolia NOCO AS, with a 20% interest each;
- a 30% interest (as a partner) in the PL891 licence area in the North Sea. The licence operator is ConocoPhilips (with a 40% interest), while the other partner is Aker BP ASA (a 30% interest).

Based on the results of geological and economic analyses, the company and its partners decided to relinquish the PL703 and PL799 licences, with no wells drilled.

Licences held at the end of June 2017

Licence	Operator	PGNiG UN's interest	Type	Planned activities
PL029C (Gina Krog)	Statoil	29.63% (8% in the project)	Exploration/Development	Production (starting from June 30th 2017), Development, Exploration
PL036D (Vilje)	Det norske	24.243 %	Production	Production
PL036 (Vale) **PL249 (Vale)**	Centrica	24.243 %	Exploration/Production	Production
PL134B (Morvin) **PL134C (Morvin)**	Statoil	6%	Production	Production
PL212 (Skarv) **PL212B (Skarv)** **PL262 (Skarv)**	BP	15% (11.9175% interest in the project)	Exploration/Development/ Production	Production, final preparations for the development of the Snadd field
PL212E (Snadd Outer)	BP	15%	Exploration	Possible tie-back to Snadd
PL703 (Asterix S/Loki)*	OMV	40%	Exploration	Decision was made to relinquish the licence.
PL813 (Elli)	Statoil	8%	Exploration	Drill or Drop (DoD) decision: February 2018
Op. PL838 (Tunfisk/Shrek)	PGNiG	40%	Exploration	DoD: February 2018
PL839 (Nise/Storkobbe)	BP	11.9175%	Exploration	DoD: February 2018, interpretation of seismics
PL850 (Ulv)	Edison	20%	Exploration	DoD: February 2019
PL856 (Princesse)	Capricorn	25%	Exploration	DoD: July 2018
PL887 (Novus East)	PGNiG	40%	Exploration	DoD: February 2019
PL891 (Tunfisk South)	ConocoPhilips	30%	Exploration	DoD: February 2019

In the first half of 2017, the company took extensive steps to enable imports of Norwegian gas to Poland. To this end, negotiations were continued with the transmission system operators in Poland, Denmark and Norway to construct a new infrastructural link between Norway and Poland (the Norwegian Corridor).

In accordance with the PGNiG Group's Strategy, PGNiG UN analysed other projects that may lead to further increase in the production volumes in Norway. In the first half of 2017, PGNiG acquired a 35% interest in the recently discovered Storklakken field (the PL460 licence) from Aker BP ASA. The remaining 65% interest in the PL460 licence is owned by Aker BP ASA, which acts as the licence operator. According to the operator, recoverable reserves attributable to PGNiG's interest amount to 3.85m boe. In accordance with the field development plan, launch of production from the field is expected in 2020. Approval of the transaction by the Norwegian authorities is pending. Development investments will be financed with funds generated in the course PGNiG's operations in Norway.

In the first half of 2017, PGNiG UN and its partners completed preparatory work on the Gina Krog field, and production from the field started at the end of June 2017. The company also refined the development concept for the Snadd field. The preferred scenario provides for drilling three new production wells and launch of production in 2020.

As of January 2017, the corporate tax rate in Norway was reduced from 25% to 24%. At the same time, the lower tax rate was offset by an increase in the special petroleum tax from 53% to 54% and a reduction of the uplift tax incentive from 22% to 21.6%. The marginal tax rate on production activities remained at 78%. Therefore, the changes had little impact on the company's business.

In the first half of 2017, the company produced, as planned, a total of 251 thousand tonnes of crude oil with condensate and NGL (measured as tonnes of crude oil equivalent) and 288m m^3 of natural gas from the Skarv, Morvin, Vilje, Vale, and Gina Krog fields. The higher output from the Skarv, Morvin and Vilje fields made up for the delay in launch of production from the Gina Krog field, which commenced on June 30th 2017.

Pakistan

PGNiG carries out exploration work in Pakistan under an agreement for hydrocarbon exploration and production in the Kirthar licence area. The work is conducted jointly with Pakistan Petroleum Ltd. (PPL), with production and expenses shared proportionately to the parties' interests in the licence: PGNiG (operator) – 70%, PPL – 30%. So far, two gas fields, Rehman and Rizq, with recoverable reserves of 11.5bn m^3 and 3.8bn m^3, respectively, have been discovered in the area.

Gas from the Rehman and Rizq fields is produced via facilities located in the Rehman field. On March 6 2017, PGNiG completed drilling of the Rehman-3 well and, on May 1st, and drilling of the Rizq-2 well was started. Currently, preparatory work is under way for the drilling of the Roshan-1 (N2 structure) and Rehman-5 boreholes. In March 2017, the Rehman-2 well was brought on stream. Work has begun to connect the Rehman-3 well to the production infrastructure, which is scheduled for completion in August 2017.

Libya

In the first half of 2017, POGC Libya continued its activities started in previous years to reduce the impact of the force majeure on the project. The work, pre-approved by the National Oil Corporation, involved analyses of seismic data and review of the prospectivity of the LC113 licence.

Iran

In the first half of 2017, PGNiG completed the preliminary development concept for the Soumar field (Technical Proposal), which was submitted to and approved by National Iranian Oil Company and Iranian Central Oil Fields Company. Initial estimates of crude reserves in the Soumar field are at 14.8m m^3. The preliminary field development concept provides for the drilling of nine wells. Depending on the final concept, the estimated capital expenditure may range from USD 63m to USD 114m.

5.1.6. Segment's prospects

Poland

In the second half of 2017, PGNiG will continue exploration for and appraisal of crude oil and natural gas deposits in its licence areas and will seek to maintain stable production volumes. The Company commenced an oil production intensification programme at the Barnówko-Mostno-Buszewo field, which involves injecting excess gas back into the Mostno-1 and Mostno-3 wells.

In the second half of the year, processing and interpretation of acquired seismic data will continue (400 km^2 of 3D seismics and over 300 km of 2D seismics). New seismic data acquisition projects are to be started (a total area of ca. 750 km^2). Exploration drillings will be carried out in 13 boreholes and five production wells. Exploration work will continue to be concentrated in the Przemyśl, Rzeszów and Poznań areas. One borehole (Szczecin area) will be drilled in cooperation with the LOTOS Group.

In Upper Silesia, the Gilowice research project will continue work to identify the potential for natural gas production from coal bed, and acquisition of 3D seismic data will be carried out in the Międzyrzecze licence, which is PGNiG's first coal-bed methane (CBM) licence.

Norway

In the second half of 2017, PGNiG UN will continue analyses of infrastructure scenarios for transmission of gas from Norway to Poland, and will consider potential acquisitions of gas deposits in Norway. The company intends to participate in further stages of the open season procedure launched by transmission system operators in Denmark and Poland. PGNiG UN will also actively seek opportunities to acquire further production and development assets.

In the second half of 2017, production volumes from the Skarv, Morvin, Vale and Vilje fields are expected to be slightly lower than in the first half of the year due to natural depletion of the reserves. This, however, will be offset by the launch of production from the first Gina Krog wells. Production from the Gina Krog field will grow in the coming months as further wells will be gradually brought on stream. The process will continue until Q1/Q2 2019, when maximum production rates from the field are expected to be achieved.

In the second half of 2017, the company will continue investments in the Snadd project and the recently acquired Storklakken assets. At the same time, a long-term production test of the Snadd field continues. In the next six months, the development plans for the Snadd and Storklakken fields are to be submitted for approval by the Norwegian authorities.

Pakistan

In 2017, PGNiG intends to start drilling the Rehman-4 well. In the following years, the Company will gradually expand the capacity of the Kirthar production infrastructure and will continue the drilling work on the Rehman and Rizq fields. PGNiG also intends to continue exploration work within three potential deposits N2, W1 and W2. The Company is taking steps to secure grant of an exploration licence in the Baran Block, adjacent to the Kirthar licence area. PGNiG commenced talks with its current partner in the Kirthar licence area (PPL) to acquire an interest in the Dhok Sultan licence, where oil deposits have been discovered.

5.2. Trade and Storage

The principal activity of the segment is trade in natural gas. In Poland, where the PGNiG Group is the largest natural gas supplier, the segment sells natural gas produced from domestic fields as well as imported gas. Through PGNiG Sales and Trading GmbH (wholesale) and PST Europe Sales GmbH (retail), the PGNiG Group is developing its natural gas business (both wholesale and direct sales) in Germany and Austria. The segment also trades in electricity, certificates of origin for electricity, and CO_2 emission allowances. The segment operates seven underground gas storage facilities (Brzeźnica, Husów, Mogilno, Strachocina, Swarzów, Wierzchowice and Kosakowo).

5.2.1. Segment's strategy

Diversification of gas supply sources

The PGNiG Group's current market position has been adversely affected by the long-term contract for gas supplies to Poland, concluded in the past. As the Yamal contract is nearing its expiry, the Group will seek to ensure real diversification of gas supplies to Poland. To this end, the Group will focus primarily on supporting construction of the pipeline connecting Norway to Poland, developing LNG trading and logistic competencies on the global market, and expanding its portfolio of natural gas reserves.

- Support for the construction of the Norwegian Corridor

  The Group's strategic objective is to build a mix of gas supply sources which would be available via the Norwegian Corridor, to enable gas imports from new directions and at market prices, thus ensuring flexibility of the gas supply portfolio beyond 2022.

- Developing LNG trading and logistic competencies on the global market

  Once built, LNG trading and logistic competencies will help create a more flexible gas supply portfolio beyond 2022 as the Group will be able to swiftly balance its gas imports. During the Strategy term, efforts involving development of such competencies and strengthening the Company's presence on the global LNG market will be continued. The Group intends to analyse the possibility of executing contracts for LNG imports from new directions (e.g. from North America, Australia) and to expand cooperation with the existing LNG suppliers.

- Expanding natural gas reserves in Poland and abroad

  Completion of the Norwegian Corridor project would enable transport of gas from the Group's own fields directly to Poland.

Increase gas volume in wholesale

In wholesale, the strategic objective is to expand the Group's gas trading volume from approximately 166 TWh (ca. 15bn m^3) in 2017 to approximately 178 TWh (ca. 16bn m^3) in 2022 (i.e. by 7%).

This is to be achieved by increasing the volume of gas sales in Poland, taking steps to reduce the rate of decline in sales of gas to end users due to market deregulation, and expanding the volume of gas sales on foreign markets by over 250%.

In the coming years, PGNiG will continue efforts to secure its position in the natural gas market.

As a matter of strategy, and supported by PST's experience and competencies, the Group's will seek to expand into other gas and energy trading markets in Central and Eastern Europe. PGNiG intends to continue its efforts aimed at strengthening its presence in Ukraine, one of the most promising markets in the region.

Maintaining current market position and maximising retail margins

During the term of the Strategy, the overriding objective of PGNiG OD is to improve margins on retail sales of gas and to maintain the total volume of retail sales at around 67−69 TWh/year (6.0−6.2bn m^3/year).

In the near term, the key factor with a bearing on PGNiG OD's business will be the deregulation of retail gas prices. The obligation to seek approval for institutional tariffs will no longer apply as of October 1st 2017, which means that approximately 50% of the gas volume sold by PGNiG OD will be exempt from the tariff obligation.

PGNiG OD has already taken steps aimed at enhancing its product offering. In 2016, to meet the expectations of end users, the company launched discount schemes, which were very well received by the customers. PGNiG's retail segment has developed a dual-fuel offering, comprising gas and electricity, for a range of customer groups. To build lasting partnership-based relations with customers, steps have been taken to develop new value-added services and to increase customer satisfaction by improving service quality and launching modern sales channels.

In the near future, the company will focus on:

- developing and implementing a new pricing policy which will be based on results of a comprehensive analysis of PGNiG OD customers' expectations and of activities conducted the company's by direct competitors. In particular, PGNiG OD will focus on developing a new segmentation to match the expectations of and reflect margins earned on sales to individual customer groups;
- developing and launching a new product offering − developing an extended product offering for the B2C segment in response to customers' expectations, and to enable cross-selling and increasing sales of CNG and LNG;
- implementing a customer loyalty scheme, which will also include definition of tariff groups/customer segments to which new discount schemes will be offered.

Increasing available storage capacities

In its storage business, the PGNiG Group focuses on two key strategic objectives, i.e. to secure storage capacities to match actual actual demand, and to further improve efficiency of the storage operations. It is expected that upon completion of the extension of the underground facilities, the storage capacities will be sufficient to satisfy the anticipated demand for storage services until 2022. The key objective is to complete the current projects (Kosakowo UGSF). Once the projects are completed, Poland's total capacity to store high-methane gas will be approximately 3bn m^3 (33.3 TWh).

In response to market expectations, in early February 2017 PGNiG added to its offering a ticketing service which allows gas importers and traders to meet their gas-stocking obligations in accordance with the applicable Polish regulations. The ticketing service will allow the storage capacities to be efficiently utilised by gas market participants.

5.2.2. Segment's volumes

Natural gas sales outside the PGNiG Group mln m^3	H1 2017	H1 2016	2016	2015	2014	2013
High-methane gas (E)	13,668	11,919	22,822	21,600	17,289	14,934
Nitrogen-rich gas (Ls/Lw as E equivalent)	396	340	671	612	514	519
TOTAL (measured as E equivalent)	14,064	12,259	23,493	22,211	17,802	15,453
including:						
PGNiG	8,349	7,009	13,734	12,415	12,834	14,070
PGNiG OD	4,266	3,909	7,246	7,483	3,209	-
PST	1,471	1,377	2,511	2,311	1,760	1,383

5.2.3. Segment's financial results

PLNm	H1 2017	H1 2016 restated	2016 restated	2016*	2015*	2014*	2013*
Total revenue	15,819	14,883	28,180	28,180	31,742	28,825	25,659
Revenue from sales outside the Group, including:	15,630	14,712	27,733	27,740	31,274	28,367	25,341
- high-methane and nitrogen-rich gas,	14,666	13,628	25,644	25,644	29,413	26,555	24,392
Inters-egment revenue	189	171	447	440	468	458	318
EBITDA	89	431	614	1,410	623	764	170
EBITDA adjusted for impairment losses on property, plant and equipment	89	433	626	1,437	627	822	183

** Reported data, does not reflect changes in the presentation of reporting segments discussed in section 4.3, introduced in 2017.*

In the six months to June 2017, the Trade and Storage segment incurred operating loss of PLN -13m, down -104% from a PLN 343m operating profit a year before. The main contributing factor was a PLN 1,279m (9%) increase in operating expenses which offset a PLN 937m (6%) increase in the segment's revenue. These changes were caused chiefly by:

- a 17% increase in the volume of the segment's gas sold by the Group, to 164.3 TWh. The strongest increase was reported in the group of PGNiG's largest industrial customers. The Trade and Storage segment's revenue from gas sales outside the PGNiG Group in the first half of 2017 was PLN 918m higher year on year;
- higher price of domestically produced gas transferred from the Exploration and Production segment (for description of the underlying causes of the increase, see the section on the Exploration and Production segment);
- a PLN 177m increase in regasification costs in the first half of 2017 on larger LNG imports, relative to PLN 4m in the corresponding period of the previous year.

5.2.4. Segment's trading activities in Poland

The segment's principal activity is trade in natural gas in Poland. In Poland, where the PGNiG Group is the largest natural gas supplier, the segment sells natural gas produced from domestic fields as well as imported gas. On August 1st 2014, there was a change in the PGNiG Group's structure: retail sales were separated from the wholesale gas business, the latter remaining with PGNiG. The retail business was transferred to PGNiG OD.

Natural gas sales in Poland outside the PGNiG Group (including gas exports from Poland) mln m^3	H1 2017	H1 2016	2016	2015	2014	2013
High-methane gas (E)	12,242	10,708	20,438	19,561	15,543	13,555
Nitrogen-rich gas (Ls/Lw as E equivalent)	396	340	671	612	514	519
TOTAL (measured as E equivalent)	12,638	11,048	21,109	20,172	16,057	14,075
including:						
PGNiG	8,057	7,009	13,734	12,415	12,834	13,555
PGNiG OD	4,289	3,909	7,246	7,483	3,209	-
PST	-	128	128	272	14	5

Natural gas sales in Poland outside the PGNiG Group by customer group (including gas exports from Poland) mln m^3	H1 2017	H1 2016	2016	2015
Households	2,326	2,132	3,913	3,630
Other industrial customers	1,518	1,266	2,468	3,097
Retail, services, wholesale	1,039	818	1,475	1,520
Nitrogen plants	1,019	931	1,798	1,757
Power and heat plants	501	222	607	598
Refineries and petrochemical plants	1,170	604	1,338	1,238
Exchange	4,774	5,075	9,141	8,332
Exports from Poland	291	-	370	-
TOTAL sales outside the Group	12,638	11,048	21,109	20,172

Wholesale market

Gas imports

In the first half of 2017, gas imports to Poland were 81.22 TWh, up 3.51 TWh and 8.62 TWh on the first half of 2016 and the second half of 2016, respectively. Year on year, imports from countries east of Poland remained stable, while gas supplies from the EU increased by 15%. Exports to Ukraine increased by 79%. The volume of LNG regasified at the LNG terminal grew by 1.41 TWh compared with the second half of 2016.

Gas flows at Polish borders (TWh)

Direction and type of supplies	H1 2017	H1 2016	H2 2016	Change H1 2017 to H1 2016
Supplies from European Union	13.86	12.07	14.88	15%
including Lasów, Gubin (GCP)	3.07	2.24	2.63	37%
including Cieszyn	0.02	0.06	0.00	-69%
including Mallnow	10.77	9.77	12.24	10%
Supplies from across Poland's eastern border	57.55	57.68	54.43	0%
including Drozdovitse	25.08	24.58	23.54	2%
including Teterovka	0.50	0.44	0.38	13%
including Kondratki	14.86	14.76	13.38	1%
including Vysokoye	17.11	17.90	17.13	-4%
Regasification	9.81	2.85	8.40	244%
Exports to Ukraine	6.11	3.42	6.84	79%

Source: Entsog

On June 20th 2017, the dew point of natural gas supplied through the Yamal gas pipeline changed, which adversely affected the quality of the fuel. As a result, OGP GAZ-SYSTEM S.A. stopped supplying gas to the Polish transmission system through the Interconnection Point from 6.00 am on June 21st 2017 to 6.00 am on June 23rd 2017. During that period, to secure continuity of supplies, PGNiG drew gas from the storage facilities.

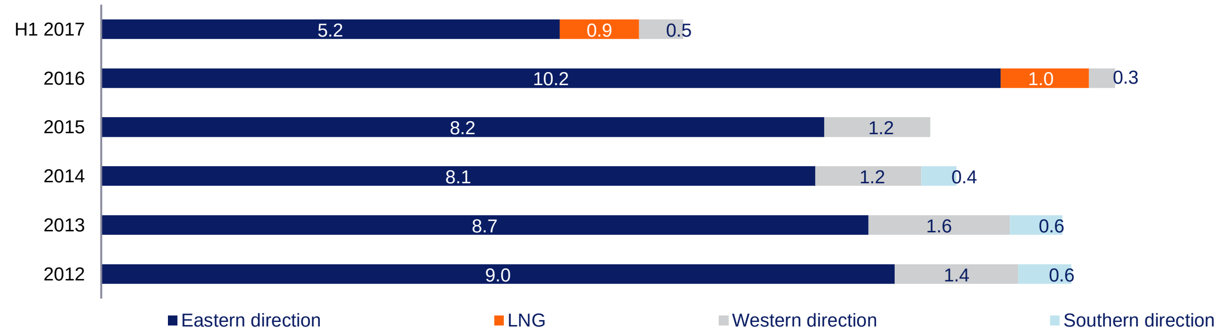
LNG supplies

On March 14th 2017, PGNiG and Qatargas signed a Supplemental Agreement to the contract for supply of liquefied natural gas of June 29th 2009. Under the agreement, expiring on June 30th 2034, the shipments of LNG from Qatar to Poland will be doubled as of 2018. The total volume of LNG supplied under the long-term contracts with Qatargas will increase to 2m tonnes in 2017 (equivalent to about 2.7bn m^3 of grid gas), and in 2018–2020 to 2.17m tonnes a year (equivalent to about 2.9bn m^3 of grid gas).

On February 1st 2017, PGNiG opened its LNG trading office in London. In the first half of the year, the office handled its first shipment of LNG to PGNiG purchased on the spot market (approximately 150,000 m^3).

In the reporting period, PGNiG received a total of seven LNG shipments (six under the long-term contract with Qatar Liquefied Gas Company Limited (3) and one spot shipment) – approximately 1.4m m^3 in total (ca. 9.5 TWh, which corresponds to ca. 0.9bn m^3 of grid gas). This marks more than a 2.5-fold year-on-year increase.

Imports of natural gas to Poland in 2012–2016 and in H1 2017 (bn m^3)



Renegotiation of price terms under the contract with OOO Gazprom Export

In the first half of 2017, PGNiG continued its efforts to change the price terms under the Yamal Contract as part of the procedure formally launched on November 1st 2014. The arbitration proceedings are expected to conclude in the third quarter of 2017. The fact that the dispute was referred to the Arbitration Court does not preclude commercial negotiations and an amicable settlement with the supplier.

Sales of gas

In the first half of 2017, sales of gas to wholesale customers were tariff-regulated. However, in practice customers are billed at market prices (i.e. below the tariff prices which are viewed as maximum prices). Prices in contracts which are currently being negotiated are based on a uniform and objective pricing mechanism, with no discretionary criteria, which guarantees equal treatment of all customers. Settlements with customers are based on pricing formulas or fixed prices linked to exchange indices.

In the first half of 2017, the largest amounts of gas in Poland were sold to industrial customers. The largest Polish customers in this group include Grupa Azoty S.A., PKN Orlen S.A., Polska Grupa Energetyczna S.A., KGHM Polska Miedź S.A., and Grupa LOTOS S.A.

Key gas supply contracts executed in the first half of 2017:

Grupa Azoty

On June 21st 2017, PGNiG concluded new Individual Contracts for the supply of gas fuel with Grupa Azoty S.A. and its subsidiaries. Under the Individual Contracts, PGNIG is to supply gas fuel from October 1st 2018 to September 30th 2020, with an option to extend the term until September 30th 2022. Assuming that the term will be four years, the estimated value of the contracts may reach approximately PLN 7bn, with up to ca. 8.5bn m^3 of gas to be supplied. The applied pricing formula is based on gas market price indices.

Upon the signing of the new contracts, the Individual Contracts between the Azoty Group and PGNiG S.A. of April 13th 2016, originally valid until September 30th 2018, were terminated.

ArcelorMittal Group

PGNiG signed a long-term gas supply contract with the ArcelorMittal Group, the largest steel manufacturer in Poland, effective from January 1st 2017 to January 1st 2020, with an option to extend the term until January 1st 2023. The total volume of gas to be supplied in that period may reach around 1.6bn m^3, with the maximum value of the contract of approximately PLN 1.4b m^3. The contract provides ArcelorMittal Poland with flexibility to purchase gas on market terms, at prices linked to exchange indices.

Competition

In the reporting period, PGNiG's sales of high-methane grid gas in Poland was 86.0 GWh (7.6bn m^3), which represented a 14.3% increase on the first half of 2016 (75.2 GWh, or 6.7bn m^3). On the one hand, the higher sales volume resulted from stronger market demand, but on the other, the increase was driven by the falling share of competitors in gas imports. In the first half of 2017, net gas imports by PGNiG's competitors fell by 2.7 GWh (240m m^3), or 30%, year on year.

Gas exports

Since August 2016 PGNiG has been exporting gas fuel to Ukraine. In the first half of 2017, as part of its cooperation with the ERU Group, the Company sold ca. 290m m^3 of gas on the Ukrainian market. In April 2017, the two companies were jointly awarded a contract for the supply of natural gas to Ukrtransgaz, a Ukrainian transmission and storage operator. The total volume of natural gas to be supplied under the contract is 218m m^3.

Sales of electricity

On the electricity market, PGNiG is engaged primarily in wholesale trading. Total sales of electricity to trading companies and on the Polish Power Exchange accounted for more than 90% of the Company's total electricity sales in the six months to June 2017.

Sales of electricity by PGNiG S.A.	GWh	%
End customers	6.3	0.2
Trading companies	535.5	15.4
Balancing market	265.2	7.6
Exchange	2,680.1	76.9
TOTAL	3,487.0	100.0

In the first half of 2017, PGNiG engaged in wholesale trading in electricity and related products in Poland and Germany. In Poland, the Company traded on the OTC market and on the PPX. In Germany, the Company traded in spot contracts on the European Power Exchange as part of cross-border electricity trading, and in futures contracts on the European Energy Exchange. PGNiG also provided services under a commercial balancing agreement to PGNiG OD, PGNiG TERMIKA, and new companies in the PGNiG TERMIKA Group: Energetyka Przemysłowa, Energetyka Rozproszona and PEC. PST traded in electricity on the German market as part of exchange (EEX) and OTC transactions.

Retail market

The focus of PGNiG OD's business is sale of natural gas (high-methane and nitrogen-rich gas), electricity, compressed natural gas (CNG), and liquefied natural gas (LNG).

Sources of gas

PGNiG OD purchases high-methane gas on the PPX; under a contract with PGNiG for delivery of gas to a virtual trading point in the transmission network operated by OGP GAZ-SYSTEM; and under a contract with PGNiG for delivery of gas to a physical trading point in Słubice. The PPX accounts for the largest share in the volumes of high-methane gas purchases by PGNiG OD.

Nitrogen-rich gas and LNG are purchased under a contract with PGNiG.

Sales of gas

In the first half of 2017, retail sales of gas were tariff-regulated. Business customers of PGNiG OD buy gas both for technological purposes as well as for heating. As at the end of May 2017, PGNiG OD provided its services to 25.8 thousand customers in tariff groups above 4, of which 24.2 thousand (94%) customers received high-methane gas, and 1.6 thousand – nitrogen-rich gas. In the first half of 2017, those customer groups consumed a total of 17.9 TWh of gas, including 16.5 TWh of high-methane gas. In the same period, close to 35 thousand new accounts in tariff groups 1–4 were added to the retail customer base. The segment of business customers expanded by 1.5 thousand gas delivery points and 0.3 thousand electricity delivery points.

Sales of LNG/CNG products

The company sells and delivers LNG to seven island LNG regasification plants. PGNiG OD is also a party to two LNG supply contracts, one of which was executed in the first half of 2017. CNG is sold to road transport companies through a network of 20 CNG filling stations.

Sales of electricity

PGNiG OD sells electricity to retail and business customers alike, with the G11 tariff applied to electricity sales to the vast majority of the accounts (ca. 85%). The main electricity product is sold based on a fixed price mechanism. In early 2017, PGNiG OD launched advanced plans where electricity is offered in tranches or sales are based on exchange indices.

In the six months to June 2017, PGNiG OD continued mass electricity sales to households and small businesses, launched in September 2016. The offering is targeted at both existing gas customers and customers who do not buy grid gas from the company. As at the end of June 2017, PGNiG OD's base of retail customers on dual fuel (electricity and gas) plans comprised consumer accounts (91%) and non-consumer accounts (9%).

Competition

According to a report released by the President of URE, the number of entities licenced to trade in gas fuels increased from 172 at the end of 2015 to 196 at the end of 2016. Of this number, 127 entities actively traded in natural gas. On the retail market, the most active competitors included in particular four operators to whom the company lost more than 1,000 gas delivery points each in the first half of 2017. In the business segment, the company identified ten most active competitors in the first half of 2017. On the LNG market, there are five particularly active operators.

According to URE, the number of customers who switched gas suppliers in 2016 was approximately 48 thousand, followed by approximately 15 thousand in the first quarter of 2017.

The number of customers who switched their electricity suppliers in January–May 2017 was 48 thousand, including a little more than 39 thousand households (G tariff groups).

5.2.5. Segment's trading activities abroad

Through PST and PST Europe Sales GmbH (retail sale), the PGNiG Group is also developing its natural gas business (both wholesale and sales to end users) in Germany and Austria. PST is an active player on organised markets (exchanges) and in OTC trading; it trades with over 70 counterparties under EFET or similar standardised contracts.

Gas sales by PST outside the PGNiG Group (excluding gas exports from Poland) mln m^3	**H1 2017**	**H1 2016**	**2016**	**2015**	**2014**	**2013**
High-methane gas (E)	1,426	1,377	2,384	2,039	1,745	1,378

Customer base

mln m^3	**H1 2017**	**H1 2016**	**2016**	**2015**
Households	31	33	51	73
Other industrial customers	14	160	57	78
Retail, services, wholesale	986	723	1,460	1,268
Exchange	395	461	816	620
TOTAL sales outside the Group	1,426	1,377	2,384	2,039

Exchange and OTC wholesale trading

In the first half of 2017, PST sold a total of 20.3 TWh of gas and 2.3 TWh of electricity in exchange and OTC transactions. The company's largest market is Germany which accounts for 59% of PST's trading volume. The shares of Polish and Dutch markets in total sales were 22% and 19%, respectively.

Retail sales

The number of customers receiving gas deliveries increased by 30%, to 42 thousand as at June 30th 2017, from 32 thousand as at December 31st 2016. In the first half of 2017, PST signed 27 thousand new contracts, 40% of which were successfully added to the PST customer portfolio, with deliveries starting in 2017 and 2018.

PST's customer base PST (gas and electricity combined)

Customers by country	June 30th 2017	December 31st 2016	December 31st 2015
Germany	41,247	31,432	39,960
Austria	382	580	763
TOTAL	41,629	32,012	40,723

Customers by market segment	June 30th 2017	December 31st 2016	December 31st 2015
Households	38,727	28,572	34,256
B2B	17	10	23
SMEs	2,885	3,430	6,444
TOTAL	41,629	32,012	40,723

5.2.6. Storage

The Trade and Storage segment uses for its own needs the working capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica underground gas storage facilities, as well as the Mogilno and Kosakowo cavern facilities. A part of the working capacity of the Mogilno facility, which was made available to OGP GAZ-SYSTEM S.A., is not a storage facility within the meaning of the Polish Energy Law. The capacities are managed by GSP.

The average volume of gas drawn from Polish storage sites in the first quarter of 2017 was 157 GWh/day, with no significant change from the previous year. In the second quarter 2017, the average volume of gas drawn was 17.3 TWh, having increased more than 2.5 times year on year. In January 2017, GSP made available 109.3m m^3 of TPA working capacity in the Kawerna SFG, the Sanok SFG and the Wierzchowice UGSF, including 59.3m m^3 of new storage capacity in the expanded Kosakowo and Brzeźnica facilities.

	Working storage capacities (mln m^3)		TPA working storage capacities (mln m^3)		TPA working storage capacities (GWh)	
	June 30th 2017	2016	June 30th 2017	2016	June 30th 2017	2016[1)]
Kawerna SFG*	735	714	693	709	7,603	7,774
Wierzchowice UGSF	1,200	1,200	1,200	1,200	13,166	13,166
Sanok SFG**)	1,050	1,015	1,050	1,015	11,520	11,137
TOTAL	2,985	2,929	2,943	2,924	32,289	32,077

[1)]Converted to gas with calorific value of 39.5 MJ/m^3.
** Kawerna SFG – Storage Facility Group comprising the Kosakowo CGSF and Mogilno CUGSF.*
*** Sanok SFG – Storage Facility Group comprising the Husów UGSF, Strachocina UGSF, Brzeźnica UGSF and Swarzów UGSF.*

5.2.7. Segment's prospects

Progress of infrastructural projects on the European gas market

In February 2017, Gazprom approved the purchase of a 50% interest in Nord Stream 2 AG from five European companies, which originally were to form a consortium, and thus became the sole owner of the project. In March 2017, Gazprom Export booked new transmission capacities in Germany, the Czech Republic and Slovakia to enable future deliveries through the planned gas pipeline. The capacities were mostly reserved for deliveries from October 1st 2019 until 2039. In early June 2017, the European Commission proposed a mandate to negotiate with Russia on the pipeline, construing the EU's restrictive Third Internal Energy Market legislative package as applicable only to its onshore sections. Such construction have been contested by some member states, including Poland.

On May 7th 2017, construction works were commenced on the Turkish Stream gas pipeline, which will run from Russia to Turkey under the Black Sea. In February, contract was signed for construction of the second line of the pipeline. The first line will supply gas to Turkey, to meet the country's internal demand, while the second line will supply gas to southern and south-eastern parts of Europe.

In February, the Poland-Slovakia Gas Interconnection Project received EU funding of EUR 108m. In April, OGP GAZ-SYSTEM S.A. made a decision to expand its LNG Terminal in Świnoujście. When completed, the project will increase the Terminal's LNG regasification capacity to 7.5bn m^3 annually. In June, transmission system operators in Denmark and Poland launched an open season procedure to collect bids for pipeline capacities. The projects are part of the Northern Gate and North-South Gas Corridor concepts.

Import strategy

In the long term, PGNiG will focus on meeting its obligations under the long-term contracts with Gazprom Eksport and Qatargas with respect to the minimum offtake volumes. If an unforeseen increase in demand occurs, the Company will purchase natural gas under short-term contracts from the neighbouring countries or on the LNG market, wherever more favourable prices are available.

PGNiG also pursues its strategy of becoming an active player on the international LNG market by entering into spot transactions to secure deliveries to the Świnoujście Terminal and by trading in LNG on the global market.

Wholesale and retail trade abroad

PST intends to further expand its business of selling electricity and gas to end customers and in wholesale. In the retail area, the company will seek to continuously expand its customer base. PST is committed to reducing customer acquisition costs and improving efficiency of the customer acquisition process. In 2016, 60 thousand new contracts were signed, with deliveries starting mostly in 2017. In the first half of 2017, 27 thousand new accounts were added, with deliveries planned to start mostly in 2017 and 2018.

As part of its trading activity, besides being an active player in OTC and exchange markets, PST intends to develop a business model based on cooperation with municipal entities as well as gas and electricity trading companies, by offering them standard and structured trading and balancing products.

Retail sales in Poland

In the second half of 2017, the company intends to implement strategic recommendations aimed at enhancing operational efficiency and customer service quality.

In the segment of business customers, the company will be developing products which will enable it to effectively defend its market share and sales margins. Market deregulation, in particular in tariff groups 3 and 4 (non-consumers), will likely drive significant product changes. To secure its position in this part of the market, the company intends to launch attractive promotions, ahead of it competitors. The rising competitive pressure also poses a challenge in the retail (consumer) segment (tarrifs W3 and W4). To target the W3 tariff group, a new dedicated product has been developed in partnership with communes and municipalities which subsidise replacement of heating boilers by households. In the coming months, the company intends to add insurance and assistance products to its portfolio.

In the second half of 2017, the company will continue to develop its retail offering. In addition, to fight off growing competition, efforts will be continued to maintain the natural gas sales volumes by offering customers dedicated discount plans, including tailor-made plans and solutions for purchasing groups.

Regarding purchase of electricity and certificates of origin PGNiG OD has also taken steps towards greater flexibility of supply sources by increasing its participation in the OTC market.

Storage

The segment is executing a construction project at the Kosakowo CGSF ('Kosakowo UGS – Construction of Five Caverns, Cluster B). Construction (leaching) of caverns K-6, K-8, K-9 and K-10 will continue, and leaching of caverns K6, K-8 and K-9 will be completed. Preparations for leaching of cavern K-7 will start. Equipment needed to fill and operate caverns K-6, K8 and K-9 will be purchased.

In the second half of 2017, the CO_2 cylinder discharge system at the Mogilno CGSF is planned to be upgraded (the project will be carried out by PGNiG) to improve the operating safety of the system.

5.3. Distribution

The segment's business activity consists in the transmission of high-methane and nitrogen-rich gas, as well as of small amounts of coke-oven gas, over the distribution network to retail and corporate customers. The segment is also engaged in extending and upgrading the gas network and connecting new customers. PSG is responsible for natural gas distribution within the segment. As the Distribution System Operator, the company conducts its business across the whole of Poland. Being the owner of approximately 96% of Poland's gas distribution network and nearly 99% of the gas service lines, PSG enjoys a dominant market share.

5.3.1. Segment's strategy

Accelerate the rate of connecting new customers

The new Strategy provides for significant acceleration of development of the distribution system and for increasing the rate of connecting new customers to the grid. In previous years, the Distribution System Operator's approach to the development of the gas market was reactive and, as a result, the company's market development potential was not fully realised. At present, one of the key strategic objectives of the distribution business is to increase the pace of connecting new customers to the distribution network from about 47 thousand new connections in 2017 to about 55 thousand new connections a year (up 8 thousand or ca. 17%).

This, however, will not be possible without optimisation of the related processes (shortening the time to approve and construct new connections), improvements in customer service, and deployment of remote channels.

Increase gas distribution volumes

The higher rate of connecting new premises to the gas network will enable PSG to increase the volume of distributed natural gas, from the 2017 target of approximately 10.6bn m^3 (117.8 TWh) to approximately 12.3bn m^3 (136.7 TWh) in 2022 (an increase of about +1.7bn m^3 (18.9 TWh, or 16%).

The development potential of Poland's distribution market is very large. The share of natural gas in Poland's total fuel consumption is relatively low vs EU countries (16% in Poland compared with 37% in Hungary, 36% in Italy, 35% in the Netherlands, and 32% in the UK). Saturation of the natural gas distribution network in Poland is also relatively low against the EU backdrop (40 customers per kilometre of the PSG network vs 115 at Italgas or 109 at GasNatural Fenosa).

The increase in the volume of distributed gas will be achieved by connecting new customers to the existing distribution network, expanding the distribution network into unserved areas, and delivering gas to customers lacking access to the gas transmission and distribution network through roll-out of local gas delivery solutions.

Given the growing supply of LNG on the Polish market, the Group plans to build local distribution networks which would not be connected to the national gas system, but instead will be fed with LNG (island distribution networks). Other drivers of increase in the volume of distributed natural gas will be efforts to solve the growing problem of low emissions (smog) in many Polish cities, and local governments' initiatives for air quality improvement through such measures as conversion to low carbon fuels, including gas.

5.3.2. Segment's volumes

Volume of distributed gas (high-methane, nitrogen-rich, propane-butane, and coke gas), mln m^3

	H1 2017	H1 2016	2016	2015	2014	2013
Total volume of distributed gas	6,382	5,538	10,858	9,823	9,586	10,128
- including high-methane gas	5,369	4,887	9,301	8,646	8,495	8,922
- including nitrogen-rich gas	580	364	836	643	568	610
including outside the PGNiG Group	*1,616*	*1,491*	*3,081*	*1,793*	*804*	*641*

5.3.3. Segment's financial results

PLNm	H1 2017	H1 2016	2016	2015	2014	2013
Total revenue, including	2,610	2,462	4,915	4,585	4,283	4,250
- external sales of distribution services	403	358	729	363	67	23
- intra-group sales of distribution services	2,048	1,910	3,657	3,748	3,868	4,045
EBITDA	1,383	1,423	2,559	2,339	2,002	1,596
EBITDA adjusted for impairment losses on property, plant and equipment	1,384	1,423	2,563	2,341	1,994	1,597

In the first half of 2017, the Distribution segment's operating profit fell by PLN 45m, or 5%, year on year, to PLN 923m, while EBITDA came in at PLN 1,383m, down by PLN 40m year on year. The segment's operating result was mainly driven by:

- PLN 148m (6%) year-on-year increase in revenue, mainly on a 15% increase in the volume of distributed gas (the average air temperature in the first half of 2017 was 1.4°C lower than a year before);
- PLN 117m (or 26%) rise in employee benefits expense, with a ca. 3.5% increase in the number of employees and amended rules of remuneration among the contributing factors. The increase in employment in the distribution segment resulted primarily from changes in the PSG organizational structure. The changes are intended to support delivery of the company's strategic objectives (i.e. intensified network roll-out efforts and acquisition of new customers);
- Increase in transmission service costs by PLN 53m year on year, directly attributable to increased sales of gas distribution services, which grew by 15% year on year, and to the change (as of February 1st 2017) of the tariff rates charged by OGP GAZ-SYSTEM S.A.

5.3.4. Segment's activities

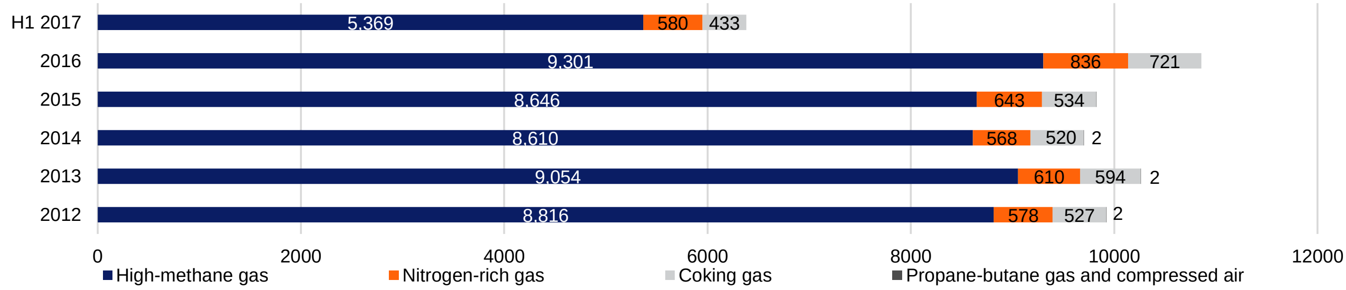
As of January 1st 2017, the structure of PSG changed with formation of 17 Gas Distribution Branches, 172 local gas utilities and 59 service points, based on which PSG will establish 52 new organisational units.

In the first half of 2017, the segment developed initiatives in response to the strategic challenges outlined for the distribution business in the PGNiG Group's 2017−2022 Strategy. PSG planned that around 30% of the total number of new gas connections scheduled for 2017 will be built in the first half of the year, with the remaining 70% to be delivered in the second half of 2017. It is estimated that in the reporting period PSG built about 18.5 thousand new B1 and B2 connections, thus exceeding the target by approximately 2.8 thousand connections.

All initiatives are focused on connecting new customers to the gas network, and on the network roll-out into unserved areas. Since July 2016, PSG has been organising meetings with local governments to discus cooperation between the company and municipalities/communes. So far, a number of letters of intent have been signed with local government units. The company's strategy set the target of 74 new municipalities and communes to be connected to the network, with 350 thousand new service lines to be built by 2022.

In the first half of 2017, there was an almost 15% year-on-year increase in the volume of gas distributed by the segment.

Volume of gas transmitted via the distribution system (m m^3) in 2012–2016 and in H1 2017



The main factors which contributed to the increase in the volume of distributed gas included a higher number of end users, favourable weather conditions, more competitive pricing terms of the offering, and customers' improved access to gas. The trend is likely to be maintained in the future, particularly in the context of the abolition of the tariff obligation for gas sales to all consumer groups except households; this will take place in October 2017. The volume of distributed gas was also driven by an increase in the number of new connection approvals and of new service line contracts. It is estimated that in the six months to June 2017, PSG:

- issued approximately 76 thousand connection approval decisions (an increase of ca. 15% on the first half of 2016, when 66 thousand new connections were authorised);
- concluded approximately 39 thousand service line contracts (an increase of ca. 19% on the first half of 2016, when 33 thousand such contracts were executed).

In March 2017, the Office of Competition and Consumer Protection (UOKiK) issued an anti-trust clearance for business concentration consisting in the acquisition by PSG of some of the assets of OGP GAZ-SYSTEM. Both companies have defined the framework for future transactions. In the first stage of the project, PSG is to purchase selected segments of the transmission system and gas stations from OGP GAZ-SYSTEM. The companies will also analyse the PSG infrastructure to determine which elements of the system will be purchased by OGP GAZ-SYSTEM.

In April 2017, the Development Strategy for PSG's high-pressure distribution network for 2017−2026 (Development Strategy) was adopted. The Development Strategy outlines the directions for development of the distribution system in the ten-year horizon, including high-pressure system connections, regional increased-medium-pressure and medium-pressure networks, and the list of municipalities and communes with a potential for growth in demand for natural gas. The expansion of the gas network is intended to ensure the system's long-term ability to provide distribution services and manage network traffic, while ensuring the system's operational safety.

As at June 30th 2017, the length of the PGS network (excluding service lines) was 132 thousand km, and the number of customers was 6.9m.

5.3.5. Segment's prospects

In the second half of 2017, PSG will continue its business development efforts by connecting new customers and increasing the volume of distributed gas, by maintaining high service standards, and by ensuring security and continuity of gas supply. The company also plans to connect new areas to the gas distribution network. PSG intends to spend over PLN 580m on expanding the network and connecting of new customers. In the second half of 2017, the key theme will be to continue customer acquisition, in line with the plan to build approximately 30.5 thousnad new service lines during the period to ensure successful delivery of the Strategy.

In order to maintain and improve the technical condition of the gas distribution lines and to guarantee operational safety, PSG invests in upgrading its network assets. In the second half of 2017, the company intends to spend over PLN 330.5m on reconstruction and modernisation of the network. According to PSG's current spending plans, in the second half of 2017 the capital expenditure will amount to PLN 1,124.9m, of which 52% is to be spent on network extension and new connections, 29% on network upgrades, 6% on purchases of metering devices (the aggregate share of network investments in total capex is 87%).

The most important of PSG's network development activities the second half of 2017 include construction of LNG-based distribution networks across the country. PSG will also continue to partner with the ORLEN and LOTOS Groups in development of innovative power supply sources based on the CNG and LNG technologies.

The PSG Development Strategy provides for construction of almost 3.77 thousand kilometres of new segments of the network and 82 high-pressure gas stations. The expenditure is estimated at PLN 3bn. The Development Strategy is consistent with PSG's Strategy for 2016−2022 and with other ongoing initiatives, including the LNG-based distribution system development project.

Preliminary analyses have identified 218 heat sources and cogeneration units representing potential demand for gas of approximately 2.67bn m^3 a year, with peak gas consumption of 553 thousand m^3 per hour.

5.4. Generation

The segment's principal business consists in the production of heat and electricity, and execution of large natural gas-fired projects in the power sector. PGNiG TERMIKA is the largest producer of electricity and heat from high-efficiency cogeneration and the ninth largest electricity producer in Poland, with an 11% share in all heat generated by licensed domestic producers. In 2016, Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie Zdrój (PEC) and Spółka Energetyczna Jastrzębie S.A. (formerly SEJ, currently PGNiG TERMIKA Energetyka Przemysłowa S.A.) were included in the Generation segment.

5.4.1. Segment's strategy

Maximise cash flows from the generation business

The PGNiG Group's strategy for the generation business is to expand its share in the heat generation and distribution market. On April 28th 2016, PGNiG TERMIKA acquired a 100% interest in PEC of Jastrzębie Zdrój, and on August 11th 2016 it acquired SEJ (currently PGNiG TERMIKA EP) from Jastrzębska Spółka Węglowa S.A. PEC and PGNiG TERMIKA EP operate in the promising heat markets of Upper Silesia. The PGNiG Group is building a strong group of companies around PGNiG TERMIKA, offering significant growth potential that will create value for the entire Group.

In terms of electricity and heat generation, the Group's strategic ambition is to increase the volume of electricity and heat sales from approximately 15 TWh in 2017 to around 18 TWh in 2022. This objective will be attained mainly through:

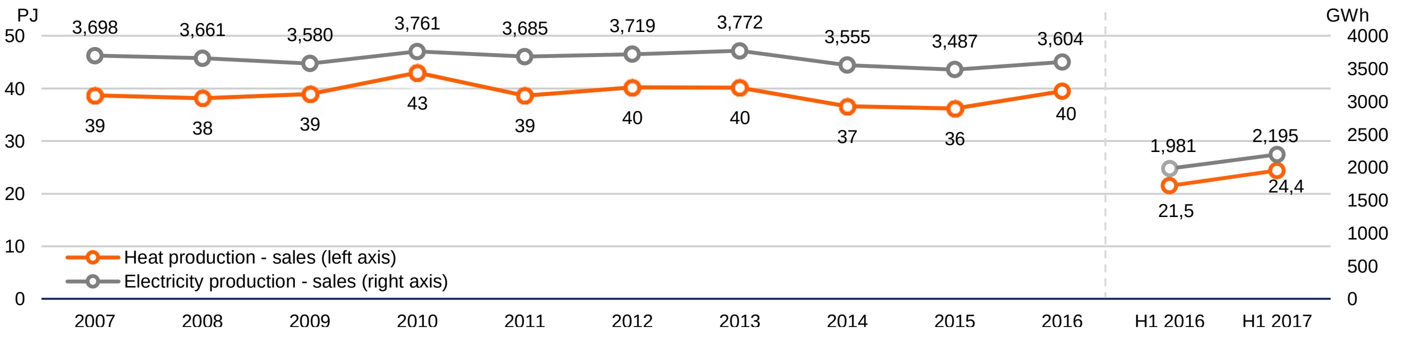
- upgrades to and development of the existing production facilities (new CCGT unit at the Żerań CHP plant);
- full integration of the heating assets acquired by the TERMIKA Group (PEC and PGNiG TERMIKA EP), and increase in the volume of electricity and heat produced by PGNiG TERMIKA EP and PEC following the launch of a new unit at the Zofiówka CHP plant;
- further acquisitions of local heating systems.

Work is also in progress to launch an auction-based capacity market. The currently proposed solutions permit cogeneration units to participate in the capacity market. However, the decision to implement the proposed system, as well as its final shape, are subject to uncertainty. Moreover, no binding decisions have so far been made on extending or changing the current cogeneration support system, which will be effective only until 2018. The PGNiG Group will actively advocate regulatory changes to promote the concept of capacity market and to secure support for cogeneration after 2018.

The current market and regulatory environment as well as tariffs provide favourable conditions for the growth of Poland's heating market. Available market forecasts suggest a stable growth of the total price of district heat and a moderate increase in demand for district heat in the coming years. The regulated nature of the business guarantees stable rates of return.

5.4.2. Segment's volumes

Heat and electricity sales volumes from own generation sources



5.4.3. Segment's financial results

PLNm	H1 2017	H1 2016	2016	2015	2014	2013
Total revenue	1,267	1,123	2,195	1,887	1,943	2,063
Revenue from sales outside the Group, including:	943	730	1,472	1,215	1,149	1,658
- heat	765	675	1,262	1,126	1,079	1,069
- electricity	32	5	36	8	7	514
Inter-segment revenue	324	393	723	672	794	405
EBITDA	580	450	759	679	463	503
EBITDA adjusted for impairment losses on property, plant and equipment	580	454	775	710	463	503

The segment's operating profit in the first half of 2017 was PLN 382m, which represented a PLN 108m increase year on year. EBITDA was PLN 580m, having improved 29% year on year. The segment's result was mainly driven by:

- consolidation of PEC (in May 2016) and PGNiG TERMIKA EP (in August 2016). In the reporting period, the companies generated PLN 205m in revenue and earned a combined EBITDA of PLN 77m;
- increase in revenue from sales of heat and electricity from own generation sources on higher sales volumes (year-on-year increase of 13% and 10%, respectively). The improved sales were largely driven by lower average air temperatures in the first half of 2017;
- lower costs of coal, the main fuel for heat production, at PGNiG TERMIKA (the average price of coal in the six months to June 2017 was 6% lower year on year).

5.4.4. Segment's activities

In the reporting period, the company monitored the market for potential acquisition opportunities. In June 2017, it signed a turn-key contract for construction of a 497 MWe CCGT unit at the Żerań CHP plant. A tender procedure was also conducted and bids were collected for construction of a 390 MW gas-fired unit at the Żerań CHP plant. For economic reasons, a decision was made to abandon plans to construct mains which would connect the heating systems of Warsaw and Pruszków.

In the first half of 2017, PEC carried out a range of upgrade projects to replace sections of the existing infrastructure with pre-insulated network sections to reduce transmission losses; continued customer acquisition efforts to compensate for decline in contracted capacities; and worked on improving efficiency of its heat generating assets.

PGNiG TERMIKA EP is pursuing a strategic initiative to expand its network coverage, increase revenue, and build a portfolio of outsourcing projects ready for launch once favourable market conditions appear (target: 15 MWe in 2022). The company's current efforts as part of the initiative are focused on active search for potential projects and customers.

In the first half of 2017, PGNiG TERMIKA – jointly with PGE, ENEA and ENERGA – participated in negotiations to purchase EDF Polska's power generation assets. However, in the course of the due diligence process, PGNiG TERMIKA decided to withdraw from the project.

5.4.5. Segment's prospects

In May 2017, PGNiG TERMIKA updated its strategy for 2017–2022. The main themes in the PGNiG TERMIKA Group's development efforts are geographical expansion through acquisition of heating systems and development of new markets. The PGNiG TERMIKA Group seeks development opportunities in industrial energy generation, which is the domain of PGNiG TERMIKA EP (development of coal-bed methane projects, use of waste gases, such as coke gas); and in the roll-out of local heating systems by PGNiG TERMIKA ER (construction and operation of low-capacity heating plants and co-generation systems, development of power generation clusters in partnership with local governments and other PGNiG Group companies).

PGNiG TERMIKA is also working to develop its generation capacities in Warsaw to secure the necessary supply of heat and power now and in the future (construction of a CCGT unit at the Żerań CHP and a multi-fuel block project in the Siekierki CHP).

In the second half of 2017, PGNiG TERMIKA EP will work on its merger with PEC and will be involved in the construction of the CFB unit, which is scheduled to be commissioned at the Zofiówka CHP plant by the end of 2017.

5.4.6. Investment in PGG

Under the Investment Agreement of April 28th 2016, PGNiG TERMIKA, as a new shareholder, acquired PGG shares worth PLN 500m. In January 2017, PGG took steps to acquire coal production assets from Katowicki Holding Węglowy S.A. On March 31st 2017, PGNiG TERMIKA agreed to invest PLN 300m in PGG.

As a result, on June 30th 2017 PGNiG TERMIKA held 6,500,000 shares in PGG, representing 19.02% of the company's share capital.

The increase in the share capital of PGG effected on June 14th 2017 was registered with the National Court Register on July 7th 2017. As at July 12th 2017, the shareholding structure of PGG was as follows:

1. PGE Górnictwo i Energetyka Konwencjonalna S.A. held 5,700,000 shares – 15.76% of the share capital,
2. ENERGA Kogeneracja Sp. z o.o. held 5,700,000 shares – 15.76% of the share capital,
3. PGNiG TERMIKA S.A. held 7,100,000 shares – 19.63% of the share capial,
4. PFR Fundusz Inwestycji Polskich Przedsiębiorstw Fundusz Inwestycji Zamkniętych Aktywów Niepublicznych held 3,000,000 shares – 8.29% of the share capital,
5. Towarzystwo Finansowe SILESIA Sp. z o.o. held 5,400,000 shares – 14.93% of the share capital,
6. Węglokoks S.A. held 7,167,181 shares – 19.82% of the share capital,
7. ENEA S.A. held 2,100,000 shares – 5.81% of the share capital,
8. State Treasury held one share, which represented 0.000003% of the share capital.

(in PLN million, unless stated otherwise)

PGNiG TERMIKA recognises its equity interest in PGG as a long-term financial investment. The decision to invest in PGG was based on the assumption that the profitability of coal sales would improve markedly in the long term, mainly due to optimisation of production costs. Currently, PGG is implementing its long-term Business Plan approved by the Investors, and a Technical and Economic Plan for 2017.

5.5. Other Segments

5.5.1. Segment's key data

PLNm	H1 2017	H1 2016 restated	2016 restated	2016*	2015*	2014*	2013*
Revenue	160	184	362	240	325	325	424
EBITDA	(120)	(76)	(186)	(61)	12	(49)	(44)

** Reported data, does not reflect changes in the presentation of reporting segments discussed in section 4.3, introduced in 2017.*

5.5.2. Segment's activities

PGNiG Branch – Head Office

The Company's Head Office performs supervision, planning, executive and oversight functions with respect to PGNiG Branches. It organises PGNiG's business and exercises ongoing supervision over all Group companies.

PGNiG Branch – Central Measurement and Testing Laboratory (CLPB)

Services provided by the CLPB include testing of measurement devices and systems used in the natural gas industry; calibration of measurement devices in terms of pressure, volume, temperature, geometric measurements, electrical values, chemical properties (including gas composition); supervision of measurement systems at entry points in Belarus and Ukraine, and at the LNG Terminal in Świnoujście; and performance of technical analyses.

The CLPB's key customers are EuRoPol Gaz S.A. (ca. 33%), OGP GAZ-SYSTEM S.A. (ca. 15%), and the PGNiG Group (ca. 20%); other customers account for ca. 32% sales of the CLBP.

PGNiG Technologie

The principal business of PGNiG Technologie is comprehensive execution of projects involving construction of crude oil and natural gas production facilities as well as gas transmission systems; construction of and upgrades to process units at gas storage facilities; manufacture and repair of drilling and production equipment; manufacture of pressure vessels, storage tanks and steel structures; and repairs of diesel engines.

PGNiG Serwis

The principal business of PGNiG Serwis is the provision of comprehensive finance, accounting, HR, and ICT services; project management support; property and fleet management; porter and reception services; and direct physical security services for the PGNiG Group companies.

Biuro Studiów i Projektów Gazownictwa Gazoprojekt

Gazoprojekt provides consultancy and planning services at all stages of administrative procedures: development of technical and economic project assumptions, and drafting of documentation and project execution plans. It performs feasibility and environmental studies, drafts legally required documents, produces design and as-built documentation, and prepares 3D visualisations.

Geovita

Geovita's business involves leisure-related activities, spa treatment services, health protection, medical rehabilitation, and provision of conference and training services.

(in PLN million, unless stated otherwise)

6. Additional information on the PGNiG Group

6.1. Structure of the PGNiG Group

As at June 30th 2017, the PGNiG Group comprised PGNiG (the Parent), 34 production, trade and service companies, and a mutual insurance company, including:

- 20 direct subsidiaries of PGNiG
- 15 indirect subsidiaries of PGNiG.

The table below presents the PGNiG Group companies as at June 30th 2017.

PGNiG Group companies as at June 30th 2017

No.	Company name	Share capital	Value of shares held by PGNiG	PGNiG's ownership interest (%, direct holdings)	PGNiG Group's ownership interest (%, direct and indirect holdings)
	Subsidiaries – first tier				
1	BSiPG Gazoprojekt S.A.	4,000,000	3,000,000	75%	75%
2	EXALO Drilling S.A.	981,500,000	981,500,000	100%	100%
3	GEOFIZYKA Kraków S.A. w likwidacji (in liquidation)	64,400,000	64,400,000	100%	100%
4	GEOFIZYKA Toruń S.A.	66,000,000	66,000,000	100%	100%
5	Geovita S.A.	86,139,000	86,139,000	100%	100%
6	Gas Storage Poland Sp. z o.o.	15,290,000	15,290,000	100%	100%
7	PGNiG Obrót Detaliczny Sp. z o.o.	600,050,000	600,050,000	100%	100%
8	PGNiG Serwis Sp. z o.o.	9,995,000	9,995,000	100%	100%
9	PGNiG Technologie S.A.	272,727,400	272,727,400	100%	100%
10	PGNiG TERMIKA S.A.	1,440,324,950	1,440,324,950	100%	100%
11	Polska Spółka Gazownictwa Sp. z o.o.	10,454,206,550	10,454,206,550	100%	100%
12	PGNiG Finance AB	SEK 500,000	SEK 500,000	100%	100%
13	PGNiG Supply & Trading GmbH	EUR 10,000,000	EUR 10,000,000	100%	100%
14	PGNiG Upstream Norway AS	NOK 1,100,000,000	NOK 1,100,000,000	100%	100%
15	Polish Oil And Gas Company – Libya B.V.	EUR 20,000	EUR 20,000	100%	100%
16	GAS-TRADING S.A.	2,975,000	1,291,350	43.41%	79.58%[2)]
17	PGNiG SPV 5 Sp. z o.o.	250,000	250,000	100%	100%
18	PGNiG SPV 6 Sp. z o.o.	51,381,000	51,381,000	100%	100%
19	PGNiG SPV 7 Sp. z o.o.	250,000	250,000	100%	100%
20	Polski Gaz Towarzystwo Ubezpieczeń Wzajemnych*	20,000,000	20,000,000	100%	100%
	Subsidiaries – second tier				
21	Przedsiębiorstwo Energetyki Cieplnej S.A.	85,000,000	85,000,000	-	100%[9)]
22	PGNiG TERMIKA Energetyka Przemysłowa S.A.	288,233,300	288,233,300	-	100%[9)]
23	GAZ Sp. z o.o.	300,000	300,000	-	100%[3)]
24	PSG Inwestycje Sp. z o.o.	81,131,000	81,131,000	-	100%[3)]
25	Oil Tech International F.Z.E.	USD 20,000	USD 20,000	-	100%[4)]
26	EXALO DRILLING UKRAINE LLC	EUR 20,000	EUR 20,000	-	100%[4)]
27	PST Europe Sales GmbH	EUR 1,000,000	EUR 1,000,000	-	100%[5)]
28	Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000	2,565,350	-	85.51%[6)]
29	Gas Assets Management Sp. z o.o.	1,360,000	1,360,000	-	100%[7)]
30	Gas-Trading Podkarpacie Sp. z o.o.	6,670,627	5,257,523.51	-	78.82%[8)]
31	PGNiG Serwis Doradztwo Ubezpieczeniowe Sp. z o.o.	5,000	5,000	-	100%[1)]
32	PGNiG TERMIKA Energetyka Rozproszona Sp. z o.o.	9,881,000	9,881,000	-	100%[9)]
33	Zakład Gospodarki Mieszkaniowej Sp. z o.o.	1,806,500	1,806,500	-	100%[4)]
	Subsidiaries – third tier				
34	XOOL GmbH	EUR 500,000	EUR 500,000	-	100%[10)]
35	SEJ-Serwis Sp. z o.o.	200,000	200,000	-	100%[11)]

1) PGNiG's interest held indirectly through PGNiG Serwis Sp. z o.o.
2) PGNiG's direct interest is 43.41%, with a 36.17% interest held indirectly through PGNiG SPV 6 Sp. z o.o.
3) PGNiG's interest held indirectly through Polska Spółka Gazownictwa Sp. z o.o.
4) PGNiG's interest held indirectly through EXALO Drilling S.A.
5) PGNiG's interest held indirectly through PGNiG Supply & Trading GmbH.
6) PGNiG's interest held indirectly through Gas Storage Poland Sp. z o.o.
7) PGNiG's indirect interest in the company is 100%, with 99.98% held through PGNiG SPV 6 Sp. z o.o. and 0.02% held through PGNiG SPV 5 Sp. z o.o.
8) PGNiG's interest held indirectly through GAS TRADING S.A.
9) PGNiG's interest held indirectly through PGNiG TERMIKA S.A.
10) PGNiG's interest held indirectly through PGNiG Supply & Trading GmbH and PST Europe Sales GmbH.
11) PGNiG's interest held indirectly through PGNiG TERMIKA S.A., Przedsiębiorstwo Energetyki Cieplnej S.A. (45%) and PGNiG TERMIKA Energetyka Przemysłowa S.A. (55%)

(in PLN million, unless stated otherwise)

Changes in the Group structure in the six months to June 2017:

- On January 18th 2017, the Extraordinary General Meeting of PGNiG Technologie resolved to increase the company's share capital from PLN 182,127,240 to PLN 272,727,240, i.e. by PLN 90,600,000. The share capital was increased through an issue of 90,600,000 Series C ordinary (non-preference) registered shares with a par value of PLN 1 per share. All the new shares were acquired by PGNiG for a cash contribution of PLN 90,600,000. The increase in the share capital of PGNiG Technologie was registered with the National Court Register on March 9th 2017.
- On February 22nd 2017, PGNiG Technologie and PGNiG entered into a share purchase agreement, whereby PGNiG acquired from PGNiG Technologie 21,000 shares in BSiPG Gazoprojekt S.A.
- On March 9th 2017, the change of company name from NYSAGAZ Sp. z o.o. to PGNiG TERMIKA Energetyka Rozproszona Sp. z o.o. was entered in the National Court Register.
- On March 10th 2017, the Extraordinary General Meeting of Powiśle Park Sp. z o.o. passed a resolution to amend the company's Articles of Association and to change the company's name. The change of the company name was entered in the National Court Register on March 20th 2017.
- On March 23rd 2017, the management of PGNiG's subsidiary of Sandnes, Norway, was notified that on March 18th 2017 the change of the company's name from PGNiG Upstream International AS to PGNiG Upstream Norway AS was entered in the Norwegian register of commercial companies. A relevant resolution was passed by the company's Extraordinary General Meeting on March 8th 2017.
- On March 31st 2017, the Extraordinary General Meeting of PGNiG TERMIKA resolved to increase the company's share capital from PLN 1,440,324,950 to PLN 1,740,324,950, i.e. by PLN 300,000,000. The share capital was increased through an issue of PLN 30,000,000 Series H ordinary (non-preference) registered shares with a par value of PLN 10 per share. All the new shares acquired by PGNiG for a cash contribution of PLN 300,000,000. As at the date of this Report, the increase in the share capital of PGNiG TERMIKA was not registered with the National Court Register.
- On April 12th 2017 the District Court of Gliwice, 10th Commercial Division of the National Court Register, registered amendments to the Articles of Association and change of the name of Spółka Energetyczna Jastrzębie. As of April 12th 2017, the company trades as PGNiG TERMIKA Energetyka Przemysłowa Spółka Akcyjna.
- On April 19th 2017, PGNiG recapitalized POGC Libya BV with USD 1,100,000, without issuing new shares.
- On April 28th 2017, PGNiG Serwis acquired 100 shares in QILIN INTERNATIONAL Sp. z o.o. with a par value of PLN 50 per share, representing 100% of the company's share capital. By way of Resolution No. 3 of April 28th 2017, the General Meeting of QILIN INTERNATIONAL Sp. z o.o. amended the company's articles of association, including the company's name. As of May 16th 2017, the company trades as PGNiG Serwis Doradztwo Ubezpieczeniowe (the change of name was registered with the National Court Register on May 16th 2017).
- On May 17th 2017, the name of Poltava Services LLC was changed to EXALO DRILLING UKRAINE LLC.
- On June 29th 2017, the Extraordinary General Meeting of PEC resolved to merge the company with PGNiG TERMIKA Energetyka Przemysłowa. Registration of the merger with the registry court is pending. On June 29th 2017, the Extraordinary General Meeting of PGNiG TERMIKA EP resolved to merge the company with Przedsiębiorstwo Energetyki Cieplnej S.A. Registration of the merger with the registry court is pending.
- On June 29th 2017, the Extraordinary General Meeting of PGNiG TERMIKA EP resolved to increase the company's share capital from PLN 288,233,300 to PLN 370,836,300, i.e. by PLN 82,603,000, through an issue of PLN 826,030 Series N ordinary registered shares with a par value of PLN 100 per share. As at the date of this Report, the increase in the share capital of PGNiG TERMIKA EP was not registered with the National Court Register.

6.2. Other ownership interests and organisational links

The table below presents the PGNiG Group's associated companies as at June 30th 2017.

PGNiG Group's associated companies as at June 30th 2017

No.	Company name	Share capital	Value of shares held by PGNiG	PGNiG's ownership interest (%, direct holdings)	PGNiG Group's ownership interest (%, direct and indirect holdings)
	Jointly-controlled and associated entities - first tier				
1	Sahara Petroleum Technology Llc w likwidacji) (in liquidation)	150,000.00	OMR 73,500	49.00%	49.00%
2	SGT EUROPOL GAZ S.A.	80,000,000.00	38,400,000.00	48.00%	51.18%[1)]
3	PFK GASKON S.A.	13,061,325.00	6,000,000.00	45.94%	45.94%
4	ZWUG INTERGAZ Sp. z o.o.	4,700,000.00	1,800,000.00	38.30%	38.30%
5	Dewon ZSA	11,146,800.00	UAH 4,055,205.84	36.38%	36.38%
	Jointly-controlled and associated entities - second tier				
6	Zakład Separacji Popiołów Siekierki Sp. z o.o.	10,000,000.00	7,000,000.00	-	70%[2)]
7	Elektrociepłownia Stalowa Wola S.A.	28,200,000.00	14,100,000.00	-	50%[2)]
8	Polska Grupa Górnicza Sp. z o.o.	3,416,718,200.00	650,000,000.00	-	19.02%[2)]
9	Polimex-Mostostal S.A.	473,237,604.00	78,000,048.00	-	16.48%[3)]

1) PGNiG's direct interest is 48.00%, with a 3.18% interest held indirectly through GAS-TRADING S.A.
2) PGNiG's interest held indirectly through PGNiG TERMIKA S.A.
3) PGNiG's interest held indirectly through PGNiG Technologie S.A.

Changes in other ownership interests within the PGNiG Group in the six months to June 2017:

- On January 18th 2017, PGNiG Technologie acquired 37,500,000 new shares in Polimex-Mostostal S.A., with a par value of PLN 2 per share, for a total price of PLN 75m. The share capital increase was registered with the National Court Register on February 21st 2017. The registered share capital of Polimex-Mostostal S.A. is PLN 473,237,604. Also, in the performance of the agreement with SPV Operator Sp. z o.o., PGNiG Technologie acquired 1,500,000 Polimex-Mostostal shares for a total price of PLN 5,640 thousand, i.e. at PLN 3.76 per share. Followig a tender offer of April 26th 2017 (the transaction was cleared at KDPW on April 28th 2017), PGNiG Technologie acquired a further 24 Polimex-Mostostal shares. As a result, PGNiG Technologie's equity interest in Polimex-Mostostal S.A. is 16.48%.
- On January 27th 2017, an increase in the share capital of PGG, effected under a resolution of the company's General Meeting of November 3rd 2016, was registered with the National Court Register. Following the registration of the increase, the company's share capital amounted to PLN 2,672,274,200. PGNiG TERMIKA held 4,444,444 PGG shares, with a par value of PLN 100 per share and a total par value of PLN 444,444,400, which represented 16.63% of PGG's share capital and total voting rights.
- On February 1st 2017, the Extraordinary General Meeting of PGG passed another resolution to increase the company's share capital, by PLN 244,444,000, i.e. to PLN 2,916,718,200, through an issue of 2,444,440 new shares with a par value of PLN 100 per share. 555,556 new shares with a par value of PLN 100 per share and a total par value of PLN 55,555,600 were acquired by PGNiG TERMIKA for a cash contribution of PLN 55,555,600. The share capital increase was registered with the National Court Register on March 10th 2017. After the share capital increase, PGNiG TERMIKA held 5,000,000 PGG shares, with a par value of PLN 100 per share and a total par value of PLN 500,000,000, which represented 17.14% of PGG's share capital and total voting rights.
- On April 3rd 2017, the Extraordinary General Meeting of PGG passed a resolution to increase the company's share capital by PLN 500,000,000, i.e. from PLN 2,916,718,200 to PLN 3,416,718,200, through an issue of 5,000,000 new shares with a par value of PLN 100 per share. PGNiG TERMIKA acquired 1,500,000 new shares with a par value of PLN 100 per share and a total par value of PLN 150,000,000 in the increased share capital of PGG, for a cash contribution of PLN 150,000,000. After the share capital increase, PGNiG TERMIKA held 6,500,000 PGG shares, with a par value of PLN 100 per share and a total par value of PLN 650,000,000, which represented 19.02% of PGG's share capital and total voting rights. The increase in the share capital of PGG was registered with the National Court Register on June 7th 2017.
- On June 14th 2017, the Extraordinary General Meeting of PGG passed a resolution to increase the company's share capital by PLN 200,000,000, i.e. from PLN 3,416,718,200 to PLN 3,616,718,200, through an issue of 2,000,000 new shares with a par value of PLN 100 per share. PGNiG TERMIKA acquired 600,000 new shares with a par value of PLN 100 per share and a total par value of PLN 60,000,000 in the increased share capital of PGG, for a cash contribution of PLN 60,000,000. After the share capital increase, PGNiG TERMIKA holds 7,100,000 PGG shares, with a par value of PLN 100 per share and a total par value of PLN 710,000,000, which represents 19.63% of PGG's share capital and total voting rights.

By the date of this Report, the following changes occurred in other ownership interests within the PGNiG Group:

- On July 7th 2017, the increase in the share capital of PGG, effected under the resolution of the company's Extraordinary General Meeting of June 14th 2017, was registered with the National Court Register. Following the registration of the increase, the company's share capital amounts to PLN 3,616,718,200. PGNiG TERMIKA holds 7,100,000 PGG shares, with a par value of PLN 100 per share and a total par value of PLN 710,000,000, which represents 19.63% of PGG's share capital and total voting rights.

6.3. Governing bodies

6.3.1. PGNiG Management Board

Composition of the PGNiG Management Board as at January 1st 2017:

- Piotr Woźniak − President of the Management Board
- Radosław Bartosik − Vice President, Chief Operating Officer
- Łukasz Kroplewski – Vice President, Development
- Michał Pietrzyk – Vice President, Finance
- Maciej Woźniak – Vice President, Trade
- Waldemar Wójcik – Vice President.

On March 6th 2017, the PGNiG Supervisory Board removed Mr Waldemar Wójcik from the Management Board and appointed Ms Magdalena Zegarska as Vice President of the Management Board for a joint term of office ending on December 31st 2019.

On June 28th 2017, the PGNiG Annual General Meeting resolved to grant discharge to all members of the PGNiG Management Board who served on the Supervisory Board in the financial year 2016.

Composition of the PGNiG Management Board as at June 30th 2017:

- Piotr Woźniak − President of the Management Board
- Radosław Bartosik − Vice President, Chief Operating Officer

- Łukasz Kroplewski – Vice President, Development
- Michał Pietrzyk – Vice President, Finance
- Maciej Woźniak – Vice President, Trade
- Magdalena Zegarska – Vice President.

6.3.2. PGNiG Supervisory Board

As at January 1st 2017, the composition of the PGNiG Supervisory Board was as follows:

- Bartłomiej Nowak – Chairman of the Supervisory Board,
- Wojciech Bieńkowski – Deputy Chairman,
- Magdalena Zegarska – Secretary,
- Sławomir Borowiec – Member,
- Mateusz Boznański – Member,
- Andrzej Gonet – Member,
- Piotr Sprzączak − Member,
- Ryszard Wąsowicz – Member,
- Anna Wellisz − Member.

Ms Magdalena Zegarska resigned as Member of the PGNiG Supervisory Board, with effect as of March 5th 2017. As of the same date, Mr Sławomir Borowiec was appointed Secretary of the Supervisory Board.

Mr Ryszard Wąsowicz resigned as Member of the PGNiG Supervisory Board, with effect from May 30th 2017.

On June 28th 2017, the PGNiG Annual General Meeting resolved to grant discharge to all members of the PGNiG Supervisory Board who served on the Supevisory Board in the financial year 2016. By way of a resolution of the Annual General Meeting of PGNiG S.A. all Supervisory Board members were removed from office with effect from June 28th 2017. Then, also with effect from June 28th 2017, the General Meeting appointed to the Supervisory Board the following persons, who as at June 30th 2017 served as Supervisory Board members:

- Bartłomiej Nowak,
- Andrzej Gonet,
- Piotr Sprzączak,
- Grzegorz Tchorek,
- Piotr Broda,
- Mieczysław Kawecki,
- Slawomir Borowiec,
- Stanisław Sieradzki.

On June 29th 2017, the PGNiG Supervisory Board appointed Mr Bartłomiej Nowak as Chairman of the Supervisory Board, Mr Piotr Sprzączak as Deputy Chairman of the Supervisory Board, and Mr Sławomir Borowiec as Secretary of the Supervisory Board.

6.4. Court proceedings

6.4.1. Pending court proceedings

A detailed description of the pending court proceedings is presented in section 6 of the Directors' Report on the operations of PGNiG and the PGNiG Group in 2016. In the first half of 2017, the following changes occurred:

Anti-trust proceedings instigated before the President of the Office of Competition and Consumer Protection (UOKiK) on December 28th 2010

On January 10th 2017 (case No. III SK 61/15), the Supreme Court reversed the Court of Appeals' judgment concerning PGNiG's cassation complaint and remanded the case to the Court of Appeals for re-examination and decision on the costs of the cassation procedure. At the same time, the Supreme Court dismissed the President of UOKiK's cassation complaint and ordered the President of UOKiK to reimburse the costs of the cassation proceedings to PGNiG. On June 8th 2017, the Court of Appeals reversed the ruling of the Competition and Consumer Protection Court of May 12th 2014 and remanded the case for re-examination by that court.

Anti-trust proceedings instigated before the President of UOKiK on April 3rd 2013

On November 2nd 2015, PGNiG filed an appeal against the decision of the President of UOKiK with the Competition and Consumer Protection Court at the Regional Court of Warsaw. The first hearing was scheduled for March 14th 2017. On March 21st 2017, the Competition and Consumer Protection Court at the Regional Court of Warsaw dismissed the appeal. On April 18th 2017, the Company appealed against the judgment.

Proceedings concerning the OPAL pipeline

Proceedings concerning the OPAL pipeline are pending before:

- the General Court of the European Union, with which a complaint and a request for injunctive relief were filed separately by:
    - PST on December 4th 2016 (the scope of the complaint and of the request was subsequently extended on March 13th 2017),
    - PGNiG on March 1st 2017;
- the Higher Regional Court in Düsseldorf (Oberlandesgericht Düsseldorf) where PGNiG and PST lodged complaints and requests for injunctive reliefs on December 15th 2016, subsequently extended on January 20th 2017.

The complaints and requests for injunctive relief filed with the General Court of the European Union concern the European Commission's decision of October 28th 2016 whereby the Commission allowed a revision to the exemption of the OPAL pipeline from the common gas market regulations (especially with respect to the Third Party Access - TPA rule), in accordance with text of the administrative decision issued by the German regulator – Federal Network Agency (Bundesnetzagentur), subject to modifications referred to in the Commission's decision. The complaint and the application for injunctive relief were submitted by PST. On December 23rd 2016, the President of the General Court of the European Union stayed execution of the challenged decision of the European Commission, temporarily granting PST's request for injunctive relief. The parties exchanged pleadings. On March 13th 2017, PST supplemented its complaint and request for injunctive relief due to the fact the European Commission's decision was not published until January 3rd 2017, while the complaint and the request of December 4th 2017 were based on the Commission's press release. On July 5th 2017, the President of the General Court of the European Union held hearings regarding the injunctive relief in the cases instigated by PST and PGNiG. On July 21st 2017, the President of the General Court of the European Union decided to revoke the injunctive relief in the PST case and dismiss the request filed by PGNiG. No decisions have so far been issued with respect to the complaint.

The complaint and the request to apply injunctive measures filed with the Higher Regional Court of Düsseldorf are primarily against the administrative settlement between the German regulator, OPAL Gastransport GmbH & Co. KG, OAO Gazprom and OOO Gazprom Export, specifying the revised conditions for exemption of the OPAL pipeline from the common gas market regulations. On December 30th 2016, the Higher Regional Court of Düsseldorf issued an injunction whereby it obliged the German regulator to suspend the effects of the disputed administrative settlement by prohibiting OPAL Gastransport GmbH & Co. KG from holding any further daily, weekly, monthly and annual capacity auctions for the OPAL pipeline. Following the Court's ruling, on the same day the German regulator issued an immediately enforceable decision whereby it prohibited OPAL Gastransport GmbH & Co. KG from conducting such auctions.

On January 20th 2017, PGNiG and PST extended the earlier complaint by lodging a complaint against a decision of the German regulator – Federal Network Agency (Bundesnetzagentur), dated December 20th 2016, whereunder the regulator refused to instigate formal administrative proceedings concerning revised conditions for the pipeline's exemption from the common gas market regulations and allow the applicants, i.e. PGNiG and PST, to join the proceedings. The companies also extended the list of arguments contained in their earlier pleading. On July 27th 2017, the Higher Regional Court of Düsseldorf issued a decision to revoke the injunctive relief. No decisions have so far been issued with respect to the complaint.

Proceedings with respect to the obligation to sell gas on the exchange market

Until the date of this Report, there were no significant developments in the proceedings to impose a financial penalty on PGNiG for its failure to meet the obligation to sell gas on the exchange market in 2013 and 2014.

Proceedings with value of claims equal to 10% or more of the Company's equity

Neither PGNiG nor its subsidiaries were engaged in any proceedings before a court, arbitration court or administrative authority concerning liabilities or claims whose value (whether in any single case or in two or more cases jointly) would represent at least 10% of PGNiG's equity.

Proceedings concerning resolutions of the Annual General Meeting

The Company was notified that a shareholder had filed a statement of claim for repeal of Resolution No. 7/VI/2016 of the PGNiG Annual General Meeting held on June 28th 2016, whereby the General Meeting refused to grant discharge to Mr Jarosław Bauc, Member of the PGNiG Management Board, in respect of performance of his duties in the financial year 2015.

7. Shareholding structure. PGNiG at WSE

7.1. Shareholding structure

As at June 30th 2017, the share capital of PGNiG was approximately PLN 5.78bn, and comprised 5,778,314,857 shares with a par value of PLN 1 per share. Series A shares were ordinary bearer shares and each share conferred the right to one vote at the General Meeting. The State Treasury remains PGNiG's majority shareholder.

On June 26th 2008, the disposal by the Minister of State Treasury of one PGNiG share in accordance with general trading rules triggered the eligible employees' rights to acquire a total of up to 750,000,000 PGNiG shares free of charge. First share transfer agreements were executed on April 6th 2009 and the eligible employees' rights to acquire PGNiG shares free of charge expired on October 1st 2010. As at June 30th 2017, nearly 60 thousand eligible employees acquired 728,294 thousand shares. The Company shares acquired by eligible employees free of charge were subject to a lock-up until July 1st 2010, while trading in shares acquired free of charge by members of the Company's Management Board was restricted until July 1st 2011.

Shareholding structure as at June 30th 2017

Shareholders*	Number of shares/voting rights attached to the shares as at June 30th 2017	Percentage of share capital/total voting rights at the GM as at June 30th 2017
State Treasury	4,153,706,157	71.88%
Other shareholders	1,624,608,700	28.12%
TOTAL	5,778,314,857	100.00%

**As at December 31st 2016, PGNiG held a total of 121,685,143 treasury shares, representing 2.06% of its share capital. Pursuant to Art. 364.2 of the Commercial Companies Code, the Company did not exercise voting rights from its treasury shares. The Extraordinary General Meeting of November 24th 2016 resolved to cancel PGNiG's treasury shares. Cancellation of the treasury shares and changes in the share capital were registered with the National Court Register on March 2nd 2017. As at June 30th 2017 PGNiG did not hold any treasury shares.*

PGNiG shares and shares in PGNiG's related entities held by management and supervisory personnel

Full name	Position	Number of shares as at December 31st 2016	Par value of shares as at December 31st 2016 (PLN)	Number of shares as at June 30th 2017	Par value of shares as at June 30th 2017 (PLN)
Mieczysław Kawecki	Member of the Supervisory Board	Not applicable	Not applicable	9,500	9,500
Sławomir Sieradzki	Member of the Supervisory Board	Not applicable	Not applicable	17,225	17,225
Ryszard Wąsowicz*	Member of the Supervisory Board	19,500	19,500	Not applicable	Not applicable

Mr Ryszard Wąsowicz resigned as Member of the PGNiG Supervisory Board, with effect as of May 30th 2017.

7.2. Dividend

The PGNiG Group's Strategy for 2017–2022 in effect as at the date of this Report provides for distribution of up to 50% of consolidated net profit as dividend, with the proviso that in recommending dividend payments the PGNiG Management Board must always take into account the PGNiG Group's current financial condition and investment plans. PGNiG recognises net profit of its subsidiaries in the consolidated accounts net of any dividends paid by the subsidiaries, which may result in such dividend payment being postponed by one year.

Dividend paid

	2016	2015	2014	2013	2012	2011
Dividend for financial year (PLNbn)	1.16	1.06	1.18	0.89	0.77	-
Dividend per share (PLN)	0.20	0.18	0.20	0.15	0.13	-
Average annualised share price (PLN)	5.16	5.94	4.85	5.83	4.06	3.97
Dividend yield	3.88%	3.03%	4.12%	2.57%	3.20%	-

PGNiG Management Board:

President of the Management Board	Piotr Woźniak	....
Vice President of the Management Board	Radosław Bartosik	....
Vice President of the Management Board	Łukasz Kroplewski	....
Vice President of the Management Board	Michał Pietrzyk	....
Vice President of the Management Board	Maciej Woźniak	....
Vice President of the Management Board	Magdalena Zegarska	....

Warsaw, August 16th 2017