Polskie Górnictwo Naftowe i Gazownictwo S.A.

Consolidated Full-Year Report of the PGNiG Group

for the period January 1st 2017 – December 31st 2017

THE CONSOLIDATED FULL-YEAR REPORT OF THE PGNiG GROUP

FOR THE YEAR ENDED DECEMBER 31ST 2017 COMPRISES:

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Letter from the President of the Management Board

Ladies and Gentlemen,

It is my pleasure to present to you the 2017 Annual Report of the PGNiG Group.

This past year was full of developments and decisions that set the direction of growth for the PGNiG Group in the coming years. In March, we unveiled a new Strategy, which outlines our targets and aspirations for 2017−2022. The plan is ambitious, but we believe it is necessary to successfully meet the challenges of the rapidly changing market and technology environment. I am pleased to say that in the first year of the new Strategy we already made substantial progress towards many of its objectives.

Our primary goal is to increase the PGNiG Group's value and ensure its financial stability. 2017 was successful in this respect. Revenue increased 8% year on year, to PLN 35.86bn, and EBITDA reached an all-time high of PLN 6.58bn. PGNiG S.A. was the fifth largest company on the Warsaw Stock Exchange in terms of market capitalisation.

Oil and gas prices rose significantly year on year, supporting the stellar performance delivered by our upstream business. But rising oil and gas prices had a major adverse impact on cost of gas, which was reflected by a negative contribution of the trading segment to EBITDA.

The performance of the gas distribution segment remained strong, fuelled by the robust growth of Poland's economy and stronger natural gas demand. Another important fact is that the heat and power generation business delivered solid performance for another consecutive year. The segment posted a year-on-year growth in revenue and record sales volumes of heat and power from our own sources.

In 2017, we successfully implemented a plan to diversify our sources of gas imports, leveraging the opportunities offered by the expanding LNG market. We diversified supply sources and contract types. For instance, we signed a supplementary agreement to the long-term contract with Qatargas increasing gas supplies from Qatar, as well as a medium-term contract for the supply of LNG from the US. We also imported gas from Norway and the US under spot contracts.

An important element of our diversification efforts is to increase our own production on the Norwegian Continental Shelf. After 2022 we want to produce 2.5 bcm of natural gas a year from our Norwegian assets, hence the decision to reserve capacity in the planned gas link between Poland and Denmark. The pipeline will be connected to the North Sea transmission system, enabling us to bring gas extracted in Norway to Poland.

Last year, retail gas sales recorded solid performance, with a series of contracts signed with new and existing strategic customers. We prepared attractive new deals for households.

Our Strategy puts a strong focus on the heat and power generation business. A project to build a CCGT unit at the Żerań CHP plant in Warsaw with an electrical capacity of 497 MW and a maximum thermal capacity of 326 MW will help us to deliver on our plans. The unit will replace the old coal-fired plant, not only increasing the output, but also reducing air pollution in Warsaw. In 2018, we also plan to complete the construction of a 70 MWe and 120 MWt cogeneration unit at the Zofiówka CHP plant that will help to consolidate our position in the heat and power market in the Upper Silesia region.

In 2017, we moved forward on our research and development projects. The initial results of our coal bed methane production programme are very promising and have prompted a decision to expand and step up methane extraction.

I am confident that in 2018 we will continue to deliver on our commitment to strengthening our position in Poland and internationally and to building the PGNiG Group's value. We would like to thank our Shareholders, Customers and Contractors for the trust they place in us.

Kind regards,

Piotr Woźniak

President of the PGNiG Management Board

Financial highlights of the PGNiG Group

Consolidated financial data	PLN million		EUR million	
	2017	2016	2017	2016
Revenue	35,857	33,196	8,447	7,586
Operating profit before depreciation and amortisation (EBITDA)	6,579	5,974	1,550	1,365
Operating profit (EBIT)	3,910	3,360	921	768
Profit before tax	3,922	3,210	924	734
Net profit attributable to owners of the parent	2,923	2,351	689	537
Net profit	2,921	2,349	688	537
Total comprehensive income attributable to owners of the parent	2,769	2,984	652	682
Total comprehensive income	2,767	2,982	652	681
Net cash from operating activities	4,816	5,922	1,135	1,353
Net cash from investing activities	(3,863)	(3,842)	(910)	(878)
Net cash from financing activities	(4,204)	(2,269)	(990)	(519)
Net cash flows	(3,251)	(189)	(766)	(43)
Basic and diluted earnings per share (PLN)	0.51	0.40	0.12	0.09
	2017	2016	2017	2016
Total assets	48,203	49,672	11,557	11,228
Total liabilities	14,576	17,656	3,495	3,991
Total non-current liabilities	7,004	7,303	1,679	1,651
Total current liabilities	7,572	10,353	1,816	2,340
Total equity	33,627	32,016	8,062	7,237
Share capital	5,778	5,778	1,385	1,306
Weighted average number of ordinary shares (million)	5,778	5,867	5,778	5,867
Book value per share and diluted book value per share (PLN and EUR)	5.82	5.46	1.40	1.23
Dividend per share declared or paid (PLN and EUR)	0.20	0.18	0.05	0.04

Rules followed in the preparation of the consolidated financial statements

Items of the statement of profit or loss, statement of comprehensive income, and statement of cash flows were translated at the EUR/PLN exchange rate computed as the arithmetic mean of the mid rates quoted by the National Bank of Poland (NBP) for the last day of each calendar month in the reporting period.

Items of the statement of financial position were translated at the mid EUR/PLN exchange rate quoted by the NBP for the end of the reporting period.

Average EUR/PLN exchange rates quoted by the NBP	2017	2016
Average exchange rate in period	4.2447	4.3757
Exchange rate at end of period	4.1709	4.4240

PGNIG CAPITAL GROUP

WARSAW, UL. MARCINA KASPRZAKA 25

CONSOLIDATED
FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR 2017

WITH

AUDITOR'S REPORT

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AUDITOR'S REPORT

To the Shareholders' Meeting and Supervisory Board of Polskie Górnictwo Naftowe i Gazownictwo S.A.

Auditor's report

We have audited the attached annual consolidated financial statements of the PGNiG Capital Group (hereinafter: "Capital Group"), for which Polskie Górnictwo Naftowe i Gazownictwo S.A. with its registered office in Warsaw at ul. Marcina Kasprzaka 25 is the Parent Company (hereinafter: "Parent Company"). These consolidated financial statements include: a consolidated statement of financial position prepared as at 31 December 2017, consolidated profit and loss account and consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows prepared for the financial year from 1 January 2017 to 31 December 2017 and notes comprising a summary of significant accounting policies and other explanatory information (hereinafter: "consolidated financial statements").

Responsibility of the Parent Company's manager and those charged with governance for the consolidated financial statements

The Management Board of the Parent Company is obliged to prepare the consolidated financial statements and to present them fairly in line with the International Accounting Standards, International Financial Reporting Standards and related interpretations published as European Commission regulations and other applicable laws as well as the entity's articles of association. The Management Board of the Parent Company is also responsible for ensuring internal control necessary for the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Under the Accounting Act, the Management Board of the Parent Company and members of its Supervisory Board are obliged to ensure that the consolidated financial statements meet the requirements of the Accounting Act of 29 September 1994 (Journal of Laws of 2018, item 395), hereinafter referred to as the "Accounting Act".

Auditor's responsibility

Our responsibility was to express an opinion whether the consolidated financial statements give a true and fair view of the financial and economic position as well as the financial performance of the Capital Group in line with the applicable International Accounting Standards, International Financial Reporting Standards and related interpretations published as European Commission regulations and the adopted accounting principles (policies).

Our audit of the consolidated financial statements has been performed in accordance with:

1) the Act on statutory auditors, auditing companies and public oversight of 11 May 2017 (Journal of Laws of 2017, item 1089) ("*Act on statutory auditors*");
2) National Auditing Standards in the wording of the International Standards on Auditing adopted by resolution No. 2783/52/2015 of the National Council of Statutory Auditors of 10 February 2015, as amended;

3) Regulation (EU) No. 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC (OJ EU L 158, 27 May 2014, p. 77 and OJ EU L 170, 11 June 2014, p. 66) ("*Regulation 537/2014*").

Those regulations require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

The objective of the audit is to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the above standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control and may involve any area of law and regulation not just those directly affecting the consolidated financial statements.

The audit involved performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The audit procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Parent Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Management Board of the Parent Company, as well as evaluating the overall presentation of the consolidated financial statements.

The scope of the audit does not include an assurance regarding the future profitability of the audited Capital Group or the effectiveness of the Parent Company's Management Board in managing the Capital Group's affairs at present and in future.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. The opinion is consistent with the additional report to the Audit Committee of 12 March 2018.

Independence

During the audit the key certified auditor and the audit firm remained independent of the audited members of the Capital Group in accordance with the provisions of the Act on statutory auditors, Regulation 537/2014 and the ethical requirements set out in resolution of the National Council of Statutory Auditors.

We certify that, to the best of our knowledge and belief, we have not provided non-audit services, which are prohibited under Article 136 of the Act on statutory auditors and Article 5.1 of Regulation 537/2014, to the entities that belong to the Capital Group.

Choice of audit firm

We were appointed to audit the consolidated financial statements of the Capital Group by resolution no 30/VII/2016 of Supervisory Board of PGNiG S.A. adopted on 10 February 2016. We have been auditing the consolidated financial statements of the Capital Group for an uninterrupted period beginning with the financial year ended 31 December 2016, i.e. for two consecutive financial years.

Most significant risks

During the audit we identified the following, most significant risks of material misstatement, also resulting from fraud, and we designed audit procedures responsive to those risks. Where deemed appropriate for the understanding of the identified risks and the audit procedures performed by the auditor, we also included the most important findings related to those risks.

Description of the risks of material misstatement	**Procedures carried out by the auditor in response to identified risks and key observations arising with respect to those risks**
Impairment of shares in joint ventures	

As presented in Note 2.4 to the consolidated financial statements, as at 31 December 2017 the Capital Group held shares in joint ventures and associates measured using the equity method, which totaled PLN 1,601 million net. In accordance with the accounting policies, shares in entities measured using the equity method are initially measured at cost, taking account of the Group's share in the changes in net assets which have occurred between the date when it assumed joint control and the balance sheet date, less impairment losses.
 	
An analysis of indications of impairment is conducted by the Management Board of the Parent regularly and impairment tests are performed if such indications are identified.
 	
The impairment tests relating to shares are based on the Management Board's assumptions and estimates as to future cash flows and the discount rate, in addition to taking account of strategic and financial plans for the upcoming years. Such projections involve a considerable volatility risk associated with the fact that the market conditions are difficult to forecast.
 	
We placed a special focus on the issue of impairment of investments in entities measured using the equity method due to their materiality and the necessity to make significant assumptions and complex estimates.
	Detailed procedures were preceded by gaining an understanding of and analyzing the design and implementation of key internal controls over the process of monitoring indications of impairment as well as the process of estimating impairment losses.
	
	In particular, our audit procedures included:
	– identification of the key indications of impairment of shares;
	– interviews with the Management Board and the key personnel about financial predictions and business plans of material related parties and associates;
	– a critical assessment of the assumptions made by the Management Board for the measurement model (including with the involvement of Deloitte's in-house experts in valuation and modelling), specifically:
	  - the financial projections;
	  - the discount rate;
	  - the growth rate;
	  - the residual value;
	– a critical assessment of the model, including the correctness of its calculations;
	– reconciliation of the recognition of impairment losses determined with the use of the model with the accounting records and the financial statements;
	– an assessment of the completeness and correctness of the disclosures of the analysis of share impairment in the financial statements.

Description of the risks of material misstatement	Procedures carried out by the auditor in response to identified risks and key observations arising with respect to those risks
Impairment of property, plant and equipment	
In Note 6.1 to the consolidated financial statements, as at 31 December 2017 the Capital Group provided information concerning impairment of its non-financial assets. At the end of the reporting period, impairment losses on non-financial assets totaled PLN 4,122 million. Under IAS 36, the Company is required to verify whether or not any indications exist which could form the basis for impairment tests relating to property, plant and equipment. Assets which are grouped into cash-generating units are tested for impairment. Items of property, plant and equipment account for 67% of the Capital Group's assets. Considering the materiality of their value as well as the necessity to perform tests based on numerous assumptions and estimates, we concluded that impairment of property, plant and equipment was a key audit matter.	In particular, our procedures included: – gaining an understanding of and evaluating the process of asset grouping into cash-generating units in accordance with the financial reporting standards; – a critical assessment of the measurement model based on future cash flows; – an assessment of the methodology used and assumptions made by the Management Board in relation to the model; – reconciliation of model inputs with the source documents; – verification of the mathematical correctness of calculations and reconciliation of the resulting impairment losses with the accounting records and the financial statements; – an assessment of the completeness and correctness of the disclosures in the financial statements.

Opinion

In our opinion, the attached annual consolidated financial statements:

- give a true and fair view of the economic and financial position of the Capital Group as at 31 December 2017 and its financial performance during the financial year from 1 January 2017 to 31 December 2017, in accordance with the applicable International Accounting Standards, International Financial Reporting Standards and related interpretations published as European Commission regulations and the adopted accounting principles (policies);
- comply, with respect to their form and content, with the applicable provisions of law, including the Ordinance of the Minister of Finance of 19 February 2009 on current and periodic information provided by issuers of securities and conditions for recognizing as equivalent information required under the law of a non-member state (Journal of Laws of 2014, item 133, as amended) and the articles of association of the Parent Company.

Deloitte.

Report on other legal and regulatory requirements

Opinion on the report on the activities

We do not express an opinion on the report on the activities of the Capital Group.

It is the responsibility of the Management Board of the Parent Company to prepare the report on the activities of the Capital Group in accordance with the Accounting Act and other applicable laws. The Management Board of the Parent Company and members of the Supervisory Board are also obliged to ensure that the report on the activities of the Capital Group meets the requirements of the Accounting Act.

Under the act on statutory auditors we were obliged to issue an opinion as to whether the report on the activities of the Capital Group complies with the provisions of law and is consistent with underlying information disclosed in the attached consolidated financial statements. Additionally, it was our responsibility to indicate whether we have detected any material misstatement in the report on the activities of the Capital Group based on our knowledge of the Capital Group and its business environment obtained in the course of the audit and to explain the nature of each such material misstatement.

The Directors' Report on the Operations of PGNiG S.A. and the PGNiG Group in the 2017 financial year (hereinafter: "the report on the activities") was prepared as one document in accordance with Article 55.2a of the Accounting Act.

In our opinion, the report on the activities has been prepared in line with the applicable provisions of law and is consistent with the underlying information disclosed in the attached consolidated financial statements. Furthermore, based on our knowledge of the Capital Group and its business environment obtained in the course of the audit we believe that the report on the activities of the Capital Group is free from material misstatement.

Opinion on the statement of compliance with corporate governance principles

The Management Board of the Parent Company and members of the Supervisory Board are responsible for compliance with corporate governance principles in line with the provisions of law.

As the auditors of the financial statements we were obliged — under the act on statutory auditors — to issue an opinion as to whether the issuer, required to submit a statement of compliance with corporate governance principles, which constitutes a separate part of the report on the activities, included in such statement the legally required information and — with respect to specific information so required or required by other rules — a declaration whether it complies with applicable regulations and is consistent with the information included in the annual consolidated financial statements.

In our opinion, the statement of compliance with corporate governance principles includes information specified in Article 91.5.4 letters a, b, g, j, k and l of the Ordinance of the Minister of Finance of 19 February 2009 on current and periodic information provided by issuers of securities and conditions for recognizing as equivalent information required under the law of a non-member state (Journal of Laws of 2014, item 133, as amended) ("*Ordinance*"). The information specified in Article 91.5.4 letters c-f, h and i of the Ordinance given in the statement of compliance with corporate governance principles is consistent with the applicable provisions of law and the information presented in the annual consolidated financial statements.

Information about the non-financial statement

In accordance with the requirements set out in the Act on statutory auditors, we would like to inform you that the Parent Company has prepared a non-financial statement referred to in Article 49b.1 of the Accounting Act which constitutes a separate part of the report on the activities.

We have not performed any assurance works as regards the non-financial statement and we do not express any assurance regarding that statement.

Conducting the audit on behalf of Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. — entity entered under number 73 on the list of audit firms kept by the National Council of Statutory Auditors:

Piotr Sokołowski
Key certified auditor
No. 9752

Warsaw, 12 March 2018

This Report is an English version of the original Polish version. In case of any discrepancies between the Polish and English version, the Polish version shall prevail.

Representation of the Management Board on reliability of the consolidated full-year financial statements of the PGNiG Group for 2017

We represent that, to the best of our knowledge, the consolidated full-year financial statements of the PGNiG Group as at December 31st 2017 and the comparative data have been prepared in compliance with the applicable accounting policies and give a true, clear and fair view of the assets, financial condition and financial performance of the PGNiG Group.

We further represent that, to the best of our knowledge, the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group gives a fair view of the Group's development, achievements and standing, and includes a description of key risks and threats.

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, March 12th 2018

Representation of the Management Board on appointment of the auditor to audit the consolidated full-year financial statements of the PGNiG Group for 2017

We represent that the qualified auditor of financial statements that audited the consolidated full-year financial statements of the PGNiG Group as at December 31st 2017 had been appointed in accordance with the applicable laws.

Both the auditing firm and the auditors who performed the audit met the conditions required to issue an impartial and independent opinion on the audited consolidated full-year financial statements, in accordance with the applicable laws and professional standards.

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, March 12th 2018

Polskie Górnictwo Naftowe i Gazownictwo S.A.

CONSOLIDATED FINANCIAL STATEMENTS OF THE PGNiG GROUP FOR 2017

prepared in accordance with International Financial Reporting Standards as endorsed by the European Union

PGNiG

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Financial statements

Consolidated statement of profit or loss	2017	2016	
Revenue from sales of gas	28,613	26,429	*Note 3.1.*
Other revenue	7,244	6,767	*Note 3.1.*
Revenue	**35,857**	**33,196**	
Cost of gas sold	(20,127)	(18,320)	*Note 3.2.*
Other raw materials and consumables	(2,586)	(2,427)	*Note 3.2.*
Employee benefits expense	(2,696)	(2,573)	*Note 3.2.*
Transmission services	(1,144)	(1,106)	
Other services	(1,749)	(1,412)	*Note 3.2.*
Taxes and charges	(793)	(765)	
Other income and expenses	(342)	(332)	*Note 3.3.*
Work performed by the entity and capitalised	992	868	
Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	(833)	(1,155)	*Note 3.2.*
Operating profit before depreciation and amortisation (EBITDA)	**6,579**	**5,974**	*Note 2.2.*
Depreciation and amortisation	(2,669)	(2,614)	*Note 2.2.*
Operating profit (EBIT)	**3,910**	**3,360**	*Note 2.2.*
Net finance costs	(16)	(76)	*Note 3.4*
Profit/(loss) from equity-accounted investees	28	(74)	*Note 2.4.*
Profit before tax	**3,922**	**3,210**	
Income tax	(1,001)	(861)	*Note 4.1.*
Net profit	**2,921**	**2,349**	
Net profit attributable to:			
owners of the parent	2,923	2,351	
non-controlling interests	(2)	(2)	
Weighted average number of ordinary shares (million)	5,778	5,867	
Basic and diluted earnings per share (PLN)	0.51	0.40	

Consolidated statement of comprehensive income	2017	2016	
Net profit	**2,921**	**2,349**	
Exchange differences on translating foreign operations	(65)	23	
Hedge accounting	(76)	783	*Note 7.1.3*
Revaluation of financial assets available for sale	(6)	2	
Deferred tax	15	(149)	
Share of other comprehensive income of equity-accounted investees	(4)	-	
Other comprehensive income subject to reclassification to profit or loss	**(136)**	**659**	
Actuarial losses on employee benefits	(23)	(29)	
Deferred tax	4	5	
Share of other comprehensive income of equity-accounted investees	1	(2)	
Other comprehensive income not subject to reclassification to profit or loss	**(18)**	**(26)**	
Other comprehensive income, net	**(154)**	**633**	
Total comprehensive income	**2,767**	**2,982**	
Total comprehensive income attributable to:			
owners of the parent	2,769	2,984	
non-controlling interests	(2)	(2)	

(in PLN million, unless stated otherwise)

Consolidated statement of cash flows	2017	2016	
Cash flows from operating activities			
Net profit	2,921	2,349	
Depreciation and amortisation	2,669	2,614	
Current tax expense	1,001	861	
Net gain/(loss) on investing activities	452	884	
Other non-cash adjustments	304	368	*Note 5.5.2.*
Income tax paid	(755)	(611)	
Movements in working capital	(1,776)	(543)	*Note 5.5.*
Net cash from operating activities	**4,816**	**5,922**	
Cash flows from investing activities			
Payments for acquisition of tangible exploration and evaluation assets under construction	(740)	(713)	*Note 2.2.*
Payments for other items of property, plant and equipment and intangible assets	(2,422)	(2,255)	*Note 2.2.*
Payments for shares in related entities	(347)	(1,027)	
Other items, net	(354)	153	
Net cash from investing activities	**(3,863)**	**(3,842)**	
Cash flows from financing activities			
Payment for treasury shares	-	(645)	
Increase in debt	2,218	451	*Note 5.1.*
Proceeds from derivative financial instruments	165	89	
Decrease in debt	(5,407)	(1,021)	*Note 5.1.*
Dividends paid	(1,156)	(1,062)	*Note 3.5.*
Payments for derivative financial instruments	(20)	(78)	
Other items, net	(4)	(3)	
Net cash from financing activities	**(4,204)**	**(2,269)**	
Net cash flows	**(3,251)**	**(189)**	
Cash and cash equivalents at beginning of period	5,832	6,021	
Foreign exchange differences on cash and cash equivalents	-	(4)	
Cash and cash equivalents at end of period	**2,581**	**5,832**	*Note 5.5.3.*

(in PLN million, unless stated otherwise)

Consolidated statement of financial position	2017	2016	
ASSETS			
Property, plant and equipment	32,452	33,149	*Note 6.1.1.*
Intangible assets	1,115	1,079	*Note 6.1.2.*
Deferred tax assets	141	100	*Note 4.1.2.*
Equity-accounted investees	1,601	1,229	*Note 2.4.*
Other assets	1,055	679	*Note 8.4.*
Non-current assets	**36,364**	**36,236**	
Inventories	2,748	2,510	*Note 6.2.1.*
Receivables	5,781	4,288	*Note 6.2.2.*
Derivative financial instruments	450	623	*Note 7.2.*
Other assets	216	129	*Note 8.4.*
Cash and cash equivalents	2,578	5,829	*Note 5.4.*
Assets held for sale	66	57	*Note 8.3.*
Current assets	**11,839**	**13,436**	
TOTAL ASSETS	**48,203**	**49,672**	
EQUITY AND LIABILITIES			
Share capital and share premium	7,518	7,518	
Accumulated other comprehensive income	(158)	(4)	
Retained earnings	26,266	24,499	
Equity attributable to owners of the parent	33,626	32,013	
Equity attributable to non-controlling interests	1	3	
TOTAL EQUITY	**33,627**	**32,016**	
Financing liabilities	951	1,346	*Note 5.1.*
Employee benefit obligations	725	702	*Note 6.3.1.*
Provision for well decommissioning costs	1,717	1,641	*Note 6.1.1.1.*
Other provisions	181	198	*Note 6.3.2.*
Grants	767	815	*Note 6.3.3.*
Deferred tax liabilities	2,019	1,932	*Note 4.1.2.*
Other liabilities	644	669	*Note 6.3.4.*
Non-current liabilities	**7,004**	**7,303**	
Financing liabilities	2,055	5,006	*Note 5.1.*
Derivative financial instruments	322	346	*Note 7.2.*
Trade and tax payables*	3,249	3,179	*Note 6.2.3.*
Employee benefit obligations	371	334	*Note 6.3.1.*
Provision for well decommissioning costs	53	20	*Note 6.1.1.1.*
Other provisions	621	560	*Note 6.3.2.*
Other liabilities	901	908	*Note 6.3.4.*
Current liabilities	**7,572**	**10,353**	
TOTAL LIABILITIES	**14,576**	**17,656**	
TOTAL EQUITY AND LIABILITIES	**48,203**	**49,672**	

*Including income tax of PLN 217m (2016: PLN 180m)

(in PLN million, unless stated otherwise)

Consolidated statement of changes in equity

	Equity attributable to owners of the parent												
	Share capital and share premium, including:			Accumulated other comprehensive income:									
	Share capital	Share premium	Treasury shares	Exchange differences on translating foreign operations	Hedging reserve	Revaluation of financial assets available for sale	Actuarial gains/(losses) on employee benefits	Share of other comprehensive income of equity-accounted investees	Retained earnings	Total	Equity attributable to non-controlling interests	Total equity	
At Jan 1 2016	**5,900**	**1,740**	**-**	**(51)**	**(565)**	**-**	**(21)**	**-**	**23,733**	**30,736**	**5**	**30,741**	
Net profit	-	-	-	-	-	-	-	-	2,351	**2,351**	(2)	**2,349**	
Other comprehensive income, net	-	-	-	23	634	2	(24)	(2)	-	**633**	-	**633**	
Total comprehensive income	**-**	**-**	**-**	**23**	**634**	**2**	**(24)**	**(2)**	**2,351**	**2,984**	**(2)**	**2,982**	
Dividend	-	-	-	-	-	-	-	-	(1,062)	**(1,062)**	-	**(1,062)**	*Note 3.5.*
Purchase of treasury shares	-	-	(645)	-	-	-	-	-	-	**(645)**	-	**(645)**	
Cancellation of treasury shares	(122)	-	645	-	-	-	-	-	(523)	**-**	-	**-**	
At Dec 31 2016	**5,778**	**1,740**	**-**	**(28)**	**69**	**2**	**(45)**	**(2)**	**24,499**	**32,013**	**3**	**32,016**	
Net profit	-	-	-	-	-	-	-	-	2,923	**2,923**	(2)	**2,921**	
Other comprehensive income, net	-	-	-	(65)	(62)	(5)	(19)	(3)	-	**(154)**	-	**(154)**	
Total comprehensive income	**-**	**-**	**-**	**(65)**	**(62)**	**(5)**	**(19)**	**(3)**	**2,923**	**2,769**	**(2)**	**2,767**	
Dividend	-	-	-	-	-	-	-	-	(1,156)	**(1,156)**	-	**(1,156)**	*Note 3.5.*
As at Dec 31 2017	**5,778**	**1,740**	**-**	**(93)**	**7**	**(3)**	**(64)**	**(5)**	**26,266**	**33,626**	**1**	**33,627**	
	Note 8.1.												

(in PLN million, unless stated otherwise)

1. General information

1.1. Key information about the PGNiG Group and basis of preparation of the financial statements

1.1.1. The Group

Name	Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna
Registered office	ul. Marcina Kasprzaka 25, 01-224 Warsaw, Poland
Court of registration	District Court for the Capital City of Warsaw, 16th Commercial Division
NATIONAL COURT REGISTER (KRS) NO.	0000059492
INDUSTRY IDENTIFICATION NUMBER (REGON)	012216736
TAX IDENTIFICATION NUMBER (NIP)	525-000-80-28
Description of business	The Company's principal business activity is exploration for and production of natural gas and crude oil, import, storage and sale of gas and liquid fuels, and trade in electricity.

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna is the parent ("PGNiG", "Company", "Parent") of the PGNiG Group ("PGNiG Group", "Group"). PGNiG shares are listed on the Warsaw Stock Exchange ("WSE"). As at the date of issue of these consolidated financial statements for 2017, the State Treasury was the only shareholder holding 5% or more of total voting rights at the General Meeting of PGNiG S.A.

The PGNiG Group plays a key role in the Polish gas sector. As the market leader, it is responsible for national energy security, ensuring diversification of gas supplies by developing domestic deposits and sourcing gas from abroad. PGNiG's principal business comprises exploration for and production of natural gas and crude oil, and through its key companies PGNiG is active in the area of import, storage, sale and distribution of gas and liquid fuels, as well as heat and electricity generation.

The PGNiG Group is a leader in all areas of its operations. In Poland, the Group is the largest importer of gas fuel from Russia and Germany, key producer of natural gas from Polish deposits, and significant producer of heat and electricity. The Group's upstream business is one of the key factors ensuring PGNiG's competitive position on the liberalised gas market in Poland.

For further information on the Group's operating segments and consolidated entities, see **Note 2**.

1.1.2. Basis of preparation

These consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as endorsed for application in the European Union (EU).

Rules followed in the preparation of the consolidated financial statements

These consolidated financial statements include data of the Parent, its subsidiaries and joint arrangements (joint ventures and joint operations).

The financial statements of the entities which are consolidated or accounted for with the equity method have been prepared for the same reporting period, with the exception of Polski Gaz TUW, whose opening balance sheet was prepared as at October 22nd 2016 (under the Polish Accounting Act, an entity which commences its activity in the second half of a financial year may include that period in the accounting books and financial statements for the next year).

These consolidated financial statements have been prepared based on uniform accounting policies adopted by the entities which are consolidated or accounted for with the equity method. Where necessary, adjustments are made to separate financial statements to ensure consistency between the accounting policies applied by a given entity and those applied by the Group.

Joint arrangements are accounted for in accordance with the policies presented in **Notes 2.4** and **8.6**.

Subsidiaries are consolidated with the full method from their acquisition date (the date of assuming control of the company) until the date the control is lost. Control is exercised when the parent is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over that entity.

Acquisition of control of an entity representing a business is accounted for with the acquisition method. Identifiable acquired assets and assumed liabilities of an acquiree which is a business within the meaning of IFRS 3 are recognised as at the acquisition date and are measured at fair value. The excess of the acquisition cost (the consideration transferred (at fair value), any non-controlling interest in the acquiree measured in accordance with IFRS 3, and − in a business combination achieved in stages − the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree) over the net of the acquisition-date fair value of the identifiable assets acquired and the liabilities assumed, is recognised as goodwill. If the acquisition cost is lower than the net of the acquisition-date fair value of the identifiable assets acquired and the liabilities assumed, the difference is recognised as gain in profit or loss as at the acquisition date (gain on bargain purchase). The transaction costs are recognised in profit or loss when incurred. Non-controlling interests are initially measured at the non-controlling interest's proportionate share of net assets of the acquiree or at fair value.

If the Parent loses control of a subsidiary in a reporting period, the consolidated financial statements account for the subsidiary's results for such part of the reporting year in which control was held by the Parent.

These consolidated financial statements have been prepared on the assumption that the Group companies will continue as going concerns in the foreseeable future, with the exception of two subsidiaries: Geofizyka Kraków S.A. w likwidacji and PGNiG Finance AB i likvidation, which have been placed in liquidation. As at the date of authorisation of these financial statements for issue, no circumstances were identified which would indicate any threat to the Group's continuing as a going concern.

These consolidated financial statements have been prepared in accordance with the historical cost convention, except with respect to financial derivatives measured at fair value and financial assets available for sale.

The reporting currency of these consolidated financial statements is the Polish złoty (PLN).

The Polish zloty (PLN) is the functional currency of PGNiG S.A. and the presentation currency of these consolidated financial statements.

Items denominated in foreign currencies

Transactions denominated in foreign currencies are **initially disclosed** at the exchange rate of the functional currency as at the transaction date.

At the **end of a reporting period**:

- Monetary items denominated in foreign currencies are translated at the exchange rate of the functional currency quoted by the National Bank of Poland for the reporting date.
- Non-cash items measured at historical cost in a foreign currency are translated at the exchange rate as at the date of the transaction.

Exchange differences arising on settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition are taken to profit or loss. Exchange differences which are part of a gain (loss) on measurement of a hedging instrument in hedge accounting are recognised in other comprehensive income.

The financial data of all foreign operations and branches which are accounted for in consolidated financial statements must be translated into the Group's presentation currency, i.e. into PLN. For this purpose, their data from the statement of financial position is translated at the mid rate quoted for the given currency by the National Bank of Poland for the end of the reporting period, and data from the statement of profit or loss – at the rate equal to the arithmetic mean of mid rates quoted for the given currency by the National Bank of Poland for the last day of each month of the financial year.

Foreign currency differences arising on translation of assets and liabilities of foreign operations are recognised in other comprehensive income and accumulated as a separate item of equity. Upon disposal of a foreign operation, foreign exchange differences accumulated in equity are transferred to the statement of profit or loss and disclosed as part of the overall net gain/(loss) on the disposal.

To hedge against foreign currency risk, the Group enters into currency derivative contracts (for a description of the accounting policies applied by the Group to derivative financial instruments, see **Note 7.2**).

These financial statements were signed and authorised for issue by the Parent's Management Board on March 14th 2018.

(in PLN million, unless stated otherwise)

1.2. Effect of new standards on the financial statements of the PGNiG Group

1.2.1. New and amended standards and interpretations

The following new and amended standards and interpretations effective as of January 1st 2017 had an effect on these consolidated financial statements:

Standard	Description	Estimated effect
Amendments to IAS 7: Disclosure initiative	The entities will be required to disclose a reconciliation of changes in liabilities arising from financing activities.	Reconciliation of net debt is presented in Note 5.1.
Amendments to IAS 12: Income tax	Amendments to IAS 12 clarify the method of recognising deferred tax assets in connection with debt instruments measured at fair value.	These consolidated financial statements present deferred tax assets on unrealised losses.

Amendments other than those referred to above were either not applicable or irrelevant to the Group's consolidated financial statements.

1.2.2. Issued standards and interpretations which are not yet effective and have not been adopted by the Group early

In these consolidated financial statements, the Group did not opt for early application of the following standards, interpretations or amendments to existing standards which have been issued and are relevant to the Group's business:

Standard	Description	Estimated effect
IFRS 9 Financial Instruments **Effective date** ***Effective from January 1st 2018***	The standard introduces a model based on the following classification categories of financial assets: measured at fair value through profit or loss (FVTPL), at fair value through other comprehensive income (FVTOCI), and at amortised cost. Assets are classified on initial recognition depending on the financial instrument management model applied by the entity and the characteristics of contractual cash flows from such instruments. IFRS 9 introduces a new impairment recognition model based on expected credit losses. The majority of the requirements of IAS 39 for classification and measurement of financial liabilities were incorporated into IFRS 9 unchanged. The key change is the new requirement that entities present in other comprehensive income the effect of changes in their own credit risk related to financial liabilities designated at fair value through profit or loss. Changes were also made to the hedge accounting model to factor in risk management.	In 2017, the Group commenced the work on implementing IFRS 9. With respect to classification and measurement of financial assets, the consolidated entities carried out an analysis of their business model and the solely payments of principal and interest (SPPI) test. As a result of the analysis, new categories were identified in accordance with IFRS 9 and loans were reclassified from items measured at amortised cost (in line with IAS 39) to financial instruments at fair value through profit and loss. Other changes resulting from adoption of the standard were related to calculation of asset impairment and recognition of impairment losses using the expected credit loss impairment model. The standard was implemented using a modified retrospective method, namely the cumulative effect of changes was recognised in the opening balance of retained earnings. Due to the applied method of transition to IFRS 9, no impact of IFRS 9 on the consolidated statement of profit and loss was identified. The estimated impact of the amendments to IFRS 9 on the consolidated statement of financial position is presented in **Note 1.2.3.**
IFRS 15 Revenue from Contracts with Customers **Effective date** ***Effective from January 1st 2018***	IFRS 15 will apply to all contracts giving rise to revenue. The core principle of the new standard is that revenue is to be recognised upon transfer of goods or services to a customer, at the transaction price. Any goods or services that are sold in bundles and are distinct within the bundle should	The Group analysed the effect of IFRS 15 on its consolidated financial statements. As a result of the analysis of the effect of amendments to IFRS 15, a change was made in the presentation of costs of gas transmission and distribution services transferred to the customer, based on the conclusion that distribution and

(in PLN million, unless stated otherwise)

Standard	Description	Estimated effect
	be recognised separately, and any discounts and rebates on the transaction price should be allocated to specific bundle items. Where a contract contains elements of variable consideration, under the new standard such variable consideration is recognised as revenue only if it is highly probable that its remeasurement will not result in a revenue reversal in the future. Furthermore, in accordance with IFRS 15, the cost of obtaining and securing a contract with a customer should be capitalised and amortised over the period in which the contract's benefits are consumed.	transmission system operators are primarily responsible for the provision of these services. The Group has no influence on the main characteristics or price of such services, acting solely as an agent. Therefore, revenues generated from the sale of these services will be recognised in the net amount, i.e. after deduction of costs of their purchase from the Operator. At the same time, the Group separated revenues from distribution services (generated by the Group's distribution company and transferred to external recipients) from revenue from gas sales and presented them under Other revenues. The estimated impact of the amendments to IFRS 15 on the consolidated statement of profit or loss is presented in **Note 1.2.3.** The Group did not identify any impact of IFRS 15 on the consolidated statement of financial position.
IFRS 16 Leases **Effective date** ***Effective from January 1st 2019***	The new standard establishes principles for the recognition, measurement, presentation and disclosure of leases. All lease transactions result in the lessee acquiring a right-of-use asset and incurring a lease liability. Thus, IFRS 16 abolishes the operating and finance lease classification under IFRS 17 and provides a single lessee accounting model. Requiring lessees to recognise: a) assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value and b) amortisation of the leased asset separately from interest on lease liability in the statement of profit or loss. IFRS 16's approach to lessor accounting is substantially unchanged from its predecessor, IAS 17. Lessors continue to classify leases as operating or finance leases, with each of them subject to different accounting treatment.	Based on preliminary assessment, IFRS 16 may potentially have an effect on the consolidated financial statements mainly due to perpetual usufruct rights to land used by the Group. In accordance with the currently applied accounting policy, the Group does not recognise the right of perpetual usufruct of land as a lease agreement. The Group has not yet analysed the potential effect of the new standard on its financial statements; the analysis is to be performed in 2018.

The other standards and interpretations that have been issued but are not yet effective are not relevant to the Group's business.

(in PLN million, unless stated otherwise)

1.2.3. Effect of new standards and interpretations on the Group's financial statements

In connection with the entry into force of IFRS 9 and IFRS 15 on January 1st 2018, in 2017 the Group companies conducted an analysis of the impact of new standards and started work related to their implementation. The estimated impact of those amendments is presented in the tables below.

Consolidated statement of financial position	As at Dec 31 2017 − before amendment	Effect of IFRS 9 on the consolidated statement of financial position	As at Dec 31 2017 − after amendment
ASSETS			
Non-current assets	**36,364**	**(17)**	**36,347**
including:			
Deferred tax assets	141	4	145
Other assets	1,055	(21)	1,034
Current assets	**11,839**	**(64)**	**11,775**
including:			
Receivables	5,781	(64)	5,717
TOTAL ASSETS	**48,203**	**(81)**	**48,122**
EQUITY AND LIABILITIES			
TOTAL EQUITY	**33,627**	**(110)**	**33,517**
including:			
Accumulated other comprehensive income	(158)	4	(154)
Retained earnings	26,266	(114)	26,152
Non-current liabilities	**7,004**	**3**	**7,007**
including:			
Other liabilities	644	3	647
Current liabilities	**7,572**	**26**	**7,598**
including:			
Other provisions	621	18	639
Other liabilities	901	8	909
TOTAL LIABILITIES	**14,576**	**29**	**14,605**
TOTAL EQUITY AND LIABILITIES	**48,203**	**(81)**	**48,122**

Consolidated statement of profit or loss	Year ended Dec 31 2017 - before amendment	Effect of IFRS 15 on the consolidated statement of profit or loss	Year ended Dec 31 2017 - after amendment
Revenue	**35,857**	**(176)**	**35,681**
including:			
Revenue from sales of gas	28,613	(3,958)	24,655
Other revenue	7,244	3,782	11,026
Operating expenses (excl. D&A)	**(29,278)**	**176**	**(29,102)**
including:			
Transmission services	(1,144)	152	(992)
Other services	(1,749)	24	(1,725)
Operating profit before depreciation and amortisation (EBITDA)	**6,579**	**-**	**6,579**
Operating profit (EBIT)	**3,910**	**-**	**3,910**
Profit before tax	**3,922**	**-**	**3,922**
Net profit	**2,921**	**-**	**2,921**

1.3. Presentation changes in the financial statements

In the consolidated financial statements for 2017, the Group made presentation changes with respect to the following items of the statement of financial position:

1. For the purposes of transferring gas produced in Poland 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 within PGNiG S.A. (especially for gas used for own consumption needs) was changed and is now determined as the average monthly price quoted on the PPX Day-Ahead Market.
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 i likvidation 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 i likvidation, which perform support functions for the other segments of the PGNiG Group.

As the above changes were applied retrospectively, the table below presents the restated data at December 31st 2016.

(in PLN million, unless stated otherwise)

Reporting segments in 2016	Sales to external customers	Inter-segment sales	Total revenue	EBITDA	Depreciation and amortisation	EBIT (operating profit)	Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	Equity-accounted investees	Expenditure on acquisition of property, plant and equipment and intangible assets	Property, plant and equipment	Workforce
Exploration and Production before restatement	**2,776**	**1,515**	**4,291**	**1,285**	**(1,066)**	**219**	**(1,089)**	**(53)**	**(1,314)**	**12,881**	**7,720**
Change of policy for determining revenue from inter-segment sale of gas produced in Poland in the Exploration and Production segment	-	969	969	969	-	969	-	-	-	-	-
Other reallocation of income and expenses at PGNiG S.A.	-	29	29	(48)	(2)	(50)	-	-	-	-	-
Exploration and Production after restatement	**2,776**	**2,513**	**5,289**	**2,206**	**(1,068)**	**1,138**	**(1,089)**	**(53)**	**(1,314)**	**12,881**	**7,720**
Trade and Storage before restatement	**27,740**	**440**	**28,180**	**1,410**	**(252)**	**1,158**	**(28)**	**-**	**(121)**	**4,227**	**3,520**
Change of policy for determining revenue from inter-segment sale of gas produced in Poland in the Exploration and Production segment	-	-	-	(969)	-	(969)	-	-	-	-	-
Other reallocation of income and expenses at PGNiG S.A.	-	-	-	48	2	50	-	-	-	-	-
Change of presentation of Corporate Centre	(7)	7	-	125	41	166	16	-	84	(402)	(609)
Trade and Storage after restatement	**27,733**	**447**	**28,180**	**614**	**(209)**	**405**	**(12)**	**-**	**(37)**	**3,825**	**2,911**
Other Segments before restatement	**130**	**110**	**240**	**(61)**	**(14)**	**(75)**	**(18)**	**-**	**(9)**	**110**	**1,315**
Change of presentation of Corporate Centre	7	115	122	(125)	(41)	(166)	(16)	-	(84)	402	609
Other Segments after restatement	**137**	**225**	**362**	**(186)**	**(55)**	**(241)**	**(34)**	**-**	**(93)**	**512**	**1,924**
Reconciliation with consolidated data before restatement			**(6,625)**	**22**	**2**	**24**	**-**	**-**	**(10)**	**(212)**	**-**
Change of policy for determining revenue from inter-segment sale of gas produced in Poland in the Exploration and Production segment			(969)	-	-	-	-	-	-	-	-
Other reallocation of income and expenses at PGNiG S.A.			(29)	-	-	-	-	-	-	-	-
Change of presentation of Corporate Centre			(122)	-	-	-	-	-	-	-	-
Reconciliation with consolidated data after restatement			**(7,745)**	**22**	**2**	**24**	**-**	**-**	**(10)**	**(212)**	**-**

2. Description of the Group and its reporting segments

2.1. Key information on the Group and its reporting segments.

These consolidated financial statements include financial information of the Parent and of:

- 16 direct subsidiaries of PGNiG, and
- 8 indirect subsidiaries of PGNiG.

PGNiG S.A. holds 100% of shares in the consolidated subsidiaries, with the exception of PGNiG GAZOPROJEKT S.A., in which PGNiG holds 75% of shares.

In the case of Polski Gaz Towarzystwo Ubezpieczeń Wzajemnych, PGNiG is that company's sole equity holder holding 100% of its share capital, while the remaining members hold shares in the company's reserve capital.

The assets and liabilities of companies in which the Group holds non-controlling interests are not material.

The Group identifies five reporting segments.

Below is presented a classification of the Group's fully-consolidated entities by reporting segment. For more information on the Group structure, see the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group.

[] - Country of registration (if other than Poland).

* Principal place of business (if other than country of registration)

Figure 1 ***Group structure by operating segments***

The reporting segments have been identified based on the type of business conducted by the Group companies. The individual operating segments were aggregated into reporting segments according to the aggregation criteria presented in the table below. The parent's Management Board is the chief operating decision maker (CODM).

Segment	Description	Operating segments and aggregation criteria
Exploration and Production	The segment's principal business focuses on extracting hydrocarbons from deposits and preparing them 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 segment sells natural gas to customers outside the Group and to other segments of the PGNiG Group. It also sells crude oil and other products in Poland and abroad.	This reporting segment comprises the operating segments of PGNiG S.A. (the exploration and production business) as well as the Group companies specified in ***Figure 1.*** The key aggregation criteria were similarity of products and services; similar characteristics of the production process and of the customer base; and economic similarities (exposure to the same market risks, as reflected in the correlation of results (margins) generated by the aggregated operating segments).
Trade and Storage	The segment's principal business activities are sale of natural gas (imported, produced or purchased on gas exchanges), operation of underground gas storage facilities for trading purposes (Mogilno, Wierzchowice, Kosakowo, Husów, Brzeźnica, Strachocina and Swarzów), and electricity trading.	This reporting segment comprises the operating segments of PGNiG S.A. related to the gas fuel and electricity trading business, as well as the Group companies specified in **Figure 1**. The segment operates seven underground gas storage facilities to ensure Poland's energy security and to build a gas portfolio that meets the market demand, which is subject to seasonal fluctuations. The key aggregation criteria were similarity of products and services, similarity of the customer base, and similar economic characteristics.
Distribution	The segment's principal business activity consists in distribution of natural gas via distribution networks to retail, industrial and wholesale customers, as well as operation, maintenance (repairs) and expansion of gas distribution networks.	This operating segment overlaps with the reporting segment Distribution, and comprises Polska Spółka Gazownictwa Sp. z o.o. and its subsidiaries specified in ***Figure 1***.
Generation	The segment's principal business activities consist in generation and sale of electricity and heat.	This reporting segment comprises the operating segments of PGNiG TERMIKA S.A. and its subsidiary PGNiG TERMIKA Energetyka Przemysłowa S.A. The key aggregation criteria were similarity of products and services, similarity of the customer base, and similar economic characteristics.
Other segments	This segment comprises operations which cannot be classified into any of the segments listed above, i.e. the functions performed by the PGNiG Corporate Centre, financial services for the Group, engineering design and construction of structures, machinery and equipment for the extraction and energy sectors, as well as catering and hospitality and insurance services.	It includes PGNiG S.A.'s activities relating to corporate support for other reporting segments, and the Group companies which do not qualify to be included in the other reporting segments, specified under Other Segments in ***Figure 1.***

(in PLN million, unless stated otherwise)

2.2. Key data on the reporting segments

2017	Sales to external customers	Inter-segment sales	Total revenue	EBITDA	Depreciation and amortisation	EBIT (operating profit)	Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	Profit/(loss) from equity-accounted investees	Expenditure on acquisition of property, plant and equipment and intangible assets	Property, plant and equipment	Workforce*
Exploration and Production	3,092	3,026	6,118	3,865	(1,060)	2,805	(479)	18	(1,142)	12,244	6,998
Trade and Storage	30,000	495	30,495	(435)	(205)	(640)	(364)	-	(89)	3,337	2,961
Distribution	969	3,968	4,937	2,493	(925)	1,568	3	-	(1,190)	13,142	11,114
Generation	1,655	596	2,251	843	(418)	425	3	-	(603)	3,485	1,785
Other segments	141	318	459	(162)	(61)	(223)	4	10	(93)	440	1,836
Total	**35,857**	**8,403**	**44,260**	**6,604**	**(2,669)**	**3,935**	**(833)**	**28**	**(3,117)**	**32,648**	**24,694**
Reconciliation with consolidated data			(8,403)	(25)	-	(25)	-	-	(45)	(196)	
Total			**35,857**	**6,579**	**(2,669)**	**3,910**	**(833)**	**28**	**(3,162)**	**32,452**	

*Excluding employees of equity-accounted investees.

2016	Sales to external customers	Inter-segment sales	Total revenue	EBITDA	Depreciation and amortisation	EBIT (operating profit)	Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	Profit/(loss) from equity-accounted investees	Expenditure on acquisition of property, plant and equipment and intangible assets	Property, plant and equipment	Workforce*
Exploration and Production	2,776	2,513	5,289	2,206	(1,068)	1,138	(1,089)	(53)	(1,314)	12,881	7,720
Trade and Storage	27,733	447	28,180	614	(209)	405	(12)	-	(37)	3,825	2,911
Distribution	1,078	3,837	4,915	2,559	(924)	1,635	(4)	-	(1,123)	12,765	10,846
Generation	1,472	723	2,195	759	(360)	399	(16)	(21)	(391)	3,378	1,870
Other segments	137	225	362	(186)	(55)	(241)	(34)	-	(93)	512	1,924
Total	**33,196**	**7,745**	**40,941**	**5,952**	**(2,616)**	**3,336**	**(1,155)**	**(74)**	**(2,958)**	**33,361**	**25,271**
Reconciliation with consolidated data			(7,745)	22	2	24	-	-	(10)	(212)	
Total			**33,196**	**5,974**	**(2,614)**	**3,360**	**(1,155)**	**(74)**	**(2,968)**	**33,149**	

*Excluding employees of equity-accounted investees.

The segment information has been prepared in accordance with the accounting policies applied in these consolidated financial statements.

The Management Board analyses the segments' results using basic performance measures, such as segment's net profit, as well as key efficiency indicators such as EBITDA, which is not a standardised measure.

The definition of EBITDA and how it is calculated by the Group are presented below.

Definition adopted by the Group:

EBITDA– *profit before tax, less net finance costs, share of profit/(loss) of equity-accounted investees, and depreciation and amortisation*.

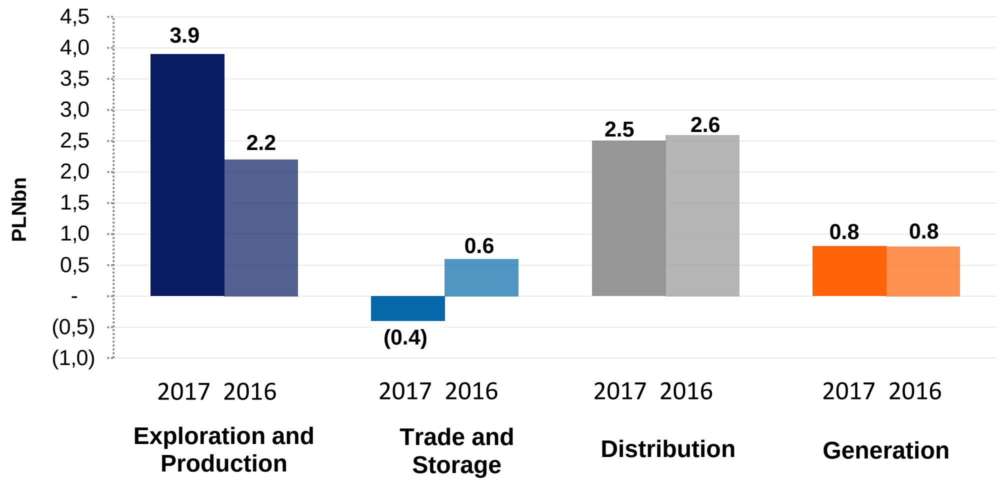

Chart 1 ***Segments' contributions to the Group's EBITDA (PLNbn)***

For more information on the operations of each segment, see the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group.

(in PLN million, unless stated otherwise)

2.3. Related-party transactions

The Group's related parties include entities jointly controlled by the Group, the Group's associates, the Group's subsidiaries which are not consolidated due to immateriality of their data, companies in which the State Treasury holds an equity interest (subsidiaries, jointly controlled entities and associates), as well as the Group's key management personnel (i.e. members of the Management and Supervisory Board of the Parent and its subsidiaries).

The State Treasury is the entity having control of the Group.

	2017			2016		
	Joint ventures	Other related parties	Total	Joint ventures	Other related parties	Total
Turnover and revenue/expenses for period						
Sale of products and services	66	7	73	28	5	33
Interest income from loans advanced	19	4	23	11	7	18
Total	**85**	**11**	**96**	**39**	**12**	**51**
Purchase of services, merchandise and materials	(23)	(7)	(30)	(11)	(4)	(15)
Purchase of tangible assets under construction	-	(12)	(12)	-	(24)	(24)
Other purchases	(205)	(3)	(208)	(91)	(1)	(92)
Total	**(228)**	**(22)**	**(250)**	**(102)**	**(29)**	**(131)**
Balance at end of period						
Trade receivables	38	1	39	4	1	5
Including impairment losses	-	-	-	-	-	-
Loans advanced	572	1	573	250	-	250
Including impairment losses	-	(50)	(50)	-	(56)	(56)
Total	**610**	**2**	**612**	**254**	**1**	**255**
Trade payables	43	6	49	23	5	28
Total	**43**	**6**	**49**	**23**	**5**	**28**

In 2017, neither the Parent nor its subsidiaries entered into any material related-party transactions other than on arm's length terms.

2.3.1. Transactions with entities in which the State Treasury holds equity interests

Transactions with entities in which the State Treasury holds equity interests (and has control or joint control of, or significant influence on, such entities) are mainly transactions executed in the course of the Group's day-to-day operations, i.e. natural gas trading, sale of crude oil, and sale of electricity.

	2017	2016
Revenue	6,227	3,855
Expenses	(730)	(888)
Receivables	1,405	631
Liabilities	249	78

The data above applies to the following companies: Polski Koncern Naftowy ORLEN S.A., Grupa LOTOS S.A., Grupa Azoty Zakłady Azotowe PUŁAWY S.A., Grupa Azoty Zakłady Chemiczne POLICE S.A ORLEN Południe S.A., PGE Górnictwo i Energetyka Konwencjonalna S.A., Grupa Azoty Zakłady Azotowe Kędzierzyn S.A., Operator Gazociągów Przesyłowych GAZ-SYSTEM S.A., KGHM Polska Miedź S.A., Zakłady Azotowe w Tarnowie - Mościcach S.A., Polskie Sieci Elektroenergetyczne S.A., Energa Obrót S.A., Anwil S.A.

(in PLN million, unless stated otherwise)

2.3.2. Benefits paid to the Group's key personnel

	2017			2016		
	Management Board	Supervisory Board	Total	Management Board*	Supervisory Board	Total
Parent	**8.6**	**0.7**	**9.3**	**7.6**	**0.5**	**8.1**
Short-term employee benefits	8.0	0.7	8.7	6.1	0.5	6.6
Termination benefits	0.6	-	0.6	1.5	-	1.5
Subsidiaries	**22.2**	**5.3**	**27.5**	**21.5**	**5.3**	**26.8**
Short-term employee benefits	20.7	5.3	26.0	18.7	5.3	24.0
Post-employment benefits	0.6	-	0.6	-	-	-
Other long-term benefits expense	0.4	-	0.4	-	-	-
Termination benefits	0.5	-	0.5	2.8	-	2.8
Total	**30.8**	**6.0**	**36.8**	**29.1**	**5.8**	**34.9**

* Data adjusted to the amount of costs recognised in a given year (previously presented by maturity).

For more information on remuneration of the key management personnel and the remuneration policy applied at the Group, see the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in 2017.

2.3.3. Loans granted to the management and supervisory personnel of the Group companies

In the current reporting period, persons managing and supervising PGNiG Group entities did not receive any loans. As at December 31st 2017, the balance of advanced loans was zero.

At the end of 2016, the balance of loans granted to supervisory personnel amounted to PLN 11,000.

2.4. Equity-accounted investees

Accounting policies

Joint arrangements

Joint arrangements include:

- Joint operations (see **Note 8.6**),
- Joint ventures.

As a partner in a **joint venture**, in the consolidated financial statements the Group recognises its interest in the joint venture as an investment and accounts for that investment with the equity method.

According to the equity method, investments are initially recognised at cost, and subsequently adjusted for the Group's share in changes of their net assets which occurred in the period from the date joint control was assumed to the reporting date, less impairment. When the Group's share of losses of a jointly controlled entity exceeds the Group's interest in that entity, the Group discontinues recognising its share of further losses. Unrealised gains and losses on transactions between the Group and a jointly controlled entity are eliminated on consolidation proportionately to the Group's interest in the jointly controlled entity.

Material estimates

Impairment of investment in joint venture SGT EUROPOL GAZ S.A.

As at the end of each reporting period, the Parent tests its investment in SGT EUROPOL GAZ S.A. (a jointly controlled entity accounted for with the equity method) for impairment and measures its value in use using the DCF method. The valuation was based on the Inter-Governmental Protocol of October 29th 2010, which specified the company's expected net profit.

The company's value estimated as at the same date with the discounted cash flow method was PLN 840m.

The calculations were based on the assumption that in each year in 2011−2021 net profit earned by SGT EUROPOL GAZ S.A. (EUROPOL GAZ) will be PLN 21m. The discounted cash flows include all cash flows generated by EUROPOL GAZ, including cash flows related to the servicing of interest-bearing borrowings (interest expense and principal repayments) and other risks known to the issuer. The cash flows were discounted using a discount rate of 7.69% (in real terms).

As at the end of 2017, the value of the Parent's interest in EUROPOL GAZ determined using the equity method was PLN 805m. Therefore, a PLN 35m reversal of the impairment loss was recognised in the current reporting period to align the equity method valuation of the interest with its valuation obtained using the DCF method.

The impairment test result is sensitive to the adopted assumptions regarding future cash flows (which depend on whether the provisions of the Inter-Governmental Protocol with respect to net profit to be earned in each of the years are implemented by the company) and discount rate. Changes in those assumptions following from updates of the company's financial forecasts and changes in the discount rate due to general or company-specific factors, may have a material effect on the company's future value.

(in PLN million, unless stated otherwise)

2.4.1. Material restrictions of the ability to transfer earnings from interests in joint ventures to the Group

Polska Grupa Górnicza S.A.

Under Polska Grupa Górnicza S.A.'s (PGG) note issue programme agreement dividends may be paid only when all of the following conditions are met:

- a part of notes of individual tranches maturing in the period for which the dividend is to be paid are redeemed before dividend can be distributed;
- The following ratios are maintained within the permitted limits: net debt/EBITDA less replacement capital expenditure (for the last quarter), DSCR (ratio of cash available for debt servicing to mature debt – for the last year) and the Future Cash Flow Ratio (for the last quarter);
- The forecast values of the ratios will not exceed the permitted limits by the note redemption date as a result of the payment;
- The dividend will be paid to the shareholders and to the holders of participation notes in the proportion defined in the terms and conditions of participation notes.

Elektrociepłownia Stalowa Wola S.A. (ECSW)

Construction of the unit at ECSW is financed by the investment sponsors (PGNiG and Tauron PE). The ECSW construction project is under way. As at the date of these consolidated financial statements, negotiations on the bank loan agreement with the participation of PGNiG S.A. as a co-financing party were still under way.

On March 8th 2018, ECSW signed a loan agreement with Bank Gospodarstwa Krajowego and PGNiG. Pursuant to the concluded agreement, BGK and PGNiG will give the company loans in the amount of PLN 450 million each side, with a view to refinancing the debt and covering further investment expenditures.

SGT EUROPOL GAZ S.A.

In the reporting period, at EUROPOL GAZ there were no restrictions with respect to payment of dividend, repayment of borrowings, or payment of advances by the company.

The table below contains financial information relating to equity accounted investees.

	2017				2016		
	Joint venture				Joint venture		
	SGT EUROPOL GAZ S.A.	Polska Grupa Górnicza S.A.	Elektrociepłownia Stalowa Wola S.A.	Polimex-Mostostal S.A. Group	SGT EUROPOL GAZ S.A.	Polska Grupa Górnicza S.A.	Elektrociepłownia Stalowa Wola S.A.
At beginning of period	**840**	**389**	**-**	**-**	**840**	**-**	**-**
Acquisition of shares	-	266	-	81	-	444	-
Consolidation	-	-	-	-	-	-	21
Changes accounted for in profit (loss) from equity-accounted investees, including:							
Share of net profit/(loss)	(33)	19	(3)	10	64	(55)	(47)
Elimination of unrealised profits between the Group and the joint venture	(2)	(1)	-	-	(2)	2	-
Reversal of negative value of shares accounted for with the equity method	-	-	3	-	-	-	26
Impairment losses	35	-	-	-	(62)	-	-
Changes accounted for in other comprehensive income from equity-accounted investees	-	1	-	(4)	-	(2)	-
At end of period	**840**	**674**	**-**	**87**	**840**	**389**	**-**

(in PLN million, unless stated otherwise)

Below is presented information on significant equity-accounted investees.

	2017			2016	
	SGT EUROPOL GAZ S.A.[1]	Polska Grupa Górnicza S.A.[2]	GK Polimex-Mostostal S.A.[3]	SGT EUROPOL GAZ S.A.[1]	Polska Grupa Górnicza S.A.[2]
PGNiG Group's ownership interest	**51.18%**	**19.63%**	**16.48%**	**51.18%**	**16.63%**
Description of business	Transmission of natural gas	Production of coal	Construction	Transmission of natural gas	Production of coal
Key financial data[4]					
Non-current assets	1,964	9,074	926	2,201	6,277
Current assets	1,973	1,876	1,586	2,125	1,008
including cash and cash equivalents	1,752	788	563	1,900	310
Non-current liabilities	19	4,167	714	198	2,442
including non-current financial liabilities	1	2,280	400	115	1,148
Current liabilities	184	3,409	954	322	2,516
including current financial liabilities	123	151	25	229	92
Net assets	**3,734**	**3,374**	**844**	**3,806**	**2,327**
Revenue	899	8,236	2,069	1,120	3,828
Depreciation and amortisation	287	1,717	26	281	910
Interest income	27	19	9	23	9
Interest expense	11	98	24	18	48
Income tax	(22)	(67)	(18)	29	55
Net profit/(loss)	(72)	86	39	117	(332)
Other comprehensive income	-	4	20	-	(11)
Carrying amount of the investment					
Share of net assets	**1,911**	**662**	**139**	**1,948**	**387**
Adjustment to ensure consistency of accounting policies with those of the Group	(47)	-	(69)	(51)	-
Elimination of unrealised profits between the Group and the joint venture	(184)	1	-	(182)	2
Goodwill	6	11	17	6	-
Goodwill write-off	(6)	-	-	(6)	-
Impairment losses	(840)	-	-	(875)	-
Carrying amount of the investment in the consolidated statement of financial position	**840**	**674**	**87**	**840**	**389**

1. Resolutions are passed by a majority of three quarters of votes represented at the General Meeting. Resolutions may be passed if the General Meeting is attended by all founding shareholders, each of them holding 30% or more shares.

2. Indirect interest held through PGNiG TERMIKA S.A., which is entitled to appoint one member of the Supervisory Board and can block material decisions.

3. PGNiG S.A.'s interest held indirectly through PGNiG Technologie S.A. which, under the agreement relating to the investment in Polimex, assumes that the parties will reach, by voting, common positions when making key decisions on matters falling within the powers of the Polimex -Mostostal S.A. General Meeting and Supervisory Board, including on the composition of its Management Board.

4. Financial data for the Polimex-Mostostal S.A. Group for 11 months of 2017.

3. Notes to the statement of profit or loss

3.1. Revenue

Accounting policies

Revenue

The Group's revenue comes primarily from trade in high-methane and nitrogen-rich natural gas, generation and sale of electricity and heat, as well as sale of produced crude oil.

The Group's business includes services, such as distribution of gas fuels, storage of gas fuels, geophysical and geological services, gas service connection, drilling and oilfield services, real estate rental and other services.

The Group also generates revenue from construction contracts.

Revenue is measured at fair value of the consideration received or receivable, less any discounts, sales taxes (VAT, excise duty) and other charges.

Material estimates

Estimating natural gas sales

In order to correctly recognise revenue from gas sales in appropriate reporting periods, at the end of each reporting period the Group estimates the quantity and value of gas delivered to retail customers but not invoiced.

The value of natural gas supplied to retail customers but not invoiced is estimated on the basis of the customers' historical consumption patterns in comparable reporting periods. The value of estimated gas sales is calculated as the product of quantities assigned to the individual tariff groups and the rates defined in the applicable tariff. There is a risk that the actual final volume of gas fuel sold might differ from the estimate. Accordingly, profit or loss for a given period may account for a portion of the estimated sales volume which will never be realised.

At the end of 2017, an estimated amount of PLN 25m was included in gas sales revenue (adjustment reducing invoiced revenue), while gas sales revenue for 2016 was increased by PLN 103m relative to the invoiced amounts.

Revenue from sale of crude oil

With regard to sales of crude oil produced from the Norwegian Continental Shelf, where the Group holds interests in licences together with other entities, the revenue from sale of crude oil is recognised based on crude volumes produced and sold to customers. However, the volume of crude oil sold to customers may differ from the volume of crude which is attributable to the Group in a given period based on its interest in a given licence. If the production volume attributable to the Group is higher than the sales volume, an asset (underlift) is recognised in the consolidated financial statements. Conversely, if in a given reporting period the volume of crude oil sold exceeds the production volume the Group is entitled to, a liability (overlift) is recognised in the consolidated financial statements.

At the end of 2017 and 2016, the volume of crude oil sold was lower than the Group's share of production. Therefore, an asset of PLN 67m was recognised under receivables in the consolidated statement of financial position for 2017 (2016: PLN 7m).

Revenue from construction contracts

If the outcome of a construction contract can be estimated reliably, revenue and costs should be recognised in proportion to the stage of completion of contract activity at the end of the reporting period.

If the outcome cannot be estimated reliably, contract revenue should be recognised only to the extent that contract costs incurred are expected to be recoverable.

(in PLN million, unless stated otherwise)

	2017			2016		
	Domestic sales	Export sales*	Total	Domestic sales	Export sales*	Total
Revenue from sales of gas, including:	**26,026**	**2,587**	**28,613**	**24,323**	**2,106**	**26,429**
High-methane gas	24,452	2,485	26,937	22,707	2,095	24,802
Nitrogen-rich gas	1,401	102	1,503	1,348	11	1,359
LNG	74	-	74	185	-	185
CNG	33	-	33	34	-	34
Propane-butane gas	66	-	66	49	-	49
Other revenue, including:	**4,974**	**2,270**	**7,244**	**4,946**	**1,821**	**6,767**
Sale of crude oil and natural gasoline	854	919	1,773	646	875	1,521
Sale of NGL	-	90	90	-	86	86
Sales of heat	1,348	-	1,348	1,264	-	1,264
Sale of electricity	1,161	863	2,024	1,410	442	1,852
Revenue from rendering of services:						
- drilling and oilfield services	34	125	159	45	167	212
- geophysical and geological services	28	171	199	50	167	217
- construction and assembly services	99	-	99	90	-	90
- distribution services	852	-	852	762	-	762
- connection charge	147	-	147	130	-	130
- other	242	27	269	208	11	219
Other	209	75	284	341	73	414
Total revenue	**31,000**	**4,857**	**35,857**	**29,269**	**3,927**	**33,196**

*By customer's country.

The Group does not have any single external customer accounting for 10% or more of total revenue earned by the Group.

On foreign markets the Group sells its products mainly to customers in Germany (42% of export sales), the Netherlands, the United Kingdom, Ukraine, and Switzerland.

	2017	2016
Value of non-current assets other than financial instruments located in Poland	29,756	29,734
Value of non-current assets other than financial instruments located abroad*	3,967	4,513
Total	**33,723**	**34,247**
% share of assets located outside of Poland in total assets	**11.76%**	**13.18%**
*Including PGNiG Upstream Norway AS (PUN).	3,305	3,929

(in PLN million, unless stated otherwise)

3.2. Operating expenses

Accounting policies

Cost of gas sold

This item comprises the cost of gas purchased on gas exchanges and from trading partners. The cost of gas purchased includes an appropriate portion of costs of system and transaction charges, costs of domestically produced gas, costs of denitrification and regasification. For details of the valuation of those items, see **Note 6.2.1.**

Raw materials and consumables used

This item comprises the costs of raw materials and consumables used in core activities, in particular fuels for electricity and heat generation. Another material item in this cost group is the cost of electricity for trading.

Employee benefits expense

Employee benefits expense includes in particular salaries, wages and social security contributions. For details of employee benefits expense, see **Note 6.3.1.**

Transmission services

In providing transmission services, the Group pays the costs of gas fuel and heat transmission.

Other services

This item comprises the cost of third-party services required for the core activities of the Group companies, other than transmission services. Other services include in particular:

- Regasification services, consisting in converting liquefied natural gas back to the gaseous form by heating liquefied gas;
- Repair and construction services and services related to repairs of production machinery and equipment, in particular equipment associated with heat generation;
- Mineral resources production services related to hydrocarbon production;
- Rental services (mainly rental of real estate).

Taxes and charges

This item includes in particular costs incurred by the Group in relation to property tax and charges for perpetual usufruct of land.

Recognition and reversal of impairment losses on property, plant and equipment and intangible assets

For details of impairment of non-financial assets, see **Note 6.1.3**

Depreciation and amortisation

This item comprises costs of depreciation/amortisation charges on property, plant and equipment and intangible assets, calculated based on the adopted depreciation/amortisation rates (for details, see **Note 6.1.1.** and **Note 6.1.2.).**

	2017	2016
Cost of gas sold	**(20,127)**	**(18,320)**
Gas fuel	(20,115)	(17,624)
Cost of transactions hedging gas prices	(12)	(696)
Other raw materials and consumables used	**(2,586)**	**(2,427)**
Fuels for electricity and heat generation	(741)	(715)
Electricity for trading	(1,328)	(1,190)
Other raw materials and consumables used	(517)	(522)
Employee benefits expense	**(2,696)**	**(2,573)**
Salaries and wages	(2,018)	(1,910)
Social security contributions	(436)	(403)
Cost of long-term employee benefits	(46)	(40)
Other employee benefits expense	(196)	(220)
Transmission services	**(1,144)**	**(1,106)**
Other services	**(1,749)**	**(1,412)**
Regasification services	(352)	(172)
Repair and construction services	(217)	(203)
Mineral resources production services	(191)	(165)
Rental services	(102)	(98)
Other services	(887)	(774)
Taxes and charges	**(793)**	**(765)**
Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	**(833)**	**(1,155)**
Cost of exploration and evaluation assets written-off	(400)	(319)
Impairment losses on property, plant and equipment	(430)	(825)
Impairment losses on intangible assets	(3)	(11)
Depreciation and amortisation	**(2,669)**	**(2,614)**
Total	**(32,597)**	**(30,372)**

(in PLN million, unless stated otherwise)

3.3. Other income and expenses

	2017	2016
Compensations, penalties, and fines received	60	45
Exchange differences related to operating activities	(122)	128
Measurement and exercise of derivative financial instruments	137	(165)
Change in inventory write-downs	(68)	182
Change in impairment losses on trade and other receivables	(1)	(20)
Change in provision for well decommissioning costs	(9)	(14)
Change in provision for certificates of origin and energy efficiency certificates	(147)	(112)
Change in other provisions	(91)	(2)
Other income and costs	(101)	(374)
Total other income and expenses	**(342)**	**(332)**

3.4. Net finance costs

	2017	2016
Interest on debt (including fees)	(81)	(209)
Foreign exchange differences	46	(26)
Measurement and exercise of derivative financial instruments not designated for hedge accounting	(44)	59
Other net finance costs	63	100
Total net finance costs	**(16)**	**(76)**

3.5. Dividend paid and proposed

	2017	2016
Dividends declared and paid in period		
Dividend per share paid (PLN)	0.20	0.18
Number of shares	5,778	5,778
Dividend paid	**1,156**	**1,062**
dividend paid to owners of the parent	1,156	1,062
dividend paid to minority shareholders	-	-

4. Notes on taxation

4.1. Income tax

Accounting policies

Mandatory increases in loss/decreases in profit include current income tax (CIT) and deferred tax.

Deferred tax is determined using the balance-sheet method, based on temporary differences between the carrying amounts of assets and liabilities for accounting purposes and their tax base, except where temporary differences arise from the initial recognition of an asset or liability in a transaction which is not a business combination and, at the time of the transaction, affected neither profit before tax nor taxable income (tax loss).

Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled.

A deferred tax asset is recognised to the extent it is probable that taxable profit will be available against which deductible temporary differences, including tax losses and tax credit, can be utilised. For more information on tax credit, see **Note 4.1.1**.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries, joint ventures and associates, unless the Group company controls the timing of reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset if and only if the Group:

- Has a legally enforceable right to set off current tax assets against current tax liabilities; and
- The deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

Deferred and current tax is recognised as income or expense and included in profit or loss, except to the extent that the tax arises from a transaction or event that is credited or charged directly to other comprehensive income or to equity (deferred tax is then recognised in other comprehensive income or charged directly to equity).

Tax group

PGNiG S.A. is the company that represents the PGNiG Tax Group, established on April 1st 2014. Under the agreement concluded in 2014, the PGNiG Tax Group was dissolved on December 31st 2016. On September 19th 2016, another agreement was signed to establish the PGNiG Tax Group, which will continue in force until December 31th 2020.

The PGNiG Tax Group comprises PGNiG S.A., PGNiG Obrót Detaliczny Sp. z o.o., Polska Spółka Gazownictwa Sp. z o.o., PGNiG TERMIKA S.A., Gas Storage Poland Sp. z o.o., PGNiG SPV 5 Sp. z o.o., PGNiG SPV 6 Sp. z o.o., PGNiG SPV 7 Sp. z o.o., GEOFIZYKA Toruń S.A., PGNiG Technologie S.A., and PGNiG Serwis Sp. z o.o.

The present PGNiG Tax Group replaced the former PGNiG Tax Group, established for the period April 1st 2014−December 31st 2016, which comprised: PGNiG S.A., PGNiG Obrót Detaliczny Sp. z o.o., Polską Spółkę Gazownictwa Sp. z o.o., PGNiG TERMIKA S.A., Gas Storage Poland Sp. z o.o., PGNiG SPV 5 Sp. z o.o., PGNiG SPV 6 Sp. z o.o. and PGNiG SPV 7 Sp. z o.o.

In accordance with applicable tax laws, the companies included in the PGNiG Tax Group lost their status as separate payers of corporate income tax and such status was acquired by the PGNiG Tax Group, which allows corporate income tax to be calculated jointly for all members of the PGNiG Tax Group. The PGNiG Tax Group is a separate entity only for corporate income tax purposes, and it should not be viewed as a separate legal person. Its tax status does not extend to other types of taxes; in particular, each of the companies forming the PGNiG Tax Group is a separate payer of value-added tax and of tax on civil-law transactions, and a separate remitter of personal income tax withholdings. The other companies of the PGNiG Group are separate payers of corporate income tax.

The PGNiG Tax Group is a source of certain benefits for its member companies, including:

- ability to offset losses generated by individual members of the PGNiG Tax Group against profits earned by other member companies in the period when such losses are incurred,
- ability to recognise donations to other members of the PGNiG Tax Group as tax deductible expenses,
- CIT settlements are processed by a single entity.

(in PLN million, unless stated otherwise)

4.1.1. Income tax expense disclosed in the statement of profit or loss

Reconciliation of effective tax rate	2017	2016	
Profit before tax	3,922	3,210	
Corporate income tax at the 19% statutory rate applicable in Poland	(745)	(610)	
Differences in tax rates of the Group companies (from 34% to 78% for Norway, 33% for Germany, from 20% to 31% for other)	(237)	(135)	
Deductible temporary differences in respect of which no deferred tax was recognised	(19)	(116)	
Income tax expense disclosed in the statement of profit or loss	**(1,001)**	**(861)**	
Including:			
Current tax expense	(804)	(712)	
Deferred tax expense	(197)	(149)	*Note 4.1.2.*
Effective tax rate	26%	27%	

In the case of PGNiG Upstream Norway AS ("PUN"), the tax rate is 78%. PUN's activities in the Norwegian Continental Shelf in 2017 were subject to taxation under two separate tax regimes:

- the corporate income tax regime (tax rate of 24%; in 2016: 25%), and
- the petroleum tax regime (additional tax rate of 54%; in 2016: 53%).

The high tax rate in Norway comes with a wide range of investment incentives and additional deductions.

- For instance, the company may apply a high depreciation/amortisation rate (the annual depreciation/amortisation rate is 16.67%) and commence depreciation/amortisation immediately after capital expenditure is incurred. In the year in which capital expenditure is incurred, the company is entitled to charge depreciation/amortisation for the full year, regardless of the date when it was actually incurred.
- The company may benefit from an investment incentive of 5% per annum for four years under the petroleum tax regime. The incentive relates to capital expenditure made in the Norwegian Continental Shelf (excluding exploration expenditure) and amounts to 22% of depreciable expenditure (5% over four years). The incentive is deducted only from income taxable with the petroleum tax (54% rate; in 2016: 53%) and does not apply to income tax. If the incentive amount exceeds income generated in a given year, it becomes deductible in subsequent years.
- Total expenditure on exploration activities may be deducted from revenue. If a company does not generate income from which expenditure on exploration could be deducted, it is entitled to reimbursement of 78% of the exploration expenditure. The funds are returned in cash by the end of the year following the year covered by the tax return.
- Finance costs may be deducted under both taxation systems.

Under the Norwegian tax system there is no time limit within which tax losses should be used, and interest accrues on losses carried forward. The interest rate applicable to such losses is calculated as a risk-free interest rate, net of income tax (24%; in 2016: 25%). Tax losses incurred by PUN in earlier years (until 2012), increased by accrued interest, reduce its current tax expense. Therefore, throughout the entire period of its existence, i.e. starting from its establishment until the end of 2017, the company paid no income tax in Norway.

Current income tax	2017	2016
At beginning of period (tax receivables and payables, net)	(142)	(46)
Income tax expense recognised in profit or loss for period	(804)	(712)
Tax paid in period	755	611
Other changes	12	5
At end of period (tax receivables and payables, net)	**(179)**	**(142)**
including:		
- receivables	38	38
- payables	(217)	(180)

(in PLN million, unless stated otherwise)

4.1.2. Deferred tax expense

		CREDITED/(CHARGED)					CREDITED/(CHARGED)				
	January 1st 2016	Net profit/(loss)	Other comprehensive income	Currency translation differences	Other changes	December 31st 2016	Net profit/(loss)	Other comprehensive income	Currency translation differences	Other changes	December 31st 2017
Deferred tax assets											
Employee benefits expense	115	5	8	-	4	132	-	2	-	-	134
Provision for well decommissioning costs	127	10	-	-	-	137	14	-	-	-	151
Other provisions	178	(71)	(3)	-	3	107	19	2	3	(1)	130
Investment tax credit (Norway)	289	(73)	-	26	-	242	(187)	-	(19)	-	36
Valuation of derivatives	274	(140)	-	4	-	138	(5)	-	(7)	-	126
Impairment of property, plant and equipment	203	38	-	-	(1)	240	(49)	-	-	-	191
Tax loss	217	(120)	-	16	-	113	(74)	-	(7)	-	32
Other	172	(47)	-	-	47	172	27	1	-	1	201
Total	**1,575**	**(398)**	**5**	**46**	**53**	**1,281**	**(255)**	**5**	**(30)**	**-**	**1,001**
Deferred tax liabilities											
Difference between tax and accounting value of non-current assets	2,829	(965)	-	84	6	1,954	(91)	-	(31)	-	1,832
Valuation of derivative financial instruments	181	(144)	149	4	-	190	(14)	(14)	(7)	-	155
Other	80	860	-	27	2	969	47	-	(123)	(1)	892
Total	**3,090**	**(249)**	**149**	**115**	**8**	**3,113**	**(58)**	**(14)**	**(161)**	**(1)**	**2,879**
Set-off of assets and liabilities	**(1,533)**					**(1,181)**					**(860)**
After set-off											
Assets	**42**	**(398)**				**100**	**(255)**				**141**
Liabilities	**1,557**	**(249)**				**1,932**	**(58)**				**2,019**
Net effect of changes in the period		**(149)**	**(144)**	**(69)**	**45**		**(197)**	**19**	**131**	**1**	

(in PLN million, unless stated otherwise)

5. Notes to the statement of cash flows and information on debt

5.1. Debt reconciliation

Accounting policies

The Group defines **net debt** as the total of existing bank borrowings (both short- and long-term), debt securities, lease liabilities and liabilities under non-bank borrowings, less cash and cash equivalents and cash classified as non-current assets. The Group presents net debt to EBITDA as a measure of its debt.

Net debt	2017	2016	
Bank borrowings	945	1,180	
Debt securities	-	143	
Other	6	23	
Total liabilities under long-term debt	**951**	**1,346**	
Bank borrowings	140	143	
Debt securities	1,898	4,841	
Other	17	22	
Total liabilities under short-term debt	**2,055**	**5,006**	
Total debt	**3,006**	**6,352**	
Cash and cash equivalents	2,578	5,829	*Note 5.4.*
Net debt	**428**	**523**	
EBITDA	**6,579**	**5,974**	*Note 2.2.*
Net debt / EBITDA	**0.07**	**0.09**	

Change in debt	Bank borrowings	Debt securities	Other	Total
At Jan 1 2016	**1,524**	**4,772**	**86**	**6,382**
Increase in debt	317	147	-	464
financing received	304	147	-	451
transaction costs	13	-	-	13
Interest accrued	67	17	4	88
Debt-related payments	(554)	(408)	(59)	(1,021)
principal repayments	(478)	(270)	(55)	(803)
interest paid	(68)	(138)	(4)	(210)
commission fees paid	(8)	-	-	(8)
Exchange differences on debt in foreign currencies	(56)	261	(1)	204
Finance lease	-	-	2	2
Changes in the Group	25	195	13	233
At Dec 31 2016	**1,323**	**4,984**	**45**	**6,352**
Increase in debt	333	1,897	-	2,230
financing received	322	1,896	-	2,218
transaction costs	11	1	-	12
Interest accrued	52	33	(3)	82
Debt-related payments	(502)	(4,891)	(14)	(5,407)
principal repayments	(440)	(4,782)	(18)	(5,240)
interest paid	(52)	(109)	4	(157)
commission fees paid	(10)	-	-	(10)
Exchange differences on debt in foreign currencies	(121)	(125)	(8)	(254)
Finance lease	-	-	3	3
As at Dec 31 2017	**1,085**	**1,898**	**23**	**3,006**

(in PLN million, unless stated otherwise)

5.2. Financing liabilities

Accounting policies

The Group's financing liabilities are classified under three main categories: bank borrowings, debt securities and other financing liabilities (including chiefly finance lease liabilities and non-bank borrowings). On initial recognition, all financing liability categories are measured at fair value less transaction costs. As at the reporting date, financing liabilities are measured at amortised cost with the use of the effective interest rate method.

2017	In functional currency – PLN	In foreign currency	
		EUR	USD
Bank borrowings	274	539	272
Debt securities	1,898	-	-
Other	7	-	16
Total, including:	**2,179**	**539**	**288**
variable-rate	277	539	288
fixed-rate	1,902	-	-

2016	In functional currency – PLN	In foreign currency	
		EUR	USD
Bank borrowings	36	715	572
Debt securities	2,698	2,286	-
Other	9	-	36
Total, including:	**2,743**	**3,001**	**608**
variable-rate	2,739	715	608
fixed-rate	4	2,286	-

Interest on variable-rate debt denominated in the Polish złoty is calculated based on 1M WIBOR, 3M WIBOR or 6M WIBOR rates; USD-denominated debt: 1M LIBOR and 3M LIBOR rates; EUR-denominated debt: EONIA, 1M EURIBOR and 3M EURIBOR rates. Fixed interest rate is applicable only to PLN-denominated debt securities.

The Group's debt is subject to interest rate risk, currency risk and liquidity risk. For detailed information on these risks, see Note 7.3.

In the reporting period, the Group operated the following debt security programmes:

Start date	End date	Subject matter of agreement	Participating banks as at the reporting date	Limit	Utilisation (%) as at December 31st 2017	Outstanding debt (PLNbn) 2017	Outstanding debt (PLNbn) 2016
Authorised issuer: **PGNiG S.A**							
Jun 10 2010	July 31st 2020	Note issuance programme for short-term discount notes and coupon-bearing notes with maturities from one to twelve months	Bank Pekao S.A., ING Bank Śląski S.A., PKO BP S.A., Bank Handlowy w Warszawie S.A., Societe Generale S.A., BNP Paribas S.A. Oddział w Polsce (Polish Branch), mBank S.A. and Bank Zachodni WBK S.A.	PLN 7bn	27.1%	1.9	-
May 22nd 2012	May 22nd 2017	Note issuance programme	Bank Pekao S.A. and ING Bank Śląski S.A.	PLN 4.5bn	-	-	2.5
Oct 2 2014	Sep 30 2024	Note issuance programme for notes with maturities of at least 12 months [1]	Bank Gospodarstwa Krajowego	PLN 1bn	-	-	-
Dec 21 2017	Dec 21 2022	Note issuance programme	Bank Pekao S.A. , ING Bank Śląski S.A., Bank Handlowy w Warszawie S.A., BGŻ BNP Paribas S.A.	PLN 5bn	-	-	-
Authorised issuers: **PGNiG S.A. and PGNiG Finance AB i likvidation**							
Aug 25 2011	Feb 14 2017	Euro medium-term note programme (notes with maturities of up to 10 years)	Societe Generale S.A., BGŻ BNP Paribas S.A. and Unicredit Bank AG	EUR 1.2bn	-	-	2, 2
Authorised issuer: **PGNiG TERMIKA S.A.**							
Jul 4 2012	Dec 21 2017[2]	Note issuance programme for coupon-bearing notes or discount notes	ING Bank Śląski S.A., PKO Bank Polski S.A., Nordea Bank Polska S.A. and Bank Zachodni WBK S.A.	PLN 1.5bn	-	-	-
Authorised issuer: **PGNiG TERMIKA Energetyka Przemysłowa** (formerly Spółka Energetyczna Jastrzębie S.A.)							
Oct 17 2013	Aug 31 2017[3]	Note issuance programme	Bank Gospodarstwa Krajowego, Alior Bank S.A.	PLN 0.42bn	-	-	0.2

1. In accordance with the agreement, the note issue proceeds may only be used to finance capital expenditure, including on maintaining producing capacities, diversification of gas supply sources, oil and gas exploration and appraisal, development of the power segment and ongoing projects involving the construction of storage infrastructure.
2. On December 21st 2017, due to the mismatch between the investment programme and the Bond Issue Programme, PGNiG TERMIKA S.A. entered into two arrangements terminating the PLN 1,500m Note Issuance Programme established on July 4th 2012:
   - Arrangement relating to the Guarantee Agreement and the Agency and Custody Agreement, concluded between PGNiG TERMIKA SA, ING Bank Śląski S.A., PKO Bank Polski S.A. and Bank Zachodni WBK S.A., which terminated the above Agreements as of the date of the Arrangement, and
   - Arrangement relating to the Subordination Agreement, concluded between PGNiG TERMIKA SA, Polskie Górnictwo Naftowe i Gazownictwo S.A., ING Bank Śląski S.A., PKO Bank Polski S.A. and Bank Zachodni WBK S.A., which terminated the above Agreement as of the date of the Arrangement.
3. On August 31st 2017, Bank Gospodarstwa Krajowego, Alior Bank S.A. and PGNiG TERMIKA Energetyka Przemysłowa S.A. signed an agreement on termination of the Note Programme Agreement and release of security.

On February 14th 2017, PGNiG Finance AB i likvidation redeemed at maturity the 5-year EUR 500m Eurobonds with accrued interest. The bonds were redeemed with internally generated funds.

On June 19th 2017, PGNiG S.A. redeemed at maturity the 5-year PLN 2.5bn domestic bonds with accrued interest. The bonds were redeemed with internally generated funds, through the Central Securities Depository of Poland (KDPW).

(in PLN million, unless stated otherwise)

On December 21st 2017, PGNiG S.A. signed a PLN 5bn bond programme agreement. The issue is organised by: ING Bank Śląski S.A., Bank Polska Kasa Opieki S.A., Bank Handlowy w Warszawie S.A., and Bank BGŻ BNP Paribas S.A.

In the current and comparative periods, the Group repaid its financing liabilities in a timely manner. In the reporting period and as at the date of authorisation of these financial statements for issue, there were no instances of default under material provisions of any credit facility, loan, or debt securities issue agreement that could trigger accelerated repayment.

5.2.1. Financing available but not drawn

	2017			2016		
	Obtained limit	Used provision	Undrawn	Obtained limit	Used provision	Undrawn
Credit facilities	1,598	(820)	778	2,064	(1,272)	792
Debt securities	13,000	(1,900)	11,100	19,723	(4,904)	14,819
Total	**14,598**	**(2,720)**	**11,878**	**21,787**	**(6,176)**	**15,611**

5.3. Equity and capital management policy

Accounting policies

Share capital is disclosed at par value, in the amount specified in the Parent's Articles of Association and the entry in the court register.

Share premium comprises the positive difference between the issue price of shares and the par value of the shares which remains after covering issue costs.

Accumulated other comprehensive income includes exchange differences on translating foreign operations, effects of the application of cash-flow hedge accounting which are taken to equity, actuarial gains and losses on employee benefits, and valuation of financial assets available for sale.

Retained earnings are the aggregate of the profit for the reporting period and accumulated profits brought forward which were not distributed as dividend but were transferred to reserve funds or remained undistributed.

PGNiG SA's largest shareholder is the State Treasury, which as at December 31st 2017 held 71.88% of the Company's shares, and is the entity having control of the Group. For detailed information on the shareholding structure, see the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group.

As at the end of 2017, the Company's share capital comprised 5,778,314,857 shares with a par value of PLN 1 per share.

As at the end of the previous reporting period, the share capital comprised 5,778m shares with a par value of PLN 1 per share and the total value of the share capital was PLN 5,778m.

In the reporting period, the Annual General Meeting of PGNiG S.A. decided to pay dividend of PLN 1,156m (PLN 0.20 per share) (2016: PLN 1,062m, i.e. PLN 0.18 per share). The dividend for 2016 was approved on June 28th 2017, and the dividend record date was set for July 19th 2017. The dividend was paid on August 3rd 2017.

For detailed information on the dividend policy, see Directors' Report on the operations of PGNiG SA and the PGNiG Group.

The key objective of the Group's capital management is to maintain the ability to continue its operations, taking into account investment plans, while increasing the Group's shareholder value. Furthermore, the PGNiG Group monitors its ability to pay liabilities based on the net debt to EBITDA ratio.

(in PLN million, unless stated otherwise)

5.4. Cash and cash equivalents

Accounting policies

Cash and cash equivalents include cash at bank and in hand as well as highly liquid current financial assets with the original maturity of up to three months, which are readily convertible into specific cash amounts and subject to an insignificant risk of fluctuation in value.

In the statement of cash flows, cash and cash equivalents are presented net of outstanding current account debt.

	2017	2016
Cash in hand	1	1
Cash at banks	1,066	875
Bank deposits	907	4,593
Other cash	604	360
Total	**2,578**	**5,829**
including restricted cash	845	742

The Group classifies the following as cash equivalents: commercial bills, treasury bills, NBP bills, certificates of deposit, cash in transit, cheques and third-party notes maturing in less than three months.

Risks associated with cash and cash equivalents include the credit risk, foreign exchange risk, and interest rate risk. For detailed information on these risks, see **Note 7.3**.

Based on agency ratings	2017	2016
A+ rated banks according to Fitch	-	532
A rated banks according to Fitch	38	1,289
A- rated banks according to Fitch	802	2,314
A2 rated banks according to Moody's	-	321
A3 rated banks according to Moody's	7	-
B+ rated banks according to Fitch	23	-
BB rated banks according to Fitch	2	24
BB- rated banks according to Fitch	-	16
BBB+ rated banks according to Fitch	-	5
BBB rated banks according to Fitch	35	92
Total cash deposits at banks	**907**	**4,593**

(in PLN million, unless stated otherwise)

5.5. Additional information on consolidated statement of cash flows

5.5.1. Reconciliation of movements in working capital with the statement of cash flows

2017	Difference resulting from the statement of financial position	Change in current tax receivable/payable	Net cash from investing activities	Net cash from financing activities	Changes in the Group	Non-cash transactions	Other	Net cash from operating activities (movements in working capital)
Inventories	(238)	-	-	-	-	-	-	(238)
Receivables	(1,493)	-	190	-	-	(93)	-	(1,396)
Other assets	(87)	-	181	(6)	-	(159)	-	(71)
Trade and tax payables	70	(38)	(64)	-	-	47	-	15
Employee benefit obligations	37	-	-	-	-	24	-	61
Provision for well decommissioning costs	33	-	(186)	-	-	76	-	(77)
Other provisions	61	-	-	-	-	(17)	-	44
Other liabilities	(7)	-	14	-	-	(121)	-	(114)
Total working capital	**(1,624)**	**(38)**	**135**	**(6)**	**-**	**(243)**	**-**	**(1,776)**

2016	Difference resulting from the statement of financial position	Change in current tax receivable/payable	Net cash from investing activities	Net cash from financing activities	Changes in the Group	Non-cash transactions	Other	Net cash from operating activities (movements in working capital)
Inventories	(281)	-	-	-	16	-	-	(265)
Receivables	(909)	31	149	-	131	17	-	(581)
Other assets	17	-	(4)	(5)	10	-	-	18
Trade and tax payables	414	(127)	67	-	(105)	(15)	-	234
Employee benefit obligations	(18)	-	-	-	(31)	136	-	87
Provision for well decommissioning costs	(13)	-	(62)	-	-	101	-	26
Other provisions	(101)	-	-	-	(8)	10	-	(99)
Other liabilities	178	-	(25)	-	(3)	(113)	-	37
Total working capital	**(713)**	**(96)**	**125**	**(5)**	**10**	**136**	**-**	**(543)**

5.5.2. Other non-cash adjustments to the statement of cash flows

	2017	2016
Net interest and dividend	27	27
Net foreign exchange gains/(losses)	(13)	208
Profit/(loss) from equity-accounted investees	(28)	74
Derivative financial instruments	(40)	71
Written-off expenditure on non-financial non-current assets	399	322
Acquired CO_2 emission allowances	(96)	(95)
Other items, net	55	(239)
Other non-cash adjustments	**304**	**368**

(in PLN million, unless stated otherwise)

5.5.3. Reconciliation of cash as presented in the statement of cash flows with the statement of financial position

	2017	2016
1) Cash in the statement of financial position at beginning of period	5,829	6,022
a) Net exchange differences on cash at beginning of period	(3)	1
Cash and cash equivalents in the statement of cash flows at beginning of period (1-a)	**5,832**	**6,021**
2) Cash in the statement of financial position at end of period	2,578	5,829
b) Net exchange differences on cash at end of period	(3)	(3)
Cash and cash equivalents in the statement of cash flows at end of period (2-b)	**2,581**	**5,832**
I. Change in cash in the statement of financial position (2-1)	(3,251)	(193)
II. Change in net exchange differences on cash (b-a)	-	(4)
Change in cash in the statement of cash flows (I. - II.)	**(3,251)**	**(189)**

(in PLN million, unless stated otherwise)

6. Notes to the statement of financial position

6.1. Non-current property, plant and equipment and intangible assets

6.1.1. Property, plant and equipment and related provisions

Accounting policies

Property, plant and equipment

The most material items of property, plant and equipment are buildings and structures, and plant and equipment, mostly associated with exploration for and production of natural gas and crude oil, as well as with gas trading, storage and distribution. The Group also holds vehicles and land. Tangible assets under construction include mostly capitalised expenditure on exploration for and evaluation of oil and gas deposits incurred until production commences or the assets are written off (for detailed accounting policies, see 'Exploration and evaluation assets').

Material spare parts and maintenance equipment are disclosed as property, plant and equipment if the Group expects to use such spare parts or equipment for a period longer than one year and they may be assigned to specific items of property, plant and equipment.

Property, plant and equipment are carried at cost less accumulated depreciation and impairment (for information on policies governing the recognition of impairment, see **Note 6.1.3**.).

The initially recognised cost of gas pipelines and gas storage facilities (classified in buildings and structures) includes the value of gas used to fill the pipelines or facilities for the first time. The amount of gas required to fill a pipeline or a storage chamber for the first time equals the amount required to obtain the minimum operating pressure in the pipeline or chamber.

The cost of property, plant and equipment includes also borrowing costs.

Costs of day-to-day maintenance and repairs of property, plant and equipment are expensed as incurred. In the event of a leak, the costs of pipeline refilling or replacing lost fuel are charged to profit or loss in the period when they were incurred.

The Group uses the following depreciation methods and periods:

Category	Depreciation method	Useful life	Average remaining useful life as at the reporting date
Buildings and structures	Straight-line method	1−50 years	30
Plant and equipment	Straight-line method	1−50 years	16
Vehicles	Straight-line method	1−35 years	11
Other property, plant and equipment	Straight-line method	1−35 years	13
Reserves in the Norwegian Continental Shelf	Units of production method*	more than 10 years	more than 10 years
Land		Not depreciated	
Tangible assets under construction		Not depreciated	

*The amounts of production and products sold are strongly correlated, and contracts on sale of hydrocarbons from the Norwegian Continental Shelf preclude major discrepancies between the production volumes and sales volumes, which justifies the applied depreciation method.

Exploration and evaluation expenditure

Natural gas and crude oil exploration and evaluation expenditure covers geological work performed to discover and document deposits and is accounted for with the successful efforts method.

Natural gas and/or crude oil (mineral) deposits can be evaluated once the Group obtains:

- A licence for appraisal of mineral deposits,
- A licence for exploration for and appraisal of mineral deposits,
- A signed agreement establishing mining rights.

The cost of a licence for appraisal of natural gas and/or crude oil deposits and the cost of its extension is equal to the fees charged for conducting the licensed operations. The Group recognises the costs of such appraisal licences as intangible assets.

Expenditure on seismic surveys is capitalised in exploration and evaluation assets.

Expenditure incurred on individual wells is initially capitalised in tangible exploration and evaluation assets under construction. If exploration activities are successful and lead to a discovery of recoverable reserves, the Group analyses the areas and structures to determine whether production would be economically viable. If following the evaluation process a decision is made to launch commercial production of hydrocarbons, the Group reclassifies the tangible exploration and evaluation assets under construction to property, plant and equipment after the production launch.

(in PLN million, unless stated otherwise)

If exploration is unsuccessful or the Group entity does not file for a licence for appraisal of natural gas and/or crude oil reserves following an analysis of the areas and structures in terms of economic viability of commercial production, the full amount of capitalised expenditure incurred on the wells drilled in the exploration phase is expensed to profit or loss in the period in which the decision to discontinue exploration was made. Capitalised seismic survey expenses related to a given structure are also recognised in profit or loss.

The Group recognises provisions for costs of decommissioning of exploration, production and storage wells (for details, see **Note 6.1.1.1.**). Discounted amounts of such provisions are added to the initial cost of wells recognised in exploration and evaluation assets or in property, plant and equipment, and in the latter case are depreciated over the useful lives of the items to which they relate.

Material estimates

Useful lives of property, plant and equipment

The useful lives of the property, plant and equipment were determined on the basis of assessments made by the engineering personnel responsible for their operation. Any such assessment is connected with uncertainty as to the future business environment, technology changes and market competition, which could lead to a different assessment of the economic usefulness of the assets and their remaining useful lives, and ultimately have a material effect on the value of the property, plant and equipment and the future depreciation charges.

The Group reviews the useful lives of property, plant and equipment on an annual basis. As a result of the most recent review, made as at December 31st 2017, depreciation was reduced by about PLN 39m.

	2017			2016		
	Gross carrying amount	Accumulated depreciation and impairment	Net carrying amount	Gross carrying amount	Accumulated depreciation and impairment	Net carrying amount
Land	112	(11)	101	93	(13)	80
Buildings and structures	33,513	(15,211)	18,302	32,351	(14,217)	18,134
Plant and equipment	17,223	(8,611)	8,612	16,188	(7,587)	8,601
Vehicles and other	2,959	(1,832)	1,127	2,817	(1,678)	1,139
Total tangible assets	**53,807**	**(25,665)**	**28,142**	**51,449**	**(23,495)**	**27,954**
Tangible exploration and evaluation assets under construction	3,693	(1,539)	2,154	3,761	(1,609)	2,152
Other tangible assets under construction	2,208	(52)	2,156	3,099	(56)	3,043
Total property, plant and equipment	**59,708**	**(27,256)**	**32,452**	**58,309**	**(25,160)**	**33,149**

The Group has off-balance-sheet liabilities under executed agreements on acquisition of property, plant and equipment which have not yet been disclosed in the statement of financial position.

	2017	2016
Obligations assumed under agreements on acquisition of property, plant and equipment	4,861	6,683
Portion discharged as at the reporting date	(1,792)	(2,289)
Contractual obligations to be met after the reporting date	**3,069**	**4,394**

(in PLN million, unless stated otherwise)

For information on property, plant and equipment serving as collateral for the repayment of financing liabilities, see Note 5.2.

	Land	Buildings and structures	Plant and equipment	Vehicles and other	Total tangible assets	Tangible assets under construction		Total property, plant and equipment	
						Tangible exploration and evaluation assets	Other		
Gross carrying amount as at Jan 1 2016	**78**	**30,570**	**14,552**	**2,704**	**47,904**	**3,637**	**2,961**	**54,502**	
Accumulated amortisation	-	(11,337)	(5,757)	(1,499)	**(18,593)**	-	-	**(18,593)**	
Impairment losses	(11)	(1,178)	(277)	(24)	**(1,490)**	(1,400)	(52)	**(2,942)**	
Net carrying amount as at Jan 1 2016	**67**	**18,055**	**8,518**	**1,181**	**27,821**	**2,237**	**2,909**	**32,967**	
Exchange differences on translating foreign operations	-	(1)	269	-	**268**	36	80	**384**	
Acquisition	-	-	-	-	**-**	675	2,243	**2,918**	
Disposal	-	(2)	-	(2)	**(4)**	-	-	**(4)**	
Provision for well decommissioning costs	-	(19)	-	-	**(19)**	14	67	**62**	*Note 6.1.1.1.*
Transfer from tangible assets under construction	2	1,617	904	198	**2,721**	(286)	(2,490)	**(55)**	
Transfers between asset groups and between items of the statement of financial position	-	(55)	14	1	**(40)**	(11)	11	**(40)**	
Depreciation and amortisation	-	(1,116)	(1,080)	(212)	**(2,408)**	-	-	**(2,408)**	
Impairment losses	(2)	(458)	(124)	(19)	**(603)**	(209)	(4)	**(816)**	
Changes in the Group	14	154	148	4	**320**	-	192	**512**	
Capitalised interest	-	-	-	-	**-**	16	45	**61**	
Retirement	-	(36)	(30)	(7)	**(73)**	-	-	**(73)**	
Tangible assets under construction written off without bringing economic effects	-	-	-	-	**-**	(318)	(3)	**(321)**	
Other changes	(1)	(5)	(18)	(5)	**(29)**	(2)	(7)	**(38)**	
Gross carrying amount as at Dec 31 2016	**93**	**32,351**	**16,188**	**2,817**	**51,449**	**3,761**	**3,099**	**58,309**	
Accumulated amortisation	-	(12,581)	(7,186)	(1,635)	**(21,402)**	-	-	**(21,402)**	
Impairment losses	(13)	(1,636)	(401)	(43)	**(2,093)**	(1,609)	(56)	**(3,758)**	
Net carrying amount as at Dec 31 2016	**80**	**18,134**	**8,601**	**1,139**	**27,954**	**2,152**	**3,043**	**33,149**	
Exchange differences on translating foreign operations	**-**	**-**	**(408)**	**-**	**(408)**	**(73)**	**(85)**	**(566)**	
Acquisition	-	-	-	-	**-**	695	2,348	**3,043**	
Disposal	(1)	(4)	(3)	(3)	**(11)**	-	(4)	**(15)**	
Provision for well decommissioning costs	-	145	-	-	**145**	46	(7)	**184**	*Note 6.1.1.1.*
Transfer from tangible assets under construction	20	1,295	1,812	238	**3,365**	(348)	(3,187)	**(170)**	
Transfers between asset groups and between items of the statement of financial position	-	(34)	35	(5)	**(4)**	(3)	(9)	**(16)**	
Depreciation and amortisation	-	(1,110)	(1,105)	(236)	**(2,451)**	-	-	**(2,451)**	
Impairment losses	2	(55)	(305)	4	**(354)**	70	4	**(280)**	
Capitalised interest	-	-	-	-	**-**	13	34	**47**	
Retirement	-	(62)	(15)	(3)	**(80)**	-	-	**(80)**	
Tangible assets under construction written off without bringing economic effects	-	-	-	-	**-**	(398)	(2)	**(400)**	
Other changes	-	(7)	-	(7)	**(14)**	-	21	**7**	
Gross carrying amount as at Dec 31 2017	**112**	**33,513**	**17,223**	**2,959**	**53,807**	**3,693**	**2,208**	**59,708**	
Accumulated amortisation	-	(13,520)	(7,905)	(1,793)	**(23,218)**	-	-	**(23,218)**	
Impairment losses	(11)	(1,691)	(706)	(39)	**(2,447)**	(1,539)	(52)	**(4,038)**	
Net carrying amount as at Dec 31 2017	**101**	**18,302**	**8,612**	**1,127**	**28,142**	**2,154**	**2,156**	**32,452**	

(in PLN million, unless stated otherwise)

6.1.1.1. Provisions related to property, plant and equipment (including the provision for well decommissioning costs)

Accounting policies

Provision for future well decommissioning costs and contributions to the Extraction Facilities Decommissioning Fund.

The Group recognises a provision for future well decommissioning costs and makes contributions to the Extraction Facilities Decommissioning Fund.

The provision for well decommissioning costs is recognised when the Group has the obligation to properly decommission and abandon wells after production is discontinued. When the provision for well decommissioning costs is recognised with respect to wells classified as tangible exploration and evaluation assets, the discounted amount of the provision is added to the amount of those assets, and after the production phase starts, it is depreciated over the expected useful life of the wells (accounting policies in **Note 6.1.1**). Any subsequent adjustments to the provision due to changes in estimates are also recognised as an adjustment to the value of the relevant item of property, plant and equipment. Adjustments to provisions resulting from changes of discount rates are taken to profit or loss. The amount of the provision for future costs of decommissioning of production and storage wells is adjusted for any unused contributions to the Extraction Facilities Decommissioning Fund.

The Extraction Facilities Decommissioning Fund is created on the basis of the Mining and Geological Law, which requires the Group to decommission extraction facilities once their operation is discontinued. Contributions to the Extraction Facilities Decommissioning Fund are recognised in correspondence with other expenses. The assets accumulated in the Extraction Facilities Decommissioning Fund are kept in a separate bank account and may be used only to cover the costs of decommissioning of an extraction facility or its specific part, in particular the costs of:

- Abandonment of and securing production, storage, discharge, observation and monitoring wells;
- Liquidation of redundant facilities and disassembly of machinery and equipment;
- Reclamation of land and development of areas after completion of extraction activities;
- Maintenance of facilities intended for decommissioning in an order ensuring safety of extraction facility operations.

The Fund assets are presented under non-current assets in the statement of financial position, as other assets.

Material estimates

Provision for well decommissioning costs

The amount of the provision for well decommissioning costs is based on the estimates of future asset decommissioning and land reclamation costs, which largely depend on the applied discount rate and the estimate of time when the outflow of cash is expected to take place.

The provision for well decommissioning costs is calculated based on the average cost of well decommissioning at the individual extraction facilities over the last three full years preceding the reporting period, adjusted for the projected consumer price index (CPI) and changes in the time value of money. The adoption of a three-year time horizon was due to the varied number of decommissioned wells and their decommissioning costs in the individual years.

Extraction Facilities Decommissioning Fund

Contributions to the Extraction Facilities Decommissioning Fund are made in the amount of 3% to 10% of the value of the annual tax depreciation of extraction property, plant and equipment (determined in accordance with income tax laws).

Provision for well decommissioning costs	2017	2016	
At beginning of reporting period	**1,661**	**1,573**	
Recognised provision capitalised in the cost of property, plant and equipment	184	62	*Note 6.1.1.*
Recognised write-downs taken to profit or loss	73	37	*Note 3.3.*
Other increases – Extraction Facilities Decommissioning Fund	2	2	
Used provision	(34)	(20)	
Write-down reversal taken to profit or loss	(64)	(23)	*Note 3.3.*
Exchange differences on translating foreign operations	(50)	30	
Transfer to other reserves	(2)	-	
At end of reporting period	**1,770**	**1,661**	
- long-term	1,717	1,641	
- short-term	53	20	

With respect to the costs of decommissioning of wells and site infrastructure in Poland, in 2017 the discount rate applied to calculate the provision for well decommissioning was 0.80%, and resulted from a 3.32% rate of return on assets and an inflation rate assumed at the NBP's continuous inflation target of 2.5% (as at the end of 2016, the discount rate was 1.04%, and resulted from the rates of 3.6% and 2.5%, respectively).

6.1.2. Intangible assets

Accounting policies

Intangible assets

The Group identifies the following main categories of intangible assets:

- Perpetual usufruct rights to land,
- Software,
- CO_2 emission allowances,
- Licences obtained under the Polish Geological and Mining Law, mining rights and geological information ("Licences").

Perpetual usufruct rights to land

The Group uses perpetual usufruct rights to land which it has acquired in the market against consideration or obtained from the State Treasury or a local government unit.

Perpetual usufruct rights to land acquired for consideration (from other entities) are presented as intangible assets and amortised over their useful lives. The useful life of a perpetual usufruct right to land acquired for consideration from an entity other than the State Treasury or local government unit is equal to the period from the acquisition date of the perpetual usufruct right to the last day of the perpetual usufruct period set out in the perpetual usufruct agreement. Useful lives of perpetual usufruct rights acquired against consideration range from 40 to 99 years.

As at December 31st 2017, the average remaining useful life of perpetual usufruct rights held by the Group was 51 years.

In the case of perpetual usufruct rights obtained under perpetual usufruct agreements made with the State Treasury or a local government unit, the Group discloses in intangible assets the excess of the first payment over the annual perpetual usufruct charge. The useful life of the excess of the first payment over the annual perpetual usufruct charge is equal to the perpetual usufruct period specified in the perpetual usufruct agreement.

Perpetual usufruct rights to land acquired free of charge pursuant to an administrative decision issued under the Amendment to the Act on Land Management and Expropriation of Real Estate of September 20th 1990 are presented only in off-balance-sheet records.

CO_2 emission allowances

Pursuant to the Act on Trading in Greenhouse Gas Emission Allowances, the Group holds CO_2 emission allowances allocated for individual installations.

The Group classifies emission allowances as:

- Acquired for redemption – recognised as intangible assets and measured in accordance with the policies discussed below,
- Acquired for resale – recognised as inventory (**Note 6.2.1**) and measured initially at cost; at the end of each reporting period they are measured at the lower of cost or net realisable value,
- Received free of charge under the National Allocation Plan – recognised as off-balance-sheet items at nominal value (equal to zero).

Licences, mining rights and rights to geological information

In its exploration and production operations, the Group uses licences obtained under the Polish Geological and Mining Law, rights to geological information, and mining rights.

Costs of licences for exploration for and production of natural gas and/or crude oil and charges for the grant of mining rights payable to the State Treasury are disclosed as capitalised expenditure.

Measurement

The Group initially recognises intangible assets at cost. In the case of granted mining rights, the initial value is equal to the charges paid to the State Treasury for the grant of the mining rights.

Subsequent to initial recognition, intangible assets are carried at cost less accumulated amortisation and impairment (for accounting policies relating to impairment, see **Note 6.1.3**.).

Intangible assets are amortised using the straight-line method based onamortisation rates that reflect the expected useful lives of the assets. Acquired CO_2 emission allowances are amortised depending on the actual emission volumes.

(in PLN million, unless stated otherwise)

Material estimates

Useful lives of intangible assets

The useful lives of intangible assets were determined on the basis of assessments made by the engineering personnel responsible for their use. Any such assessment is connected with uncertainty as to the future business environment, technology changes and market competition, which could lead to a different assessment of the economic usefulness of the assets and their remaining useful lives, and ultimately have a material effect on the value of intangible assets and the future amortisation charges.

The estimated amortisation period and amortisation method are reviewed at the end of each financial year. If the forecast useful life of an asset is significantly different from previous estimates, the amortisation period is changed. Such transactions are recognised by the Group as revision of estimates and are recognised in profit or loss in the period in which such estimates are revised.

As a result of the review, annual amortisation charges were reduced by about PLN 6.7m as at December 31st 2017.

	Perpetual usufruct rights to land	CO_2 emission allowances	Software	Licences	Other intangible assets	Total
Gross carrying amount as at Jan 1 2016	**677**	**430**	**499**	**243**	**423**	**2,272**
Accumulated amortisation	(16)	(349)	(324)	(94)	(277)	**(1,060)**
Impairment losses	(22)	-	(3)	(48)	(1)	**(74)**
Net carrying amount as at Jan 1 2016	**639**	**81**	**172**	**101**	**145**	**1,138**
Exchange differences on translating foreign operations	-	-	-	2	-	**2**
Transfer from tangible assets under construction	1	2	28	5	19	**55**
Transfers between asset groups and between items of the statement of financial position	(3)	-	-	-	-	**(3)**
Acquisition	-	94	-	-	-	**94**
Disposal	(2)	-	-	-	-	**(2)**
Depreciation and amortisation	(2)	(89)	(59)	(20)	(35)	**(205)**
Impairment losses	(7)	-	(1)	(5)	(1)	**(14)**
Changes in the Group	8	11	2	-	20	**41**
Retirement	-	-	(1)	(2)	-	**(3)**
Other changes	3	-	-	(27)	-	**(24)**
Gross carrying amount as at Dec 31 2016	**676**	**538**	**529**	**203**	**460**	**2,406**
Accumulated amortisation	(10)	(439)	(384)	(96)	(310)	**(1,239)**
Impairment losses	(29)	-	(4)	(53)	(2)	**(88)**
Net carrying amount as at Dec 31 2016	**637**	**99**	**141**	**54**	**148**	**1,079**
Exchange differences on translating foreign operations	-	-	-	(6)	-	**(6)**
Transfer from tangible assets under construction	3	4	16	21	126	**170**
Transfers between asset groups and between items of the statement of financial position	-	-	(2)	-	2	**-**
Acquisition	-	96	-	-	-	**96**
Depreciation and amortisation	(3)	(95)	(57)	(13)	(47)	**(215)**
Impairment losses	(1)	-	-	5	-	**4**
Retirement	-	-	-	(6)	-	**(6)**
Other changes	(4)	-	-	(1)	(2)	**(7)**
Gross carrying amount as at Dec 31 2017	**675**	**636**	**526**	**170**	**575**	**2,582**
Accumulated amortisation	(13)	(532)	(424)	(68)	(346)	**(1,383)**
Impairment losses	(30)	-	(4)	(48)	(2)	**(84)**
Net carrying amount as at Dec 31 2017	**632**	**104**	**98**	**54**	**227**	**1,115**

(in PLN million, unless stated otherwise)

6.1.3. Impairment of non-financial assets

Material estimates

Impairment of non-financial assets

Property, plant and equipment and intangible assets are tested for impairment when there are indications of impairment. Impairment tests are based on the comparison of the carrying amount of an asset (or cash-generating unit if the asset does not independently generate separate cash inflows) with its recoverable amount, equal to the higher of its fair value less cost to sell and value in use.
If the recoverable amount is lower than the carrying amount of an asset (or cash-generating unit), the carrying amount is decreased to the recoverable amount of the asset (or cash-generating unit). An impairment loss is recognised as cost of the period in which the impairment loss arose.

Impairment losses recognised in 2017 in respect of property, plant and equipment are presented in the table below:

	2017			2016		
	Upstream operations	Trade and storage	Other	Upstream operations	Trade and storage	Other
Land	(4)	-	(7)	(4)	(6)	(3)
Buildings and structures	(1,452)	(47)	(192)	(1,429)	(168)	(39)
Plant and equipment	(318)	(316)	(72)	(324)	(48)	(29)
Vehicles and other	(34)	(1)	(4)	(39)	(4)	-
Tangible assets under construction:						
Tangible exploration and evaluation assets under construction	(1,539)	-	-	(1,609)	-	-
Other	(1)	-	(51)	(1)	(9)	(46)
Total	**(3,348)**	**(364)**	**(326)**	**(3,406)**	**(235)**	**(117)**

In the reporting year, an impairment test was performed for the Group's main operating assets, including oil and gas production assets and tangible assets under construction (wells). Below is presented basic information on the performed tests, relating to those areas where the largest amounts of impairment losses were recognised.

(in PLN million, unless stated otherwise)

Description of cash generating unit:	*In the case of assets classified as assets of oil and gas production units, impairment tests were performed for the individual CGUs, represented by specific production units in Poland and in Pakistan*

	2017		2016	
	impairment loss reversal	impairment loss recognition	impairment loss reversal	impairment loss recognition
Description of cash generating unit:	CGU - 160 production units		CGU - 158 production units	
Reasons for impairment / value increase	*Discount rate reduction in 2017. *Update of production forecast based on well tests and taking into account new wells brought on stream.	*Change in price forecasts - drop in oil prices. *Update of production forecast to account for deterioration of reservoir conditions experienced by certain production units. *Increase in transmission fee costs.	*Change in macroeconomic assumptions – higher forecast exchange rates in 2016 and increase in hydrocarbon prices as at December 31st 2016. *Update of production forecast taking into account new wells brought on stream.	*Change in price forecasts - drop in hydrocarbon prices as at June 30th 2016. *Update of production forecast to account for deterioration of reservoir conditions experienced by certain production units. *Change in discount rate in 2016.
Value in use	21,827		18,849	
Nominal pre-tax discount rate	Poland 11.52% - 12.02%		Poland 12.12% - 12.28%	
	Pakistan 20.75% - 22.79%		Pakistan 22.09% -24.18%	
Amount of recognised impairment loss	**231**	**323**	**128**	**684**

Description of cash generating unit:	*Impairment tests were performed for individual CGUs, represented by specific wells in Poland*

	2017		2016	
	impairment loss reversal	impairment loss recognition	impairment loss reversal	impairment loss recognition
Description of cash generating unit:	CGU - 124 wells		CGU - 121 wells	
Reasons for impairment / value increase	*Discount rate reduction in 2017. *Update of production forecast and reduction of planned expenditures.	*Change in price forecasts - drop in oil prices. *Decision not to proceed to drilling wells following unsatisfactory results of geological work. *Update of production forecast following well tests. *Increase in transmission fee costs.	*Change in macroeconomic assumptions – higher forecast exchange rates in 2016 and increase in hydrocarbon prices as at December 31st 2016. *Update of production forecast and reduction of planned expenditures.	*Change in price forecasts - drop in hydrocarbon prices as at June 30th 2016. *Decision not to proceed to drilling wells following unsatisfactory results of geological work. *Change in discount rate in 2016.
Value in use	3,708		3,004	
Nominal pre-tax discount rate	Poland 12.50% - 13.00%		Poland 13.17% - 13.33%	
Amount of recognised impairment loss	**39**	**95**	**24**	**350**

(in PLN million, unless stated otherwise)

Description of cash generating unit: *LNG regasification stations in Ełk and Olecko – Head Office; impairment tests were performed for individual CGUs*

	2017		2016	
	impairment loss reversal	impairment loss recognition	impairment loss reversal	impairment loss recognition
Description of cash generating unit	CGU – two units		CGU – two units	
Reasons for impairment / value increase	*The sum of discounted cash and residual value exceeds the net value of property, plant and equipment.		*Higher demand for regasification services – higher expected revenue. *Change in discount rate.	*Lower contracted volumes than projected in the tariff application.
Value in use [PLN]	13		9	
Nominal pre-tax discount rate	3.28% - 3.53%		3.86% - 4.62%	
Amount of recognised impairment loss (PLN)	-	-	2	2

Description of cash generating unit: *Leased assets (transmission assets, CNG stations, non-contributed assets) - Head Office*

	2017		2016	
	impairment loss reversal	impairment loss recognition	impairment loss reversal	impairment loss recognition
Description of cash generating unit	CGU – 212 units		CGU – 200 units	
Reasons for impairment / value increase	*Higher rental income from certain properties. *Lower cost of planned repairs and maintenance costs.	*Lower revenue from certain properties. *Higher costs of property maintenance and planned repairs. *Reversal of impairment loss (BC) on unused assets, assets held for rental, recognition of impairment loss following a DCF-based impairment test.	*Higher rental income. *Change in discount rate.	*Lower revenues, reduced rental rates for CNG stations *Reversal of impairment loss (BC) on unused assets, assets held for rental, recognition of impairment loss following a DCF-based impairment test. *Higher costs of property maintenance and planned repairs.
Value in use (PLN)	245		119	
Nominal pre-tax discount rate	3.28% - 6.08%		3.86% - 7.66%	
Amount of recognised impairment loss (PLN)	15	9	3	22

(in PLN million, unless stated otherwise)

Description of cash generating unit: *Impairment tests were performed for individual CGU - the Wierzchowice unit*

	2017		2016	
	impairment loss reversal	impairment loss recognition	impairment loss reversal	impairment loss recognition
Description of cash generating unit	**CGU - 1**		**-**	
Reasons for impairment / value increase	-	*Change in the business model for the Wierzchowice power generating unit, which has recently begun operating more on a commercial basis than for the purposes of the segment's own underground gas storage unit, i.e. in a mode similar to that of a pumped-storage power plant. *The analysis of the power generating unit does not take into account the potential financial effects related to the regulations on the power market being introduced.	-	-
Value in use (PLN)	-		-	
Nominal pre-tax discount rate	5.88%		-	
Amount of recognised impairment loss (PLN)	**-**	**364**	**-**	**-**

Summary table (all cash-generating units in total)

	2017		2016	
	impairment loss reversal	impairment loss recognition	impairment loss reversal	impairment loss recognition
Value in use of assets tested for impairment	25,793		21,985	
Amount of recognised impairment loss (PLN)	**285**	**791**	**156**	**1,057**

(in PLN million, unless stated otherwise)

6.2. Working capital

6.2.1. Inventories

Accounting policies

The Group's most material **inventory items** include:

- Gas fuel and fuels for electricity and heat generation,
- Certificates of origin for electricity obtained in connection with electricity production and certificates of origin for electricity purchased in order to be surrendered for cancellation,
- Energy efficiency certificates,
- Spare parts that do not qualify as property, plant and equipment (**Note 6.1.1.**) and are used or may be used in different facilities.

Inventories are initially measured at cost. As at the reporting date, inventories are measured at the lower of cost and net realisable value.

Gas fuel at storage facilities is measured jointly for all storage units, at the average weighted cost. Changes in the inventories of gas fuel stored in the Underground Gas Storage Facilities for sale and own consumption, as well as balance-sheet differences, are measured at the average weighted cost, which includes in particular: costs of purchase of gas fuel from all sources together with an appropriate portion of costs of system and transaction charges, actual costs of its production from domestic sources, costs of nitrogen removal and regasification.

Changes in the inventories of spare parts are measured using the weighted average method. Spare parts are recognised in profit or loss as at the date of their use.

The Group is obliged to obtain and surrender for cancellation certificates of origin for electricity and energy efficiency certificates corresponding to the volume of electricity sold to end customers. Property rights granted to the Group in connection with the production of electricity as well as energy efficiency certificates are disclosed as inventories at market value (in correspondence with revenue) when their receipt becomes probable. Purchased certificates of origin and energy efficiency certificates are recognised at cost. Changes in the certificates are measured using the weighted average method. Certificates of origin for electricity and energy efficiency certificates are accounted for at the time of their cancellation in correspondence with the relevant provision (**Note 6.3.2.**).

Material estimates

Inventory write-downs

If the cost of inventories is not recoverable, the Group recognises a write down to net realisable value.

An exception is spare parts, which are not written down to net realisable value if they are planned to be used.

Certificates of origin for electricity and energy efficiency certificates are written down based on a comparison between their carrying amounts and their net realisable values derived from an active market.

Write-downs of non-perishable inventories are determined by way of a case-by-case assessment of their usefulness, based on the following assumptions:

Inventories of purchased materials which are idle for a period of:	Write-down rate
1–5 years	Generally, a write-down of 20% is recognised; where the case-by-case assessment of usefulness, the possibility of using a category of materials, and their cycle structure, is taken into account, the Group may recognise write-downs of 5% and 10% of the value of the materials
5–10 years	20%−100%
More than 10 years	100% for materials which are useless and intended for sale or scrapping

(in PLN million, unless stated otherwise)

Inventories	2017			2016		
	Initial value	Write-down	Net carrying amount	Initial value	Write-down	Net carrying amount
Materials, including:	2,715	(125)	2,590	2,463	(119)	2,344
Gas fuel	2,086	(50)	2,036	1,788	(53)	1,735
Fuels for electricity and heat generation	173	-	173	255	-	255
crude oil	13	-	13	17	-	17
spare parts	71	(20)	51	66	-	66
other materials	372	(55)	317	337	(66)	271
Certificates of origin for electricity	213	(30)	183	157	(5)	152
Other inventories	11	(36)	(25)	18	(4)	14
Total	**2,939**	**(191)**	**2,748**	**2,638**	**(128)**	**2,510**

Changes in write-downs	2017	2016
Write-downs at beginning of period	**(128)**	**(309)**
Taken to profit or loss, including:		
Recognised write-downs taken to profit or loss	(127)	(82)
Write-down reversal taken to profit or loss	59	264
Used provision	1	1
Currency translation differences	4	(2)
Write-downs at end of period	**(191)**	**(128)**

(in PLN million, unless stated otherwise)

6.2.2. Receivables

Accounting policies

Receivables include chiefly short-term trade receivables (mainly in connection with sale of gas fuel), taxes, customs duties and social security.

Short-term trade receivables are initially recognised at fair value, equal to their nominal value. Following initial recognition, receivables are measured at amortised cost, taking into account impairment losses, if any.

Taxes, customs duties and social security receivable by the Group are determined in accordance with applicable laws and regulations.

Material estimates

The amount of impairment loss on receivables equals the difference between the carrying amount of an asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

Depending on the type of receivables, impairment losses are determined using the statistical or individual method.

The Group recognises impairment losses on receivables using the **individual method** if the receivable is past due by more than 90 days or if the receivable is at risk (e.g. the debtor has filed for bankruptcy). Impairment loss is recognised for 100% of the amount of such a receivable.

Impairment losses on receivables for gas deliveries to customers from tariff groups 1−4 (chiefly retail customers and SMEs) are determined using the **statistical method**. The impairment losses are determined based on the analysis of historical data on payment of past due receivables in particular ageing groups. The results of the analysis are then used to calculate recovery ratios on the basis of which the amounts of impairment losses on receivables in each ageing group are determined.

Impairment losses are charged to other expenses or finance costs, as appropriate, depending on the type of receivables for which an impairment loss is recognised.

Receivables	2017			2016		
	Gross carrying amount	Impairment loss	Net carrying amount	Gross carrying amount	Impairment loss	Net carrying amount
Trade receivables (mainly in connection with sale of gas fuel)	5,065	(322)	4,743	3,834	(318)	3,516
VAT receivable	359	(1)	358	375	(1)	374
Corporate income tax receivable	39	(1)	38	39	(1)	38
Other taxes, customs duties and social security receivable	71	(5)	66	28	(6)	22
Other receivables	1,006	(430)	576	784	(446)	338
Total, including:	**6,540**	**(759)**	**5,781**	**5,060**	**(772)**	**4,288**
not past due	4,953	(15)	4,938	3,848	(4)	3,844
past due and impaired	744	(744)	-	768	(768)	-
past due but unimpaired	843	-	843	444	-	444

Ageing structure of trade receivables past due but unimpaired:

Delay	2017	2016
Up to 1 month	612	290
From 1 to 3 months	84	60
From 3 months to 1 year	47	53
from 1 to 5 years	39	9
over 5 years	-	2
Total net past due receivables	**782**	**414**

(in PLN million, unless stated otherwise)

Trade receivables are the source of the Group's credit and currency risk exposure. For information on credit risk management (including assessment of the credit quality of receivables and credit risk concentration), see **Note 7.3.1**. For information on currency risk related to receivables, see **Note 7.3.2.2**.

6.2.3. Trade and tax payables

Accounting policies

Short-term trade payables and liabilities under purchase of property, plant and equipment and intangible assets are initially recognised at fair value, which is equal to their nominal value, and as at the reporting date are measured at amortised cost.

Taxes, customs duties and social security payable are determined in amounts due to Group companies in accordance with applicable laws and regulations.

Trade and tax payables	2017	2016
Trade payables	1,326	1,290
Liabilities under purchase of property, plant and equipment and intangible assets	439	425
VAT payable	940	1,032
Other taxes, customs duties and social security payable	327	252
Current income tax liabilities	217	180
Total	**3,249**	**3,179**

The Group is exposed to currency risk and liquidity risk in relation to trade payables and liabilities under purchase of property, plant and equipment and intangible assets. For information on those risks, see **Note 7.3.2.2**. and **7.3.3**.

(in PLN million, unless stated otherwise)

6.3. Provisions and liabilities

6.3.1. Employee benefit obligations

Accounting policies

Short-term benefits

Short-term employee benefits are benefits (other than termination benefits) which fall due wholly within twelve months after the end of the annual reporting period in which the employees render the related service. Short-term employee benefits require no actuarial assumptions. The Group recognises the anticipated undiscounted amount of short-term benefits to be paid out. Expenses on benefits paid during employment are charged to profit or loss of the current reporting period.

Short-term employee benefits paid by the Group include:

- Salaries, wages and social security contributions,
- Short-term compensated absences,
- Profit-sharing and bonuses payable within 12 months after the end of the period in which the employees acquired the related entitlements,
- Non-cash benefits for current employees.

Short-term employee benefits, including payments towards defined contribution plans, are recognised in the periods in which the employee provided the services to a Group entity, and in the case of profit-sharing and bonus payments – when the following conditions are met:

- A Group entity has a legal or constructive obligation to make such payments as a result of past events, and
- A reliable estimate of the expected cost can be made.

The Group recognises expected short-term employee benefits expense related to compensated absences in the case of accumulated compensated absences (that is absences to which the entitlement is transferred to the future periods and can be used in the future if the absences were not fully used in the current period).

Long-term benefits

Long-term employee benefits are all benefits which are payable after 12 months from the reporting date. They include:

- Post-employment benefits,
- Other long-term employee benefits.

Post-employment benefits include termination benefits, retirement severance payments, and benefits from the Company Social Benefits Fund.

Provision for long-term employee benefits is determined using the projected unit credit method, with the actuarial valuation made as at the end of the reporting period.

Actuarial gains and losses related to defined post-employment benefits are presented in other comprehensive income, whereas gains and losses related to other benefits paid during employment are charged to profit or loss of the current reporting period.

Employee benefit obligations	2017		2016	
	Long-term	Short-term	Long-term	Short-term
Liabilities under length-of-service awards	474	45	473	45
Liabilities under severance payments	190	3	178	4
Wages and salaries payable	-	68	-	72
Amounts payable for unused holiday entitlements	-	62	-	54
Termination benefits	-	11	-	20
Other employee benefit obligations	61	182	51	139
Total	**725**	**371**	**702**	**334**

(in PLN million, unless stated otherwise)

Changes in obligations under retirement severance payments and length-of-service awards were as follows:

	Length-of-service awards		Retirement severance payments	
	2017	2016	2017	2016
Obligations at beginning of period	518	481	182	115
Interest expense	17	17	6	4
Current service cost	25	24	8	7
Benefits paid	(50)	(51)	(12)	(16)
Actuarial gain/(loss) − changes in financial assumptions	21	9	11	4
Actuarial gain/(loss) − changes in demographic assumptions	(12)	87	(2)	38
Gain/(loss) due to curtailments or settlements	-	(63)	-	24
Changes in the Group	-	14	-	6
Reclassification to liabilities relating to groups of assets held for sale	-	-	-	-
Obligations at end of period	**519**	**518**	**193**	**182**

The technical rate applied to calculate the discounted value of future retirement severance obligations was 0.6%, and resulted from a 3.3% annual return on long-term Treasury bonds and a 2.7% forecast annual salary growth (at the end of 2016 the applied technical rate was 1.1%, and resulted from the rates of 3.6% and 2.5%, respectively).

(in PLN million, unless stated otherwise)

6.3.1.1. Workforce streamlining within the Group

In accordance with the PGNiG Group Efficiency Improvement Programme, PGNiG Group companies are implementing programmes related to workforce streamlining. The Pogramme is part of initiatives designed to improve the Group's cost effectiveness and organisational efficiency pursued under the PGNiG Group's Strategy for 2014–2022, adopted in December 2014.

Key workforce streamlining initiatives implemented by Group companies in 2017 are presented below.

Company	Workforce restructuring/streamlining process
GEOFIZYKA Kraków S.A. w likwidacji (in liquidation)	In 2016, the company's liquidation process began. In 2017, the collective redundancy process was continued, as a result of which all employment contracts with 143 employees in Poland were terminated. The costs of severance payments on termination of employment amounted to PLN 1.9m.
EXALO Drilling S.A.	The restructuring activities undertaken by the company in 2017 were only a continuation of the collective redundancy process initiated in 2016 due to the company's difficult financial situation. In 2017, 137 employment contracts were terminated and the costs of severance payments made in the reporting period amounted to PLN 2m.
PGNiG TERMIKA Energetyka Przemysłowa S.A.	On September 1st 2017, a merger of two PGNiG Group companies, PGNiG TERMIKA Energetyka Przemysłowa S.A. and Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie-Zdrój was effected, with PGNiG TERMIKA Energetyka Przemysłowa S.A. as the acquirer. The merger optimised the employment structure and reduced the number of FTEs by 93. In order to minimise the social costs of the restructuring process, the company launched two programmes for employees: the Leave Until Retirement Programme (UTE Bis) and the Voluntary Redundancy Programme (PDO).

6.3.2. Other provisions

Accounting policies	Material estimates
Provision for certificates of origin and energy efficiency certificates	
If at a reporting date the number of certificates in not sufficient to meet the requirements stipulated in the Energy Law and the Energy Efficiency Act, the Group recognises a provision for cancellation of certificates of origin and energy efficiency certificates or for the payment of emission charge, whichever of the two is lower. The provision is measured based on the carrying amount of the certificates held and the then current price (on the Polish Power Exchange) of certificates which should be additionally purchased to meet the cancellation requirement resulting from the volume of electricity sales to end users. The provision and the registered certificates of origin disclosed under inventories (see **Note 6.2.1**) are accounted for at the time of registering their cancellation in the Register of Certificates of Origin maintained by the Polish Power Exchange ("TGE").	The provision is recognised as at the end of reporting period, based on the amounts of electricity, heat and gas fuel sold to end users, and the amount of electricity generated and used for company's own purposes, taking into consideration the applicable unit emission charge or price of a certificate on the PPE.
Provision for liabilities associated with exploration work abroad	
In 2013, the Parent recognised a provision for liabilities associated with the exploration work carried out by PGNiG Upstream North Africa B.V., PGNiG's subsidiary. Owing to the Force Majeure risk present in Libya, PGNiG Upstream North Africa B.V. has suspended operations. Therefore, the Parent has been maintaining a provision for licence obligations under licence agreements concluded with the Libyan government.	The amount of the provision is based on the obligations contracted under the licence agreements, but not met.
Provision for environmental liabilities	
The Group recognises a provision for the cost of identification and reclamation of ground and water contamination, required under the applicable laws. The provision recognised for such liabilities reflects estimated costs projected to be incurred, which are estimated and reviewed periodically based on current prices.	The amount of the provision is based on the estimates of future reclamation costs, which largely depend on the applied discount rate and the estimate of time when the cash flows are expected to take place.
Provision for claims under extra-contractual use of land	
In the ordinary course of business, the Group installs technical equipment on land owned by third parties, often natural persons. Where possible, at the time of installing the elements of the infrastructure, the Group enters into agreements establishing standard land easements and transmission easements. The Group recognises a provision for claims under extra-contractual use of land. The provision for claims under extra-contractual use of land is estimated in respect of those claims which have been confirmed to be valid (the claimant presented a legal title to land) and in the case of which correspondence has been exchanged with the claimant in the last three years.	The Group estimates the provision for claims under extra-contractual use of land based on an estimate survey made by an expert appraiser, or its own valuation, taking into account the size of the controlled area in square meters, the amount of annual rent per square meter for similar land in a given municipality, and the period of extra-contractual use of land (not more than ten years). If it is not possible to obtain reliable data required to apply the method described above, the Group analyses submitted claims on a case-by-case basis. As the amounts used in the above calculations are arrived at based on a number of variables, the actual amounts of compensation for extra-contractual use of land that the Group will be required to pay may differ from amounts of the related provisions.

(in PLN million, unless stated otherwise)

	Provision for certificates of origin and energy efficiency certificates	Provision for liabilities associated with exploration work abroad	Provision for environmental liabilities	Provision for UOKiK fine*	Provision for claims under extra-contractual use of land	Other provisions	Total	
At Jan 1 2016	**215**	**182**	**98**	**65**	**46**	**243**	**849**	
Recognised provision taken to profit or loss	150	12	31	-	8	119	320	*Note 3.3.*
Provision reversal taken to profit or loss	(38)	-	(18)	(55)	(19)	(76)	(206)	*Note 3.3.*
Used provision	(184)	-	-	-	-	(33)	(217)	
Changes in the Group	-	-	-	-	-	8	8	
Other changes	-	-	6	-	1	(3)	4	
At Dec 31 2016	**143**	**194**	**117**	**10**	**36**	**258**	**758**	
long-term	-	4	95	-	24	75	198	
short-term	143	190	22	10	12	183	560	
At Jan 1 2017	**143**	**194**	**117**	**10**	**36**	**258**	**758**	
Recognised provision taken to profit or loss	160	-	24	-	7	148	339	*Note 3.3.*
Provision reversal taken to profit or loss	(13)	-	(17)	-	(12)	(59)	(101)	*Note 3.3.*
Used provision	(133)	-	-	-	-	(28)	(161)	
Other changes	(2)	(31)	-	-	-	-	(33)	
As at Dec 31 2017	**155**	**163**	**124**	**10**	**31**	**319**	**802**	
long-term	-	4	63	-	20	94	181	
short-term	155	159	61	10	11	225	621	

*For more information, see the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group

(in PLN million, unless stated otherwise)

6.3.3. Grants

Accounting policies

Grants

The Group receives grants related to assets, receivable on condition that the Group purchases, produces, or otherwise obtains non-current assets.

Grants related to assets are recognised in the statement of financial position under grants (long-term portion) and other liabilities (short-term), and subsequently taken – through equal annual charges – to profit or loss throughout the expected useful life of the assets.

Grants	2017	2016
Grants related to assets, including:	807	856
Kosakowo UGSC construction	80	89
Wierzchowice UGS extension	421	443
Strachocina UGS extension	55	57
Husów UGS extension	29	31
Construction of gas distribution systems in new areas and upgrades of existing distribution networks	158	164
Other	64	72
Total	**807**	**856**
Including long-term	767	815

Grants related to assets

Group companies are executing projects for which EU co-financing has been obtained.

The largest projects are carried out by the Parent and involve extension of the gas storage capacities to ensure proper operation of the gas distribution system.

In the reporting period under analysis, no new grants was given to PGNiG S.A. for those projects. On the other hand, the company received PLN 0.2m as co-financing from the budget of the Pyzdry Municipality and Town Office in the form of *de minimis* aid for the construction of external gas networks under the project ‘Construction of the Pyzdry gas station’.

In 2016, PGNiG S.A. received PLN 1.8m under the EU grant for the financing of the ‘LNG-based conversion of Ełk and Olecko from propane-butane to E-gas’ project.

In 2016, also Polska Spółka Gazownictwa Sp. z o.o. received a grant, in the amount of PLN 22m. From the European Regional Development Fund (ERDF) under a programme involving construction of gas distribution systems in areas where no such infrastructure had existed before, and upgrades of existing distribution networks.

6.3.4. Other liabilities

Accounting policies

Other liabilities

A subsidiary of the Group, Polska Spółka Gazownictwa Sp. z o.o., as a distribution system operator, recognises as dererred revenue connection charges (received for the provision of the connection service before June 30th 2009).

This income is amortised over time, proportionately to depreciation charges on those connections disclosed under property, plant and equipment.

Other liabilities	2017		2016	
	Non-current	Current	Non-current	Current
Connection charges received in cash	318	20	339	20
Non-depreciable portion of the value of gas service lines provided by gas buyers	186	46	238	47
Prepaid deliveries	-	210	-	212
Accruals and deferred revenue	-	120	-	132
Liabilities under licences, rights to geological information and mining rights	76	-	24	-
Other deferred revenue	4	148	2	121
Other	60	357	66	376
Total	**644**	**901**	**669**	**908**

7. Notes on financial instruments and financial risk management

7.1. Instrumenty finansowe

Accounting policies

The Group holds the following categories of financial instruments:

- Loans and receivables at amortised cost,
- Financial liabilities at amortised cost,
- Financial assets and liabilities at fair value through profit or loss,
- Assets and liabilities hedging specific risks under hedge accounting

Loans and receivables

The Group classifies mainly the following financial assets as loans and receivables:

- Trade receivables (**Note 6.2.2.**),
- Cash and cash equivalents (**Note 5.4.**).

Financial liabilities at amortised cost

This item comprises mainly:

- Trade payables (**Note 6.2.3.**),
- Financing liabilities (**Note 5.2.**).

Financial assets and liabilities at fair value through profit or loss

Derivative financial instruments which are not hedging instruments are classified by the Group as financial assets/liabilities at fair value through profit or loss. For information on accounting policies, see **Note 7.2.**

Assets and liabilities hedging specific risks under hedge accounting

This category comprises derivative instruments to which the Group applies hedge accounting. For description of the applied hedge accounting policies, see **Note 7.2**.

(in PLN million, unless stated otherwise)

7.1.1. Reconciliation of key balance-sheet items of financial assets to groups required under IAS 39

			2017				2016			
Balance-sheet item	**Item referenced in Note**	**Notes**	**Loans and receivables at amortised cost**	**Financial assets at fair value through profit or loss**	**Financial instruments designated for hedge accounting**	**Total**	**Loans and receivables at amortised cost**	**Financial assets at fair value through profit or loss**	**Financial instruments designated for hedge accounting**	**Total**
Receivables	Trade receivables	*Note 6.2.2.*	4,743	-	-	4,743	3,516	-	-	3,516
Derivative financial instruments		*Note 7.2.*	-	425	25	450	-	483	140	623
Cash and cash equivalents		*Note 5.4.*	2,578	-	-	2,578	5,829	-	-	5,829
Total			**7,321**	**425**	**25**	**7,771**	**9,345**	**483**	**140**	**9,968**

7.1.2. Reconciliation of key balance-sheet items of liabilities to groups required under IAS 39

			2017				2016			
Balance-sheet item	**Item referenced in Note**	**Notes**	**Financial liabilities at amortised cost**	**Financial liabilities at fair value through profit or loss**	**Financial instruments designated for hedge accounting**	**Total**	**Financial liabilities at amortised cost**	**Financial liabilities at fair value through profit or loss**	**Financial instruments designated for hedge accounting**	**Total**
Financing liabilities	Bank borrowings	*Note 5.2.*	1,085	-	-	1,085	1,323	-	-	1,323
	Debt securities	*Note 5.2.*	1,898	-	-	1,898	4,984	-	-	4,984
Trade and tax payables	Trade payables	*Note 6.2.3.*	1,326	-	-	1,326	1,290	-	-	1,290
Derivative financial instruments		*Note 7.2.*	-	297	25	322	-	254	92	346
Total			**4,309**	**297**	**25**	**4,631**	**7,597**	**254**	**92**	**7,943**

(in PLN million, unless stated otherwise)

7.1.3. Items of income and expenses related to financial assets and liabilities

Item of statement of profit or loss and statement of comprehensive income	Item referenced in Note / additional explanations	Notes	2017 Loans, receivables and liabilities at amortised cost	2017 Derivative financial instruments not designated for hedge accounting	2017 Derivative financial instruments designated for cash flow hedge accounting	2016 Loans, receivables and liabilities at amortised cost	2016 Derivative financial instruments not designated for hedge accounting	2016 Derivative financial instruments designated for cash flow hedge accounting
Effect on statement of profit or loss								
Net finance costs	Interest on debt	*Note 3.4*	(70)	-	-	(204)	-	-
	Foreign exchange differences	*Note 3.4*	36	-	-	(29)	-	-
	Measurement and exercise of derivative financial instruments not designated for hedge accounting	*Note 3.4*	-	(44)	-	-	59	-
Other income and expenses	Foreign exchange differences	*Note 3.3.*	(122)	-	-	128	-	-
	Impairment losses	*Note 3.3.*	(1)	-	-	(17)	-	-
	Measurement and exercise of derivative financial instruments not designated for hedge accounting	*Note 3.3.*	-	137	-	-	(202)	-
	Reclassification from other comprehensive income	*Note 3.3.*	-	-	-	-	-	37
Raw materials and consumables used	Reclassification from other comprehensive income	*Note 3.2.*	-	-	(12)	-	-	(696)
			(157)	**93**	**(12)**	**(122)**	**(143)**	**(659)**
Effect on other comprehensive income								
Gains/(losses) on measurement of derivative instruments designated for cash flow hedge accounting [effective portion]					(88)			124
Reclassification of derivative instruments valuation to profit or loss upon exercise (cash flow hedges)					12			659
					(76)			**783**
Effect on comprehensive income			**(157)**	**93**	**(88)**	**(122)**	**(143)**	**124**

7.2. Derivative financial instruments

Accounting policies

Derivative financial instruments not designated for hedge accounting

Derivative financial instruments which are not hedging instruments in hedge accounting are classified as financial assets/liabilities at fair value through profit or loss. The instruments are economic hedges.

Derivative instruments at fair value include also derivatives with hedging relationship terminated.

Derivative instruments are initially recognised at fair value and as at each reporting date they are measured at fair value with gains or losses from the measurement recognised in statement of profit or loss under net finance costs (e.g. measurement of instruments hedging financing activity, such as debt liabilities) and other income and expenses (hedging transactions not designated for hedge accounting, e.g. forward contracts).

Hedge accounting

The Group applies hedge accounting to hedge against the risk of movements in gas prices and exchange rates (EUR/PLN and USD/PLN) for future gas purchases. The gas price risk is related to the highly probable future gas purchase transactions. The Group applies cash flow hedge accounting to these transactions.

Derivatives are designated as hedging instruments.

The portion of gains or losses on the hedging instrument that is determined to be an effective hedge is recognised in other comprehensive income. The ineffective portion is charged to net finance costs in the statement of profit or loss. Amounts previously recognised in other comprehensive income are reclassified to profit or loss (line item ‘raw materials and consumables used’) in the period when the hedged item affects profit or loss.

The Group ceases to classify an instrument as a hedge if the derivative expires or is sold, terminated or exercised, if the Group revokes its designation as a hedge, the hedge no longer meets the criteria of hedge accounting, or if the hedged transaction is no longer expected to be executed.

The Group enters into transactions involving the following derivative instruments:

Derivative instruments designated for hedge accounting

Description and purpose of instrument

Currency forwards	A currency forward is a contract for the purchase or sale of a currency for a specified exercise price, with delivery date falling no earlier than after two business days from the date when the forward terms have been agreed. The Group uses currency forwards to hedge against currency risk of USD and EUR exchange rates in future gas purchase contracts.
Currency call options	A currency call option gives the holder the right to purchase a set amount of a currency at a specified price (exercise price). The right may be exercised at the option expiration date (European option). For the right represented by the option the seller receives option premium. The Group buys call options to hedge against adverse movements in USD and EUR exchange rates in future gas purchase contracts.
Commodity call options	A call option gives the holder the right to receive specified payment. The payment amount depends on the arithmetic mean of the value of the underlying instrument computed for the period when the instrument is valid. For the right represented by the option the seller receives option premium. The Group companies buy call options to hedge against movements in prices of TTF gas[1].
Commodity put options	The Group uses put options exclusively under zero-cost collar strategies. The instrument gives the right to receive a specified amount upon exercise. The amount depends on the arithmetic mean of the value of the underlying instrument computed for the period when the instrument is valid. For the right represented by the option the seller receives option premium. The Group companies sell put options to hedge against movements in prices of TTF gas[1].
Commodity swap	A commodity swap is a contract where two parties agree to exchange payments on a specified date. The payments are calculated based on agreed amounts of a specified commodity and its price. In the transaction, one party agrees to pay a fixed price, and the other party pays a floating price. However, no physical exchange of the underlying commodities takes place. The Group companies use the instrument to hedge against movements in prices of TTF gas[1].
IRS	An interest rate swap is an instrument exchanging fixed rate interest payments denominated in PLN for variable rate interest payments on a specified principal amount.

(in PLN million, unless stated otherwise)

Derivative instruments not designated for hedge accounting

Description and purpose of instrument	
CCIRS	A cross currency interest rate swap is an instrument which exchanges cash flows associated with an interest rate and a currency in respect of an agreed base amount at a fixed pre-agreed exchange rate. The Group uses CCIRS to exchange variable rate interest payments denominated in NOK into variable rate interest payments denominated in PLN or fixed rate interest payments denominated in EUR into variable rate interest payments denominated in PLN.
Currency forwards	For instrument description see the previous table.
Electricity futures contracts[2]	A futures contract (futures) is a standard contract enabling the sale or purchase of a commodity in a regulated market for a set exercise price, with a delivery date falling no earlier than after two business days from the date when the terms of the futures contract have been agreed. The Group uses this instrument as economic hedge against price changes in future purchases of electricity and gas.
CO_2 futures contracts	A futures contract is standard contract enabling the sale or purchase of CO_2 emission allowances in a regulated market for a set exercise price, with a delivery date falling no earlier than after two business days from the date when the terms of the futures contract have been agreed. The Group uses this instrument as economic hedge against price changes in future purchases of CO_2 emission allowances.
Electricity and gas forward contracts	A commodity forward is a contract for the purchase or sale of a commodity for a set exercise price, with delivery date falling no earlier than after two business days from the date when the forward terms have been agreed. The Group uses this instrument as economic hedge against price changes in future purchases of electricity and gas. [3]

1. Natural Gas at the Title Transfer Facility (TTF) – an exchange index for natural gas, used in connection with the virtual trading activity conducted by the transmission system operator in the Netherlands
2. EE – Phelix power futures contracts traded at the EEX
electricity and gas forward contracts traded at the Polish Power Exchange

	2017		2016	
	Assets	Liabilities	Assets	Liabilities
Derivative instruments covered by hedge accounting	25	25	140	92
Derivative instruments not covered by hedge accounting	425	297	483	254
Total	**450**	**322**	**623**	**346**

(in PLN million, unless stated otherwise)

Derivative instruments designated for hedge accounting

Type of derivative instrument	2017 Notional amount	2017 Period over which cash flow will occur and affect the financial result	2017 Exercise price (exercise price range)	2017 Weighted average exercise price	2017 Fair value of instruments for which cash flow hedge accounting is applied	2016 Notional amount	2016 Period over which cash flow will occur and affect the financial result	2016 Fair value of instruments for which cash flow hedge accounting is applied
Derivative instruments used to hedge currency risk in gas purchase contracts								
Forward USD	70 USD	1–3 months	3,51-3,72	3.60	(8)	-	-	-
Call options USD	-	-	-	-	-	70 USD	1–3 months	15
					(8)			**15**
Derivative instruments used to hedge gas purchase prices								
TTF call options	2 MWh	1–12 months	16,6-22,0	17.11	13	8 MWh	up to 3 years	83
TTF put options	-	-	-	-	-	0.26 MWh	up to 3 years	(2)
TTF swap	1 MWh	1–12 months	13,72-18,1	14.57	12	4 MWh	up to 3 years	42
TTF swap	0.13 MWh	1–3 months	20,65-20,93	20.74	(1)	5 MWh	up to 3 years	(44)
					24			**79**
Derivative instruments used to hedge interest rate risk								
IRS	-	-	-	-	-	143 PLN	from 6 months to 3.5 years	-
IRS	1,500 PLN	1–3 years	3.65%-4.07%	0.04	(16)	1,500 PLN	1–3 years	(46)
				Total	**-**		**Total**	**48**
			Including:	Assets	25	Including:	Assets	140
				Liabilities	25		Liabilities	92

(in PLN million, unless stated otherwise)

Derivative instruments not designated for hedge accounting

Type of derivative instrument	2017 Notional amount	2017 Fair value of instruments not designated for hedge accounting	2016 Notional amount	2016 Fair value of instruments not designated for hedge accounting
Derivative instruments used to hedge interest rate risk and currency risk				
CCIRS				
EUR	-	-	500 EUR	204
NOK	2,318 NOK	114	2,318 NOK	14
Forward				
EUR	98 EUR	(12)	-	-
		102		**218**
Derivative instruments used as economic hedges of electricity purchase prices				
Forward				
electricity – PPX	476 MWh	36	3 MWh	12
electricity – PPX	882 MWh	(34)	7 MWh	(7)
electricity – OTC	1 MWh	40	1 MWh	22
electricity – OTC	2 MWh	(64)	1 MWh	(39)
Futures				
electricity – EEX AG	2 MWh	71	2 MWh	67
electricity – EEX AG	2 MWh	(47)	1 MWh	(48)
		2		**7**
Derivative instruments used to hedge gas purchase prices				
Forward				
gas - TGE	3 MWh	-	-	-
gas – OTC	15 MWh	94	11 MWh	130
gas – OTC	17 MWh	(113)	11 MWh	(133)
Futures				
gas – ICE ENDEX B.V.	2 MWh	16	1 MWh	13
gas – ICE ENDEX B.V.	2 MWh	(9)	1 MWh	(12)
gas – POWERNEXT SA	4 MWh	28	1 MWh	16
gas – POWERNEXT SA	3 MWh	(17)	1 MWh	(15)
		(1)		**(1)**
Derivatives used as hedges of purchase prices of CO_2 emission allowances				
Forward	7 EUR	-	3 EUR	-
Forward	12 t	(1)	-	-
Futures	11 t	1	2 t	5
Derivative instruments used to hedge prices of property rights to certificates of energy origin – RES				
Forward	0.86 MWh	1	-	-
		1		**-**
Derivative instruments used to hedge share purchase prices				
Options	9	24	-	-
	Total	**128**	**Total**	**229**
	Including:		Including:	
	Assets	425	Assets	483
	Liabilities	297	Liabilities	254

(in PLN million, unless stated otherwise)

Measurement of derivative financial assets and derivative financial liabilities is classified as level 2 in the fair value hierarchy (level 2: valuation based on observable inputs other than quoted prices).

Instrument	Valuation method	Key inputs
Currency call options	Garman Kohl Hagen model	Market data such as interest rates, foreign-exchange rates, basis spreads, commodity prices and volatility of commodity prices
Asian commodity call and put options	Espen Levy model	
Forwards, average rate forwards, swaps, CCIRS and IRS	Discount method	

7.3. Financial risk management policies

In its business activities, the Group is exposed in particular to the following types of financial risk:

- Credit risk **(Note 7.3.1.)**
- Market risk, including:
  - Commodity price risk **(Note 7.3.2.1.)**
  - Currency risk **(Note 7.3.2.2.)**
  - Interest rate risk **(Note 7.3.2.3.)**
- Liquidity risk **(Note 7.3.3.)**

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

7.3.1. Credit risk

Credit risk is defined as the probability of failure by a Group’s trading partner to meet its obligations on time or failure to meet such obligations at all, or the probability that the Group may be unable to recover any monies that have been deposited at a bank or otherwise invested.

The PGNiG Group’s credit exposure arises mostly in connection with the following items:

Maximum risk exposure, equal to the carrying amount of the item	2017	2016
Cash and cash equivalents (cash at banks and bank deposits)	2,578	5,829
Non-current restricted cash	180	190
Trade receivables	4,743	3,516
Loans advanced	573	249
Positive value of derivative financial instruments	450	623
Total	**8,524**	**10,407**

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

Credit risk exposure associated with the individual items specified above is determined by reference to the carrying amounts of those items.

(in PLN million, unless stated otherwise)

7.3.1.1. Credit risk related to cash and bank deposits

The Group seeks to minimize its credit exposure mainly by diversifying the portfolio of the institutions (mostly banks) with which the Group companies place their funds.

As at the reporting date, there was no concentration of credit risk within the Group. As at the end of 2017, the three banks with which the Group deposited the largest amounts of their funds accounted for 36%, 22% and 19% of the Group's total cash, respectively (2016: 38%, 28%, 12%).

Moreover, the parent has concluded Framework Agreements with all its relationship banks. The Framework Agreements stipulate detailed terms of execution and settlement of financial transactions between the parties.

The Group assesses the credit risk by reviewing the banks' financial standings on a regular basis, as reflected in ratings assigned to the banks by rating agencies.

The Group places its funds in a diversified portfolio of deposits held with reputable banks – the breakdown of the portfolio is presented below (the table also provides information on any derivatives contracts entered into with the financial institutions (where the Group carries assets in connection with such contracts)).

	Rating assigned by	2017		2016	
	Fitch	Bank deposits	Derivative instruments (assets)	Bank deposits	Derivative instruments (assets)
Bank\Financial Institution	A+	0%	0%	12%	6%
Bank\Financial Institution	A	4%	4%	28%	0%
Bank\Financial Institution	A-	88%	19%	50%	8%
Bank\Financial Institution	A1 (Moody's)	0%	0%	0%	2%
Bank\Financial Institution	A2	0%	7%	7%	26%
Bank\Financial Institution	A2 (Moody's)	0%	0%	0%	3%
Bank\Financial Institution	A3 (Moody's)	1%	0%	0%	2%
Bank\Financial Institution	AA-	0%	0%	0%	3%
Bank\Financial Institution	BBB+	0%	0%	0%	7%
Bank\Financial Institution	BBB	4%	0%	2%	0%
Exchanges	-	0%	26%	0%	16%
OTC market	-	0%	38%	0%	26%
Bank\Financial Institution, other	-	3%	6%	1%	1%
Total		**100%**	**100%**	**100%**	**100%**

7.3.1.2. Credit risk related to receivables

The Group is exposed to credit risk of material value in connection with its trade receivables (i.e. amounts it is owed for any natural gas, LNG, crude oil or electricity the Group has sold) and other receivables (i.e. amounts owed to the Group for sold CO_2 emission allowances and certificates of origin for electricity).

Some of the Group's gas sales transactions are effected via the Polish Power Exchange ("PPX"). Transactions made at the Polish Power Exchange do not generate exposure to credit risk, as the system of guaranteed settlements operated by the Commodity Exchange Clearing House protects Clearing House members against insolvency of individual market participants. These transactions account for about 55% of the Group's annual revenue. As at the reporting date, outstanding balances from settlement of transactions effected via the PPX were not material.

In order to minimise the risk of uncollectible receivables arising in connection with sale transactions executed outside of the PPE, uniform rules designed to secure trade receivables are in place.

In line with the procedures applied by the Group, each institutional trading partner's ability to meet current and future contractual obligations is assessed on a regular basis. Results of such assessment are used to determine individual credit limits granted to trading partners and the terms and conditions of the agreement, including the methods of settlement and potentially the security to be provided by the trading partners. The Group also minimizes its trade receivables credit risk by continuously monitoring the financial condition of each of its trading partners and taking appropriate measures to collect any debt in compliance with the procedures operated by the Group.

(in PLN million, unless stated otherwise)

With respect to private customers, the Group's debt collection teams continuously monitor the balance of a customer's past-due receivables from the day when such arrears first arise. As part of the internal pre-litigation process, standard debt collection steps are taken: notification to the trading partners of overdue payments (by SMS, email or phone call), payment notice, notification and suspension of gas supply pursuant to Art. 6b.1.2) of the Energy Law. As a last resort, the Company terminates contracts due to non-payment, And the case is referred to court and subject to enforcement proceedings. Any debt that has not been recovered by the Group as part of its internal procedures is sold.

There is no credit risk concentration within the Group. As at December 31st 2017, trade receivables from the Group's three largest customers accounted for 10.4%, 2.1%, and 1.5% of the total balance of trade receivables, respectively (December 31st 2016: 4.7%, 2.8%, and 2.7%, respectively).

7.3.1.3. Credit risk related to derivative transactions

Transactions in financial derivatives are executed with most reputable banks with high credit ratings. The Group has also concluded either Framework Agreements or ISDA Agreements with each of their relationship banks, stipulating detailed terms of service and limits of maximum exposure arising from the fair value of derivatives. The Group believes that all the measures described above protect it against any material credit-risk-related losses.

The relationship banks' credit ratings are presented in **Note 7.3.1.1**.

As at December 31st 2017, the shares of the three counterparty banks which accounted the largest proportion (in value terms) of transactions in derivative instruments with positive valuations were 61%, 23%, and 5% (2016: 18%, 8%, and 7%). Market risk

Market risk is defined as the risk of the Group's financial results or economic value being adversely affected by changes in the financial and commodity markets.

In line with the adopted policy, the purpose of the market risk management process in place at the Group is to:

- Reduce the volatility of cash flows related to the Group's operations to acceptable levels in the short- and medium term
- Build company value in the long term.

Considering potential impacts on its financial results, the Group has identified the following market risks:

Impact on financial results

Market risk	Approach to risk management
Natural gas and oil product prices	The Group manages the risk by purchasing derivatives to hedge natural gas prices.
EUR/PLN, USD/PLN and NOK/PLN exchange rates	[see above] The risk is mainly related to trade payables and debt instruments in issue. The Group hedges the risk by making purchases in the same currency.
Interest rates	The Group hedges the risk by purchasing derivatives.
Other commodity prices	The risk considered immaterial.

(in PLN million, unless stated otherwise)

7.3.1.4. Commodity price risk

Commodity price risk is defined as the risk of the Group's financial results being adversely affected by changes in commodity prices.

The Group's exposure to commodity price risk arises mainly in connection with its gas fuel purchase and sale contracts entered into as part of daily trading activities on the PPX. It stems from volatility of prices of gas and oil products quoted on global markets. Under some of the contracts for gas fuel supply, the pricing formula relies on a weighted average of the prices recorded in previous months, which mitigates the volatility risk.

Commodity risk is also related to electricity trading, certificates of origin, and carbon credits. Trade in electricity is carried out on regulated exchange markets in Poland and abroad. The Group also executes transactions outside of regulated markets, under framework agreements. Commodity risk exposure is managed by mechanisms for identifying, calculating and monitoring exposure levels, as well as by valuation of open positions, value-at-risk measurement, and market risk limits.

In 2017 and 2016, the Group applied cash flow hedge accounting to hedge against fluctuations in natural gas prices. For details on hedge accounting, see **Note 7.2**.

For prices of electricity, carbon credits and certificates of origin, the Group applies economic hedges, but does not apply hedge accounting. For more information on derivatives not designated for hedge accounting, see **Note 7.2**.

The tables below present an analysis of sensitivity of material energy commodity derivatives (TTF) to price changes in 2017 and 2016.

2017	Carrying amount	TTF, EE - price change by:			
		+20%		-20%	
		Profit/(loss)	Other comprehensive income	Profit/(loss)	Other comprehensive income
Energy commodity derivative assets	312	45	-	10	-
Energy commodity derivative liabilities	286	(10)	-	(28)	-
Effect of TTF, EE* price changes		**35**	**-**	**(18)**	**-**

*The abbreviations TTF and EE are explained in Note 7.2.

2016	Carrying amount	TTF, EE - price change by:			
		+25%		-25%	
		Profit/(loss)	Other comprehensive income	Profit/(loss)	Other comprehensive income
Energy commodity derivative assets	389	31	248	2	-
Energy commodity derivative liabilities	299	(7)	-	(34)	(164)
Effect of TTF, EE* price changes		**24**	**248**	**(32)**	**(164)**

*The abbreviations TTF and EE are explained in Note 7.2.

7.3.1.5. Currency risk

Currency risk is defined as the risk of the Group's financial results being adversely affected by changes in the price of one currency against another.

Currency risk largely arises on account of fluctuations in the EUR/PLN, USD/PLN and NOK/PLN exchange rates, And it mainly affects the Parent. The key sources of exposure include:

- Trade payables (mainly in respect of natural gas purchased by the Group (**Note 6.2.3**.),
- EUR-denominated debt securities in issue (**Note 5.2**.),
- CCIRS hedging a NOK-denominated loan to PGNiG Upstream Norway AS (the loan is eliminated in the consolidated financial statements) (**Note 7.2.**), and
- Cash and cash equivalents (**Note 5.4.**).

The hedging measures implemented by the Group are mainly intended to provide protection against currency risk. For details of the hedging transactions, see **Note 7.2**.

In 2017, the Group used derivative instruments to hedge against currency risk associated with trade payables denominated in foreign currencies (chiefly USD and EUR), including European call options and forwards. For detailed information on derivative transactions executed by the Group (derivatives designated for hedge accounting and economic hedges not designated for hedge accounting), see **Note 7.2**.

The table below presents the Group's exposure to currency risk arising in connection with material items denominated in foreign currencies, and an analysis of the Group's sensitivity to the risk of movements in foreign exchange rates that the Group considers to be reasonably possible as at the reporting date (December 31st 2017).

(in PLN million, unless stated otherwise)

2017	Carrying amount	Value at risk	EUR/PLN				USD/PLN				NOK/PLN				
			Exchange rate change: +10%		Exchange rate change: -10%		Exchange rate change: +10%		Exchange rate change: -10%		Exchange rate change: +10%		Exchange rate change: -10%		
			Profit/ (loss)	Other comprehensive income	Profit/ (loss)	Other comprehensive income	Profit/ (loss)	Other comprehensive income	Profit/ (loss)	Other comprehensive income	Profit/ (loss)	Other comprehensive income	Profit/ (loss)	Other comprehensive income	
Financial assets															
Trade receivables	4,743	1,164	66	-	(66)	-	21	-	(21)	-	2	-	(2)	-	*Note 6.2.2.*
Derivative financial instruments (assets)	450	114	2	-	-	-	-	20	-	-	-	-	86	-	*Note 7.2.*
Cash and cash equivalents	2,578	246	15	-	(15)	-	3	-	(3)	-	-	-	-	-	*Note 5.4.*
Financial liabilities															
Financing liability	3,006	827	(44)	-	44	-	(23)	-	23	-	-	-	-	-	*Note 5.2.*
Trade payables	1,326	904	(29)	-	29	-	(40)	-	40	-	(2)	-	2	-	*Note 6.2.3.*
Derivative financial instruments (liabilities)	322	20	-	-	(2)	-	-	-	-	(20)	(86)	-	-	-	*Note 7.2.*
Effect of exchange rate movements			**10**	**-**	**(10)**	**-**	**(39)**	**20**	**39**	**(20)**	**(86)**	**-**	**86**	**-**	

2016	Carrying amount	Value at risk	EUR/PLN				USD/PLN				NOK/PLN				
			Exchange rate change: +10%		Exchange rate change: -10%		Exchange rate change: +10%		Exchange rate change: -10%		Exchange rate change: +10%		Exchange rate change: -10%		
			Profit/ (loss)	Other comprehensive income	Profit/ (loss)	Other comprehensive income	Profit/ (loss)	Other comprehensive income	Profit/ (loss)	Other comprehensive income	Profit/ (loss)	Other comprehensive income	Profit/ (loss)	Other comprehensive income	
Financial assets															
Trade receivables	3,516	686	32	-	(32)	-	19	-	(19)	-	1	-	(1)	-	*Note 6.2.2.*
Derivative financial instruments (assets)	623	233	187	-	-	-	-	24	-	-	-	-	94	-	*Note 7.2.*
Cash and cash equivalents	5,829	640	18	-	(18)	-	32	-	(32)	-	-	-	-	-	*Note 5.4.*
Financial liabilities															
Financing liability	6,352	3,609	(243)	-	243	-	(49)	-	49	-	-	-	-	-	*Note 5.2.*
Trade payables	1,290	939	(23)	-	23	-	(48)	-	48	-	(2)	-	2	-	*Note 6.2.3.*
Derivative financial instruments (liabilities)	346	-	-	-	(187)	-	-	-	-	(12)	(94)	-	-	-	*Note 7.2.*
Effect of exchange rate movements			**(29)**	**-**	**29**	**-**	**(46)**	**24**	**46**	**(12)**	**(95)**	**-**	**95**	**-**	

(in PLN million, unless stated otherwise)

7.3.1.6. Interest rate risk

Interest rate risk is defined as the risk of the Group's financial results being adversely affected by changes in interest rates.

The Group is exposed to interest rate risk primarily in connection with its:

- Cash and cash equivalents (bank deposits) (**Note 5.4.**).
- Financing liabilities (**Note 5.2**.),
- CCIRS and IRS not designated for hedge accounting (**Note 7.2**.).

Market risk (currency and interest rate risk) is monitored by the Group through sensitivity analysis and VaR measurement. VaR (value at sk) means that the maximum loss arising from a change in the market (fair) value will not exceed that value over the next n business days, given a specified probability level (e.g. 99%). VaR is estimated using the variance-covariance method. VaR is estimated using the variance-covariance method.

Items bearing variable-rate interest expose the Group to the risk of interest rate movements causing changes in cash flows associated with a given item by affecting interest income/expense recognised in profit or loss. Items bearing fixed-rate interest expose the Group to the risk of fair value changes. However, since the items are measured at amortised cost (save for derivatives), any such change has no impact on their carrying amounts or on profit or loss.

The table below presents key items exposed to interest rate risk, and an analysis of the Group's sensitivity to interest rate movements affecting items bearing variable-rate interest, which the Group considers reasonably possible as at the reporting date.

	2017				2016				
	Carrying amount	Balances bearing interest at variable rate	Interest rate movement: +30 pb	Interest rate movement: - 30 pb	Carrying amount	Balances bearing interest at variable rate	Interest rate movement: +40 pb	Interest rate movement: - 40 pb	
Cash and cash equivalents	2,578	907	3	(3)	5,829	4,593	18	(18)	*Note 5.4.*
CIRS not designated for hedge accounting (assets)	102	983	-	-	218	3,340	(9)	9	*Note 7.2.*
Financing liabilities	3,006	1,104	(3)	3	6,352	4,062	(16)	16	*Note 5.2.*
IRS designated for hedge accounting (liabilities)	16	1,500	5	(5)	46	1,500	6	(6)	*Note 7.2.*
Effect after hedge accounting			**5**	**(5)**			**(1)**	**1**	

(in PLN million, unless stated otherwise)

7.3.2. Liquidity risk

Liquidity risk is defined as the risk of inadequate liquidity restricting the Group's ability to finance its capital requirements or the risk of structural excess liquidity adversely affecting profitability of the Group's business.

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

The liquidity risk should not be associated exclusively with the risk of loss of liquidity by the Group. An equally serious threat is that of having excess structural liquidity, which could adversely affect the Group's profitability. The Group monitors and plans its liquidity levels on a continuous basis. As at December 31st 2017, the Group did not carry any amounts outstanding under overdraft facilities.

To enhance its liquidity position, the Group has launched several note issuance programmes. For details on note issue, see **Note 5.2**.

The Group companies have also contracted lines of credit, as set out in **Note 5.2.1.**

The liquidity risk at the Parent is significantly mitigated through the application of the "PGNiG S.A. Liquidity Management Procedure". which ensures proper financial liquidity management through:

- Settlement of payments,
- Cash flow forecasting,
- Optimal free cash management,
- Raising and restructuring funds used to finance day-to-day operations and investment projects,
- Providing protection against temporary liquidity constraints resulting from unforeseen disruptions, and servicing contracted bank loans.

Measurement of the liquidity risk is based on ongoing detailed monitoring of cash flows, which takes into account the probability that specific flows will materialise, as well as the planned net cash position.
The tables below present maturities of financial liabilities at contractual undiscounted amounts.

2017	Time to contractual maturity at the reporting date					Total	Carrying amount
	Up to 3 months	3–12 months	1-3 years	3-5 years	over 5 years		
Financing liabilities							
Bank borrowings	4	136	311	474	160	**1,085**	**1,085**
Debt securities	1,900	-	-	-	-	**1,900**	**1,898**
Other	4	12	6	1	-	**23**	**23**
Trade payables	2,190	49	64	35	38	**2,376**	**2,376**
Derivative financial liabilities							
IRS designated for hedge accounting							
- inflows	15	16	-	-	-	**31**	**-**
- outflows	(15)	(15)	-	-	-	**(30)**	**16**
Forward							
- inflows	857	573	853	1	-	**2,284**	**-**
- outflows	(120)	(514)	(809)	-	-	**(1,443)**	**232**
Other derivative instruments							
- inflows	5	9	1	-	-	**15**	**-**
- outflows	(1)	-	(5)	-	-	**(6)**	**74**
Financial liabilities (outflows)	**4,234**	**726**	**1,195**	**510**	**198**	**6,863**	**-**
Financial liabilities, including inflows from derivatives	**3,357**	**128**	**341**	**509**	**198**	**4,533**	**5,704**

(in PLN million, unless stated otherwise)

2016	Time to contractual maturity at the reporting date					Total	Carrying amount
	Up to 3 months	3–12 months	1-3 years	3-5 years	over 5 years		
Financing liabilities							
Bank borrowings	23	120	256	504	420	**1,323**	**1,323**
Debt securities	2,338	2,500	103	41	-	**4,982**	**4,984**
Other	8	18	27	-	-	**53**	**45**
Trade payables	2,168	53	34	11	45	**2,311**	**2,311**
Derivative financial liabilities							
IRS designated for hedge accounting							
- inflows	15	46	91	-	-	**152**	**-**
- outflows	(15)	(45)	(88)	-	-	**(148)**	**46**
Forward							
- inflows	405	639	200	-	-	**1,244**	**-**
- outflows	(408)	(614)	(114)	(1)	-	**(1,137)**	**179**
Other derivative instruments							
- inflows	-	-	-	40	-	**40**	**-**
- outflows	(16)	(47)	(20)	-	-	**(83)**	**121**
Financial liabilities (outflows)	**4,976**	**3,397**	**642**	**557**	**465**	**10,037**	**-**
Financial liabilities, including inflows from derivatives	**4,556**	**2,712**	**351**	**517**	**465**	**8,601**	**9,009**

(in PLN million, unless stated otherwise)

8. Other notes

8.1. Share capital and share premium

2017	Number of shares	Total par value	% of share capital / total voting rights held
Shareholder			
State Treasury	4,153,706,157	4,153,706,157	71.88%
Other shareholders	1,624,608,700	1,624,608,700	28.12%
Total	**5,778,314,857**	**5,778,314,857**	**100.00%**

2016	Number of shares	Total par value	% of share capital / total voting rights held
Shareholder			
State Treasury	4,153,706,157	4,153,706,157	71.88%
Other shareholders	1,624,608,700	1,624,608,700	28.12%
Total	**5,778,314,857**	**5,778,314,857**	**100.00%**

8.2. Earnings per share

Accounting policies

Basic earnings per share are calculated by dividing net profit/(loss) attributable to holders of the Parent's ordinary shares for a given reporting period by the weighted average number of outstanding ordinary shares in the reporting period.

Diluted earnings per share are calculated by dividing net profit/(loss) attributable to holders of the ordinary shares for a given reporting period (less interest on redeemable preference shares convertible into ordinary shares) by the weighted average number of outstanding ordinary shares in the reporting period (adjusted for the effect of dilutive options and dilutive redeemable preference shares convertible into ordinary shares).

The Group's diluted earnings per share are equal to basic earnings per share because the Group has no instruments with a dilutive effect.

Earnings per share and the weighted average number of ordinary shares are presented in the consolidated statement of profit or loss.

8.3. Assets held for sale

Accounting policies

The Group classifies a non-current asset (or disposal group) as held for sale if its carrying amount is to be recovered principally through a sale transaction rather than through continuing use. Non-current assets held for sale are measured at the lower of their net carrying amount and fair value less cost to sell. If the fair value is lower than the net carrying amount, the difference is charged to profit or loss as an impairment loss.

Asset (disposal group) held for sale	Terms and expected date of disposal	Carrying amount	
		2017	2016
Shares in held-for-sale companies	According to the valuation by an expert appraiser and as determined in negotiations (sale expected in 2018)	3	3
Property (office building) in Kraków, ul. Lubicz 25	Sale in progress	40	-
Other non-current assets held for sale	Tender (sale expected in 2018 or 2019)	23	54
Total		**66**	**57**

(in PLN million, unless stated otherwise)

8.4. Other assets

Accounting policies

Loans advanced are initially recognised at fair value and as at each reporting date are measured at amortised cost, using the effective interest rate method.

Non-current restricted cash represents cash of the Extraction Facilities Decommissioning Fund, accumulated by the Parent in a separate bank account from the first day of operation to the start of decommissioning of extraction facilities. The Fund's cash is increased by the amount of interest accruing on the Fund's assets. Due to formal and legal limitations on the use of this cash (it may only be applied towards specific long-term objectives), the assets accumulated in the Extraction Facilities Decommissioning Fund are recognised in the Group's statement of financial position as other assets under non-current assets. The amount of the provision for decommissioning of production and storage wells is adjusted for any unused contributions to the Extraction Facilities Decommissioning Fund (Note 6.1.1.1).

Connection charge is disclosed under accrued income. The charge amount is accounted for throughout the average useful lives of the relevant assets.

Unlisted shares are measured at cost (less impairment losses, if any) because their fair value cannot be measured reliably.

Amounts receivable under long-term contracts are the excess of recognised income (measured using the percentage of completion method) over progress billings.

Other non-current assets and other current assets include mainly prepayments.

	2017	2016
Other non-current assets	**1,055**	**679**
Loans advanced	242	235
Non-current restricted cash	180	190
Connection charge	128	125
Unlisted shares	26	82
Investment property	157	19
Prepayments for other tangible assets under construction, not related to exploration	186	5
Financial receivables (deposits, guarantees, and other)	99	1
Other non-current assets	37	22
Other current assets	**216**	**129**
Amounts receivable under long-term contracts	19	27
Other current assets	197	102

(in PLN million, unless stated otherwise)

8.5. Contingent assets and liabilities

Contingent asset	2017	2016
	Estimated amount	
Promissory notes received	3	-
Grants awarded	172	-
Other contingent assets	15	1
Total	**190**	**1**

In the reporting period, other contingent assets increased mainly due to agreements for EU grants executed by a Group company.

Contingent liability	2017	2016
	Estimated amount	
Guarantees and sureties	3,537	8,006
Promissory notes	702	708
Other	11	28
Total	**4,250**	**8,742**

The decrease in contingent liabilities under guarantees and sureties issued as at the end of 2017 is primarily attributable to the expiry of a guarantee which served as security for the performance of PGNiG Finance AB i likvidation's obligations towards bondholders under the Eurobond programme (for more information, see **Note 5.2.**).

Other contingent liabilities decreased following amicable resolution of a contract dispute by a Group company (the parties agreed to waive their mutual claims).

8.6. Joint operations

Accounting policies

In relation to its interest in **joint operations**, the Group, as a joint operator, recognises in its financial statements:

- its assets, including its share of any assets held jointly,
- its liabilities, including its share of any liabilities incurred jointly,
- its revenue from the sale of its share of the output arising from the joint operation;
- its share of the revenue from the sale of the output by the joint operation; and
- its expenses, including its share of any expenses incurred jointly.

As assets, liabilities, revenues and costs relating to the joint operation are also disclosed in the separate financial statements of the party, these items are not subject to adjustment or other consolidation procedures when preparing consolidated financial statements of that party.

Figure 2 Countries where the Group conducts joint operations

The Group is involved in joint operations mainly in Poland, and also in Norway and Pakistan. They consist mainly in exploration for and production of natural gas and crude oil, except for operations conducted in south-eastern Poland, where they involve an initial stage of exploration for unconventional deposits of gas.

Material estimates

As at the end of the reporting period, the Group was involved in joint ventures, as defined in IFRS 11, as part of projects carried out in Norway in the PL460 and PL856 licence areas, of which, considering all facts and circumstances, it had joint control.

As at December 31st 2017, the Group also held interests in other licences on the Norwegian Continental Shelf, covering, among others, the Skarv, Gina Krog, Morvin, Vilje, and Vale fields. Considering the IFRS 11 criteria, the Group's operations in the above fields do not represent joint arrangements as defined in the standard and the Group does not have joint control of the operations as there is more than one combination of parties that can agree to make significant decisions. Therefore, for the purpose of correct recognition and measurement of transactions related to the operations in those fields, the Group applies other relevant IFRSs taking into account its interest in the fields, which ensures that there are no material differences in the accounting recognition and measurement of transactions related to these operations and the manner of recognising operations which are carried out jointly with the PL460 and PL856 licence interest holders and meet the definition of joint operations within the meaning of IFRS 11.

For more information on joint operations, see the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in 2017.

(in PLN million, unless stated otherwise)

A detailed list of joint operations in which the Group is involved is presented in the tables below.

2017

Name of joint contractual arrangement	Country where joint operation is conducted	Interests in joint operations	Business of joint operations
Joint operation in the Sieraków licence area	Poland	PGNiG S.A. 51%; Orlen Upstream Sp. z o.o. 49%	Oil and gas exploration and production
Joint operation in the Płotki licence area	Poland	PGNiG S.A. 51%; FX Energy (Grupa ORLEN) 49%	Oil and gas exploration and production
Joint operation in the PTZ Zaniemyśl licence area	Poland	PGNiG S.A. 51%; FX Energy 24.5%; Cal Energy 24.5%	Oil and gas exploration and production
Joint operation in the Kamień Pomorski licence area	Poland	PGNiG S.A. 51%; LOTOS Petrobaltic S.A. 49%	Oil and gas exploration and production
Joint operation in the Górowo Iławieckie licence area	Poland	PGNiG S.A. 51%; LOTOS Petrobaltic S.A. 49%	Oil and gas exploration and production
Joint operation in the Poznań licence area	Poland	PGNiG S.A. 51%; FX Energy (Grupa ORLEN) 49%	Oil and gas exploration and production
Joint operation in the Bieszczady licence area	Poland	PGNiG S.A. 51%; ORLEN Upstream sp. z o.o. 49%	Oil and gas exploration and production
Joint operation in the Warszawa Południe licence area	Poland	PGNiG S.A. 49%; FX Energy (Grupa ORLEN) 51%	Oil and gas exploration and production
Joint operation in the Kirthar licence area	Pakistan	PGNiG S.A. 70%; Pakistan Petroleum Ltd. 30%	Oil and gas exploration and production
Joint operation in the PL460 licence area	Norway	PGNiG UN 35%, AkerBP 65%	Oil and gas exploration and production
Joint operation in the PL856 licence area	Norway	PGNiG UN 25%, Capricorn 75%	Oil and gas exploration and production

2016

Name of joint contractual arrangement	Country where joint operation is conducted	Interests in joint operations	Business of joint operations
Joint operation in the Sieraków licence area	Poland	PGNiG S.A. 51%; Orlen Upstream Sp. z o.o. 49%	Oil and gas exploration and production
Joint operation in the Płotki-PTZ (the Extended Zaniemyśl Area) licence area	Poland	PGNiG S.A. 51%; FX Energy 24.5%; Cal Energy 24.5%	Oil and gas exploration and production
Joint operation in the Kamień Pomorski licence area	Poland	PGNiG S.A. 51%; LOTOS Petrobaltic S.A. 49%	Oil and gas exploration and production
Joint operation in the Górowo Iławieckie licence area	Poland	PGNiG S.A. 51%; LOTOS Petrobaltic S.A. 49%	Oil and gas exploration and production
Joint operation in a subdivision of the Lubben licence area in east Germany (Brandenburg)	Germany	PGNiG S.A. 36%; Central European Petroleum Gmbh 39%;Rohöl-Aufsuchungs AG 25%	Oil and gas exploration and production
Joint operation in the Poznań licence area	Poland	PGNiG S.A. 51%; FX Energy 49%	Oil and gas exploration and production
Joint operation in the Płotki licence area	Poland	PGNiG S.A. 51%; FX Energy 49%	Oil and gas exploration and production
Joint operation in the Bieszczady licence area	Poland	PGNiG S.A. 51%; ORLEN Upstream sp. z o.o. 49%	Oil and gas exploration and production
Joint operation in the Warszawa-Południe licence area (blocks 254 and 255)	Poland	PGNiG S.A. 49%; FX Energy 51%	Oil and gas exploration and production
Joint operation covering part of Przedsudecka Monocline	Poland	PGNiG S.A. 51%; FX Energy 49%	Oil and gas exploration and production
Joint operation in the Kirthar licence area	Pakistan	PGNiG S.A. 70%; Pakistan Petroleum Ltd. 30%	Oil and gas exploration and production
Joint operation in the PL703 licence area	Norway	PGNiG UN 40%, OMV 60%	Oil and gas exploration and production
Joint operation in the PL856 licence area	Norway	PGNiG UN 25%, Capricorn 75%	Oil and gas exploration and production

(in PLN million, unless stated otherwise)

8.7. Changes in the Group structure in the reporting period

Date	Company	Event
March 10th 2017	PSG Inwestycje Sp. z o.o.	The Extraordinary General Meeting of Powiśle Park Sp. z o.o. passed a resolution to change the company's name from Powiśle Park Sp. z o.o. to PSG Inwestycje Sp. z o.o. The change was entered in the National Court Register on March 20th 2017.
March 18th 2017	PGNiG Upstream Norway AS	The change of name of PGNiG Upstream International AS to PGNiG Upstream Norway AS was entered in the Norwegian register of commercial companies.
September 1st 2017	PGNiG TERMIKA Energetyka Przemysłowa S.A.	The merger of PGNiG TERMIKA Energetyka Przemysłowa S.A. and Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie-Zdrój was registered with the National Court Register, with PGNiG TERMIKA Energetyka Przemysłowa S.A. as the acquirer.
December 29th 2017	PGNiG Upstream North Africa B.V.	POGC Libya B.V. changed its business name to PGNiG Upstream North Africa B.V.

8.8. Other relevant information

8.8.1. Auditor fees

	2017	2016
Audit of the full-year separate financial statements and the full-year consolidated financial statements of the Group	1,97	1,83
Other assurance services, including review of financial statements	0,29	0,33
Other services	0,20	0,26
Total	**2,46**	**2,42**

In the period covered by these financial statements, Deloitte Polska Sp. z o.o. Sp.k. was the entity qualified to audit and review financial statements of PGNiG S.A. and some of subsidiaries and consolidated financial statements of the PGNiG Group. The agreement was concluded on May 5th 2016 and covers the years 2016-2018.

In addition, Deloitte Polska Sp. z o.o. Sp.k. it provided review services and other allowed services for companies from the Capital Group.

8.8.2. Other information

Acquisition of Polimex-Mostostal S.A. shares

On January 18th 2017, an Investment Agreement was signed between the Investors (PGNiG Technologie S.A., a subsidiary of PGNiG; Enea S.A.; Energa S.A.; PGE Polska Grupa Energetyczna S.A.) and Polimex-Mostostal S.A. (Polimex), under which the Investors took up a total of 150 million of Polimex shares.

Based in Warsaw, Polimex is an engineering and construction company offering a wide range of general contractor services. The company is listed on the Warsaw Stock Exchange.

PGNiG Technologie S.A. acquired 37,500,000 new shares in Polimex, with a par value of PLN 2 per share, for a total of PLN 75m. The share capital increase was registered with the National Court Register on February 21st 2017. In addition, under the agreement with SPV Operator Sp. z o.o., PGNiG Technologie acquired 1,500,000 Polimex shares for a total price of PLN 5,640 thousand (PLN 3.76 per share). On April 26th 2017, following a tender offer, PGNiG Technologie S.A. acquired additional 24 shares in Polimex. As a result, PGNiG Technologie's equity interest in Polimex-Mostostal S.A. is currently at 16.48%.

Under the Investment Agreement, investors have the power to direct Polimex's financial and operating policies. This power is exercised by the Supervisory Board. In accordance with the Agreement, the Supervisory Board is composed of three members proposed by the Investors.

The Investors also signed a memorandum of understanding concerning investment in Polimex (MoU). The MoU was executed to ensure increased control over Polimex by Investors holding jointly the majority (66%) of voting rights in the company. Among other things, the parties to the MoU agreed to reach, by voting, common positions when making key decisions on matters falling within the powers of the Polimex General Meeting and the Supervisory Board, including on the composition of the Polimex Management Board.

(in PLN million, unless stated otherwise)

In view of the Investors' right referred to above, which gives them significant influence over Polimex, the interest in Polimex is classified as an associate accounted for in the consolidated financial statements of the PGNiG Group with the equity method (for more information, see **Note 2.4.**).

8.9. Events subsequent to the end of the reporting period

Date	Company	Event
January 15th 2018	PGNiG Finance AB i likvidation	The resolution on liquidation of PGNiG Finance AB of Stockholm was registered. As of January 15th 2018, the company's name is PGNiG Finance AB i likvidation
January 19th 2018	PGNiG S.A.	An agreement was concluded with the TSO company Operator Systemu Przesyłowego Gaz-System S.A. (Gaz System S.A.) for the provision of gas transmission services from October 1st 2022 to September 30th 2037, as part of the 2017 Open Season procedure of the Baltic Pipe project (transmission contract) regarding gas transmission from Norway to Poland via Denmark. On January 29th 2018 an agreement was concluded with the Danish transmission system operator Energinet for the provision of gas transmission services from October 1st 2022 to September 30th 2037, as part of the 2017 Open Season procedure of the Baltic Pipe project (transmission contract) concerning gas transmission from Norway to Poland via Denmark. Conclusion of transmission contracts with transmission system operators, i.e. Gaz-System S.A. and Energinet with a total value of PLN 8.1bn is the last stage of the Open Season 2017 procedure (for more information, see Current Report No. 90/2017 of October 31st 2017).
January 25th 2018	Polska Spółka Gazownictwa sp. z o.o.	By decision of January 25th 2018, the President of the Energy Regulatory Office ("President of URE") approved the new Tariff No. 6 for gas fuel distribution and liquefied natural gas regasification services provided by Polska Spółka Gazownictwa sp. z o.o. ("Distribution Tariff"). The average reduction of prices and rates of network fees used for settlements with customers in the Distribution Tariff in relation to the current tariff of Polska Spółka Gazownictwa sp. o.o. for all tariff groups is 7.37%. Pursuant to the Energy Law, the Distribution Tariff should come into effect within no more than 45 days from the date of its publication by the President of URE. In accordance with the decision of the President of URE, the new Distribution Tariff expires on December 31st 2018. For detailed information on the approved tariff, see www.ure.gov.pl and Biuletyn Branżowy URE – Paliwa gazowe (the URE official gazette – Gaseous fuels).
March 8th 2018	Elektrociepłownia Stalowa Wola S.A.	Elektrociepłownia Stalowa Wola S.A. ("Borrower") signed a loan agreement with Bank Gospodarstwa Krajowego ("BGK") and PGNiG. Under the agreement, the Borrower will be provided with a loan of PLN 450m by each lender, of which PLN 600m will be used to refinance the Borrower's debt owed to PGNiG and Tauron Polska Energia S.A. and PLN 300m will be used to fund new capital expenditure. The loan is due to be repaid on June 14th 2030.

PGNiG S.A. 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, March 12th 2018

Polskie Górnictwo Naftowe i Gazownictwo S.A.

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

2017

PGNiG

Definitions

Whenever any of the following acronyms and terms appear in this Directors' Report on the Operations of the PGNiG Group in 2017 and nothing to the contrary is stated herein, these acronyms and terms should be interpreted as follows:

Proper names of companies and branches **PGNiG, Company** or **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 the subsidiaries; **CLPB** – Oddział Centralne Laboratorium Pomiarowo-Badawcze PGNiG S.A.; **ECSW** – Elektrociepłownia Stalowa Wola S.A.; **EXALO** – EXALO Drilling S.A.; **Gazoprojekt** – PGNiG Gazoprojekt S.A.; **GEOFIZYKA Kraków** – GEOFIZYKA Kraków Sp. z o.o. w likwidacji; **GEOFIZYKA Toruń** – GEOFIZYKA Toruń Sp. z o.o.; **GEOVITA** – GEOVITA S.A.; **GSP** – Gas Storage Poland Sp. z o.o.; **PGNiG OD** – PGNiG Obrót Detaliczny Sp. z o.o.; **PGNiG Technologie** – PGNiG Technologie Sp. z o.o.; **PGNiG TERMIKA** – PGNiG TERMIKA S.A.; **PGNiG TERMIKA EP** – PGNiG TERMIKA Energetyka Przemysłowa S.A.; **PGNiG UN** – PGNiG Upstream Norway AS; **PGNiG UNA** – PGNiG UPSTREAM NORTH AFRICA B.V.; **PSG** – Polska Spółka Gazownictwa Sp. z o.o.; **PST** – PGNiG Supply & Trading GmbH; **PST ES –** PST Europe Sales GmbH.

Names of institutions, capital market entities and energy markets: **EEX** – European Energy Exchange (an energy exchange in Germany); **GASPOOL** – GASPOOL Balancing Services GmbH (a hub in Germany); **GAZ-SYSTEM** – Operator Gazociągów Przesyłowych GAZ-SYSTEM S.A.; **WSE –** Warsaw Stock Exchange (Giełda Papierów Wartościowych w Warszawie S.A.); **National Court Register** – National Court Register; **NCG** – NetConnect Germany GmbH & Co. KG (a hub in Germany); **NBP** – National Balancing Point (a hub in the UK); **PGG** – Polska Grupa Górnicza Sp. z o.o.; **LNG Terminal** – the President Lech Kaczyński LNG Terminal in Świnoujście; **PPX** – Towarowa Giełda Energii S.A. (Polish Power Exchange) **TTF** – Title Transfer Facility; **URE** – Energy Regulatory Office;

With respect to units: **bbl** – one barrel of crude oil; **boe** – barrel of oil equivalent; **LNG** – liquefied natural gas; **NGL** – gas composed of molecules heavier than methane: ethane, propane, butane, isobutane, etc. (natural gas liquids); **PJ –** 1 petajoule; **TWh** – 1 terawatt hour.

With respect to economic and financial ratios: **EBIT** – earnings before deducting interest and taxes; **EBITDA** – earnings before interest, taxes, depreciation and amortisation; **EV** – enterprise value; **P/BV** – price to book value; **P/E** – price to earnings; **ROA** – return on assets; **ROE** – return on equity.

Other abbreviations: **HP** – heat plant; **CHPP** – combined heat and power plant; **SFG** – Storage Facilities Group; **SF** − storage facilities; **CGSF** – Cavern gas storage facility; **EGM** – Extraordinary General Meeting; **UGSF** – Underground gas storage facilities; **GM** – General Meeting.

With respect to currency units: amounts expressed in the Polish 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**; amounts expressed in the Ukrainian hryvnia are designated with the acronym **UAH**; and amounts expressed in the Omani rial are designated with the acronym **OMR.**

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	10,972
1m tonnes of crude oil	1,113	1	0.81	42.7	7.5–7.8*	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	0.128–0.133*	0.12	6.04	1	1.70
1 TWh	0.091	0.086	0.07	3.6	0.59	1

** The converter is different for crude oil produced in Poland and Norway.*

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1. The PGNiG Group in 2017

1.1. Key financial and operating metrics

PLN 35.9bn Revenue	PLN 6.6bn EBITDA	PLN 3.9bn EBIT	PLN 2.9bn Net profit	PLN 48.2bn Total assets
5. largest company listed on the WSE*	PLN 36.3bn Market capitalisation	24.7 thousand Number of employees	8.6% ROE	6.0% ROA

5.6 EV/EBITDA	12.4 P/E	1.1 P/BV	PLN 21.8m Average daily trading value

1.3m tonnes Production of crude oil, condensate, and NGL	4.5bn m^3 Production of natural gas
54 Number of oil and gas production facilities in Poland	213 Number of production licences
over 2 thousand Number of producing wells	48 Number of hydrocarbon exploration and appraisal licences
795m boe Oil and gas reserves	

26.8bn m^3 Volume of gas sold	3.0bn m^3 Gas storage capacities
8.5bn m^3 Volume of gas sold on PPX	13.7bn m^3 Volume of imported gas

7m Number of customers	133 thousand km Length of distribution network
1,479 Number of municipalities/communes connected to the gas grid	11.6bn m^3 Volume of distributed gas

42.1 PJ Heat output	1.2 GW Electric power
5.5 GW Thermal power	3.9 TWh Electricity output

In terms of market capitalisation as at December 31st 2017.

1.2. Calendar of events

January 2017

- PGNiG Technologie accepted an offer made by the Management Board of Polimex-Mostostal S.A. to subscribe for 37,500,000 Polimex-Mostostal shares for a total issue price of PLN 75,000,000 and to buy 1,500,000 Polimex-Mostostal shares from SPV Operator in OTC block transactions. › For more information, see Section 6.1.

February 2017

- On February 14th 2017, PGNiG Finance AB redeemed EUR 500m Eurobonds and paid accrued interest.
- A trading office opened in London, the global trade centre for liquefied natural gas (LNG).

March 2017

- A share cancellation was carried out and a share capital reduction was registered following the 2016 buyback programme. ›For more information, see Section 9.2.
- A new PGNiG Group Strategy was adopted for 2017−2022 (with an outlook until 2026).› For more information, see Section 3.3.
- A supplementary long-term agreement was signed with Qatar Liquefied Gas Company Limited, effective from the beginning of 2018 to June 2034, with the total volume of LNG contracted from Qatargas raised to 2.17m tonnes per year in 2018-2020 and to 2m tonnes per year from 2021. › For more information, see Section 5.2.
- PGNiG TERMIKA signed an investment agreement to acquire more shares in PGG, with a total par value of PLN 300m. ›For more information, see Section 6.2.

April 2017

- On April 20th, Fitch assigned PGNiG a BBB- rating with a stable outlook.

May 2017

- On May 16th, Moody's affirmed PGNiG's Baa3 rating with a stable outlook.

June 2017

- First US spot LNG cargo was delivered to Poland. › For more information, see Section 5.2.
- PGNiG signed bilateral contracts for the supply of natural gas to five Grupa Azoty Group companies, with an estimated total value in excess of PLN 7bn over four years. ›For more information, see Section 5.2.
- PGNiG launched oil and gas production from the Gina Krog field in Norway. › For more information, see Section 5.1.

July 2017

- PGNiG signed a gas supply agreement with KGHM Polska Miedź S.A., running until 2033, with an estimated value of approximately PLN 4.8bn over its term. ›For more information, see Section 5.2.
- PGNiG booked capacity in the first phase of the Open Season procedure for the Baltic Pipe project. › For more information, see Section 7.1.

August 2017

- PGNiG distributed a dividend of PLN 1,156m (PLN 0.20 per share). › For more information, see Section 9.5.
- On August 28th, PGNiG signed an annex with Polskie LNG S.A. to book the full capacity of the LNG Terminal in Świnoujście.

October 2017

- From October 1st, PGNiG was exempted from the obligation to submit tariffs for business end customers (not households) for approval by the President of the Energy Regulatory Office.
- PGNiG launched the ticketing service (Storage segment). ›For more information, see Section 5.2.
- PGNiG submitted a binding bid in the Open Season 2017 Procedure for the Baltic Pipe project to book capacity from October 1st 2022 to September 30th 2037, with an estimated value of the binding commitment of approximately PLN 8.1bn. › For more information, see Section 5.2. and Section 7.1.
- PGNiG entered into agreements with the operator of transmission networks and storage facilities Ukrtransgaz for gas transmission and underground gas storage services in the territory of Ukraine. ›For more information, see Section 5.2.
- On October 26th, PGNiG signed a gas supply agreement with Grupa LOTOS, effective until 2020, with an estimated value of approximately PLN 3.1bn over its term.

November 2017

- PGNiG sent a request to PAO Gazprom and OOO Gazprom Export to renegotiate the contract price of natural gas supplied by Gazprom under the Yamal Contract. ›For more information, see Section 5.2.
- PGNiG and Centrica LNG Company Ltd. signed a five-year contract for the delivery of LNG from the United States. › For more information, see Section 5.2.

December 2017

- PGNiG UN's partners submitted applications concerning the development plans for the Aerfugl and Skogul licence areas in Norway. › For more information, see Section 5.1.

1.3. Events subsequent to the reporting date

January 2018

- On January 19th, an agreement was concluded with the transmission system operator Operator Systemu Przesyłowego Gaz-System S.A., and on January 29th – with the Danish transmission system oeprator Energinet, for the provision of gas transmission services from October 1st 2022 until September 30th 2037, as part of the 2017 Open Season procedure of the Baltic Pipe project, concerning gas transmission from Norway to Poland via Denmark. The total amount of the commitment under the transmission agreements is estimated at PLN 8.1bn.
- On January 25th, the President of the Energy Regulatory Office approved new Tariff No. 6 for gas fuel distribution and liquefied natural gas regasification services provided by Polska Spółka Gazownictwa ("Distribution Tariff").

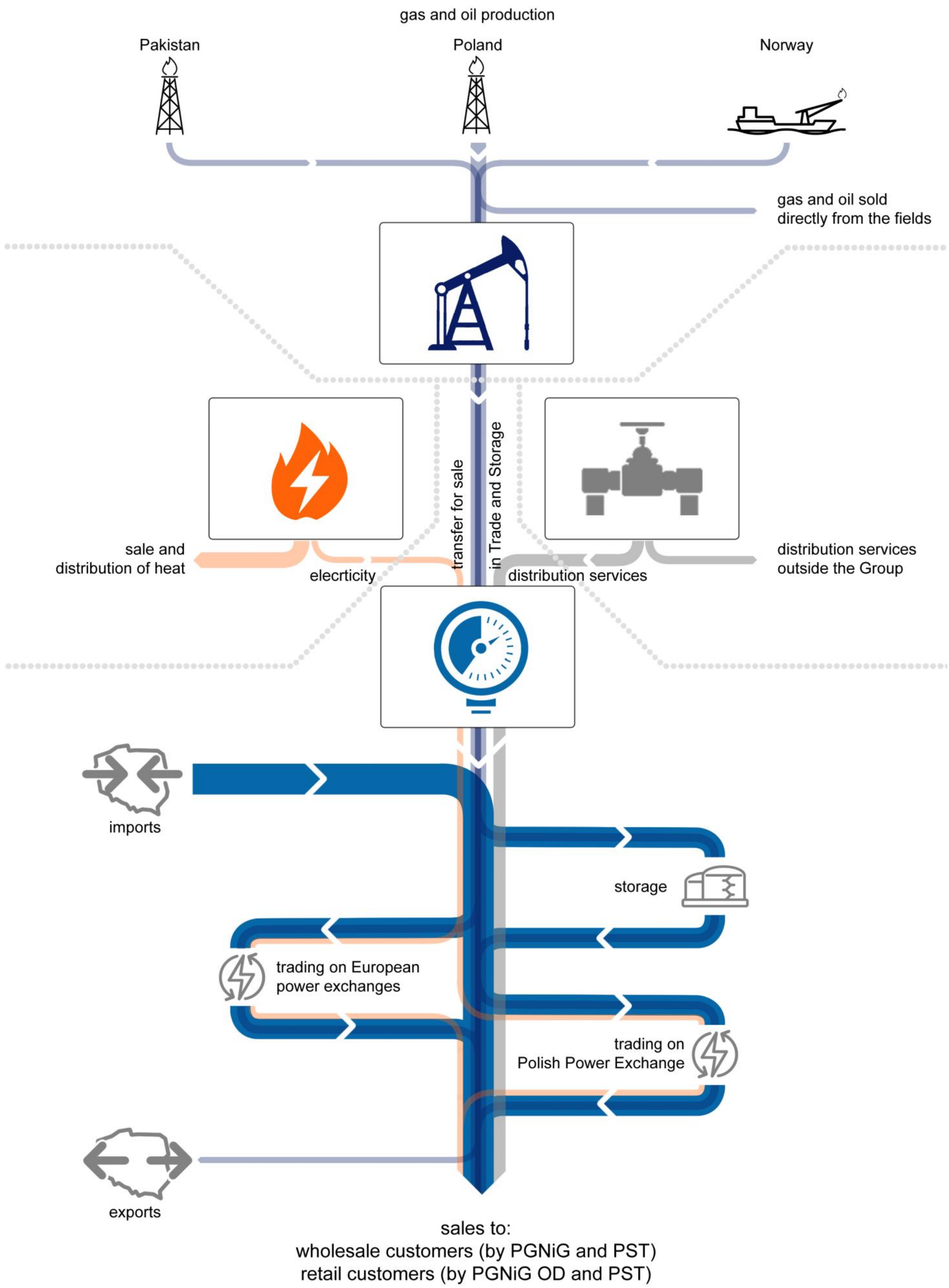
March 2018

- On March 2nd, a contract was concluded with Naftogaz for the supply of over 60 mcm of gas until the end of March 2018 following the suspension of gas deliveries to Ukraine by Gazprom.
- On March 8th, a PLN 900m loan agreement was concluded by ECSW with Bank Gospodarstwa Krajowego and PGNiG (PLN 450m from each lender) for the refinancing of ECSW's debt to PGNiG and Tauron Polska Energia S.A., totalling PLN 600m, and PLN 300m to finance ECSW's further capital expenditure. The loan is due to be finally repaid on June 14th 2030.

2. PGNiG Group's business model

2.1. PGNiG Group's business and the business model

Fig. 1 PGNiG Group's business model



2.2. Companies of the PGNiG Group

As at December 31st 2017, the consolidated companies were PGNiG (the Parent) and 24 subsidiaries.

Fig. 2Consolidated companies of the PGNiG Group

PGNiG

Exploration and Production

- PGNiG S.A. (exploration and production activities)
- Exalo Drilling S.A.
  - *Oil Tech International F.Z.E [United Arab Emirates]*
  - *EXALO DRILLING UKRAINE LLC [Ukraine]*
  - *Zakład Gospodarki Mieszkaniowej Sp. z o.o.*
- GEOFIZYKA Kraków S.A. w likwidacji (in liquidation)
- GEOFIZYKA Toruń S.A.
- PGNiG Upstream Norway AS [Norway]
- PGNiG Upstream North Africa B.V. [The Netherlands] *Libya

Trade and Storage

- PGNiG S.A. (trade and storage activities)
- Gas Storage Poland Sp z o.o.
- PGNiG Obrót Detaliczny Sp. z o.o.
- PGNiG Supply & Trading GmbH [Germany]
  - *PST Europe Sales GmbH [Germany]*
  - *XOOL GmbH [Germany]*

Distribution

- Polska Spółka Gazownictwa Sp. z o.o.
  - *PSG Inwestycje Sp z o.o.*
  - *GAZ Sp. z o.o.*

Generation

- PGNiG TERMIKA S.A.
  - *PGNiG TERMIKA Energetyka Przemysłowa S.A.*

Other segments

- PGNiG S.A. (other activities)
- PGNiG GAZOPROJEKT S.A.
- Geovita S.A.
- PGNiG Serwis Sp. z o.o.
- PGNiG Technologie S.A.
- PGNiG Finance AB i likvidation (in liquidation) [Sweden] *entire Europe
- Polski Gaz Towarzystwo Ubezpieczeń Wzajemnych

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

3. Strategy of the PGNiG Group

3.1. Mission and vision

The key objective of the 'PGNiG Group Strategy for 2017−2022 with an Outlook Until 2026' is to increase the Group's value and ensure its financial stability. To achieve that goal, the Group will need to build a strong competitive position while promoting the advancement of the Polish gas market and expanding its gas networks to unserved areas across the country.

The strategy implemented in 2017 redefines the mission and vision for the PGNiG Group.

Mission statement We are a trustworthy supplier of energy for households and businesses	**Trustworthy** – the customers can depend on premium quality and reliability of our services **Energy supplier** – our customers are offered a full range of energy products (gas + electricity + heat + other/services) **Households and businesses** – we care for and value all our customers: households, businesses, and institutions
Vision We are a responsible and effective provider of innovative energy solutions	**Responsibly** – we act transparently, in line with the principles of corporate social responsibility **Effectively** – we have implemented process and cost optimisation measures **Innovative solutions** – we are an innovation leader in the energy sector
Primary objective Increase the PGNiG Group's value and ensure its financial stability.	**Value growth** – our primary ambition is to create added value for our shareholders and customers **Financial stability** – we seek to secure long-term financial stability and creditworthiness

3.2. Challenges

The operations of the PGNiG Group largely depend on external factors which also pose challenges for the Group. Those factors include:

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

  In recent years, the changes taking place in the Polish gas market have been accompanied by steep price declines elsewhere in Europe. In addition, the past few years have seen increasingly weak correlation between the market prices of natural gas and petroleum products. The falling prices of crude oil also had major implications for the Group in recent years − the unwanted concomitant of lower gas procurement costs under long-term contracts were deteriorated economics of our foreign upstream projects with a predominant share of oil in total reserves, leading to a downward valuation of the E&P segment's foreign operations.

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

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

- **Progressing market deregulation**

  As the requirement to sell a specific portion of gas volumes on the exchange market has come into force, PGNiG is required to sell high-methane gas on commodity exchanges or other regulated markets. In the context of the above requirement, the deregulation process poses a risk of significant customer loss. PGNiG also faced the need to amend 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. However, 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 Group's gas supply mix is largely made up of contracts priced partly by reference to prices of oil products (Yamal and Qatar contracts), and differences in the gas sale 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.

- **Need for policy and regulatory changes**

  Significant changes are taking place in the PGNiG Group'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 the profitability of the Group's segments.

3.3. PGNiG Group Strategy for 2017−2022 with an Outlook until 2026

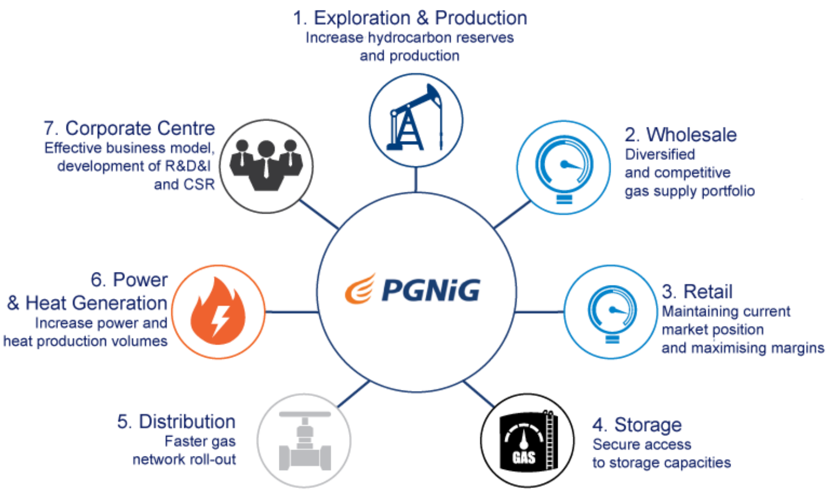
In response to the changing internal and external environment, the Group has developed the new PGNiG Group Strategy for 2017−2022 with an Outlook until 2026. The Strategy was approved by the PGNiG Supervisory Board on March 13th 2017. Following an analytical review, key macroeconomic assumptions underlying the strategic forecasts were updated, including those related to gas, oil and electricity prices. Also, new strategic objectives and ambitions for the GK PGNIG until 2022 were formulated.

A major internal change associated with the adoption of the Strategy is a novel approach to strategic management at the PGNiG Group. The Balanced Scorecard methodology enables the balancing of the Group's financial, operating and development goals based on four key 'perspectives': financial, customers, processes, and resources and growth. The result is a new way of defining the main strategic objectives, where targets and ambitions are set at the Group level and then cascaded down to the Group's key business areas.

The pursuit of sustainable development as the Group's priority will be driven by parallel investments in riskier business areas yielding relatively high rates of return (upstream) and in regulated areas offering considerable safety of the investments (gas distribution, power and heat generation). The PGNiG Group has embarked on an ambitious capital investment programme that is to lay the foundations for long-term and stable value growth.

3.3.1. Targets and ambitions for 2017−2022

Fig.3 Ambitions in the key business areas



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

1st 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 for and appraisal of deposits, and maintain unit cost of field development and hydrocarbon production;
2nd Wholesale – build a diversified and competitive gas supply portfolio beyond 2022 and increase the overall volume of natural gas sales by ca. 7%;
3rd Retail – maximise retail margins, while maintaining the total volume of retail gas sales at ca. 67–69 TWh/year;
4th Storage – secure access to storage capacities adjusted to actual demand and improve storage efficiency;
5th Distribution – build more than 300,000 new service lines and increase gas distribution volume by ca. 16%;
6th Power and Heat Generation – increase power and heat sales volumes by ca. 20%;
7th 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.

PGNiG Group's targets and ambitions for 2017−2022 according to strategic perspectives

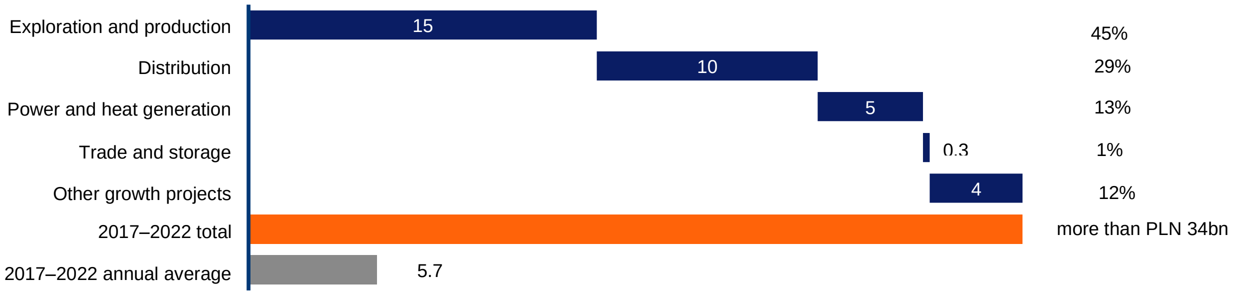
Strategic perspective	PGNiG Group's strategic objectives	Strategic ambitions for 2017-2022
Financial	Increasing the PGNiG Group's value and ensuring its financial stability	Cumulative EBITDA of PLN 33.7bn
Customers	Development of gas and electricity sales	Cumulative natural gas sales volume on wholesale markets in Poland and abroad 1,000 TWh Cumulative natural gas and electricity retail sales volume 410 TWh
Processes	Improve efficiency in connecting new customers	Over 300 thousand new customers connected to the PSG distribution network
Resources and growth	Increase hydrocarbon reserves Increase potential for hydrocarbon production Diversified gas supply portfolio	Increase the base of documented hydrocarbon reservesby 35% Increasing total output of hydrocarbons by 41% Diversification of gas supply sources

3.3.2. Investment projects in 2017−2022

The total capex has been assumed to exceed PLN 34bn in 2017−2022. Average annual capital expenditure in 2017−2022 will amount to ca. PLN 5.7bn:

- of which almost a half (45%) will be spent on hydrocarbon exploration and production,
- almost 30% of capital expenditure will be spent on developing the distribution business,
- ca. 13% − on power and heat generation projects,
- additionally, ca. 12% of capex will be allocated to other, selected growth projects offering attractive returns, including in distribution, trading, power and heat generation.

Planned capital expenditure 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.

3.4. Capital expenditure in 2017

In 2017, the PGNiG Group's capital expenditure on property, plant and equipment and intangible assets was PLN 3.2bn, having gone up by ca. 7% year on year. The tables below present the Company's and the Group's expenditure in each segment.

Capital expenditure[1] on property, plant and equipment made by PGNiG in 2017

		2017	2016[2]	Performance vs CAPEX plan 2017
I.	Exploration and Production, including:	867	830	55%
1	Exploration	475	398	
	including expenditure on dry wells	*60*	*77*	
2	Production	392	432	
II.	Trade and Storage	47	73	80%
1	Trade	3	1	
2	Storage facilities used by the Trade and Storage segment	43	72	
III.	Other Segments	134	111	76%
IV.	Total capital expenditure (I+II+III)	1,047	1,014	50%

1) Including capitalised borrowing costs.
2) The figures for 2016 take into account the transfer of the corporate centre area to the Other Segments.

Capital expenditure[1] on property, plant and equipment made by the PGNiG Group in 2017

		2017	2016[2]	Performance vs CAPEX plan 2017[3]
I.	Exploration and Production, including:	1,214	1,254	57%
1	Norway	275	343	
2	Pakistan	100	98	
3	Libya	4	6	
II.	Trade and Storage	60	82	55%
III.	Distribution	1,265	1,109	86%
IV.	Generation	526	438	58%
V.	Other Segments	145	120	66%
VI.	Total capital expenditure (I-V)	3,210	3,003	66%

1) Including capitalised borrowing costs.
2) The figures for 2016 take into account the transfer of the corporate centre area to the Other Segments.
3) Expenditure planned in 2017, net of expenditure on potential acquisitions in Norway.

Key investment projects and CAPEX in each segment:

- Exploration and Production › For more information see Section 5.1.5
- Trade and Storage › For more information, see Section 5.2.6
- Distribution › For more information, see Section 5.3.4
- Generation › For more information, see Section 5.4.4

3.5. Research and development

In 2017, more than 24 research institutions submitted 96 new R&D offers. R&D agreements were performed for 24 of those offers, for a total value of PLN 18.2m. In addition, 17 new agreements for research projects were signed. Projects under the first edition of Blue Gas Programme were also completed. Most of the research and development (R&D) activities related to the Exploration and Production segment. The most important achievements in the R&D area in 2017 are as follows:

- Conclusion, on November 16th 2017, of an agreement with the National Centre for Research and Development (NCBiR) and GAZ-SYSTEM for the execution of the INGA (Innovative Gas Industry) programme, the largest research programme in the history of the PGNiG Group, for a total amount of PLN 400m, half of which will be financed with NCBiR's funds. The programme covers the majority of the PGNiG Group's business segments and focuses on research issues that may bring the best economic benefit to the PGNiG Group. PGNiG's financial contribution to the INGA programme may reach PLN 133m in 2018-2022;
- Appointment of the Scientific Advisory Group of the second term. The Scientific Advisory Group is an interdisciplinary consulting and advisory team supporting the PGNiG Group and the Research and Development Department in their R&D operations. The Group is composed of fifteen professors, prominent scholars from top Polish universities and research institutes;
- Closing of the third edition of the 'Young Innovators for PGNiG' competition – the awarded projects concerned gas purification with ashes from coal combustion, the use of a rocket engine for methane extraction and obtaining He_3 (helium) isotope;
- 16 patent applications, prepared as projects under the First Edition of the Blue Gas Programme (with the participation of PGNiG) are under review.

The R&D activities planned for 2018 include:

- Formal launch of the INGA programme, selection of the most effective R&D projects entered for the competition, signing implementation contracts and supervision over the implementation of projects selected under the programme;
- Launch of the proprietary 'Poles Change the World' programme, in a consortium with large state-owned companies and the Catholic University of Lublin. The project is designed to strengthen or establish scientific and business cooperation with scientists, inventors, engineers of Polish origin living and working abroad;
- Launch of a new research and development project co-financed by the National Centre for Research and Development, concerning innovative technologies of exploration for and extraction of coal bed methane, with a budget of approximately PLN 140m;
- Completion of development and implementation of a model for the protection of intellectual property rights at the PGNiG Group;
- Gradual completion of the launched R&D projects and, if favourably assessed, approving them for commercialisation;
- Completion of four projects under the Second Edition of the Blue Gas Programme and processing of patent applications, if any.

4. Regulatory and market environment

4.1. Regulatory environment

4.1.1. Regulatory environment in Poland

Energy Law

The Energy Law of April 10th 1997 (consolidated text: Dz. U. of 2017, item 220, as amended; the "Energy Law") is the main legal act governing the operation of the energy sector. In particular, it specifies the rules of development of the national energy policy, matters concerning the supply and use of fuels, energy and heat, and lays downs rules of operation applicable to energy companies. The Energy Law also defines the bodies competent for matters of fuel and energy management.

As at December 31st 2017, the PGNiG Group held the following licences granted by the President of Energy Regulatory Office under the Energy Law:

- three licences to trade in gas fuels (PGNiG, PGNiG OD, PST),
- one licence to trade in natural gas with foreign partners (PGNiG),
- three licences to produce electricity (PGNiG, PGNiG TERMIKA, PGNiG TERMIKA EP),
- four licences to trade in electricity (PGNiG, PGNiG OD, PGNiG TERMIKA, PGNiG TERMIKA EP),
- two licences to produce heat (PGNiG TERMIKA, PGNiG TERMIKA EP),
- one licence to trade in heat (TERMIKA EP),
- two licences to transmit heat (PGNiG TERMIKA, PGNiG TERMIKA EP),
- two licences to liquefy natural gas and regasify LNG at LNG regasification plants (PGNiG, PSG),
- one licence to store gas fuel in storage facilities (GSP),
- one licence to distribute gas fuels (PSG),
- one licence to distribute electricity (PGNiG TERMIKA EP).

In 2017, the provisions of the Energy Law were not amended significantly. In connection with amendments to the Act on Emergency Stocks, the rules of granting licences to sell natural gas abroad were clarified.

Act on Emergency Stocks

The Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, and on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market of February 16th 2007 (consolidated text: Dz.U. of 2017, item 1210, as amended; the "Act on Emergency Stocks") lays down the rules of creating and maintaining emergency stocks of natural gas, and procedures for monitoring and proper enforcement of the act. The act also sets out the rules to be followed in the event of threat to Poland's energy security.

On July 7th 2017, the Act Amending the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, and on the Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market and Certain Other Acts (Dz.U. of 2017, item 1387) was passed. The amendments remove interpretation uncertainties reported by market participants and introduce a number of administrative improvements. The main changes include clarification regarding the principles of providing the ticketing service, introduction of transparent rules for release of emergency stocks, including related settlements, and further clarifications regarding the data and information exchanged between the transmission system operator and the storage system operator. The Act Amending the Act on Emergency Stocks also confirmed that the volume of emergency stocks of gas is calculated based on net imports. All of the aforementioned amendments have a positive effect for PGNiG as they dispel uncertainties in the interpretation of certain provisions of the Act on Emergency Stocks.

Energy Efficiency Act

The Energy Efficiency Act of May 20th 2016 (Dz.U. of 2016, item 831; "Energy Efficiency Act") establishes an energy efficiency obligation scheme, which implements into the Polish legal system the provisions of Directive 2012/27/EU of the European Parliament and of the Council of 25 October 2012 on energy efficiency, amending Directives 2009/125/EC and 2010/30/EU and repealing Directives 2004/8/EC and 2006/32/EC (OJ EU L 315 of November 14th 2012). According to these laws, entities covered by the statutory obligation are required to reach final energy savings of 1.5% each year. The Energy Efficiency Act references two principal ways to fulfil this obligation:

- to implement a project or projects designed to improve end customers' energy efficiency;
- to obtain an energy efficiency certificates and to submit the certificates to the President of URE for redemption.

The act provides for the option to fulfil the obligation by paying a substitution fee. However, as a rule this option cannot be exercised to cover more than 30% of the obligation for 2016, 20% for 2017, and 10% for 2018. The act significantly increases the substitution fee and provides for its annual indexation. It also imposes an obligation to conduct an energy efficiency audit every four years.

Act on Special Hydrocarbon Tax

Act on Special Hydrocarbon Tax of July 25th 2015 (consolidated text: Dz.U. of 2016, item 979; 'Act on Special Hydrocarbon Tax', 'SHT'), stipulates a special tax regime, where the tax base is the surplus of revenue generated from hydrocarbon extraction activities in a given year over the qualifying expense incurred in a given tax year. The date of receipt of receivables is deemed the date on which revenue from hydrocarbon production is generated. The date of making payment is deemed the date on which qualified expenditure is incurred. The obligation to pay special hydrocarbon tax will apply in respect of revenue generated after January 1st 2020.

Geological and Mining Law

The Geological and Mining Law of June 9th 2011 specifies, among others, the rules, terms and conditions for performing geological work, extraction of minerals from deposits, storage of waste matter in rock mass (including in worked-out caverns), protection of mineral deposits, underground waters and other components of the environment in connection with geological works and extraction of minerals.

Business activities consisting in exploration for and appraisal of mineral deposits, extraction of minerals from deposits, tankless storage of substances and storage of waste in rock mass, including in worked-out caverns, require a licence. Geological and mining activities are subject to supervision by competent geological and mining supervision authorities. These authorities monitor the performance of licence obligations by businesses, with particular focus on timeliness of their performance and submission of current information based on the progress of geological work documentation.

In accordance with the amended Geological and Mining Law, for two years now, a new upstream business licensing system has been in force. A single licence is granted for exploration, appraisal, and extraction of hydrocarbons. The grant of such combined licence is only possible in tender proceedings carried out *ex officio*. It should be pointed out that in 2017 the Minister of the Environment announced the tender procedure for combined licence grant with respect to eight out of the ten areas. The Minister plans to announce tender procedures for 17 areas in 2018.

What is important for the industry, according to the geological and mining law, several entities may apply for a licence together if they jointly submit one tender bid and indicate the operator. Each entrepreneur applying for a licence must be assessed by the minister competent for the environment both in terms of national security and its experience in appraisal and documenting of hydrocarbon deposits.

In 2017, it was not possible to submit applications for conversion of existing licences for exploration and appraisal of hydrocarbons into combined licences. However, the unconverted licences remain valid and may be extended only once if specific conditions are met.

The obligation to provide security for non-performance or improper performance of the conditions specified in the licence in an amount not higher than the equivalent of 20% of the costs of geological work represents an additional and considerable financial burden for the industry. In 2017, such security was provided in 21 cases. The value of such security was established at PLN 100,000 per licence as a result of compromise reached between entrepreneurs and the licensing authority.

At present, there is also a problem relating to the prohibition of injecting water from underground gas storage facilities and water used to stimulate hydrocarbon extraction. The licensing authority's position is that such water does not fall within the definition of water injection into the rock mass. The lack of approval of hydrogeological documentation for this type of water limits the possibility of conducting and expanding the exploration and production activities.

In 2017, additional secondary legislation to the law was announced:

- Regulation of the Minister of the Environment of December 8th 2017 on mining plant operation plans;
- Regulation of the Minister of the Environment of October 30th 2017 on collection and disclosure of geological information;
- Regulation of the Minister of Energy of October 16th 2017 on the detailed scope of corporate policy on prevention of dangerous occurrences and accidents;
- Regulation of the Minister of Energy on the minimum content of the report on implementation of a mining plant operation plan.

In 2017, the Minister of the Environment continued work on drafting another amendment to the Mining and Geological Law with respect to the matters excluded from the scope of the 2016 bill amending the Mining and Geological Law and implementing into the Polish legal system 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, p. 66). The draft amendment to the Geological and Mining Law of September 15th 2017 has not been submitted for public consultation.

The purpose of the new law is to simplify the regulations applicable to administrative proceedings with regard to exploration, appraisal and extraction of hydrocarbons. The main changes will be as follows:

- Withdrawal from assessing an entity's experience in the qualification procedure;
- In the event of changes to the data of the entity subject to the qualification procedure, removal of the obligation to re-conduct full procedure, which requires the entity to prepare a full application; instead, the authority will decide whether it is reasonable to initiate the procedure and if so, only to the extent pertaining to the changes, and the entity will only provide evidence of the circumstances of such changes;
- Waiver of security for non-performance or improper performance of the licence conditions;
- Introduction of a second, open-door procedure for granting hydrocarbon licences, which allows for tender proceedings to be carried out at the request of the entrepreneur.
- Inclusion in the definition of 'injection of water into rock mass' of water from underground tankless hydrocarbon storage (but not the process water requested by PGNiG).

The new regulations are expected to bring about:

- higher transparency of the provisions of the Act following removal of problems with correct interpretation of the provisions of the Act and errors preventing proper conduct of administrative proceedings with respect to exploration, appraisal and extraction of hydrocarbons, which will result in faster and more transparent proceedings;
- performance by entrepreneurs of geological work to a wider extent than before by allowing them to apply for licences for areas they consider prospective (entrepreneurs will themselves request the authority to conduct the proceedings).

Capacity Market Act

The Capacity Market Act of December 8th 2017 defines the organisation of the capacity market and sets out the rules of provision of the service consisting in remaining on standby to supply electricity to the power system, including to supply electricity to the power system in emergency periods. The purpose of the act is to ensure medium-term and long-term security of electricity supply to end users in a cost-effective, non-discriminatory and sustainable manner.

The provisions of the Act enable energy generators to earn additional revenues (besides those from sale of electricity) from the provision of a service consisting in ensuring the availability of generation capacities. Such revenues will be determined using an auction system. Detailed terms of operation of the capacity market will be specified in secondary regulations which will be prepared in 2018. Auctions for 2021-2023 are planned to be carried out in November and December 2018. Market operators will be able to derive revenue from the capacity market starting from 2021. The Capacity Market Act was notified to the European Commission and received approval on February 7th 2018.

Diversification Regulation

The Council of Ministers' Regulation of April 24th 2017 on the minimum level of diversification of foreign sources of gas supplies (Dz.U. of 2017, item 902; 'Diversification Regulation') prescribes the maximum share of gas that may be imported from a single country of origin in the total volume of gas imported in a given year. For 2017-2022, the maximum share is 70%, and for 2023-2026 – 33%.

The thresholds defined in the Diversification Regulation are convenient for PGNiG as they allow the Group to continue the performance of long-term import contracts concluded under the auspices of the Republic of Poland.

System Regulation

Regulation of the Minister of Economy of July 2nd 2010 on specific conditions for the operation of the gas system (consolidated text: Dz.U. of 2014, item 1059, as amended; 'System Regulation') specifies the rules of operation of the gas system set forth in the Energy Law. In particular, it lays down the rules and conditions for applying for grid connection, procedure for trading in gas fuel and ability to provide services in the gas system, including the manner of handling complaints, balancing and transmission constraints management; it also outlines the terms of cooperation between market participants.

According to the Minister of Energy's Regulation of January 10th 2017 amending the Regulation on detailed conditions of operation of the gas system (Dz.U. 2017, item 150), equipment and installations used for gas fuel transmission may be only connected to gas transmission networks with a diameter of DN 1,300 or higher. The Regulation has also raised the capacity threshold for customers authorised to be connected to the transmission network from 5,000 to 45,000 cm/h, thus expanding the operating reach of distribution companies and stabilising the transmission and distribution market.

Tariff Regulation

Regulation of the Minister of Economy of June 28th 2013 on detailed rules for determining and calculating tariffs for gas fuels and on settlement of transactions in gas fuels trade (Dz. U. of 2013, item 820; "Tariff Regulation") sets out the principles for determining tariffs for gas fuels, in particular the calculation of prices and rates, as well as the rules of settlements between market participants.

In 2017, PGNiG S.A. applied the following tariffs:

- from January 1st 2017 to March 31st 2017 – PGNiG Gas Fuel Supply Tariff No. 13/2017, approved by President of URE 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 2017 to June 30th 2017 – PGNiG S.A. Gas Fuel Supply Tariff No. 14/2017, approved by the President of URE on March 17th 2017; the tariff increased the average prices of high-methane gas and nitrogen-rich gas by 8% and 7.9%, respectively (the tariff was also in effect in July 2017);
- from August 1st 2017 to September 30th 2017 – PGNiG S.A. Gas Fuel Supply Tariff No. 15/2017, approved by the President of URE on July 12th 2017; the tariff reduced the average prices of high-methane gas and nitrogen-rich gas by 6.7% and 6.8%, respectively.

In 2017, PGNiG OD applied the following tariffs:

- Until February 18st 2017 – PGNiG Obrót Detaliczny Sp. z o.o. Gas Fuel Trading Tariff No. 4, approved on October 17th 2016;
- From February 18th to March 31st 2017 – PGNiG Obrót Detaliczny Sp. z o.o. Gas Fuel Trading Tariff No. 5, approved by the President of URE on January 4th 2017; subscription fees remained unchanged; the Tariff provided for a 7% average reduction in gas fuel prices relative to the previous tariff of PGNiG OD for all tariff groups, including:
    - for consumers from tariff groups with gas fuel consumption rates of up to 110 kWh/h – the gas fuel price was reduced by 6.0%,
    - for consumers from tariff groups with gas fuel consumption rates of more than 110 kWh/h – the gas fuel price was reduced by 8.6% on average.
- From April 1st to December 31st 2017 – PGNiG Obrót Detaliczny Sp. z o.o. Gas Fuel Trading Tariff No. 5, approved by the President of URE on March 17th 2017; an amendment to the tariff extended its validity period; subscription fees remained unchanged; the tariff provided for a 1.6% increase in gas fuel prices for all tariff groups relative to the previous tariff of PGNiG OD.

Furthermore, on December 14th 2017 the President of URE approved PGNiG Obrót Detaliczny Sp. z o.o. Gas Fuel Trading Tariff No. 6 for the period from January 1st to March 31st 2018. This tariff is for household consumers only and in relation to Tariff No. 5 the prices and subscription fees did not change. Based on a decision by PGNiG OD, the new tariff launch date was set at January 1st 2018.

In 2016, PSG applied Tariff No. 3 for Gas Fuel Distribution Services and LNG Regasification Services, approved on December 17th 2014 (as amended with effect from January 1st 2016 and July 1st 2016). In 2017, there was no change in the level of tariff rates relative to 2016. In 2017, events concerning new tariff approvals included the following:

- On April 21st 2017, PSG filed an application for approval of Tariff No. 5 with the President of URE. On July 31st 2017, a decision refusing approval of the tariff was issued. PSG filed an appeal against the decision of the President of URE with the Competition and Consumer Protection Court at the Regional Court of Warsaw. In compliance with the Energy Law, PSG continued to apply the previously effective tariff until the closing of the appeal proceedings.
- On October 5th 2017, the President of URE called upon PSG to submit an application for approval of another tariff. On November 6th, Tariff No. 6 for Gas Fuel Distribution Services and LNG Regasification Services was submitted by PSG for approval and was finally approved by the President of URE on January 25th 2018. The average reduction of prices and rates of network fees used for settlements with customers in relation to the current tariff of PSG for all tariff groups is 7.37%. The new Distribution Tariff expires on December 31st 2018.

In 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;
- From June 1st 2017 – Gas Fuel Storage Tariff No. 1/2017, approved by the President of URE on April 18th 2017 for a period until March 31st 2018, lowering the average rate for the provision of storage services relative to Tariff No. 1/2016 by -0.3%. 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 2017, PGNiG TERMIKA applied the following tariff:

- March 17th 2017 – a tariff for heat generated at PGNiG TERMIKA's heat generating sources: the Żerań CHP plant, Siekierki CHP plant, Pruszków CHP plant, Wola heating plant and Kawęczyn heating plant, and for transmission and distribution of heat via the heating networks in the Pruszków area (supplied from the company's own heat generating source: Pruszków CHP plant) and in the Annopol, Chełmżyńska, Jana Kazimierza, Marsa Park and Marynarska areas, approved by the President of URE on January 25th 2017; the tariff remains effective until March 17th 2018; the introduction of this tariff resulted in a decrease of the average prices applied by the company by 0.26%.

In 2017, PGNiG TERMIKA EP applied, among others, the following tariffs:

- From November 2016 – a tariff for heat generated at PGNiG TERMIKA EP's heat generating sources, approved by the President of URE on October 10th 2016;

- From December 2016 – a tariff for heat generated at PEC's (Przedsiębiorstwo Energetyki Cieplnej) heat generating sources, approved by the President of URE on November 15th 2016.

The above tariffs were effective throughout 2017. Proceedings are under way at the Energy Regulatory Office concerning a new, combined tariff.

- From November 2017 to October 2018 – a tariff for PGNiG TERMIKA EP's electricity distribution services approved by the President of URE on November 17th 2017 applies.

Pursuant to the transitional provisions for the Energy Efficiency Act, the current Tariff Regulation will cease to apply on or before March 31st 2018. Legislative work on a new regulation commenced in 2017. PGNiG has been actively participating in this work, presenting its positions and putting forward proposals aimed at protecting the interests of the PGNiG Group and its customers.

In connection with the statutory removal of tariffs, in 2017 PGNiG did not file any applications for administrative exemption from the obligation to seek tariff approval.

Statutory exemption from the obligation to seek tariff approval

The Act Amending the Energy Law and Certain Other Acts of November 30th 2016 (Dz.U., item 1986) gradually abolishes the system of administrative regulation of natural gas prices. The adopted schedule provides for exemptions from the obligation to submit gas tariffs for approval for:

- wholesale and supplies to end customers purchasing gas fuel (i) at a virtual gas trading point, (ii) in the form of LNG or CNG, and (iii) under tender, auction or public procurement procedures pursuant to the provisions of the Public Procurement Law – as of January 1st 2017,
- supplies to other end customers (businesses), other than household customers – as of October 1st 2017;
- supplies to households – as of January 1st 2024.

Draft bills

In 2017, the Minister of the Environment continued work on the draft act modifying the organisation of geological services – the Draft Act on the Polish Geological Agency (in 2016 the draft envisaged the establishment of the National Geological Service).

In addition, in 2017 the Minister of the Environment announced the draft assumptions for the National Commodity Policy, which sets out the key actions to be undertaken as part of identified objectives while providing for the possibility of their revision and modification at further stages of the policy implementation process. This document is the basis for further work on the National Commodity Policy that may be undertaken and continued by representatives of all ministries, businesses operating in the sectors concerned, scientific institutions and social groups. Proposed areas to work on:

- Primary commodities (extracted from the interior of the earth): metals, rare-earth elements, noble gases, chemical raw materials, mineral resources, precious, semi-precious and decorative stones, groundwater, curative waters, energy raw materials, radioactive elements, heat of the Earth;
- Secondary commodities: produced by recycling, circular economy, substitution;
- Other issues/Other areas to work on: tankless storage of substances and storage of waste in rock mass, education, protection of geodiversity, e.g. through creation of geoparks, technological development.

The adoption of the National Commodity Policy is expected to lead to a number of legislative changes that will affect the terms on which licensed activities are conducted in Poland.

4.1.2. European regulatory environment

Third Energy Package

In 2017, the Third Energy Package continued to be the all-inclusive framework governing the European energy (gas and electricity) market. The Package included five acts of law drawn up by EU institutions in 2009:

- Directive 2009/72/EC of the European Parliament and of the Council of July 13th 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC;
- Directive 2009/73/EC of the European Parliament and of the Council of July 13th 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC;
- Regulation (EC) No 714/2009 of the European Parliament and of the Council of July 13th 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003;
- Regulation (EC) No 715/2009 of the European Parliament and of the Council of July 13th 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005;
- Regulation (EC) No 713/2009 of the European Parliament and of the Council of July 13th 2009 establishing an Agency for the Cooperation of Energy Regulators (ACER).

The objective of the Package is to boost competition on the European energy market and create the internal energy market based on mechanisms such as ownership unbundling, organisation of cooperation between regulators and energy companies (ACER, ENTSO-E and ENTSO-G), or introduction of network codes.

On November 30th 2016, the European Commission announced a package of legislative proposals amending the acts included in the Third Energy Package. The aim of the 'Clean Energy for All Europeans' package of legislative proposals is to ensure a transition of the European economy to one based on electricity, fulfilment of the commitments made by the European Union under the Paris Agreement of 2015 and implementation of the energy and climate policy objectives. The changes relate mainly to the electricity market, but there are also amendments to the Regulation establishing an Agency for the Cooperation of Energy Regulators (ACER) and a new Regulation on the Governance of the Energy Union is to be introduced, both of which may have significant implications for the gas market and PGNiG's operations.

Until the end of 2017, the European Parliament worked on the proposals and relevant EP committees prepared reports (leading committees: ITRE and ENVI) concerning the European Commission's proposal. In parallel, the Council of the European Union reached an agreement and adopted the general approach for most of the acts included in the Clean Energy Package (with the exception of the ACER Regulation), largely consistent with the solutions the Company proposed.

Furthermore, in the third quarter of 2017 the European Commission announced proposed amendments to the Gas Directive (Directive 2009/73/EC of the European Parliament and of the Council of July 13th 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC), the objective of which is to ensure that the Directive's requirements also apply to the key infrastructure used for importing natural gas to the EU.

In 2017, work on a report analysing the LNG and gas storage market in the European Union was completed. PGNiG actively participated in the work – it submitted its official positions and its employees participated in meetings. Despite its active engagement in the process, the Company did not succeed in eliminating all the risks implicated by the report. However, according to the information given by the European Commission, no legislative measures are currently planned to implement the recommendations from the report.

In 2016, studies were conducted as part of the 'Quo Vadis EU Gas Market Regulatory Framework – A Study on a Gas Market Design for Europe' initiative launched with a view to reforming the legal framework of the European gas market. The aim of the report is to provide an analysis of the regulatory environment following the implementation of the Third Energy Package and to potentially address the regulatory gaps in the development of the EU gas market that exist despite the introduction of the Package. In its comments, PGNiG emphasises that at the present stage it is too early to investigate the legal gaps existing despite the implementation of the Package. In PGNiG's opinion, not all provisions of the legal acts adopted in 2009 have been implemented, and full implementation should be a prerequisite for any investigation into their effectiveness – also with regard to the infrastructure bringing gas to the EU. In addition, the Company draws attention to the importance and necessity of continuing the diversification of gas supply sources to the European Union, including the gas import infrastructure. Any decision as to potential legislative action is to be taken by the European Commission composed of members appointed to it after the elections to the European Parliament in 2019.

SoS Regulation

Regulation (EU) No. 994/2010 of the European Parliament and of the Council of October 20th 2010 concerning measures to safeguard security of gas supply ('SoS Regulation') is aimed at preventing disruptions in the supply of natural gas to Member States, or mitigating their effects if they occur.

To that end, in case of gas supply shortage, the Member States may announce one of the three crisis levels in their territory: early warning level, alert level, and emergency level. Each subsequent crisis level allows the Member State to take specific measures to minimise related risks. The regulation defines a group of 'protected customers', which includes all households connected to the distribution network. In addition, each Member State may extend the 'protected customer' definition to include also small and medium-sized enterprises (provided that they do not represent more than 20% of the final use of gas) and district heating installations (to the extent they deliver heat to household customers and to small and medium-sized enterprises).

On February 16th 2016, the European Commission published a new draft of the SoS Regulation. In the new draft, the role of regional cooperation in the event of gas supply disruptions was given a greater priority, and a new solidarity mechanism was introduced.

Regulation (EU) 2017/1938 of the European Parliament and of the Council of October 25th 2017 concerning measures to safeguard security of gas supply and repealing Regulation (EU) No 994/2010 entered into force on November 1st 2017.

Following the publication of the new draft SoS Regulation, PGNiG informed competent public authorities of the risks related to PGNiG's activities, and presented the position of the PGNiG Group to representatives of the European Commission and the European Parliament.

Negotiations regarding the final provisions of the new SoS Regulation continued also in 2017. PGNiG actively participated in the work and provided support to other entities involved in the process, in particular with regard to the negotiations concerning the final form of the transparency and solidarity mechanisms. Thanks to PGNiG's active involvement in the negotiations, the final version of the SoS Regulation is a compromise that takes into account to a satisfactory extent the solutions advocated by the Company.

TAR NC Regulation

September 30th 2016 saw the adoption of Commission Regulation (EU) establishing a network code on harmonised transmission tariff structures for gas, with the effective date on April 6th 2017. Work on the Regulation had begun in 2011. The objective of the Regulation is to gradually reduce discrepancies between tariff models applied in individual Member States. Legislation work carried out by the European Commission, aiming to unify the tariff structures in the EU, is designed to facilitate cross-border trade conducted by participants of the European gas market.

NC CAM Regulation

Commission Regulation (EU) No 459/2017 of 16 March 2017 establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems and repealing Regulation (EU) No 984/2013 (the 'NC CAM Regulation') is to promote the building of correctly operating interconnected transmission network systems, which would provide the foundation for further development of the EU internal energy market through harmonisation of mechanisms that ensure transparent and non-discriminatory terms of transmission capacity allocation.

The provisions of the NC CAM Regulation apply to interconnections between Member States. In order to ensure that all parties can gain access to interconnector transmission capacities on equal and non-discriminatory terms, the allocation of capacity is made through auctions organised by transmission system operators, at which intraday, daily, monthly, quarterly and annual products are offered. Compared to the repealed Regulation 984/2013, the new law introduces a detailed framework for the Open Season procedure. It is a process supporting the development of gas transmission systems, in which transmission capacities are offered for both completely new interconnectors as well as for the expansion of gas transmission infrastructure.

EU ETS

The EU Emission Trading Scheme (EU ETS) imposes the obligation to account for CO_2 emissions and regulates the allocation of free emission allowances for heat and electricity. Under the ETS Directive, emitters of greenhouse gases (including CO_2) are obliged to account for their emissions by surrendering their CO_2 emission allowances by April 30th each year for the preceding year. If the number of emission allowances is too small, the excess emissions penalty of EUR 100 per tonne of CO_2 is imposed, and the operator must acquire and surrender the necessary number of emission allowances.

Pursuant to the EU ETS Directive, industrial installations, including heat plants and combined heat and power (CHP) plants, may apply for free emission allowances. In the case of power systems, only eight Member States meeting the criteria set out in the EU ETS Directive could apply for the allocation of free emission allowances.

In the case of heat, emission allowances are granted on the basis of historical production data. Power generation installations may receive free allowances in exchange for execution of projects reducing CO_2 emissions. The PGNiG Group submitted ten investment projects to the National Investment Plan and may receive free emission allowances in exchange for their implementation.

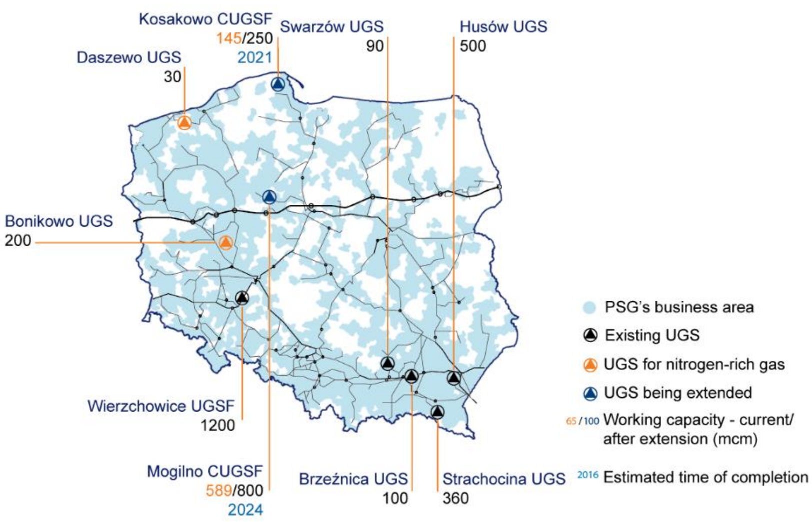
In November 2017, an agreement was reached between the Council of the European Union and the European Parliament regarding the framework for the emission allowance trading system after 2020. The agreement assumes a linear decline in the number of emission allowances (the reduction coefficient) by 2.2% per year, with a potential for increasing this number in connection with the implementation of the Paris Agreements. The modernisation fund, i.e. the instrument designed to provide funding for modernisation and improvement of energy efficiency of installations, was set at 2% of the total EU ETS allowances. It will apply to 10 member states with a gross domestic product below 60% of the EU average (including Poland). The modernisation fund will not support any fossil fuel facilities (with the exception of Romania and Bulgaria, which can support their district heating facilities). A derogation mechanism was introduced for the member states with the GDP per capita below 60% of the EU average (including Poland), which may decide to continue to allocate free allowances to the energy sector. The maximum quota to be allocated for free to the energy sector must not exceed 60% of all EU ETS allowances allocated to the member state. In addition, the compromise does not include the European Parliament's proposal under which the derogation mechanism would not cover any power installations which produce more than 450 grams of CO_2 per 1 kWh of energy.

4.2. Polish gas market

The PGNiG Group plays a key role on the Polish gas market, being responsible for preserving Poland's energy security. To this end, it takes measures necessary to satisfy the steadily growing demand for gas fuel. The PGNiG Group ensures supply diversification by developing domestic deposits and sourcing gas from abroad, as the largest importer and supplier of natural gas in Poland. Gas is transported to Poland via an extensive transmission network, with LNG fed into the network as of 2016. The Company delivers gas to end users through the distribution networks. The national gas system is complete with gas fuel storage facilities, used to cover seasonal and daily shortages of gas fuel. In gas fuel trading itself, the key role is played by the Polish Power Exchange where PGNiG has been the Gas Market Maker since 2013.

Transmission system

Fig. 4 Transmission system and reach of the distribution grid in Poland

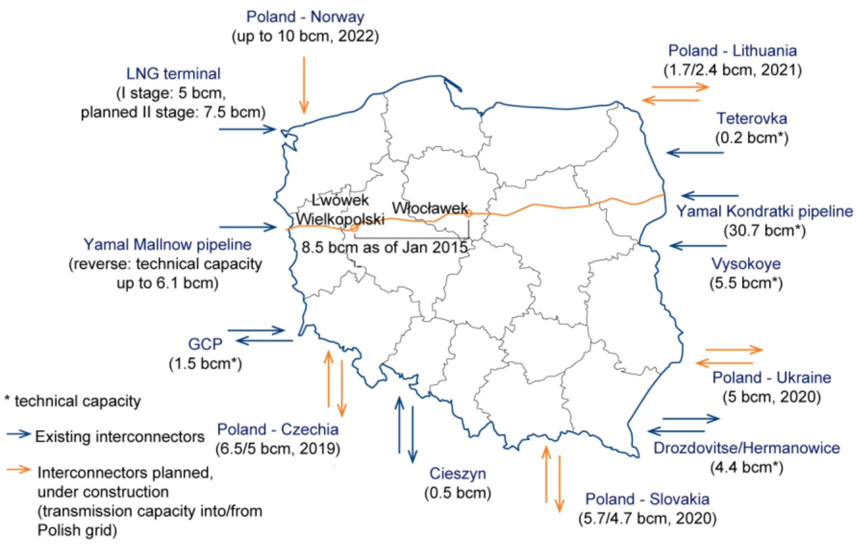


Management of the transmission network and transport of natural gas via the national transmission network to deliver it to distribution grids and end users connected to the transmission system is the responsibility of GAZ-SYSTEM, a state-owned company. The existing transmission network comprises two operationally interlinked systems, the Transit Gas Pipeline System and the National Transmission System (high-methane gas [E group] and nitrogen-rich gas [Lw subgroup]). As at the end of 2017, the length of Poland's gas transmission network totalled over 11 thousand km. The volume of gas transmitted through the network amounted to 17.6 bcm in 2017 (excluding gas fuel transmitted in the OTC market and PPX).

In December 2017, the General Meeting of GAZ-SYSTEM approved the National Ten-Year Growth Plan for 2018-2027. The planned infrastructure projects are primarily designed to meet the current and future demand for natural gas from domestic customers while ensuring uninterrupted gas supplies. With this goal in mind, the National Ten-Year Growth Plan defines a new strategic investment programme, with focus on infrastructure projects included in the Northern Gateway. The Northern Gateway programme is designed to connect Norwegian gas deposits via the offshore gas pipeline between Poland and Denmark (the Baltic Pipe project; for more information, see Section 7.1.2.) and expand the regasification capacities of the existing LNG Terminal.

GAZ-SYSTEM's plans for the coming years also include extending other interconnectors and the national transmission network. These projects will be key to ensuring stable gas supplies to Poland and other CEE countries (export to countries such as Ukraine).

Fig. 5 Existing and planned strategically important cross-border entry points into the transmission system



Source: GAZ-SYSTEM and ENTSOG

Gas flow

2017 saw growing volumes of gas fuel imported to Poland, which reached 167 TWh (up by 17 TWh, or approximately 11%), with an almost 5% decline in gas imported from east of Poland and a 58% increase in gas imports from the EU year on year. The majority of imported gas (approximately 59% of total flows) originated from countries east of Poland. According to GAZ-SYSTEM, the largest volume of natural gas was transmitted via the Drozdowicze point. As regards imports from the west, the largest flows were recorded at the Mallnow point.

In 2017, deliveries of liquefied natural gas by sea to the LNG Terminal were continued, which resulted in a 66% increase in the volume of gas regasified at the LNG Terminal compared to 2016. Gas exports to Ukraine also increased considerably (up 34% year on year).

Gas flows at Poland's gas grid entry/exit points

Entry/exit point (in TWh)	2017	2016	Change y/y
Supplies from EU	42.53	26.94	+58%
including Lasów, Gubin (GCP)	6.08	4.87	+25%
including Cieszyn	1.26	0.06	+1994%
including Mallnow	35.20	22.01	+60%
Supplies from across Poland's eastern border	106.04	112.11	-5%
including Drozdovitse	49.72	48.12	+3%
including Teterovka	0.88	0.82	+7%
including Kondratki	21.06	28.14	-25%
including Vysokoye	34.37	35.03	-2%
LNG regasification	18.47	11.14	+66%
Exports to Ukraine (mainly Hermanowice)	13.78	10.24	+35%
Total flow	180.82	160.56	+13%

Source: GAZ-SYSTEM

LNG in Poland

Since 2016, Polskie LNG S.A. has been operating in the area of collection and regasification of liquefied natural gas, with the company's LNG Terminal able to receive 5 bcm of gas per annum (after regasification). Should demand for this type of gas fuel grow, the LNG Terminal's capacity may be increased even up to 7.5 bcm without expanding the project's site. The LNG Terminal is able to receive LNG tankers not larger than Q-Flex tankers, whose maximum capacity (depending on specific vessel) ranges from 210 to 218 thousand cubic meters of LNG (approximately 130 mcm of high-methane gas after regasification). The end product of gas regasification is fed into the national transmission grid via the Goleniów gas compression station, located over 80 km away from the LNG Terminal. LNG is also transported by tankers to regasification plants and stations located throughout Poland.

PGNiG considers LNG deliveries as a means to ensure gas supply security and diversification. The company initially reserved some 60% of the terminal's capacity to receive and regasify approximately 2.5 million tonnes (just over 3 bcm after regasification) of LNG annually. In 2017, PGNiG and Polskie LNG S.A. signed an annex to the contract to increase reservation to 100% of the LNG Terminal's regasification capacity. The increase is valid until January 1st 2035. This means that as of 2018 the Company is able to import LNG by sea in the amount equal to approximately 5 bcm of natural gas per year after regasification.

In total, PGNiG imported 1.24 million tonnes of LNG via the LNG Terminal in 2017, which corresponds to approximately 18.8 TWh.

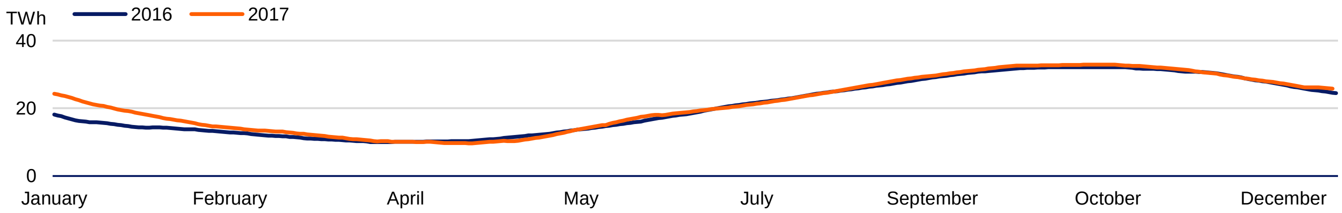
Distribution system

Distribution services are provided by one major distribution system operator (PSG) and several dozen smaller local operators, whose networks are connected to the system operated by PSG or GAZ-SYSTEM.

Gas storage

PGNiG owns 9 underground gas storage facilities in Poland. The average daily withdrawal of gas from Polish storage facilities over the withdrawal period amounted to 118.14 GWh in 2017, up 26% on the previous year. In the summer of 2017, gas was injected into storage at an average rate of 131 GWh/day, up 9.35 GWh/day on 2016.

Levels of gas in storage in Poland in 2016–2017.

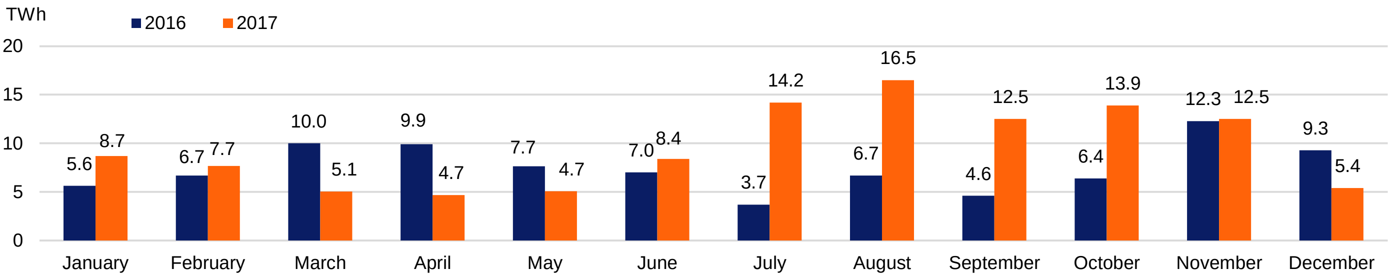


Source: In-house analysis based on Gas Infrastructure Europe and Gas Storage Europe data.

Polish Power Exchange

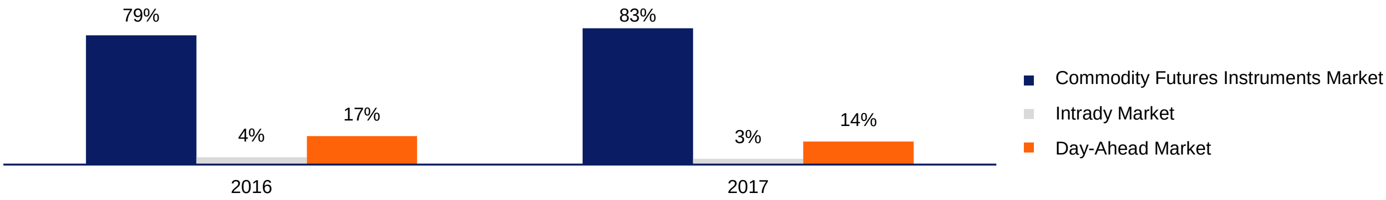
PGNiG is the leader of gas trading at the PPX. According to PPX data, in 2017 the total gas trading volume was 138.7 TWh, of which 114.7 TWh was traded on the commodity forward instruments market (RTT). This means that almost 83% of gas trades in 2017 were executed under contracts with maturities of a year, season (summer, winter), quarter, month, and week.

Commodity forwards (RTT) trading volume on the PPX in 2016 and 2017 (TWh)



Source: In-house analysis based on PPX data.

Contracts traded on the PPX in 2016 and 2017

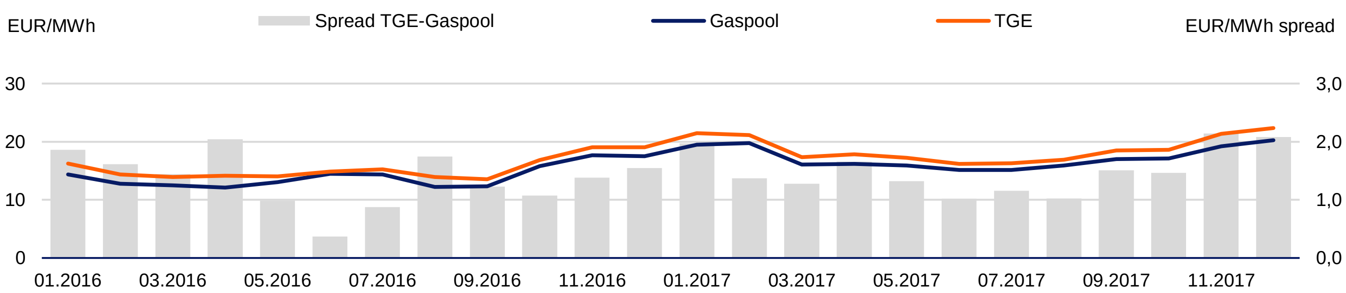


Source: In-house analysis based on PPX data.

There was an approximately 28% y-o-y increase in the volumes traded under commodity forwards. As at the end of 2017, there were 108 active participants in natural gas trading, a nearly two-fold increase on 2015, with 200 companies holding licences to trade in gas fuels, 3 more than the year before.

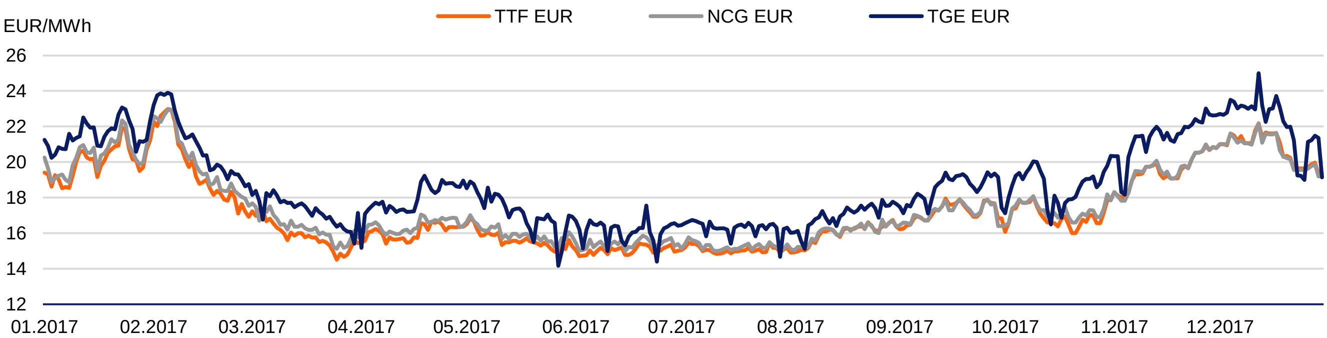
In 2017, the average spot price of gas in Poland was PLN 79.76/MWh, up by 18.5% year on year. PPX gas prices were strongly correlated with gas prices in Germany and other European markets. In 2017, the spread between spot prices on PPX and GASPOOL averaged EUR 1.49/MWh.

Average monthly natural gas spot prices in Poland and Germany



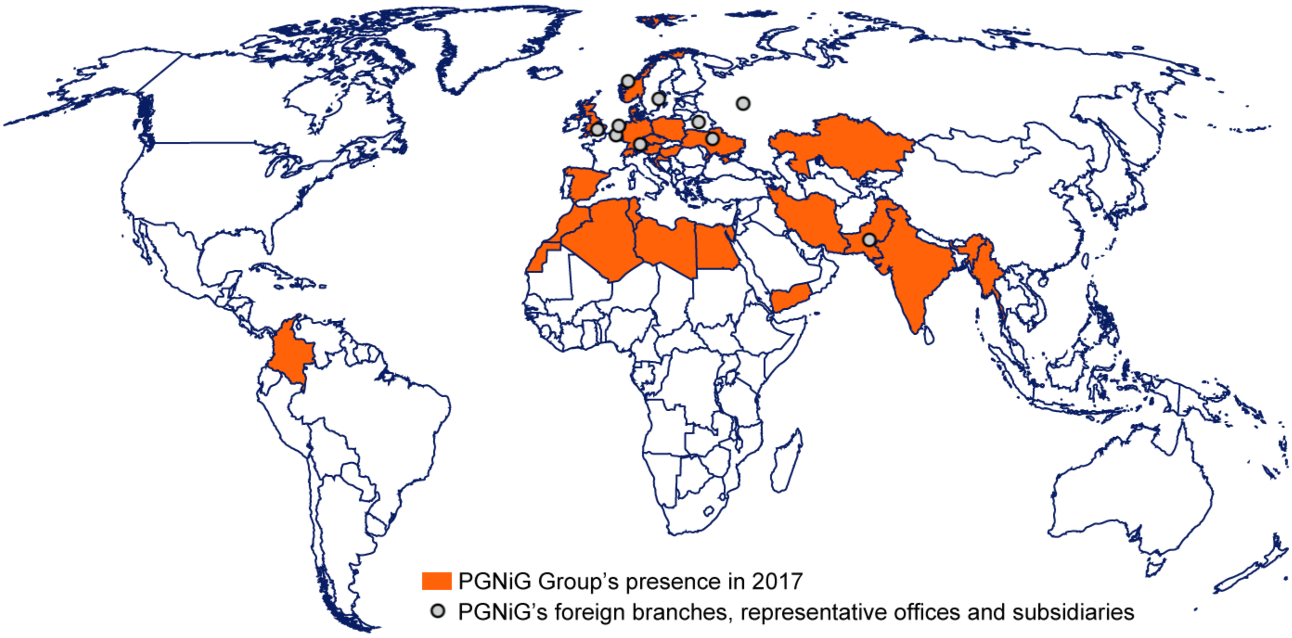
Source: In-house analysis based on PPX data and EEX data.

Spot price of gas at PPX, TTF and NCG in 2017.



Source: In-house analysis based on PPX data and EEX data.

5. Operating activities in 2017



Total sales of natural gas outside the PGNiG Group mcm	2017		2016		2015	2014	2013
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	25,291	15,977	22,895	13,580	21,653	17,322	14,970
Nitrogen-rich gas (Ls/Lw as E equivalent)	1,496	1,007	1,371	907	1,295	1,252	1,202
TOTAL (measured as E equivalent)	26,787	16,984	24,266	14,487	22,948	18,574	16,172

5.1. Exploration and Production

The segment's business focuses on extracting hydrocarbons from deposits and preparing them 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. The segment also relies on storage capacities available at the Bonikowo and Daszewo UGSFs.

5.1.1. Segment's figures

Financial highlights	2017		2016**		2015*	2014*	2013*
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
Total revenue	6,118	4,572	5,289	3,763	4,855	6,071	6,185
Revenue from sales outside the Group, including:	3,092	2,009	2,776	1,601	3,148	4,346	4,580
- high-methane and nitrogen-rich gas,	602	600	517	501	553	573	577
- crude oil, condensate, and NGL	1,862	1,184	1,606	907	1,945	2,654	2,757
- geophysical, geological and drilling services	358	-	429	-	382	761	833
Inter-segment revenue	3,026	2,563	2,513	2,162	1,707	1,725	1,605
EBITDA	3,865	2,937	2,206	1,577	2,426	3,143	3,381
EBITDA adjusted for impairment losses on property, plant and equipment	3,944	3,012	2,977	2,294	2,980	3,812	3,908

*Data not restated, as reported.
** Data restated according to the new segmentation of the PGNiG Group's operations - for more information, see Section 1.3 of the consolidated financial statements.

Natural gas production by the PGNiG Group mcm	2017		2016		2015	2014	2013
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	1,863	1,315	1,918	1,401	2,027	1,876	1,890
in Poland	1,315	1,315	1,401	1,401	1,454	1,457	1,550
PGNiG Zielona Góra Branch	-	-	-	-	-	-	-
PGNiG Sanok Branch	*1,315*	*1,315*	*1,401*	*1,401*	*1,454*	*1,457*	*1,550*
in Norway	548	-	517	-	573	419	340
Nitrogen-rich gas (Ls/Lw as E equivalent)	2,674	2,674	2,540	2,540	2,564	2,628	2,686
in Poland	2,524	2,524	2,481	2,481	2,513	2,570	2,661
PGNiG Zielona Góra Branch	*2,468*	*2,468*	*2,422*	*2,422*	*2,441*	*2,490*	*2,574*
PGNiG Sanok Branch	*56*	*56*	*59*	*59*	*72*	*80*	*87*
in Pakistan – PGNiG Pakistan Branch	150	150	59	59	52	58	25
TOTAL (measured as E equivalent)	4,537	3,989	4,458	3,941	4,591	4,504	4,576

Segment's sales of natural gas outside the PGNiG Group mcm	2017		2016		2015	2014	2013
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	31	31	77	53	54	33	36
in Poland	31	31	53	53	52	33	36
in Norway	-	-	24	-	1	-	-
Nitrogen-rich gas (Ls/Lw as E equivalent)	795	795	703	703	684	738	683
in Poland	646	646	645	645	633	682	658
in Pakistan	149	149	58	58	51	56	25
TOTAL (measured as E equivalent)	825	825	780	756	738	771	719

Crude oil* at the PGNiG Group thousand tonnes	2017		2016		2015	2014	2013
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
Crude oil production*	1,257	787	1,318	763	1,428	1,207	1,099
in Poland	787	787	763	763	765	789	815
PGNiG Zielona Góra Branch	*747*	*747*	*719*	*719*	*719*	*742*	*766*
PGNiG Sanok Branch	*40*	*40*	*44*	*44*	*46*	*47*	*49*
in Norway	470	-	555	-	664	418	283
Sale of crude oil*	1,269	791	1,347	754	1,391	1,169	1,106
including oil produced in Poland	791	791	754	754	772	780	809
including oil produced in Norway	479	-	593	-	619	389	297

** Including condensate and NGL.*

5.1.2. Segment's strategy

Increasing proven hydrocarbon reserves

One of the segment's key objectives is to increase its proven hydrocarbon reserves by 35% by taking appropriate measures in Poland and abroad. The PGNiG Group's ambition is to reverse the negative trend observed in 2010-2015, when the Group's total hydrocarbon base decreased by around 2% on average per year.

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 35 mboe in 2016 vs approximately 16 mboe in 2015). In 2017–2022, the gross annual growth in Polish hydrocarbon reserves (without accounting for production) is expected to continue at a rate close to the 2016 levels, ranging from approximately 27 to 34 mboe 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, among other things, 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.

In the light of little prospects of proving unconventional reserves and the limited capacity for growth in discoveries of new hydrocarbon reserves in Poland, the Group is looking for ways to increase its hydrocarbon reserves and step up production abroad. The Group is also committed to carrying out production projects which will yield equity gas on the Norwegian Continental Shelf, with physical transport of gas to Poland.

Increasing annual hydrocarbon production volume

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:

- in Poland: increasing output from producing fields,
- abroad:
  - participation in licence award proceedings in priority regions/countries,
  - execution of M&A projects in priority regions/countries,
  - implementation of an accelerated field development programme in the licence areas.

Increasing profitability of exploration and production operations

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 appraisal 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 aforementioned strategic measures, optimisation of operating costs of service companies and expansion of field services offered to external companies, including in new markets, optimisation of the portfolio of foreign upstream assets, stepping up exploration projects abroad (Norway and Pakistan), and enhancing business processes with innovative technologies (e.g. in management of hydrocarbon production operations).

5.1.3. Operations in Poland

Licences in Poland

As at December 31st 2017, PGNiG held 48 licences for exploration and appraisal of crude oil and natural gas deposits, vs 53 licences as at January 1st 2017. In 2017, 33 proceedings to extend, change or convert licences were closed (with a total of 21 concessions converted). 40 proceedings to approve additional works in geological projects were also completed. As at December 31st 2017, proceedings to convert 4 licences and extend 2 licences were still pending at the Ministry of the Environment. 17 additions to geological projects also await final approval.

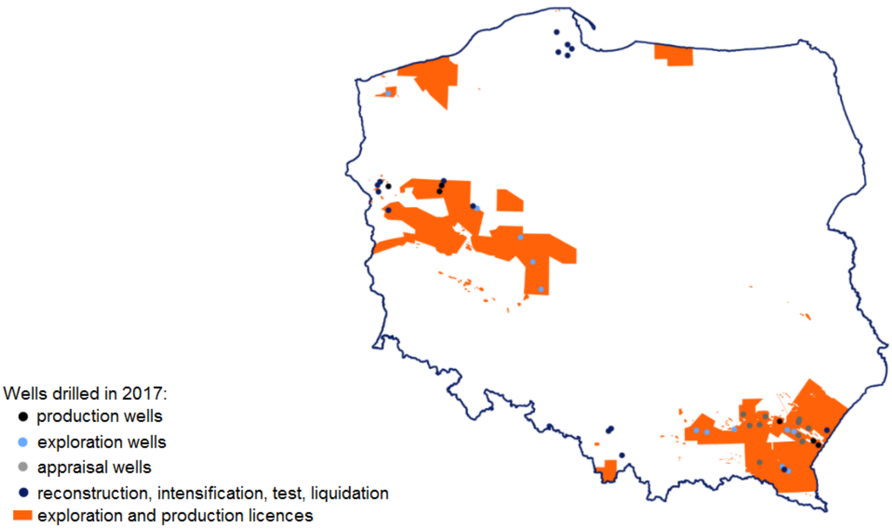
As at December 31st 2017, PGNiG held a total of 213 production licences in Poland. In 2017, no new licences were granted to PGNiG, 26 licences were changed and 12 licences expired.

Work performed

Throughout 2017, PGNiG was involved in crude oil and natural gas exploration and appraisal projects in the Carpathian Mountains, Carpathian Foothills, Sudetian Monocline, and Polish Lowlands, both on its own and jointly with partners. Drilling work in areas covered by licences awarded to PGNiG was performed on 33 boreholes, including 12 exploration wells, 10 appraisal wells and 11 production wells. In 30 of the wells the target depth was reached, including in 11 exploration wells, 10 appraisal wells, and 9 production wells.

As at the end of December 2017, formation test results were obtained from 22 boreholes (12 exploration wells and 10 appraisal wells), including 3 wells where drilling was completed in 2016.

Fig. 6 PGNiG's licences and wells in 2017



In 2017, 14 wells, including 5 exploration and 9 appraisal wells, were drilled with positive results. 8 wells failed to yield a commercial flow of hydrocarbons and were therefore abandoned. In 2017, 9 production wells were classified as positive. In 2017, workovers, enhanced recovery treatments and tests were performed on 8 research (core) boreholes, 4 exploration wells, 2 appraisal wells, and 2 production wells.

New fields in the Sanok area hooked up in 2017 include: new elements in the Husów-Albigowa-Krasne field: Siedleczka-4, Siedleczka-5K, Siedleczka-6K wells; in the Przeworsk field: Przeworsk-17, Przeworsk-18, Przeworsk19K, Przeworsk-20, Przeworsk21K, Przeworsk-22 wells; in the Lubliniec-Cieszanów field: Lubliniec-14, Lubliniec-15 wells; in the Pruchnik-Pantalowice field: Pruchnik-28, Pruchnik-29K, Pruchnik-30K wells; and in the Przemyśl field: Przemyśl-258K well. New fields in the Zielona Góra area hooked up in 2017 include: Radoszyn-2, Radoszyn-3, Radoszyn-4K and Radoszyn-5K wells, Miłosław E (Miłosław-4K well – as part of a long-term production test), and in the Brońsko field: Brońsko-23, Brońsko-27 and Brońsko-28 wells. In 2017, the Porażyn and Brzeźnica deposits were removed from the list of mineral deposits in Poland.

No. of production facilities	Sanok	Zielona Góra
Gas production facilities	18	10
Oil production facilities	5	1
Oil and gas production facilities	13	7
Total	36	18

With its oil production volume in Poland close to 800,000 tonnes in 2017, PGNiG is one of Poland's leading producers of crude oil. As regards domestic gas production, PGNiG's share is approximately 90%.

Production of natural gas in Poland

Production of natural gas in Poland mcm	2017 PGNiG Group	2017 PGNiG	2016 PGNiG Group	2016 PGNiG	2015 PGNiG Group	2014 PGNiG Group	2013 PGNiG Group
High-methane gas (E)	1,315	1,315	1,400	1,400	1,454	1,457	1,550
PGNiG Zielona Góra Branch	-	-	-	-	-	-	-
PGNiG Sanok Branch	*1,315*	*1,315*	*1,400*	*1,400*	1,454	1,457	1,550
Nitrogen-rich gas (Ls/Lw as E equivalent)	2,524	2,524	2,481	2,481	2,513	2,570	2,661
PGNiG Zielona Góra Branch	*2,467*	*2,467*	*2,422*	*2,422*	2,441	2,490	2,574
PGNiG Sanok Branch	*56*	*56*	*59*	*59*	72	80	87
Total (as E equivalent)	3,839	3,839	3,881	3,881	3,967	4,027	4,211

Production of crude oil in Poland (including condensate and NGL)

Crude oil production* in Poland thousand tonnes	2017 PGNiG Group	2017 PGNiG	2016 PGNiG Group	2016 PGNiG	2015 PGNiG Group	2014 PGNiG Group	2013 PGNiG Group
PGNiG Zielona Góra Branch	*747*	*747*	*719*	*719*	*719*	*742*	*766*
PGNiG Sanok Branch	*40*	*40*	*44*	*44*	*46*	*47*	*49*
Total	787	787	763	763	765	789	815

** including condensate and NGL*

Production of other products

thousand tonnes	2017 PGNiG Group	2017 PGNiG	2016 PGNiG Group	2016 PGNiG	2015 PGNiG Group	2014 PGNiG Group	2013 PGNiG Group
Propane-butane	38	38	37	37	35	32	30
LNG	22	22	26	26	25	30	32
mcm							
Helium	3	3	3	3	3	3	3

Collaboration with other entities

In 2017, PGNiG conducted joint operations with other entities in licence areas awarded to PGNiG, FX Energy Poland Sp. z o.o., LOTOS Petrobaltic S.A., and ORLEN Upstream Sp. z o.o. Furthermore, PGNiG was engaged in exploration work with other entities in Pakistan and Norway.

Collaboration in Poland

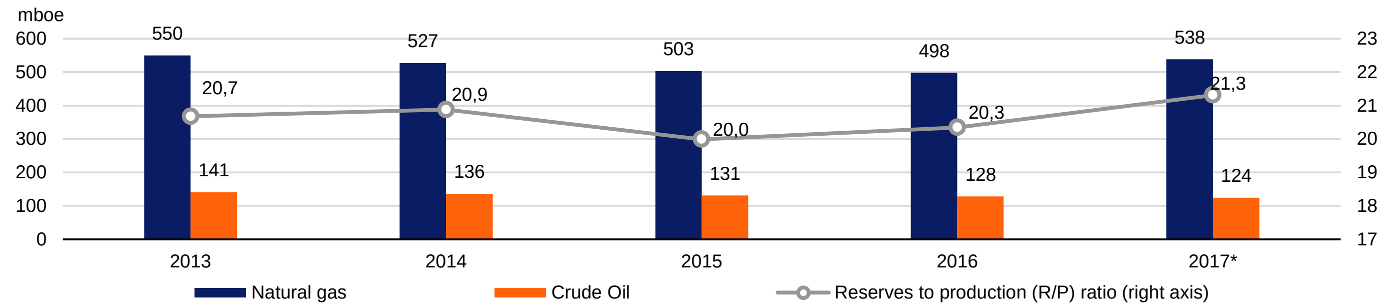
Under licences held by PGNiG, work was continued in the following areas:

- 'Płotki' – under the joint operations agreement dated May 12th 2000; licence interests: PGNiG (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%; 3D seismic surveys were completed in the Radliniec licence area and commenced in the Mechlin licence area.
- 'Płotki' – 'PTZ' (the Extended Zaniemyśl Area) – under the joint operations agreement dated October 26th 2005; licence interests: PGNiG (operator) – 51%, FX Energy Poland Sp. z o.o. – 24.5%, Calenergy Resources Poland Sp. z o.o. – 24.5%. At present, PGNiG is awaiting decision of the Ministry of the Environment to terminate the licence.
- 'Poznań' – under the joint operations agreement dated June 1st 2004; licence interests: PGNiG (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%. The construction of the Miłosław E gas production facility continued. Drilling of the Miłosław-5K/H exploration well was completed, achieving commercial flow of gas, and drilling of the Kotlin-3 exploration well was started. 3D seismic surveys in the Taczanów licence area were also completed.
- 'Bieszczady' – under the joint operations agreement dated June 1st 2007; licence interests: PGNiG (operator) – 51%, Eurogas Polska Sp. z o.o. – 24%, and Energia Bieszczady Sp. z o.o. – 25%; on July 20th 2015, ORLEN Upstream Sp. z o.o. acquired a 49% interest in licence blocks 437, 438, 456, 457, 458 and in parts of licence blocks 416, 417 and 436 held by Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o., thus becoming a party to the joint operations agreement. The processing and interpretation of 2D seismic data (Hoczew-Lutowiska) was completed in the area. Drilling of the Pisarowce-1 well (depth: 1,700 m) and the Poraż Południe-1 well (depth: 3,000 m) was completed. 2D field seismic surveys in the Barycz-Paszowa seismic area were completed. In 2017, geological data processing and interpretation was carried out for two seismic areas: Barycz-Paszowa (2D) and Wańkowa-Bandrów (3D). In November 2017, works were started to abandon the Niebieszczany-1 exploration well.

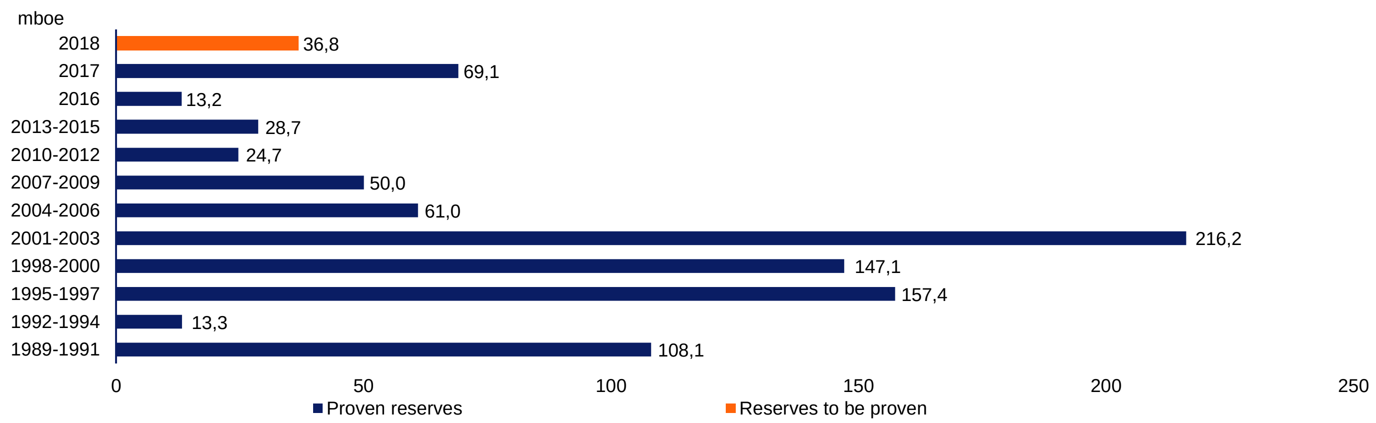
- 'Sieraków' – under the joint operations agreement dated June 22nd 2009; licence interests: PGNiG (operator) – 51%, ORLEN Upstream Sp. z o.o. – 49%. Formal and legal work connected with the development of the Sieraków oil field is under way;
- 'Kamień Pomorski' – under the agreement of August 14th 2013; licence interests: PGNiG (operator) – 51%, LOTOS Petrobaltic S.A. – 49%. In August - October 2017, a negative Stawno-1 well was drilled - work to appraise future prospects for that licence area is under way;
- 'Górowo Iławieckie' – under the agreement on joint operations of December 31st 2014; licence interests: PGNiG (operator) – 51%, LOTOS Petrobaltic S.A. – 49%. The Miłaki 3D seismic surveys were relaunched after suspension in October 2017;
- Under licences held by FX Energy Poland Sp. z o.o., work was conducted in the 'Warszawa-Południe' area (block 255), under the joint operations agreement dated May 26th 2011. The licence interests are as follows: FX Energy Poland Sp. z o.o. (operator) – 51%, and PGNiG – 49%. In May 2017, interpretation of the 3D seismic data relating to the Potycz-Wilga licence area was completed. In October, PGNiG terminated the Joint Operations Agreement.

Collaboration abroad › For more information, see Section 5.1.4

Recoverable reserves in Poland in 2013−2017 (proven by PGNiG)



*Also included are reserve increases specified in the documentation approved by the Commission for Mineral Resources, without the decision of the Minister of the Environment.



Sales of key products

The main products sold by the Trade and Storage segment are crude oil, high-methane gas and nitrogen-rich gas. Other products, obtained in the process of crude refining, include crude condensate, sulfur, and propane-butane. Some of the produced nitrogen-rich gas is further treated into high-methane gas at the Odolanów and Grodzisk Wielkopolski nitrogen rejection units. Apart from high-methane gas, the cryogenic processing of nitrogen-rich gas yields such products as liquefied natural gas (LNG), gaseous and liquid helium, and liquid nitrogen.

Part of the natural gas extracted in Poland is sold directly from gas fields to customers outside the PGNiG Group (see table below) and within the PGNiG Group. Natural gas extracted and not sold in the upstream segment is transferred for sale to the Trade and Storage segment.

Domestic sales of natural gas produced by the segment outside the PGNiG Group mcm	2017		2016		2015	2014	2013
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	30	30	53	53	52	33	36
Nitrogen-rich gas (Ls/Lw as E equivalent)	646	646	644	644	633	682	658
Total (as E equivalent)	676	676	697	697	685	715	694

As regards trading in crude oil extracted in Poland, in 2017 PGNiG continued its trading partnership with major Polish and foreign players in the fuel sector.

Crude oil* in Poland, PGNiG Group thousand tonnes	2017 PGNiG Group	2017 PGNiG	2016 PGNiG Group	2016 PGNiG	2015 PGNiG Group	2014 PGNiG Group	2013 PGNiG Group
PGNiG Zielona Góra Branch	747	747	719	719	719	742	766
PGNiG Sanok Branch	40	40	44	44	46	47	49
Crude oil production*	787	787	763	763	765	789	815
Sales of crude oil* produced in Poland	791	791	753	753	772	780	809

** Including condensate.*

Rail deliveries of crude oil (67% of sales) were made to the refinery of the LOTOS Group in Gdańsk and to Orlen Południe's Trzebinia Production Plant (the ORLEN Group). In 2017, crude oil was also delivered by road to Orlen Południe's Jedlicze Production Plant (5% of sales), and via the PERN pipeline − to TOTSA TOTAL Oil Trading S.A. (28% of sales). PGNiG sells crude oil at market prices.

Seismic surveys

In 2017, 335.17 km of 2D seismic surveys and 650.74 km^2 of 3D seismic surveys were carried out. The largest 2D and 3D projects implemented in Poland during the year include Barycz-Paszowa 2D (288 km) as well as Robotycze-Fredropol 3D (246 km^2), Kramarzówka 3D (146 km^2), Mechlin 3D (110 km^2), and Taczanów 3D (56 km^2).

Underground gas storage facilities

PGNiG's Exploration and Production segment's gas system includes two storage facilities for L group gas (Daszewo UGSF and Bonikowo UGSF), whose main role is to regulate the operation of the nitrogen-rich gas system and store gas from nitrogen-rich gas production facilities.

Key parameters of underground gas storage facilities

Underground gas storage facilities (UGSF)	Working capacity mcm	Maximum withdrawal capacity mcm/day	Maximum injection capacity mcm/day
Bonikowo	200	2.4	1.7
Daszewo	30	0.4	0.2

Exploration, appraisal and extraction of coal bed methane

As part of the exploration, appraisal and extraction project for methane deposits in the Geo-Metan coal bed, in 2017 work was completed in two wells (Gilowice-1 and Gilowice-2H) in the area of the Upper Silesian Coal Basin. The works were approved by the decision of the Minister of the Environment of June 24th 2016.

In 2017, research and test works were performed to determine the potential of gas flow from coal beds after hydraulic fracturing in the Gilowice-2H well. Field tests yielded satisfactory production results - about 880 thousand m^3 of gas were extracted with an average gas yield in the final test stage of approximately 3.7 m^3/min), confirming the effectiveness of the reservoir stimulation works carried out. At the end of Q1 2017, PGNiG secured an exploration, appraisal and production licence for coal bed methane, covering almost 19 square kilometres. The licence area covers the rural municipalities of Miedźna, Bojszowy, Pszczyna and the rural and urban municipality of Brzeszcze. The test production from coal beds yielded promising results, and extracted gas proved to be of very good quality (97% methane). More drilling is planned in these areas in early 2018.

5.1.4. Foreign operations

Natural gas production abroad mcm	2017 PGNiG Group	2017 PGNiG	2016 PGNiG Group	2016 PGNiG	2015 PGNiG Group	2014 PGNiG Group	2013 PGNiG Group
High-methane gas (E)	548	-	517	-	573	419	340
in Norway	548	-	517	-	573	419	340
Nitrogen-rich gas (Ls/Lw as E equivalent)	150	150	59	59	52	58	25
PGNiG Pakistan Branch	150	150	59	59	52	58	25
Total (as E equivalent)	698	698	576	59	625	477	365

Sales outside the Group mcm	2017 PGNiG Group	2017 PGNiG	2016 PGNiG Group	2016 PGNiG	2015 PGNiG Group	2014 PGNiG Group	2013 PGNiG Group
High-methane gas (E)	-	-	24	-	1	-	-
in Norway	-	-	24	-	1	-	-
Nitrogen-rich gas (Ls/Lw as E equivalent)	149	149	56	56	51	56	25
PGNiG Pakistan Branch	149	149	56	56	51	56	25
TOTAL (measured as E equivalent)	149	149	80	56	52	56	25

Crude oil* thousand tonnes	2017 PGNiG Group	2017 PGNiG	2016 PGNiG Group	2016 PGNiG	2015 PGNiG Group	2014 PGNiG Group	2013 PGNiG Group
Production in Norway	470	-	555	-	664	418	283
Sales in Norway	479	-	593	-	619	389	297

**Including NGL.*

Norway

PGNiG UN holds interests in exploration and production licences on the Norwegian Continental Shelf in the Norwegian Sea, in the North Sea, and in the Barents Sea. Jointly with partners, the company has been extracting hydrocarbons from the Skarv, Morvin, Vilje, Vale and Gina Krog fields and working on the development of the Ærfugl (formerly Snadd) and Skogul (formerly Storklakken) fields. In the other licence areas, the company is engaged in exploration projects.

The company's main asset is the Skarv field, which has been developed using a floating production, storage and offloading (FPSO) vessel. Since 2017, PGNiG UN has been extracting hydrocarbons from the new Gina Krog deposit, which was developed using a new platform in the North Sea. The other fields (Morvin, Vilje and Vale) comprise a group of wells connected to the existing production infrastructure. In 2017, PGNiG UN together with its partners launched two investment projects at the Ærfugl and Skogul fields. The preferred scenario provides for drilling three new production wells and launch of production in 2020.

In 2017, the company produced a total of 470 thousand tonnes of crude oil with other fractions (measured as tonnes of crude oil equivalent) and 548 mcm of natural gas from the Skarv, Morvin, Vilje, Vale, and Gina Krog fields. The extraction volume was affected by the temporary shutdown of two of the fifteen wells in the Skarv field and a downtime in the Vale field in the second half of the year. The impact of these events was partly offset by higher production from other fields and improved consistency of hydrocarbon flows from other wells in the Skarv field.

In 2017, PGNiG and its partners continued the development of the Gina Krog field, which included the drilling of production wells, tests of production installation, and technical acceptance. An FSO unit was installed near the field to serve as an oil storage facility. All these works led to the launch of production from the Gina Krog field at the end of June 2017.

In 2017, PGNiG UN recorded an increase in proven reserves in Norway, from 78 mboe at the beginning of the year to 83 mboe at the end of 2017 as a result of a positive re-evaluation of resources in the Ærfugl and Vilje fields and the acquisition of the Skogul field. In line with the PGNiG Group's Strategy, PGNiG UN analysed other projects that may lead to further increases in production volumes. In the first half of 2017, PGNiG UN acquired a 35% interest in the Skogul field (licence PL460) from Aker BP ASA, securing 3.55 mboe of the field's recoverable reserves. PGNiG UN also acquired a 20% interest in the PL433 licence, which covers the Fogelberg condensate and gas field (the transaction is awaiting approval by the Norwegian authorities). The PL433 licence is operated by Spirit Energy (formerly Centrica), which holds a 51.7% interest, and Faroe Petroleum, with an interest of 28.3%, is the project partner. The licence holders decided to drill an appraisal well in 2018, based on which a decision is to be made whether to proceed with field development. According to the data provided by the Norwegian Ministry of Oil and Gas, the estimated recoverable reserves in the Fogelberg field are 64 mboe.

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).

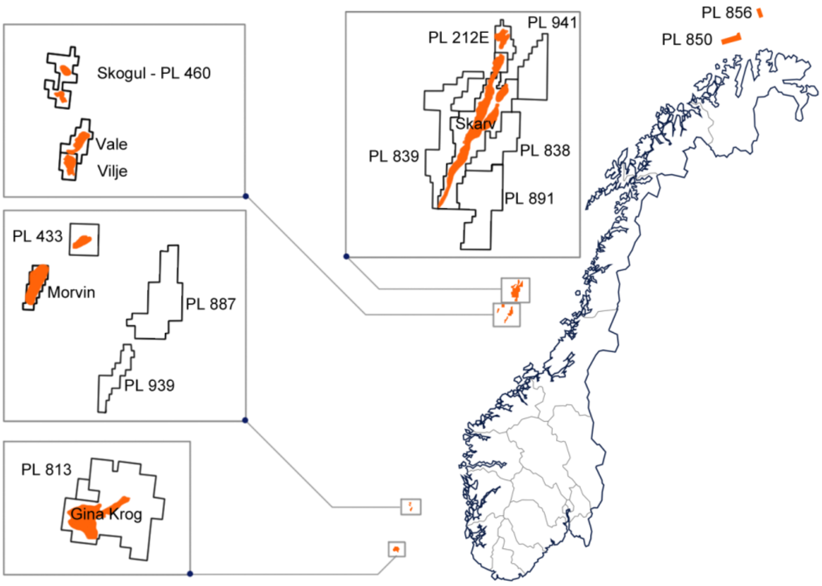
Within two years, the licence partners are to carry out necessary geological and geophysical surveys to precisely estimate the oil production potential of the licence areas. After that period, drill-or-drop decisions will be made. The awarded licences have significant gas potential, which fits in with plans envisaging gas imports from Norway to Poland. Both licences are located close to existing production and pipeline infrastructure, which will make project work much simpler and faster. They are also located near the Skarv and Åsgard fields, respectively.

Jointly with its partners, PGNiG UN also continued work in other exploration licence areas. Among other works, the company evaluated the potential of the PL839, PL850, and PL838 licence areas. Based on the results of geological surveys and economic analyses, the company and its partners decided to release the PL703 licence and the operator licence PL799, with no wells drilled.

In 2017, PGNiG UN continued the efforts 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). PGNiG UN actively participated in the consultations launched by the operators and submitted a number of proposals regarding the legal and regulatory framework for that link.

PGNiG UN holds a diversified portfolio of production and exploration licences in the North Sea, the Norwegian Sea, and the Barents Sea, and maintaining this diversification is perceived as an important element of project portfolio management. As at December 31st 2017, PGNiG UN held interests in 18 exploration and production licences, including as the operator of two licences.

Fig. 7 PGNiG UN's production fields



Licence	Operator	Interest	Type	Planned activities
PL029C (Gina Krog)	Statoil	29.63 % (8% in the project)	Exploration/development	Development (production to begin in 2017)/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% in the project)	Exploration/Development/Production	Production, development of the Ærfugl deposit, exploration, planned drilling in 2018
PL460 (Skogul)	Aker BP	35%	Development	Development (production to start in 2020)
PL212E (Snadd Outer)	BP	15%	Exploration	Possible tie-back to Snadd
PL813 (Elli)	Statoil	8%	Exploration	Expected DoD decision* February 2019
Op. PL838 (Tunfisk/Shrek)	PGNiG	40%	Exploration	DoD decision* August 2018
PL839 (Nise/Storkobbe)	BP	11.9175%	Exploration	Seismic data interpretation
PL850 (Ulv)	Edison	20%	Exploration	DoD decision* February 2019
PL856 (Princesse)	Capricorn	25%	Exploration	DoD decision* July 2018
PL887 (Novus East)	PGNiG	40%	Exploration	DoD decision* February 2019
PL891 (Tunfisk South)	ConocoPhilips	30%	Exploration	DoD decision* February 2019

**Drill-or-drop decision – a decision to either commit to drilling exploration wells or relinquish the licence*

The **Skarv** field was brought on stream in December 2012. Currently developed with 16 wells connected with five subsea templates, which can support a further seven wells, adding much flexibility to Skarv operations going forward. The Skarv FPSO has a long useful life and can be an attractive production and transport hub for future discoveries in the region.

Ærfugl field – a gas and condensate field in the Skarv licence area. Six more wells are to be tied back to the Skarv FPSO and existing transport infrastructure. Production from the new installations is to start in 2020.

Skarv and Ærfugl reserves: 54.7 mboe, including 37.1 mboe of natural gas and 17.6 mboe of crude oil and NGL

The **Morvin** field was discovered in the Norwegian Sea in 2001. Oil is produced through two subsea templates (North and South). Tied back to the Åsgard B platform, the field has a stable and predictable production profile.

Resources: 1.2 mboe, including 0.4 mboe of natural gas and 0.8 mboe of crude oil and NGL

The **Vilje** field is located in the central part of the North Sea, close to the Alvheim and Heimdal facilities. The field is developed with three subsea wells linked by pipeline to the Alvheim FPSO vessel.

Oil reserves: 4.5 mboe

Gina Krog is an oil and gas field brought on stream in June 2017 with five wells. Subsequent wells will be drilled until 2019, allowing to increase production capacity. The field was developed using a platform and a floating storage and offloading (FSO) unit for crude oil transported by tankers for transshipment. Raw natural gas is sent to the Sleipner platform. After processing, the gas is exported to Europe via Gassled. Condensate and NGL will be transported to the Kårstø processing plant in Norway.

Resources: Reserves: 17.4 mboe, including 5.5 mboe of natural gas and 11.9 mboe of crude oil and NGL

Vale is a gas and condensate field discovered in the North Sea in 1991. Output from the Vale field is expected to rise in the coming years as a result of recent investments made in the Heimdal platform.

Resources: 2.0 mboe, including 1.2 mboe of natural gas and 0.8 mboe of crude oil

Skogul is on oil field situated in the North Sea near the Vilje field. The development plan assumes drilling one well connected to the subsea installation on the Vilje field, and then using the existing infrastructure, including the Alvheim FPSO platform.

Resources: 3.5 mboe, including 0.3 mboe of natural gas and 3.2 mboe of crude oil

Sale

Crude oil is sold directly from the fields to Shell International Trading and Shipping Company Ltd (crude from the Skarv, Vilje, Vale and Gina Krog fields) and to TOTSA Total Oil Trading S.A. (from the Morvin field). All fields except for Vilje also produce associated gas, which is transferred via a gas pipeline mainly to Germany, where it is collected by PST. The key sales markets are Norway, Germany and the UK.

Pakistan

PGNiG is engaged in exploration work in Pakistan under an agreement for hydrocarbon exploration and production in the Kirthar licence area executed between PGNiG and the government of Pakistan on May 18th 2005. 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%. Exploration activities within the licence area have resulted in the discovery of two gas deposits − Rehman and Rizq.

Natural (nitrogen-rich) gas resources: 6.96 billion cubic metres (35.7 million boe) in the Rehman field and 2.44 billion cubic metres (13.7 million boe) in the Rizq field

Gas from the Rehman and Rizq fields is produced via facilities located in the Rehman field. PGNiG's share in the production from the Rehman and Rizq fields, carried out using five wells in 2017, amounted to 150 mcm of gas (measured as high-methane gas equivalent).

In March 2017, PGNiG completed drilling the Rehman-3 well and in October - the Rizq-2 well. Currently, drilling of the Rehman-4 borehole, which started in November, is continued and preparatory work is under way for drilling the Roshan-1 and Rehman-5 boreholes. The Rehman-2 well was brought on stream in March 2017, while the Rehman-3 well in August. Work to hook up the Rizq-2 well is in progress, to be completed in Q1 2018. The first tests in the Rizq-2 appraisal well were carried out in October 2017. The initial flow rate achieved at the time was approximately 28 m^3/min. After a hydraulic fracturing treatment performed in late November and early December 2017, the well flowed at a rate of around 128 m^3/min.

Libya

Due to a rapid deterioration of the security situation in Libya in mid-2014, on August 12th 2014 PGNiG UNA gave notice of a force majeure to the National Oil Corporation (NOC) and started to scale back its operations in the country.

In 2017, in agreement with NOC, PGNiG UNA carried on with measures to mitigate the impact of force majeure on the project: analysis of seismic data and verification of the prospectivity of licence LC113. The following assets were secured: offices, downhole equipment in the warehouse, and a warehouse of core samples from two wells that returned positive results (A1 and B1) from 2013 and 2014.

Iran

In 2017, PGNiG completed the preliminary development concept for the Soumar field (Technical Proposal), which was submitted to and approved by National Iranian Oil Company (NIOC) and Iranian Central Oil Fields Company. The company is analysing the possibility of further cooperation with the partners.

Seismic surveys

In 2017, the PGNiG Group carried out seismic data acquisition activities, mainly in Poland and abroad (Croatia, Myanmar (Burma), Egypt, Tunisia, Algeria, Germany, and Austria). The PGNiG Group companies performed contracts for seismic data processing and interpretation in Poland, Pakistan and Morocco.

5.1.5. Key investment projects and CAPEX

In 2017, PGNiG's capital expenditure in the Exploration and Production segment amounted to PLN 867m, 4% more than in 2016.

Exploration expenditure was made mainly on appraisal and exploratory wells (with the largest amount – PLN 75m – spent on the Kramarzówka appraisal well) and on seismic and geophysical work (with the largest amount – PLN 51m – spent on 3D seismic surveys in the Rybotycze-Fredropol area). PGNiG's total expenditure on exploration work in Poland and abroad amounted to PLN 475m.

The most important production projects included the production wells in the Lubiatów-Międzychód-Grotów area (PLN 71m) and development of the Radoszyn deposit (PLN 26m). PGNiG's total expenditure on upstream projects in Poland and abroad amounted to PLN 392m.

In 2017, capital expenditure made in Pakistan totalled PLN 100m, and was 2% higher than in 2016.

In 2017, capital expenditure in Norway totalled PLN 275m. PGNiG UN and its partners continued work on the development of the Gina Krog, Ærfugl, and Skogul fields. Drilling of additional production wells on the first of those fields is under way, which helps optimise the financing of the project. Production is expected to reach the assumed level after completion of the drilling campaign in 2019. In December 2017, development plans for the Ærfugl and Skogul fields were submitted for approval. Drilling of production wells and installation of downhole equipment in both fields is planned for 2019/2020, while production is scheduled to start in 2020.

5.1.6. Development prospects

In 2018 and 2019, PGNiG plans to produce 3.8 bcm of natural gas per year (measured as high-methane gas equivalent), whereas the planned volume of crude oil and condensate production is 820,000 tonnes in 2018 and 784,000 tonnes in 2019. The plans for 2018 in Poland include development and tie-in of 12 wells, development of three fields (Solec, Gryżyna, and Krobielewko), and modernisation and extension of existing installations.

Together with the Polish Geological Institute − National Research Institute, PGNiG will continue the research project into the application of the fracturing technology to extract coal bed methane in Gilowice. Thanks to this technology, in the future PGNiG will be able to increase its domestic production capacity. Coal bed methane may be an important element of national energy security based on production of hydrocarbons from domestic resources, while mine demethanization will improve the work safety of miners and contribute to reducing emissions of methane, an aggressive greenhouse gas, into the atmosphere.

On the Norwegian Continental Shelf, PGNiG UN, as a project partner, will continue to produce hydrocarbons from the Skarv, Morvin, Vilje, Vale, and Gina Krog fields and will proceed with the development of the Snadd and Gina Krog fields. The company will also work towards ensuring stable, predictable and long-term gas supplies to Poland. These efforts will include analysis of infrastructure scenarios for transmission of Norwegian gas to Poland, but also potential acquisitions of gas fields in Norway. At the beginning of 2018, the number of licences will increase to 21. The increase is related to the expected approval of the acquisition of the PL433 licence by Norwegian authorities and the conclusion of the last licence round.

PGNiG UN also intends to acquire new licence areas by participating in annual APA licence rounds and in regular licence rounds held every two to three years. The company may seek to acquire new licence areas through farm-in (purchase of interests from other companies) or farm-down (exchange of interests with other companies) arrangements. In the future, PGNiG UN may participate, as a partner, in drilling projects in the Arctic Zone. One of the reasons is that it has interests in two licences (PL850 and PL 856) in the Barents Sea.

As regards Pakistan, plans for 2018 include the completion of drilling, testing and bringing on stream the Rehman-4 production well and the start of drilling of the Rehman-5 and Rizq-3 production wells. At the same time, work will be carried out to expand the capacity of the production infrastructure and tie in the Rizq-2 well and the Rehman-4 well for production. It is also expected that the potential Roshan field will be brought on stream. Other plans for 2018 include acquisition of 3D seismic dataset for the area of the potential W1 field, 2D seismic dataset for the area of the potential W2 field, and drilling of the Roshan-1 exploration well, which is intended to discover another field with recoverable gas of 3.1 bcm (17 mboe). Drilling of the Roshan-1 well will represent fulfilment of the new commitments made in 2017 in connection with the renewal of the Kirthar exploration licence.

As regards seismic surveys, acquisitions of 2D and 3D seismic data in Poland (for PGNiG and counterparties outside the Group) as well as in Germany and Ukraine are planned to be made in 2018.

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 Supply and Trading GmbH (wholesale) 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. 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) and provides a ticketing service for gas storage for external customers.

5.2.1. Segment's key data

Financial highlights	2017		2016[2]		2015[1]	2014[1]	2013[1]
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
Total revenue	30,495	16,968	28,180	15,485	31,742	28,825	25,659
Revenue from sales outside the Group, including:	30,000	16,928	27,733	15,457	31,274	28,367	25,341
- high-methane and nitrogen-rich gas,	27,813	14,507	25,615	12,436	29,413	26,555	24,392

Inter-segment revenue	495	40	454	28	468	458	318
EBITDA	(435)	(890)	614	678	623	764	170
EBITDA adjusted for impairment losses on property, plant and equipment	(70)	(525)	626	690	627	822	183

1) Data not restated, as reported.
2) Data restated according to the new segmentation of the PGNiG Group's operations - for more information, see Section 1.3 of the consolidated financial statements.

Natural gas sales outside the PGNiG Group mcm	**2017**		**2016**		**2015**	**2014**	**2013**
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	25,261	15,947	22,818	13,527	21,596	17,289	14,934
Nitrogen-rich gas (Ls/Lw as E equivalent)	701	212	671	207	611	514	519
TOTAL (measured as E equivalent)	25,962	16,159	23,489	13,734	22,207	17,803	15,453
including:							
PGNiG	*16,159*	-	*13,734*	-	*12,415*	*12,834*	*14,070*
PGNiG OD	*7,617*	-	*7,245*	-	*7,753*	*3,209*	-
PST	*2,186*	-	*2,510*	-	*2,039*	*1,760*	*1,383*

5.2.2. Segment's strategy

Wholesale trade: Diversification of gas supply sources

The PGNiG Group's position has been adversely affected by the long-term contract for gas supplies to Poland, concluded in the past (the Yamal contract). As the contract is nearing expiry in 2022, the Group seeks to ensure real diversification of gas supplies. 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.

- The Group's strategic objective is to build a mix of gas supply sources based on the planned transmission infrastructure Norway-Denmark-Poland (for more information on the Baltic Pipe project, see Section 7.1.2.) to enable gas imports from new directions and at market prices, thus ensuring renewal of the gas supply portfolio beyond 2022.
- Once built, LNG trading and logistic competencies on the global market will help create a more flexible gas supply portfolio beyond 2022 as the Group will be able to swiftly balance its gas imports. Efforts to develop such competencies and strengthen the Company's presence on the global LNG market will be continued. The Group intends to analyse the possibility of entering into contracts for LNG imports from new directions (e.g. from North America, Australia, Africa), expand cooperation with the existing LNG suppliers, and acquire new competencies in LNG transport by sea.
- Expansion of the resource base in Poland and abroad accompanied by completion of the Norwegian Corridor project would enable transport of gas from the Group's own fields directly to Poland.

Wholesale trade: Increased gas volume in wholesale

In wholesale, the strategic objective is to expand the Group's gas trading volume to approximately 178 TWh in 2022 (in 2017, the volume was approximately 175.7 TWh). 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. This objective fits in with the upward trend observed in 2017 in the volumes of natural gas sold to the largest industrial gas customers in Poland and the strong sales of gas to Ukraine.

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

Given PST's experience and competencies, one of the Group's strategic objectives will be to continue the expansion into other 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.

Retail trade: Maintaining current market position and maximising retail margins

During the term of the Strategy, the overriding strategic objective of PGNiG OD is to improve the effectiveness of retail sales of gas while maintaining the total volume of retail sales at around 67−69 TWh/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 was abolished as of October 1st 2017, which means that approximately 50% of the gas volume sold by PGNiG OD is exempt from the tariff obligation.

PGNiG OD has taken steps aimed at enhancing its product offering. PGNiG's retail segment has been expanding its offering of products targeted at various customer groups (both gas and electricity products). 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.

Storage: Increasing available storage capacities

In its storage business, the PGNiG Group focuses on two key strategic goals, i.e. securing storage capacities in keeping with actual demand, and further improving efficiency of the storage operations. It is expected that upon completion of the extension of the underground gas storage 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 3 bcm.

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.

5.2.3. Trade 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, the structure of the PGNiG Group changed: retail operations were separated from the wholesale gas business, the latter remaining with PGNiG. Retail customer service was transferred to PGNiG OD, a new company.

Natural gas sales in Poland outside the PGNiG Group (including gas exports from Poland) mcm	2017		2016		2015	2014	2013
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	23,075	15,947	20,435	13,527	19,557	15,543	13,555
Nitrogen-rich gas (Ls/Lw as E equivalent)	701	212	671	207	611	514	519
TOTAL (measured as E equivalent)	23,776	16,159	21,106	13,734	20,168	16,057	14,074
including:							
PGNiG	16,159	-	13,734	-	12,415	12,834	13,555
PGNiG OD	7,617	-	7,245	-	7,481	3,209	-
PST	-	-	127	-	272	14	5

PGNiG Group's customer base mcm	2017		2016	
	PGNiG Group	PGNiG	PGNiG Group	PGNiG
Households	4,065	-	3,913	-
Retail, services, wholesale	1,775	470	1,475	233
Nitrogen plants	1,981	1,981	1,798	1,798
Power and heat plants	900	725	607	419
Refineries and petrochemical plants	2,795	2,787	1,338	1,327
Other industrial customers	3,028	1,045	2,468	618
Exchange	8,515	8,423	9,141	8,969
Exports from Poland	728	728	370	370
Total sales outside the Group	23,787	16,159	21,109	13,734

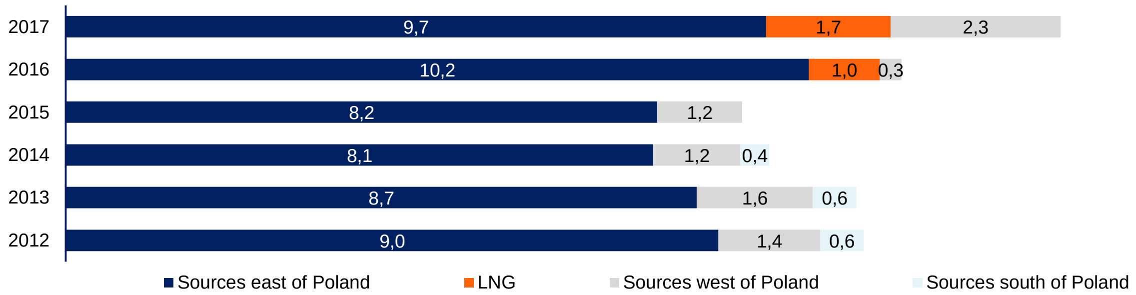
Wholesale market

Gas imports

In 2017, PGNiG purchased natural gas mainly under the long-term agreements and contracts as well as short-term gas supply agreements with European suppliers specified below:

- Contract with OOO Gazprom Export for sale of natural gas to the Republic of Poland, dated September 25th 1996, effective until 2022 (the Yamal Contract);
- Contract with Qatar Liquefied Gas Company Limited (3) for sale of liquefied natural gas, dated June 29th 2009, effective until 2034 (the Qatar Contract);

Imports of natural gas to Poland in 2012–2017 (bcm):



In 2017, purchases of imported gas rose to 13.7 bcm. Gas purchases from the Eastern direction fell by 0.5 bcm compared with 2016. Gas purchases from the Western direction increased to 2.3 mcm. LNG supplies also increased, to 1.7 bcm.

PGNiG actively supports all efforts leading to the construction of the infrastructural connection with an annual capacity of approximately 10 bcm which would give Poland direct access to gas from North Sea fields. In 2017, PGNiG took part in the 2017 Baltic Pipe Open Season Procedure announced by Gaz-System and the Danish transmission system operator Energinet, and placed a binding bid to book transmission capacity from October 1st 2022 to September 30th 2037 that would enable it to bring gas from the Norwegian Continental Shelf to Poland. A positive result of the economic test carried out by the operators and confirmation of the capacity allocation to PGNiG led to the signing of transmission agreements with the operators in January 2018 (for more information on the Baltic Pipe project, see Section 7.1.2.).

An annex to the Regasification Agreement with Polskie LNG S.A. was signed in 2017, increasing the long-term regasification capacity booking by PGNiG at the LNG Terminal to 100%. The annex runs from January 1st 2018 to January 1st 2035 and will enable gas deliveries under the supplementary agreement with Qatargas and potential purchases of additional LNG under spot and short- to medium-term contracts.

Renegotiation of price terms under the contract with OOO Gazprom Export

In 2017, PGNiG continued its efforts to revise the price terms under the Yamal Contract as part of the procedure formally launched on November 1st 2014. Since no agreement was reached with the supplier, on May 13th 2015 PGNiG instigated arbitration proceedings, in accordance with the contract. The dispute concerns bringing the contract in line with the current conditions on the European natural gas market. As at the date of preparation of this report, the proceedings before the Arbitration Court were pending. The company expects that the dispute will be settled in the first half of 2018. The fact of referring the dispute to the Arbitration Court does not preclude commercial negotiations and earlier amicable settlement with the supplier.

Despite the failed attempt to renegotiate the price terms of the Yamal Contract, on November 1st 2017 PGNiG again requested PAO Gazprom/OOO Gazprom Eksport to renegotiate the price terms of gas supplies. The Russians submitted their own renegotiation request on December 7th 2017, which the Company believes was groundless and ineffective as it failed to meet the formal requirements set out in the Yamal Contract. The parties had failed to reach an agreement by the date of this report.

LNG supplies

On March 14th 2017, PGNiG and Qatargas signed a Supplemental Agreement to the contract for sale 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 gas), and in 2018–2020 to 2.17m tonnes per year (equivalent to about 2.9bn m^3 of grid gas).

PGNiG received three spot LNG cargoes, contracted through the LNG trading office run by PST in London. The first cargo of ca. 150,000 cubic metres of LNG from the Sabine Pass terminal in the US was delivered by Cheniere Marketing International. Approximately 205,000 cubic metres of LNG was purchased from Qatar Liquefied Gas Company Limited (2) on a spot basis. The last spot cargo of around 140,000 cubic metres of LNG received in 2017 was sourced from Norway and delivered by Statoil ASA. The PGNiG Group purchased a total of ca. PLN 500,000 cubic metres of LNG on the spot market in 2017, equivalent to approximately 3.33 TWh or approximately 290 mcm of natural gas after regasification.

In an effort to further diversify its gas supply sources, in November 2017 the Group signed a five-year contract for a total of nine LNG shipments with Centrica LNG Company Limited, to be delivered from the Sabine Pass liquefaction terminal in the US. The contract will enter into force in 2018, with LNG to be delivered on a DES (Delivery Ex Ship) basis. This is the first medium-term contract concluded by PST's LNG trading office in London.

Sales of gas

Wholesale gas tariffs were partly regulated until September 30th 2017. In practice, customers have been charged market prices. Prices in contracts already signed and those being negotiated are based on a uniform 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 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., Grupa Kapitałowa ArcelorMittal, and Grupa Lotos S.A.

In 2017, PGNiG also signed new contracts to sell gas in Poland, which were an effect of the Company's consistent pursuit of its policy of high quality customised sales. The product range is updated to reflect market trends and is based on transparent market criteria which, combined with constant service quality improvements, facilitates consistent implementation of the plan to increase the volumes of gas sold to key retail and wholesale customers in Poland. The measures taken in 2017 led to a year-on-year growth in the volumes of high-methane grid gas sold to retail and wholesale customers by ca. 55% and 65%, respectively.

Key gas supply contracts executed in 2017:

Grupa Azoty S.A.

On June 21st 2017, PGNiG concluded new Individual Contracts for the supply of gas fuel with Grupa Azoty S.A. and its subsidiaries, with deliveries scheduled from October 1st 2018 to September 30th 2020, with an option to extend the period 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. 8.5 bcm 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 over the period may reach around 1.6 bcm, with the maximum value of the contract of approximately PLN 1.4bn. The contract enables ArcelorMittal Poland S.A. to purchase gas fuel on market terms, at prices linked to exchange indices.

KGHM Polska Miedź S.A.

PGNiG concluded a long-term Framework Agreement and Individual Contracts for the supply of nitrogen-rich gas to KGHM Polska Miedź S.A. Under the Individual Contracts, gas supplies are to start on two different dates, i.e. July 1st 2017 and October 1st 2017, depending on KGHM Polska Miedź S.A.'s points of delivery. The Framework Agreement and Individual Contracts guarantee gas supplies until October 1st 2033, with an option to change nitrogen-rich gas to high-methane gas. The estimated aggregate value of the agreement over its entire term is ca. PLN 4.8bn. The applied pricing formula is based on gas market price indices.

Grupa Lotos S.A.

On October 25th 2017, PGNiG signed a new Individual Contract for the supply of gas fuel to Grupa Lotos S.A., effective until September 30th 2020, with an option to extend the term until September 30th 2022. If the option is exercised, the value of the contract is estimated at approximately PLN 3.1bn. The applied pricing formula is based on gas market price indices.

In 2017, sales on the Polish Power Exchange (PPX) accounted for the largest portion of the PGNiG Group's total gas sales. The table below presents the volumes of gas sold by PGNiG in 2017 and 2016 on the PPX's Commodity Futures Instruments Market, Day-Ahead Market, and Intraday Market (data by delivery dates):

Volume (TWh)	2017	2016
Total – Commodity Futures Instruments Market (natural gas)	75.2	78.7
Total – Day-Ahead and Intraday Market (natural gas)	17.2	19.1
TOTAL – Polish Power Exchange	92.4	97.8

The volume of gas sold by PGNiG S.A. on the PPX in 2017 decreased by approximately 5.4 TWh year on year.

To meet the obligation to sell 55% of the gas fed into the national transmission system through the exchange market, PGNiG has adopted a pricing policy covering all natural gas-linked instruments on PPX, both on the futures and day-ahead markets, allowing it to offer natural gas to other market participants at prices corresponding with those on deregulated wholesale, exchange and OTC markets in Western and Northern Europe. The applied pricing policy has made the commodity exchange an attractive gas trading platform.

Competition

In the business customer segment, PGNiG's main competitors operating directly in Poland include PGE Polska Grupa Energetyczna S.A., DUON (Fortum Holdings), Hermes Energy Group S.A., RWE Polska S.A., TAURON Polska Energia S.A., and PKN ORLEN S.A. Competitors step up gas sales by strengthening their sales force, increasing the flexibility of their offering and price hedging mechanisms, as well as by bundling gas and electricity.

In the reporting period, PGNiG's sales of high-methane grid gas in Poland were 165.2 TWh, up 15.1% on 2016 (143.5 TWh). On the one hand, the higher sales volume resulted from stronger market demand, but on the other, the increase was driven by competitors' declining share in gas imports. In 2017, competitors' net gas imports fell by 8.2 TWh, or 42.6%, year on year.

Gas exports

In 2017, as part of its cooperation with the ERU Group, PGNiG sold 728 mcm of gas on the Ukrainian market, with the total volume of gas sold to Ukraine from August 2016 having reached 1.1 bcm. In April 2017, the two companies were jointly awarded a contract for the supply of natural gas to the Ukrainian transmission and storage operator Ukrtransgaz, for its own needs. The total volume of natural gas to be supplied under the contract is 195 mcm.

In October 2017, PGNiG concluded an agreement with Ukrtransgaz for the transmission of natural gas in the territory of Ukraine, which will enable the Company to use Ukrainian gas networks and storage facilities. In 2017, PGNiG sold gas to customers in Ukraine via the Hermanowice point on the Polish-Ukrainian border located before the entry point to Ukrtransgaz's transmission system. The agreement is a next step towards expanding PGNiG's business in Ukraine, providing new opportunities for cooperation with Ukrainian trade partners.

Sale 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 total electricity sales in 2017.Total trading volume in 2017 was more than 6.8 TWh.

Sales of electricity by PGNiG S.A.	GWh	%
End customers	6.7	0.1
Trading companies	948.6	14.0
Balancing market	492.8	7.3
Exchange	5,170.4	76.2
Producers	164.1	2.4
TOTAL	6,782.6	100.0

In 2017, PGNiG was 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 and Energetyka Rozproszona. 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 bilateral contract with PGNiG for delivery of gas to a virtual trading point in the transmission network operated by OGP GAZ-SYSTEM, and under a bilateral contract with PGNiG for delivery of gas to a physical trading point in Słubice. LNG is purchased under a bilateral FCA framework agreement with PGNiG and under a bilateral agreement with PGNiG. Nitrogen-rich Lw-type and Ls-type natural gas, produced from Polish assets, is purchased under an agreement with PGNiG.

The largest share in the global volume of high-methane gas purchases was attributable to transactions on PPX.

Gas supply contracts with PGNiG OD are governed by the Contracts Policy, which defines the rules on contracts with the individual customer groups, the division of responsibilities and the method of reporting wholesale trading activities. Given changes on the retail gas fuel market and the MIFID II requirements, work began to adjust the Contracts Policy to the current market conditions and to separate contracts with customers exempt from the tariff approval requirement. The remaining gas volumes covered by special price offers are hedged according to the level of utilisation of the price offers, to mitigate the risk that gas procurement costs would not correspond with current wholesale prices.

As regards bilateral contracts for the purchase of gas fuel delivered to a physical and virtual point, PGNiG OD uses contracts with PGNiG, providing an option to depart from the fixed price of purchased gas using pricing formulas that link the final price of gas to the prices of instruments traded on the PPX.

Sales of gas

PGNiG OD's customer base includes consumers and customers who are not consumers. Group 1-4 retail customers purchase gas used mainly for cooking and for water and space heating or in production process. Business customers buy gas both for technological purposes as well as for heating. An analysis of gas fuel customers showed that in 2017 small and medium enterprises represented the largest proportion of all customers. The opposite is true for sales volumes, with the largest customers purchasing the largest volumes of gas. The largest group of customers by number are businesses operating in the retail and services segment, whereas industrial customers lead in terms of gas volumes received.

In the area of LNG, PGNiG OD focuses on industrial customers whose energy demand cannot be met due to gas infrastructure constraints in terms of physical availability and capacity limits. PGNiG OD provides bunkering services as a separate business segment, supplying LNG to power marine vessels.

The key customers of the CNG segment are public transport companies (ca. 70% of all customers), which rolled out their fleets of CNG buses when excise duty was suspended and CNG transport became economically viable. The remaining share comprises customers in the utility vehicle market (ca. 15%) and retail customers (ca. 15%), but the size of this customer category is gradually decreasing due to lack of CNG incentives.

According to the Energy Regulatory Office, approximately 58,000 customers switched suppliers in 2017, compared with approximately 48,000 in 2016.

Competition

Based on PGNiG OD estimates, in 2017 there were over 60 gas suppliers on the market who actively competed for domestic and business customers, mainly by offering competitive gas prices and gas and electricity bundles as well as by cross selling products and services.

In 2017, the activity of competitors combined with growing customer awareness resulted in a greater market pressure on PGNiG OD to reduce gas prices and negotiate contract terms on a case-by-case basis. However, the trend to win back B2B customers that began in 2016 continued into 2017, and the company reported a strong order book for the gas year 2018. The net order book was again positive year on year.

Elimination of tariffs

The key project in 2017 was the preparation for the tariff elimination process, that is the process of abolishing the obligation to submit for approval tariffs for institutional customers. In the process, suppliers were in particular required to prepare new agreement templates, general terms and conditions of an agreement and price lists, as well as to plan and conduct an information campaign addressed to consumers.

Marketing policy with respect to business customers (contracted capacity >110 kWh/h)

In the first half of 2017, subsequent editions of the 'Elastyczna Cena' (Flexible Price) scheme for PGNiG OD's largest accounts were launched and covered contracts concluded for 2017, 2018 and 2019. Further, new editions of the 'Stałe Oszczędności dla Biznesu' (Constant Savings for Business) scheme were launched for customers in the W-5 tariff group, as were the 'Pewna cena' (Certain Price) and 'Wycena Indywidualna Suwak' (Individual Pricing – Zipper Mechanism) products. The 'Pewna Cena' promotional campaign was addressed to PGNiG OD's current customers. Under the scheme, customers were offered discounts on the standard tariff price. Due to strong interest of customers from the W-5 tariff group in the aforementioned promotional campaign, in June 2017 PGNiG OD launched the second edition of the scheme.

The 'Tranche Products' were also developed, fully linked to instruments listed on the Polish Power Exchange. These products enable customers to independently define planned consumption covered by the contract in an optimal way, based on annual, seasonal, quarterly or monthly instruments available at the Polish Power Exchange.

To retain its business customers, in August 2017 PGNiG OD launched a discount scheme for the other gas users in the BW-5 tariff group, connected with mass delivery of the 'Biznes Online' (Business Online) product and, in late November and early December, mass delivery of the 'Stałe Oszczędności dla Biznesu' (Permanent Savings for Business) product.

Marketing policy with respect to retail customers (contracted capacity <110 kWh/h), customer service and sale channels

In the first half of 2017, PGNiG OD settled the first edition of the promotional campaign 'Oszczędności dla Ciebie i Twojej firmy W4' (Savings for You and Your Company in the W4 Tariff Group). The scheme was available to both existing and new gas fuel buyers. In the first edition of the scheme, customers were offered discounts on the standard tariff price for the entire year 2016. Simultaneously, the second edition of the campaign was conducted, addressed to both existing and new gas buyers. In the second edition of the scheme, customers were offered discounts on the standard tariff price for the period from July 1st 2016 to June 30th 2017.

In the second half of 2017, PGNiG OD settled the promotional campaign 'Savings for You and Your Company in the W4 Tariff Group – The Second Edition'. Simultaneously, two discount schemes were offered to customers in the W3 and W4 tariff groups.

1. The discount campaign 'Stale Niska Cena' (Low Price All the Time) was addressed to (new and existing) customers who are not consumers in the W3 and W4 tariff groups. As part of this promotion, the customer could choose the 12-month or 24-month period of discount price application, starting on first day of the month following the month in which the agreement is concluded.
2. The discount campaign 'Do roku bez abonamentu' (Up to One Year without a Subscription Fee) (GAZEK) was addressed to the existing consumers and customers who are not consumers in the W3 and W4 tariff groups. Under the discount scheme, a customer could get a bonus equal to the six- or 12-month subscription fee.

Thanks to the scheme, around 97.7 thousand new accounts in tariff groups 1–4 were added to the retail customer base in 2017. A new account is understood as a new metering system or a metering system re-activated after at least a 12-month break in the supply of gas.

Sales of CNG and LNG

The pricing policy for both LNG supplies and regasified LNG supplies uses prices obtained at the Świnoujście LNG terminal, based on the natural gas prices quoted on the Polish Power Exchange. Offered prices of the finished product are linked to the ordered LNG volume and distance from the Świnoujście gas terminal. In 2017 new approach regarding pricing of CNG was introduced, based on correlation with PPX pricing.

The volume of LNG supplies to business customers was about 5 thousand tonnes in 2017. The volume of CNG sold in 2017 totalled approximately 16 mcm.

Sale of electricity

PGNiG OD's customer base includes consumers and customers who are not consumers who have concluded comprehensive service contracts for the supply of electricity or contracts for the sale of electricity. As at the end of 2017, PGNiG OD's base of retail customers on dual fuel (electricity and gas) plans comprised consumer accounts (91%) and non-consumer accounts (9%), with the G11 tariff applied to electricity sales for the vast majority of the accounts (ca. 86%).

According to the URE data, the number of customers who switched their electricity suppliers in 2017 was around 99,000, including a little more than 84,000 households (G tariff groups), compared with over 86,000 a year earlier, including more than 71,000 households (G tariff groups).

5.2.4. Trade abroad

Through PGNiG Supply and Trading GmbH (wholesale) 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.

Gas sales outside the PGNiG Group (excluding gas exports from Poland) mcm	**2017**		**2016**		**2015**	**2014**	**2013**
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	2,186	-	2,384	-	2,039	1,745	1,378
Nitrogen-rich gas (Ls/Lw as E equivalent)	-	-	-	-	-	-	-
TOTAL (measured as E equivalent), including:	2,186	-	2,384	-	2,039	1,745	1,378
PST	2,186	-	2,384	-	2,039	1,745	1,378

Customer base

mcm	**2017**		**2016**	
	PGNiG Group	PGNiG	PGNiG Group	PGNiG
Households	48	-	51	-
Other industrial customers	35	-	57	-
Retail, services, wholesale	1,303	-	1,460	-
Exchange	800	-	816	-
Total sales outside the Group	2,186	-	2,384	-

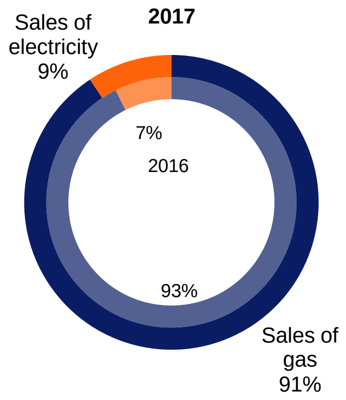
Exchange and OTC wholesale trading

PST is an active player on organised markets (exchanges) and in OTC trading. It trades with over 100 counterparties under EFET or similar standardised contracts. The company operates in Germany and its neighbouring countries, Austria and the Netherlands. PST registered for trading on the UK gas market (NBP) and launched its operations there after successful implementation of the market based on the ETRM (Energy Trading and Risk Management) system in August 2016. PST has also registered its activity in the Czech Republic and Poland. PST is also a registered supplier on the Danish and Slovak markets. PST is a market maker on the PEGAS exchange for the GASPOOL gas hub market area.

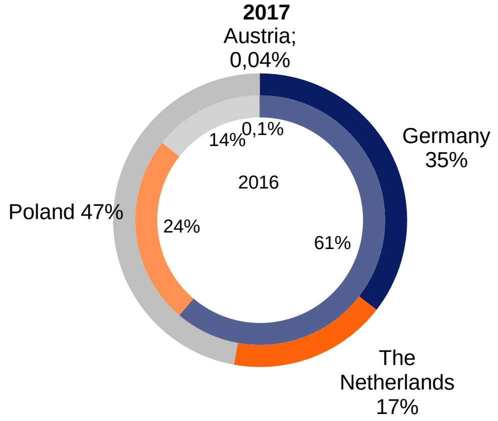
PST commenced commercial activities on the global LNG market through its branch in London, opened in February 2017. The branch contracted its first delivery with Cheniere Energy. It was the first LNG delivery from the US to Northwestern Europe. In addition, the PST London Branch concluded a medium-term contract with Centrica LNG Company Limited.

In 2017, PST and PST Sales GmbH sold a total of 49.9 TWh of gas and 5.1 TWh of electricity in exchange and OTC transactions. Poland was PST's largest gas sales market, with a 52% share in total sales volume. The shares of gas sales on the German and Dutch markets were 29% and 19%, respectively. Electricity is sold mainly in Germany (a 99% share in sales volume) with a negligible share of sales in Austria (1%).

PST's and PST ES's sales structure by product and volume



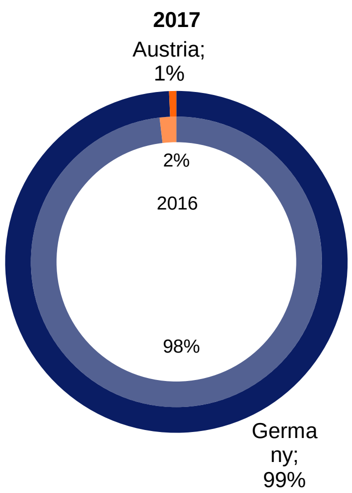
PST's and PST ES's sales structure by country and volume



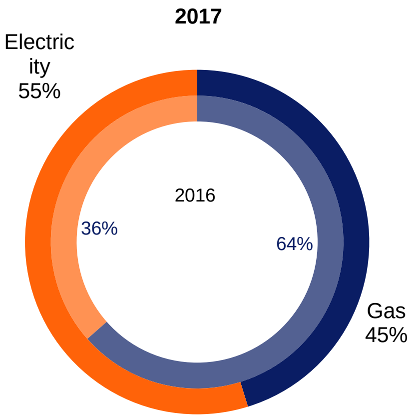
Retail sales

Over 2017, PST and its subsidiaries signed almost 36,000 new contracts, 66% of which were successfully added to the PST customer portfolio, with deliveries starting in 2017 and subsequent years. At the end of 2017, the number of customers receiving supplies increased by 39% year on year, to over 44,000.

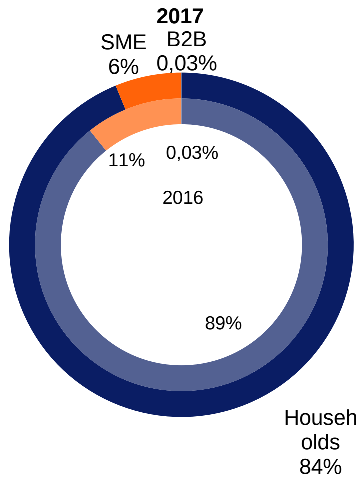
Structure of PST's customer base by country
(by number of customers)



Structure of PST's customer base by product
(by number of customers)



Profile of PST's customers
(by number of customers)



Key services provided to PGNiG Group entities

PST's key contracts effective in 2017 included contracts for the management of commercial storage capacity for own needs at gas storage facilities in the Netherlands (with a working capacity of 250 GWh) and Austria (with a working capacity of 17 GWh). The objective of storage is to optimise the trading portfolio and accommodate growing end-user demand for gas in winter. Under its current contracts, PST supplies natural gas to PGNiG on the Polish-German and Polish-Czech borders, thus securing diversification of supply sources. PST also has in place a contract with PGNiG UN for the purchase of gas produced from the Norwegian Skarv field as of 2013, from the Vale and Morvin fields as of 2015, and from the Gina Krog field as of July 2017.

5.2.5. Storage

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

- Regulated activities comprising the provision of gaseous fuel storage services at storage facilities owned by PGNiG, as well as operation of the Mogilno and Kosakowo underground gas storage caverns;
- Non-regulated activities comprising the provision of services related to design, construction and extension of underground gas storage facilities.

Under an outsourcing agreement, GSP provides storage services at underground high-methane gas storage facilities owned by PGNiG.

Short-term peak fluctuations in demand for natural gas are balanced by supplies from the Mogilno and Kosakowo facilities, where gas is stored in worked-out salt caverns. The capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica underground gas storage facilities are used to balance out changes in demand for natural gas in the summer and winter seasons, to meet the obligations under take-or-pay import contracts, to ensure the continuity and security of natural gas supplies, and to meet the obligations under gas supply contracts with customers.

GSP, in its capacity of the storage system operator, provides gas fuel storage services to storage facility users under standardised procedures, on a non-discriminatory, equal-treatment basis, so as to ensure the most efficient use of the storage capacities. Storage services are provided under standard storage service agreements (SSSA).

To ensure equal treatment of storage service users, SSSAs are concluded based on GSP's Rules of Storage Services and the gas fuel storage tariff. GSP's services are provided using the following Storage Facilities (SF) and Groups of Storage Facilities (GSF):

- Kawerna GSF (comprising the Mogilno CUGSF and Kosakowo CUGSF, located in worked-out salt caverns),

- Sanok GSF (comprising the Husów UGSF, Strachocina UGSF, Swarzów UGSF and Brzeźnica UGSF, located in partly depleted gas reservoirs),
- SFG (comprising Wierzchowice UGSF).

Service	Terms of storage services	Facility	Number of packages/flexible packages
Long-term	On a firm basis	Wierzchowice UGSF	3,863
		Kawerna SFG	6,235
		Sanok SFG	2,579
	On an interruptable basis	Wierzchowice UGSF	9,303
		Kawerna SFG	1,368
		Sanok SFG	8,941
Short-term	On an interruptable basis	Kawerna SFG	-
Total			**32,289**

As at December 31st 2017, GSP had provided a total of 32,289 long-term storage capacity packages, including 12,677 packages of services provided on a firm basis and 19,612 packages on an interruptible basis. As at December 31st 2017, 97% of the storage capacities were reserved for PGNiG S.A., 2% for external customers, with the remaining 1% of total capacities idle (408 short-term storage capacity packages on an interruptible basis at the Kawerna SFG).

Ticketing service

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 supports efficient use of storage capacities by natural gas market players, while importers of natural gas to Poland do not have to collect and maintain emergency gas stocks in storage facilities on their own.

PGNiG has entered into agreements for the provision of the ticketing service with 11 companies. The agreements entered into force on October 1st 2017. The total volume of gas stocks maintained by PGNiG for other entities is close to 370 GWh (approximately 33 mcm). PGNiG maintains gas stocks for the above entities, on a contract basis, in GSP's storage facilities, in which PGNiG previously leased appropriate storage capacities and injected gas.

Third-party access (TPA) storage capacities

As at December 31st 2017, the PGNiG Group had a total working storage capacity of 2,985.35 mcm, of which 2,942.85 mcm was made available on a TPA basis or to the Gas Transmission System Operator GAZ-SYSTEM under a long-term contract. 37.19 mcm was made available under a short-term contract. 5.23 mcm of Kawerna's working capacity is allocated for the Mogilno and Kosakowo cavern facilities' own needs.

Total working capacities and TPA working capacities

	Working storage capacities (mcm)		TPA working storage capacities (mcm)		TPA working storage capacities (GWh)	
	2017	2016	2017	2016	2017	2016
Kawerna SFG	735	714	730	709	13,166	13,166
Wierzchowice UGSF	1,200	1,200	1,200	1,200	8,011	7,774
Sanok SFG	1,050	1,015	1,050	1,015	11,520	11,137
Total	2,985	2,929	2,980	2,924	32,697	32,077

** Converted to gas with a calorific value of 39.5 MJ/cm.*

5.2.6. Key investment projects and CAPEX

In 2017, at Kosakowo UGSF, work to construct five Cluster B chambers together with the necessary technical infrastructure and land development was under way. As part of the investment project, the leaching of four caverns (K-6, K-8, K-9 and K-10) was carried out. Tenders were carried out to select, *inter alia*, contractors for gas infrastructure, land development and investor supplies. The K-6, K-8 and K-9 chambers were assumed to be put in operation in the fourth quarter of 2018. However, in the course of the monitoring of the cavern leaching process, favourable geological conditions were identified, allowing to obtain a larger geometric volume, which will translate into an increase in useful capacity for storing high-methane gas and to complete work on the K-6, K-8 and K-9 chambers by January 15th 2019, and on the K-7 and K-10 chambers by September 15th 2021.

As regards the implementation of the contract to construct the Kosakowo UGSF, an application to amend the licence held by the Kosakowo UGSF was prepared and submitted to the Ministry of the Environment. The amendment to the licence covers the construction of ten storage chambers grouped in two C and D clusters of five chambers each, along with gas pipelines and process pipelines.

5.2.7. Development prospects

Development prospects in Poland

Import strategy

In the long term, PGNiG will focus on meeting its obligations under the long-term contracts with Gazprom Export 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.

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

Given the positive results of the Economic Test of the Baltic Pipe project and the transmission contracts signed with GAZ-SYSTEM and Energinet operators in January 2018, PGNiG will seek to obtain contracts for gas supplies to Poland *via* the Baltic Pipe. ›For more information, see Section 7.1.2.

Retail sales

In 2018, PGNiG OD intends to further enhance its product offering and improve customer satisfaction by focusing on continuous improvement and streamlining of customer service, and by building new and developing the existing customer access channels. In addition, to fight off growing competition, PGNiG OD will continue efforts which are aimed at keeping up the natural gas sales volumes by offering customers dedicated discount plans, including tailor-made plans and purchases of natural gas within purchasing groups.

In order to meet customer expectations and in the fulfilment of the statutory obligations related to abolition of the obligation to submit for approval tariffs for all non-household customers, since October 1st 2017 certain steps following from the new regulatory and legal conditions have been undertaken, including:

- Development of a new product offering (for customers who are not consumers) tailored to the current needs reported by customers and taking into account all options for offer building that are provided by the abolition;
- Preparation of new contract and agreement templates;
- Preparation of the price list for the 'Gaz dla Biznesu' scheme, effective as of January 1st 2018.

Business development in the CNG and LNG segments

- Small LNG Regasification Facilities for businesses – construction of LNG stations to serve business customers (based on a one customer – one station model) if the expected consumption volume and profile guarantees economic viability of the project.
- LNG bunkering – activity in the market of LNG supply for use by ships, including submission of an application for EU co-financing under the Connecting Europe Facility;
- CNG stations for municipal transport – selective approach to customers, maintaining the existing stations, and new projects subject to economic viability.

New offers have been prepared for customers, with prices based on a flexible market-linked formula, and work commenced to investigate the possibilities of linking the offered LNG/CNG price to prices of petroleum fuels.

Storage

PGNiG will strive to develop the ticketing service. With respect to the Kosakowo CUSGF expansion, GSP will continue the work to construct five Cluster B chambers. Leaching of the K-6, K-8, K-9 and K-10 caverns is planned for 2018. The contractual deadline for completion of all works related to the construction of the five Cluster B chambers falls in 2021. At Mogilno CUGSF, a gas turbine overhaul is planned to secure the turbine and ensure the operability of compressing equipment before the injection season.

Development prospects abroad

In 2018, PGNiG will continue to sell gas on the Ukrainian market in cooperation with its Ukrainian partner ERU Trading. The Company is also keeping a close eye on the negotiations between GAZ-SYSTEM and Ukrtransgaz concerning extension of the interconnector capacity between Poland and Ukraine.

PST intends to further expand its business focused on selling electricity and gas to end customers and in wholesale. In the coming years, the acquisition of customers through traditional sales channels (telesales and door-to-door) will continue, in collaboration with the existing and new partners. In addition, the company has been developing modern customer access channels with a view to improving the quality of its retail customer base. 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 trading companies, by offering them standard and structured trading and balancing products.

The PGNiG Group will also continue to work on building its competencies and strengthening its presence in the global LNG market. The Group plans to examine the possibilities of contracting LNG from new directions and to expand its cooperation with LNG suppliers.

5.3. Distribution

The segment's principal 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. As the Distribution System Operator, the company operates in all regions of Poland. Being the owner of the majority of Poland's gas distribution network and gas service lines, PSG enjoys a dominant market share.

5.3.1. Segment's key data

Financial highlights	**2017** PGNiG Group	**2016** PGNiG Group	**2015** PGNiG Group	**2014** PGNiG Group	**2013** PGNiG Group
Total revenue, including	4,937	4,915	4,585	4,283	4,250
- external sales of distribution services	788	729	363	67	23
- intra-group sales of distribution services	3,807	3,657	3,748	3,868	4,045
EBITDA	2,493	2,559	2,339	2,002	1,596
EBITDA adjusted for impairment losses on property, plant and equipment	2,490	2,563	2,341	1,994	1,597

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

in natural units – mcm	**2017**	**2016**	**2015**	**2014**	**2013**
Total volume of distributed gas	11,645	10,858	9,823	9,586	10,128
- including high-methane gas	9,797	9,301	8,646	8,495	8,922
- including nitrogen-rich gas	989	836	643	568	610
including outside the PGNiG Group	*3,110*	*3,081*	*1,793*	*804*	*641*

Geographical coverage based on the number of communes/municipalities connected to gas mains: 59.7%. Number of communes/municipalities in Poland in 2017 according to Central Statistics Office data: 2,478, including 1,479 connected to gas mains.

5.3.2. 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, PSG's approach to the development of the gas market was reactive and, consequently, the company failed to fully realise the market development potential. 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 per year (up 8 thousand or ca. 17%).

The market's potential can be fully exploited by streamlining the connection processes (and 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 natural gas distributed, from the 2017 target of approximately 10.6 bcm to approximately 12.3 bcm in 2022 (an increase of about +1.7 bcm, or 16%).

There is vast potential for development of Poland's distribution network. On the one hand, the share of natural gas in Poland's total fuel consumption is relatively low when compared with other EU countries (such as Hungary, Italy, the Netherlands, or the UK). On the other hand, the saturation of the natural gas distribution network in Poland is also relatively lower than that observed in the case of gas distribution network operators in other EU countries, for instance Italy or Spain.

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 local gas delivery solutions.

Given the growing supply of LNG on the Polish market, PSG plans to build local distribution networks which would not be connected to the national gas system, but instead will be fed with LNG (these are known as island distribution networks). Another driver of increase in the volume of distributed natural gas will be the growing problem of smog blanketing many Polish cities and towns, and local governments' initiatives for air quality improvement through, inter alia, promoting conversion to low carbon fuels, including gas.

PSG's strategy for 2016-2022

In 2017, PSG revised its strategy for 2016-2022 announced in 2016, based on a new concept of company value management – PSG will pursue a policy of evolutionary growth through volume-focused initiatives, while maintaining cost discipline combined with cost optimisation of the processes. PSG has been building its portfolio of growth initiatives so that the portfolio supports the values highlighted in PSG's strategy for 2016–2022: building company value, continuous operational efficiency improvement; search for and implementation of innovative solutions and technologies, and taking up new market challenges.

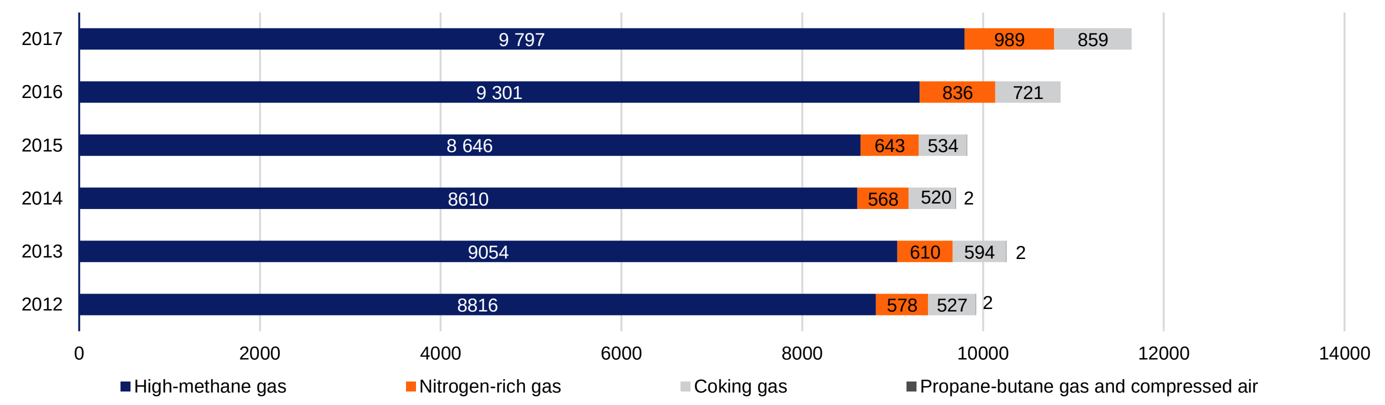
Furthermore, the Development Strategy for PSG's High-Pressure Distribution Network for 2017−2026, adopted in April 2017, defined the directions for development of the distribution system in the ten-year horizon, including high-pressure system connections, regional increased-medium-pressure and medium-pressure networks, and the list of municipalities and communes with a potential for growth in demand for natural gas. The company identified development and modernisation investment projects as part of which nearly 3.77 thousand kilometers of pipelines and 82 high-pressure gas stations would be added to the network. The total expenditure on their implementation is estimated at PLN 3bn.

To implement the projects, PSG is continuing the efforts to raise external financing from various sources, including from EU funds in the case of growth projects. Of key importance are the funds from the Infrastructure and Environment Operational Programme 2014-2020, which are available to support investment projects to construct and alter natural gas distribution networks, as well as the possibility of obtaining co-financing for innovation and R&D projects and projects involving the use of LNG-based technologies.

5.3.3. Operations in 2017

In 2017, all settlements between PSG and its customers were based on Tariff No. 3 for Gas Fuel Distribution Services and LNG Regasification Services, as well as on amendments to that tariff which entered into force on January 1st 2016 and July 1st 2016, respectively. In 2017, there was no change in the level of tariff rates relative to 2016.

Volume of gas transmitted via the distribution system (mcm)

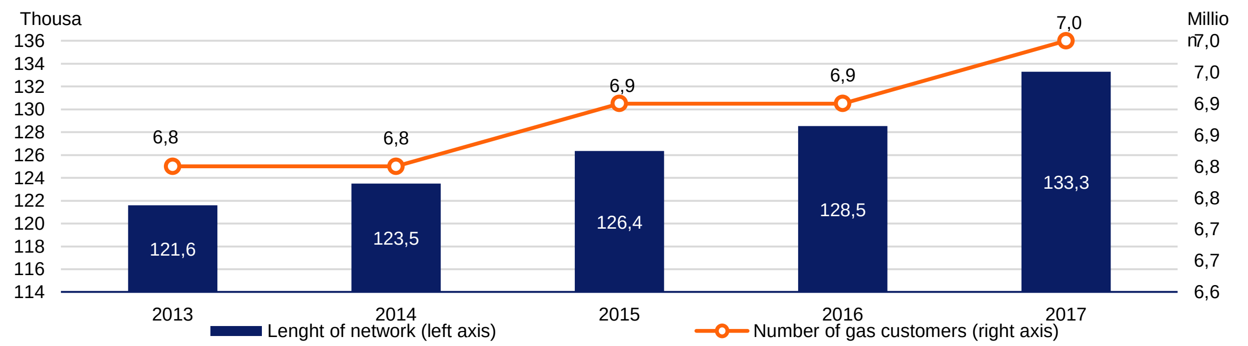


Starting from January 1st 2017, a new three-tier organisational structure was introduced, comprising the Head Office and 17 Gas Distribution Branches. Ultimately, there will be 172 local gas utilities and 59 service points operating within the Branches, making up a total 231 organizational units of PSG.

The mission of PSG as the distribution system operator is to provide gas fuel distribution services to all gas fuel consumers and traders (while ensuring that all of them receive equal treatment) on the basis of distribution agreements. In 2017, PSG executed 13 distribution agreements with Distribution Service Ordering Parties and 2 Interoperator Distribution Agreements. Moreover, throughout the year PSG carried out approximately 260 thousand Single Distribution Orders of all types.

In 2017, as part of customer connection services, PSG issued more than 150.7 thousand grid connection terms and conditions (up by about 18% on 2016) and executed more than 69.6 thousand grid connection agreements with customers providing for the construction of more than 77.8 thousand new gas service lines (up by about 21% on 2016). 486 letters of intent concerning the construction of gas networks in further municipalities and communes in Poland were signed. Throughout 2017, 54,922 gas service lines were built with a total length of 544.6 km.

Length of network, excluding service lines, and number of customers



**Customer − anyone receiving or drawing gas fuel under an agreement with a gas supplier.*

5.3.4. Key investment projects and CAPEX

In 2017, PSG spent more than PLN 643m on network expansion and connection of new customers. In order to ensure the improvement and maintenance of the technical condition of gas pipelines and to guarantee their operational safety, PSG is constantly investing in the modernisation of its network assets: in 2017 the company spent more than PLN 290m on gas network alterations and upgrades. Key investments are pursued on a project basis as part of the Strategic Investment Programme. Strategic investment projects include 52 projects which are, or are planned to be, partiallty financed with EU funds, as well as other investment projects of strategic importance to PSG.

As part of Measure 7.1. – Development of intelligent storage, transmission and distribution systems, Priority axis VII – Improvement of energy security, PSG entered into seven agreements with the Oil and Gas Institute – National Research Institute, providing for co-financing of investment projects with an overall value of more than PLN 357m (the amount of subsidies will be in excess of PLN 171m). The total length of the distribution pipelines which to be built or modernised as part of the projects is 371 km.

In 2017, PSG continued efforts aimed at intensifying its research and development work with a view to enhancing its innovativeness. PSG's R&D teams cooperated with various scientific and research institutions in Poland. Furthermore, as part of cooperation within the PGNiG Group, work was continued to prepare various R&D areas for the needs of a competition to be held as part a joint venture organised by the National Centre for Research and Development (NCBiR), PGNiG and GAZ-SYSTEM. PSG is interested in 12 research topics that will be investigated as part of the INGA (Innovative Gas) Joint Venture. In 2017, work continued on the use of an acoustic method (API-AE) for checking the technical condition of pipelines, and tests using this technology were carried out on various types of gas pipelines.

Negotiations are under way to agree the terms and scope of cooperation between PSG and major liquid fuel distributors operating in the Polish market. This cooperation relates to the possibility of extending (building) distribution infrastructure to enable the supply of gas fuels (CNG and LNG).

The investment projects implemented in 2017 increased the number of new customers (metering points) by more than 90 thousand. The length of the company's own gas network in 2017 was 133.3 thousand kilometers, nearly 5 thousand kilometers more than in 2016.

5.3.5. Development prospects

PSG intends to pursue network projects related to the construction of gas networks, connecting new customers, network modernisation, and initiatives aimed at stimulating the development of the gas market and gas distribution system, including the addition points of exit from the transmission network (projects implemented on a continuous basis), development of gas distribution at PSG based on the LNG technology and identification of possibilities for agricultural biogas plants to feed the distribution network. In 2018, PSG will continue nearly 80 projects in various areas of its business, and will also launch new projects to support the implementaion of its strategy for 2016-2022. From the point of view of development of gas fuel distribution, of key importance will be the projects focused on the roll-out of gas networks to be fed using the LNG-based technology, projects to acquire distribution networks, and projects aimed at ensuring compliance of the company's operations with the current legal framework.

As part of the 2018-2020 Investment Plan, tasks have been defined in the 'New gas network roll-outs and related alterations' sub-category, concerning large-scale extenion of the gas distribution network. In addition, tasks involving the installation of LNG regasification stations for the purpose of gas supply to island distribution zones have been identified. Based on the 2018-2020 Investment Plan, the total value of investment expenditue in the above sub-category amounts to PLN 318m (until 2020), and the overall number of tasks selected for implementation is 259, 30 of which involve the feeding of distribution networks with natural gas from LNG regasification stations. The highest number of new LNG regasification stations are planned to be built in the Province of Białystok (11), Province of Wrocław (6), Province of Łódź (5), and Province of Szczecin (5).

Project category	Expenditure in 2018 (PLNm)
Gas mains and service line extensions	1,079
Network upgrades	535
Other	546
Total	2,160

5.1. Generation

The segment's principal business consists in the production of heat and electricity, distribution of heat, and execution of large natural gas-fired projects in the power sector.

PGNiG TERMIKA is the Group's competence centre for heat and electricity generation as well as execution of heat and power projects. The PGNiG TERMIKA Group includes PGNiG TERMIKA EP, established following the merger of Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie Zdrój and Spółka Energetyczna Jastrzębie S.A., whose main activity is the production and distribution of electricity, compressed air, cooling, as well as heat generation, distribution and trading. PGNiG TERMIKA EP is the competence center for commercial power generation and extraction of coal mine methane.

The installed capacity of PGNiG TERMIKA's generating assets is 4.6 GW of achieved thermal power and 1 GW of achieved electrical power, which satisfies approximately 70% of the heat demand on the Warsaw metropolitan market. The company is a producer and supplier of heat and the owner of heat sources and heat networks in Pruszków, Komorów and Piastów. The company is also the second largest producer of electricity and heat from high-efficiency cogeneration and the ninth largest electricity producer in Poland. PGNiG TERMIKA EP operates generation assets with a total capacity of approximately 835 MWt and 130 MWe, and approximately 311 km of heat networks.

5.1.1. Segment's key data

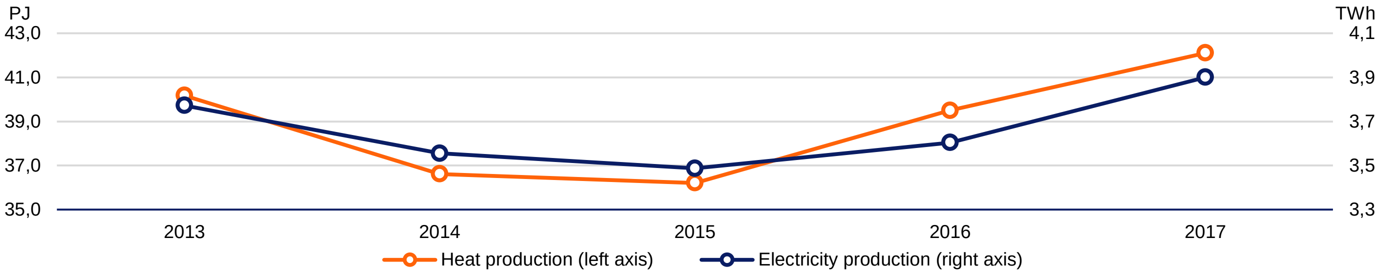
Financial highlights	2017 PGNiG Group	2016 PGNiG Group	2015 PGNiG Group	2014 PGNiG Group	2013 PGNiG Group
Total revenue	2,251	2,195	1,887	1,943	2,063
Revenue from sales outside the Group, including:	1,655	1,472	1,215	1,149	1,658
- heat	1,346	1,262	1,126	1,079	1,069
- electricity	50	36	8	7	514
Inter-segment revenue	596	723	672	794	405
EBITDA	843	759	679	463	503
EBITDA adjusted for impairment losses on property, plant and equipment	840	775	710	463	503

Heat and electricity sales volumes

(TJ)	2017	2016	2015	2014	2013
Total heat sales volumes from own generation sources	42,067	39,527	36,209	36,617	40,175
PGNiG TERMIKA	40,034	38,780	36,209	36,617	40,175
PGNiG TERMIKA EP*	2,033	747	-	-	-
(GWh)					
Total electricity sales volumes from own generation sources	3,882	3,604	3,487	3,555	3,772
PGNiG TERMIKA	3,593	3,466	3,487	3,555	3,772
PGNiG TERMIKA EP*	289	138	-	-	-

The data for 2016 represents the sales volumes generated by PEC and SEJ. As of 2017, the data represents the sales volumes generated by PGNiG TERMIKA EP (which comprises PEC and SEJ).

Heat and electricity sales volumes from own generation sources



Achievable capacity as per licence/plant/branch

Generating unit	Heat [MW]	Electricity [MW]	Cooling [MW]	Compressed air capacity [thousand cm/h]
PGNiG TERMIKA	4,625	1,015	-	-
Siekierki CHP Plant	2,068	620	-	-
Żerań CHP Plant	1,580	386	-	-
Pruszków CHP Plant	163	9	-	-
Kawęczyn Heating Plant	465	-	-	-
Wola heating plant	349	-	-	-
PGNIG TERMIKA EP	864	170	17	398
Zofiówka Branch*	313	102	-	163
Moszczenica Branch	156	38	-	-
Pniówek Branch	86	14	17	123
Suszec Branch (Suszec site)	46	11	-	112
Suszec Branch (Częstochowa site)	3	3	-	-
Żory Heating Plant	102	-	-	-
Wodzisław Śląski Heating Plant	60	2	-	-
Racibórz Heating Plant	96	-	-	-
Distribution Office	2	-	-	-

Including the 70 MWe and 120 MWt CFB unit, planned for commissioning in 2018.

5.1.2. Segment's strategy

Increase power and heat sales volumes

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 purchased shares in the companies that subsequently merged to form PGNiG TERMIKA EP. These acquisitions helped the PGNiG Group to expand into the prospective heat markets of Upper Silesia. Around PGNiG TERMIKA, the Group is building a strong group of companies 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 electricity and heat sales volume from approximately 15 TWh in 2017 to around 18 TWh in 2022. This objective will be achieved mainly through strategic upgrades and growth investments in the existing generation facilities, including the construction of a new CCGT unit at the Żerań CHP plant, integration of the acquired heating assets within the PGNIG TERMIKA Group, and increasing the production of electricity and heat at PGNiG TERMIKA EP following the launch of a new generating unit at the Zofiówka CHP plant, and further acquisitions of local heating systems.

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.

PGNiG TERMIKA's aspirations until 2022:

- Increase the PGNiG TERMIKA Group's EBITDA to PLN 1bn in 2022;
- Implement investments that will ensure compliance of generation assets with current and future environmental requirements;
- Secure a leading position among Poland's heating companies in terms of network infrastructure;
- Assert the role of moderator of regulatory and market change in the sector;
- Achieve market benchmarks for organisational efficiency in Poland;
- Develop efficient mechanisms for managing the PGNiG TERMIKA Group

5.1.3. Operations in 2017

In 2017, PGNiG TERMIKA supplied heat to two municipal networks: the Warsaw heating network, owned by Veolia Energia Warszawa S.A., and its own heating network, covering Pruszków, Piastów, and Michałowice. The company also used Veolia's network to supply heat to its own end customers, based on a transmission contract (these customers are billed on different terms as they are classified in PGNiG TERMIKA's separate tariff group – 'OKW').

PGNiG TERMIKA maintains the competitiveness of district heating in Warsaw, ensuring that district heating is the cheapest way to heat buildings in the city. The thermal power generated by the company in 2017 met the requirements set out in the annual schedule agreed with Veolia Energia Warszawa S.A., guaranteeing security of heat supply to the residents of Warsaw. Due to the expiry on August 31st 2017 of the multi-annual heat sales contract between PGNiG TERMIKA and Veolia Energia Warszawa S.A., the parties entered into an interim contract for the period until the end of the validity term of the current heat tariff, i.e. until March 17th 2018, and are negotiating a long-term contract.

During the year, the company resumed its efforts to acquire new customers in the OKW tariff group and new customers connected to the Pruszków network. The concept of connecting the Pruszków CHP plant to the Warsaw district heating network was abandoned and a decision was made to start the work on selecting a technical modernisation concept for the Pruszków CHP plant.

Work is in progress on the adaptation of the Kawęczyn Heating Plant to the Best Available Technique (BAT) requirements. The plan to carry out a programme aimed at ensuring compliance of the K9 and K10 water boilers with the BAT Conclusions has been abandoned and a decision was made to implement an alternative solution, consisting in upgrading the natural gas-fired boiler house to add an extra 260 MWt to its capacity. PGNiG TERMIKA actively participated in the consultation processes preceding the adoption of new regulations: it took part in the development of a regulatory framework for implementing 'capacity market' mechanisms in Poland (applicable also to co-generation units) and in regulatory consultations concerning renewable energy sources. The company also advocated for maintaining favourable regulations on determination of heat tariffs.

PGNiG TERMIKA is actively seeking potential acquisition targets among district heating systems. At present, the total length of the Generation segment's heating networks is 391.6 km. The total number of customers supplied by PGNiG TERMIKA (including OKW customers) is 571, while PGNiG TERMIKA EP has approximately 2.7 thousand customers.

On September 1st 2017, the merger of PGNiG TERMIKA EP and Przedsiębiorstwo Energetyki Cieplnej S.A. was completed. Its key objectives included optimisation of operating costs and business integration of the new entity with PGNiG TERMIKA to enhance business management efficiency and improve the quality of business supervision, and also to exploit the synergies between all the entities involved. As a result of the merger, the company is expected to obtain benefits totalling PLN 48.4m (in nominal terms) in 2017-2023.

5.1.4. Key investment projects and CAPEX

In order to meet the more stringent emission requirements the generating assets are being gradually modernised. In 2017, capital expenditure of PGNiG TERMIKA amounted to PLN 258m, of which approximately PLN 20m was spent on environmental protection projects.

In 2017, major investment projects included:

- Construction of a ca. 450 MW CCGT unit at the Żerań CHP plant (Żerań CCGT) - a contract for unit supply and assembly as part of the project was signed in 2017. The consortium of Mitsubishi Hitachi Power Systems Europe GmbH/Mitsubishi Hitachi Power Systems Ltd/Mitsubishi Hitachi Power System Europe Ltd/Polimex-Mostostal S.A. was selected to perform the contract. Additionally, three of the four stages of the cooling water system alteration were completed and the discharge pipeline assembly began. The construction site was handed over to the contractor and construction works began. In addition, in January 2017, GAZ-SYSTEM obtained a permit for the construction of a high-pressure pipeline from the Żerań

CHP plant to the Rembelszczyzna compressor station and prepared tender documentation for the implementation of this project.
- Construction of a ca. 450 MW CCGT unit at the Stalowa Wola CHP plant (ECSW) - in June 2017 a contract was signed with IDS-BUD S.A. for the construction of a cooling water pipeline. In September, the project as-built survey was completed, and in October an agreement was signed with the winner of the public procurement procedure held to select a company to provide EPCM services, i.e. the consortium of Zakłady Pomiarowo – Badawcze Energetyki ENERGOPOMIAR sp. o.o. (Consortium Leader) and Biuro Projektiów i Realizacji ENERGOPROJEKT - KATOWICE S.A. (Consortium Member).
- Construction of a ca. 70 MWe FBC unit at the Zofiówka CHP plant – due to a delay on the part of the contractor (Energoinstal S.A.) negotiations concerning continuation of contract performance are underway.
- Completion of conversion of the K1 boiler in the Siekierki CHP plant into a biomass boiler.
- Construction of a peak-load boiler house at the Żerań CHP plant – in November 2017, the contract was signed.
- Completion of adaptation of the K2 steam generator at the Siekierki CHP plant to BAT (Best Available Technique) requirements.
- Work on updating the concept of adaptation of the Pruszków CHP plant to operate after 2020 in connection with change of fuel from pea coals to fine coal.
- Work continued on the preparation a pilot investment project to build a gas-fired co-generation unit to which gas produced by PGNiG at the Kościan-Brońsko Gas Production Facility would be supplied. The technical concept was developed, an application for power grid connection conditions was prepared.

Furthermore, as a cost optimisation measure, PGNiG TERMIKA diversified the portfolio of suppliers of repair services to increase competition among them and completed the implementation of maintenance standards and asset life cycle management methods. Furthermore, the company reduces internal energy consumption and monitors and plans the operation of generation facilities so as to optimise the use of opportunities provided by the 17500 h derogation in the TNP (Transitional National Plan) and relaxed conditions for peak-load sources.

In addition, PGNiG TERMIKA participates in the start-up programmes of the PGNiG Group and MIT EF, as well as in the assessment of projects from InnVento ideas incubator. In 2017, the project of remote meter reading with PSG was commenced.

Equity investment in Polska Grupa Górnicza Sp. z o.o.

In 2017, PGG continued the processes connected with restructuring and optimising hard coal mining, initiated in 2016. On March 31st 2017, PGG's investors (including PGNiG TERMIKA) concluded a new Investment Agreement laying down the principles of making additional capital contributions to PGG totalling PLN 1bn, to finance the acquisition of production assets from Katowicki Holding Węglowy S.A. PGNiG TERMIKA provided PLN 300m of the aforementioned capital contribution and its target share in the share capital will amount to 20.43%.

PGNiG TERMIKA performs its owner supervision functions directly through a supervisory board member and indirectly as a result of performance of the Investors Agreement, with the said investors representing 66.4% of PGG's share capital and having the right to appoint five out of eight supervisory board members. On December 29th 2017, the District Court of Katowice-Wschód in Katowice registered the post-transformation company, which gave effect to the Investment Agreement's provisions on transformation of PGG into a joint-stock company.

In 2017, PGG posted better financial results than assumed in the Business Plan. The improvement was driven by a higher-than-expected rise in global coal prices and consistent implementation of the restructuring policy.

5.1.5. Development prospects

In 2018, PGNiG TERMIKA and its subsidiaries will continue projects related to modernisation of existing and construction of new power generation units, including:

- continued construction of the CCGT unit at the Żerań CHP plant – contract value with the maintenance contract is PLN 1.6bn (VAT inclusive), and completion is planned in 2020;
- continued construction of the peak-load boiler house at the Żerań CHP plant – the project will contribute to the delivery of strategic objectives to preserve leadership in the heat generation market in the Warsaw area and to diversify the fuel mix (coal, natural gas, biomass, alternative refuse-derived fuels).
- continued construction of a CFB cogeneration unit with an installed capacity of approximately 70 MWe at the Zofiówka CHP plant – construction of the CFB cogeneration unit will enable a gradual withdrawal of obsolete and ineffective generating units (OP-140 boilers) at the Zofiówka plant.

The PGNiG TERMIKA Group will strive to improve return on assets and to diversify the fuel portfolio (coal, gas, biomass, RDF), while ensuring that generation assets comply with environmental requirements. Furthermore, PGNiG TERMIKA will take steps to evaluate potential acquisitions of heating systems throughout the country.

5.2. Other Segments

5.2.1. Segment's key data

Financial highlights	2017	2016**	2015*	2014*	2013*

	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
Revenue	459	124	362	125	325	325	424
EBITDA	(162)	(207)	(187)	(188)	12	(49)	(44)

** Data not restated, as reported.*
*** Data restated according to the new segmentation of the PGNiG Group's operations - for more information, see Section 1.3 of the consolidated financial statements.*

5.2.2. Segment's strategy

Effective business model, development of R&D&I and CSR

This area will strive to build an efficient organisational and management model across the highly complex structure of the PGNiG Group. The three main aspirations of this area are to increase the PGNiG Group's growth potential in research, development and innovation, improve the operational efficiency of the PGNiG Group, and enhance the image of the PGNiG Group.

5.2.3. Operations in 2017

Corporate Centre

In the corporate centre, as part of the efforts to enhance the Group's image, in April 2017 PGNiG adopted the "PGNiG Group Sustainable Development Strategy 2017–2022". In 2017, the PGNiG Group also increased its engagement in R&D and innovation projects. Examples include the launch of INGA - Innovative Gas – the largest research programme at the PGNiG Group, and the InnVento initiative – the first business incubator in the oil and gas sector. › For more information on R&D projects, see Section 3.5.

PGNiG Branch – Central Measurement and Testing Laboratory (CLPB)

The CLPB provides services such as tests of accuracy and reliability of measurements of the quality and quantity of natural gas, testing of measuring devices and systems as well as technical analyses, opinions and technical expert reports. In 2017, it provided services related to the supervision of the cargo settlement system at the Świnoujście terminal, validation of gas chromatographs for the purposes of natural gas settlements, calibration of measurement systems at facilities on the Yamal pipeline and at the LNG terminal in Świnoujście, etc. The largest customers of the branch include members of the PGNiG Group, GAZ-SYSTEM and EuroPolGaz S.A.

PGNiG Technologie

PGNiG Technologie implements comprehensive projects to construct crude oil and natural gas production facilities and natural gas transmission facilities. In 2017, it provided services mainly to members of the PGNiG Group, relating to development of fields and wells as well as supply of well surface equipment. Exports in 2017 comprised finished products, the main markets being Norway, Pakistan and Ukraine.

In 2017, shares in Polimex-Mostostal S.A. were purchased.

PGNiG Serwis

The principal business of PGNiG Serwis is the provision of comprehensive finance and accounting services, HR and payroll services, ICT services, project management support, property management, vehicle fleet management, porter and reception services, and direct physical security services for the PGNiG Group companies. PGNiG Serwis acts as a Shared Services Centre for 15 companies of the PGNiG Group.

Gazoprojekt

Gazoprojekt provides consultancy and design 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 documents required under relevant regulations, produces design and as-built documentation, and prepares 3D visualisations. In 2017, there was a significant increase in the number of requests for proposal concerning large infrastructure projects in the industry on the Polish market: gas transmission and distribution pipelines and gas compression stations.

Geovita

Geovita's business involves leisure-related activities, spa treatment services, health protection, medical rehabilitation, and provision of conference and training services. Geovita's facilities are located in Dąbki, Mrzeżyno, Dźwirzyno, Jadwisin near Serock, Płotki near Piła, Jugowice, Lądek-Zdrój, Zakopane, Wisła, Złockie near Muszyna, and Krynica-Zdrój. Geovita also leases and manages three hotels: the Orient in Kraków, Bukowy Dworek in Gronowo near Łagów, and Perła Bieszczadów near Ustrzyki Dolne. In 2017, changes were made in Geovita's operations, in order to reduce operating expenses and use resources more efficiently.

Polski Gaz Towarzystwo Ubezpieczeń Wzajemnych (Polski Gaz TUW, mutual insurance company)

In 2017, cooperation with Polski Gaz TUW was continued with respect to insurance contracts for both PGNiG and PGNiG Group members. The company provides insurance mainly to PGNiG Group companies on the basis of members' mutuality within the company, which allows it to tailor the insurance services to policyholders' needs through their actual contribution to the Company's operation and the ability to directly report their insurance needs. Mutual insurance company Polski Gaz TUW was established within the PGNiG Group in order to improve the quality of insurance services used by the PGNiG Group entities, as well as to increase the cost efficiency. The first insurance policies issued by Polski Gaz TUW for the PGNiG Group companies were effective from January 1st 2017.

In H1 2017 steps were taken as a result of which from July 1st 2017 property, civil liability, and fleet insurance protection was renewed for the PGNiG Group companies. At the beginning of 2018, protection provided under the upstream business insurance for PGNiG was renewed. Steps are also planned to again renew property, civil liability, and fleet insurance protection for the PGNiG Group companies.

5.2.4. Development prospects

CLBP (Central Measurement and Testing Laboratory)

CLBP's primary objective is to maintain its position as the leading research laboratory and attestation centre for measurement systems and devices used in the natural gas industry and a natural gas quality control laboratory for all kinds of natural gas (L and E) and all their forms (CNG, LNG), as well as biogas. Its tasks include increasing the number of process analyser systems for the evaluation of gas quality, supervision of LNG custody transfer on a large scale (marine terminal) and on a small scale (tank transport), and maintenance of the leading position as a training unit which cooperates with international inspection units and in the area of gas industry and technical training.

PGNiG Technologie

In the next two years, PGNiG Technologie intends to reorganise its current business model by adapting it to current market opportunities and needs. The company will focus on tasks related to the development of wells and gas storage facilities. In line with the objectives for 2018-2020, it will operate primarily as a provider of construction and assembly services and manufacturer of finished products in the gas and oil mining sector, mainly as part of the PGNiG Group. In addition, it will seek orders with relatively high margins, in areas where it is the leader on the domestic market.

PGNiG Serwis

PGNiG Serwis will strive to increase its share in the portfolio of support services provided in the PGNiG Group both by acquiring new customers within the PGNiG Group and by expanding its service offering. The increase in the number of entities served is expected effect to result in lower prices and more diverse revenue sources.

Gazoprojekt

The main orders to be fulfilled in 2018 include developing construction and detailed designs for pipeline construction and preparing technical documentation for individual series of LNG regasification plants. Gazoprojekt will also strive to win contracts related to oil and gas transmission and storage and participate in projects for the expansion of chemical plants.

Geovita

In the near future, the company will continue its restructuring efforts to optimise costs and improve the efficiency of sales channels and operational processes.

6. Additional information on the PGNiG Group

6.1. Structure of the PGNiG Group

As at December 31st 2017, the PGNiG Group comprised PGNiG S.A. (the Parent), 33 production, trade and service companies, and a mutual insurance company, including: 20 direct subsidiaries of PGNiG and 14 indirect subsidiaries of PGNiG

The list of the PGNiG Group companies as at December 31st 2017 is presented in the table below.

PGNiG Group companies as at December 31st 2017

No.	Name	Share capital [in PLN, unless stated otherwise]	Value of shares held by PGNiG [in PLN, unless stated otherwise]	PGNiG's ownership interest (%, direct holdings)	PGNiG Group's ownership interest (%, direct and indirect holdings)
	Subsidiaries – first tier				
1	PGNiG 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.	75,240,000	75,240,000	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.	272,727,240	272,227,240	100%	100%
10	PGNiG TERMIKA S.A.	1,740,324,950	1,740,324,950	100%	100%
11	Polska Spółka Gazownictwa Sp. z o.o.	10,454,206,550	10,454,206,550	100%	100%
12	PGNiG Finance AB i likvidation	500,000 SEK	500,000 SEK	100%	100%
13	PGNiG Supply & Trading GmbH	10,000,000 EUR	10,000,000 EUR	100%	100%
14	PGNiG Upstream Norway AS	1,100,000,000 NOK	1,100,000,000 NOK	100%	100%
15	PGNiG Upstream North Africa B.V.	20,000 EUR	20,000 EUR	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	PGNiG TERMIKA Energetyka Przemysłowa S.A.	370,836,300	370,836,300	-	100%[9]
22	GAZ Sp. z o.o.	300,000	300,000	-	100%[3]
23	PSG Inwestycje Sp. z o.o.	81,131,000	81,131,000	-	100%[3]
24	Oil Tech International F.Z.E.	20,000 USD	20,000 USD	-	100%[4]
25	EXALO DRILLING UKRAINE LLC	20,000 EUR	20,000 EUR	-	100%[4]
26	PST Europe Sales GmbH	1,000,000 EUR	1,000,000 EUR	-	100%[5]
27	Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000	2,565,350	-	85.51%[6]
28	Gas Assets Management Sp. z o.o.	1,360,000	1,360,000	-	100%[7]
29	Gas-Trading Podkarpacie Sp. z o.o.	6,670,627	5,257,524	-	78.82%[8]
30	PGNiG Serwis Doradztwo Ubezpieczeniowe Sp. z o.o.	5,000	5,000	-	100%[1]
31	PGNiG TERMIKA Energetyka Rozproszona Sp. z o.o.	13,550,000	13,550,000	-	100%[9]
32	Zakład Gospodarki Mieszkaniowej Sp. z o.o.	1,806,500	1,806,500	-	100%[4]
	Subsidiaries – third tier				
33	XOOL GmbH	500,000 EUR	500,000 EUR	-	100%[10]
34	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%: 99.98% is 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. and PGNiG TERMIKA Energetyka Przemysłowa S.A. (100%)

Changes in the Group structure in 2017:

- The Extraordinary General Meeting of PGNiG Technologie passed a resolution 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 the 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 subscribed for 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 Gazoprojekt. Appropriate amendments to the company's Articles of Association, including its new name PGNiG GAZOPROJEKT S.A., were entered in the National Court Register on November 27th 2017.
- 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, an Extraordinary General Meeting of Powiśle Park Sp. z o.o. passed a resolution to amend the company's Articles of Association and change the company's name to PSG Inwestycje Sp. z o.o. The change of the company name was entered in the National Court Register on March 20th 2017.
- On March 8th 2017, the Extraordinary General Meeting of PGNiG Upstream International AS resolved to change the company's name to PGNiG Upstream Norway AS. The change was entered in the Norwegian business register on March 18th 2017.
- On March 31st 2017, an Extraordinary General Meeting of PGNiG TERMIKA resolved to increase the company's share capital from PLN 1,440,324,950 to PLN 950, i.e. by PLN 300m. 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 new shares were subscribed for by PGNiG against a cash contribution of PLN 300m. The increase in the share capital of PGNiG TERMIKA was registered with the National Court Register on August 30th 2017.
- On April 12th 2017, the District Court of Gliwice registered amendments to the Articles of Association and change of the name of Spółka Energetyczna Jastrzębie S.A. As of April 12th 2017, the company trades as PGNiG TERMIKA Energetyka Przemysłowa S.A.
- 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 Sp. z o.o.
- On May 17th 2017, the name of Poltava Services LLC was changed to EXALO DRILLING UKRAINE LLC.
- On June 29th 2017, an Extraordinary General Meeting of PGNiG TERMIKA EP resolved to merge the company with Przedsiębiorstwo Energetyki Cieplnej S.A. The merger was entered in the National Court Register on September 1st 2017.
- On June 29th 2017, an 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. The increase in the share capital of PGNiG TERMIKA EP was registered with the National Court Register on September 1st 2017.
- On September 15th 2017, an Extraordinary General Meeting of GEOFIZYKA Toruń resolved to increase the company's share capital by PLN 9,240,000, from PLN 66,000,000 to PLN 75,240,000, by increasing the par value of the company's shares (66,000,000 shares in total) from PLN 1 to PLN 1.14 each. The share capital increase was registered with the National Court Register on December 28th 2017.
- On December 29th 2017, POGC Libya B.V. changed its name to PGNiG Upstream North Africa B.V.

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

- On January 15th 2018, a resolution to liquidate PGNiG Finance AB and the change of the company's name to PGNiG Finance AB i likvidation were entered in the relevant register.

6.2. Other ownership interests and organisational links

The list of the PGNiG Group related entities as at December 31st 2017 is presented in the table below.

PGNiG Group companies as at December 31st 2017

No.	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)	OMR 150,000	OMR 73,500	49.00%	49.00%
2	SGT EUROPOL GAZ S.A.	80,000,000	38,400,000	48.00%	51.18%[1)]
3	PFK GASKON S.A.	13,061,325	6,000,000	45.94%	45.94%
4	ZWUG INTERGAZ Sp. z o.o.	4,700,000	1,800,000	38.30%	38.30%
5	Dewon ZSA	11,146,800 UAH	4,055,205.84 UAH	36.38%	36.38%
	Jointly-controlled and associated entities - second tier				
6	Zakład Separacji Popiołów Siekierki Sp. z o.o.	10,000,000	7,000,000	-	70%[2)]
7	Elektrociepłownia Stalowa Wola S.A.	28,200,000	14,100,000	-	50%[2)]
8	Polska Grupa Górnicza S.A.	3,616,718,200	710,000,000	-	19.63%[2)]
9	Polimex-Mostostal S.A.	473,237,604	78,000,048		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
3) PGNiG's interest held indirectly through PGNiG Technologie S.A.

Changes in other ownership interests within the PGNiG Group in 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. 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 was registered with the National Court Register. PGNiG TERMIKA acquired 833,333 new shares with a par value of PLN 100 per share and a total par value of PLN 833,333 in the increased share capital of PGG, in exchange for a cash contribution of PLN 83,333,300. Following the share capital increase, PGNiG TERMIKA holds 4,444,444 shares in PGG, with a par value of PLN 100 per share and a total par value of PLN 444,444,400, which corresponds to 16.63% of PGG's share capital and total voting rights.
- On February 1st 2017, an 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 the issue of 2,444,440 new shares with a par value of PLN 100 per share. PGNiG TERMIKA acquired 555,556 new shares with a par value of PLN 100 per share and a total par value of PLN 55,555,600 in the increased share capital of PGG, in exchange for a cash contribution of PLN 55,555,600. Following the share capital increase, PGNiG TERMIKA held 5,000,000 shares in PGG, with a par value of PLN 500 per share and a total par value of PLN 500m, which corresponds to 17.14% of PGG's share capital and total voting rights. The share capital increase was registered with the National Court Register on March 10th 2017.
- On April 3rd 2017, an Extraordinary General Meeting of PGG passed a resolution to increase the company's share capital by PLN 500,000,000, from PLN 2,916,718,200 to PLN 3,416,718,200, through the 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, in exchange for a cash contribution of PLN 150,000,000. Following the share capital increase, PGNiG TERMIKA holds 6,500,000 shares in PGG, with a par value of PLN 100 per share and a total par value of PLN 650m, which corresponds to 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, an Extraordinary General Meeting of PGG passed a resolution to increase the company's share capital by PLN 200,000,000, from PLN 3,416,718,200 to PLN 3,616,718,200, through the 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, in exchange for a cash contribution of PLN 60,000,000. Following the share capital increase, PGNiG TERMIKA holds 7,100,000 shares in PGG, with a par value of PLN 100 per share and a total par value of PLN 710m, which corresponds to 19.63% of PGG's share capital and total voting rights. The share capital increase was registered with the National Court Register on July 7th 2017.
- On November 28th 2017, an Extraordinary General Meeting of PGG passed a resolution to change the company's legal form to a joint-stock company trading under the name Polska Grupa Górnicza Spółka Akcyjna. The change of legal form was entered in the National Court Register on December 29th 2017. Following the change, PGNiG TERMIKA holds 7,100,000 shares in PGG S.A., with a par value of PLN 100 per share and a total par value of PLN 710m, which corresponds to 19.63% of PGG S.A.'s share capital and total voting rights.

Equity investments outside the group of related entities:

In 2017, the PGNiG Group made no material equity investments outside the group of related entities. As at the end of 2017, the total par value of the PGNiG Group's equity interests held outside the group of related entities was PLN 53.52m, of which PLN 22.66m was attributable to PGNiG.

6.3. Basic rules of management at the PGNiG Group and their changes in 2017

Following the entry into force of the laws governing the exercise of shareholder (ownership) rights by the State Treasury, in 2017 the PGNiG Group companies introduced new standards for selecting members of their governing bodies, new rules of remuneration of members of their governing bodies, and amendments to their articles of association, taking into account the ownership policy guidelines for state-owned companies.

Considering the 'Standards of corporate supervision at state-owned companies', adopted by the Prime Minister in September 2017, which recommend that Management Boards of state-owned companies strive to apply those standards at all subsidiaries within a given group, in 2018 PGNiG intends to adapt the existing internal procedures to the recommendations issued by supervisory authorities, taking into account the changes introduced to date with respect to corporate supervision.

In 2017, the remuneration policy and the amount of remuneration paid to the management and supervisory board members at the PGNiG Group subsidiaries were modified to meet the requirements stipulated by the Act on Rules of Remunerating Persons Who Manage Certain Companies of June 9th 2016. In most subsidiaries, the remuneration was adjusted in accordance with the general rule set out in the Act. In some subsidiaries, a different method permitted under the Act was used to determine the remuneration upon prior approval from the PGNiG Supervisory Board.

Delivery of the PGNiG Group's Strategy is ensured by an extensive remuneration system for members of the Management Boards of the PGNiG Group companies. › For more information, see Section 10.3.

6.4. Court proceedings

6.4.1. Pending court proceedings

Proceedings with respect to the obligation of public sale of natural gas

The Act Amending the Energy Law and Certain Other Acts, dated July 26th 2013 (Dz.U. of 2013, item 984), imposed on energy companies meeting certain criteria the obligation of public sale of no less than 55% of high-methane gas volume introduced into the transmission network in a given year:

- At entry points to the Polish transmission system, at interconnections with transmission systems of other countries, or
- Via a network of production site pipelines, or
- Through liquefied natural gas terminals.

Pursuant to the transitional provisions of the Act, the volume of gas covered by the public sale obligation from the effective date of the amendment to December 31st 2013 was 30%; from January 1st 2014 to December 31st 2014: 40%; and as from January 1st 2015: 55%.

On January 13th 2015, the President of URE initiated proceedings to fine PGNiG for failure to meet the exchange sale requirement in 2013. PGNiG filed an appeal with the Competition and Consumer Protection Court at the Regional Court of Warsaw against one of the interlocutory decisions made by the President of URE in the course of the proceedings. On April 15th 2016, the Competition and Consumer Protection Court at the Regional Court of Warsaw dismissed the appeal. On May 25th 2016, the President of URE instigated ex officio proceedings to impose a financial penalty on PGNiG for its failure to meet the exchange sale requirement in 2013. On June 17th 2016, acting under Art. 56.6a of the Energy Law, the Company filed a request that the President of URE refrain from imposing the penalty. As at the date of this Report, the proceedings instigated by the President of URE were pending.

On October 28th 2015, the President of URE instigated proceedings to impose a financial penalty on PGNiG for its failure to meet the obligation to sell gas through the exchange market in 2014. On April 20th 2016, having considered the evidence, PGNiG filed a request under Art. 56.6a of the Energy Law for refraining from imposing the penalty. By decision of May 9th 2016, the President of URE imposed a fine of PLN 15m for PGNiG's failure to meet the exchange sale requirement in 2014. On May 27th 2016, the Company appealed against the decision in its entirety and requested that a legal question be presented to the Constitutional Tribunal about the constitutionality of Art. 49b.1 of the Energy Law and Art. 25 of the Act of July 26th 2013 amending the Energy Law and certain other acts. On December 27th 2016, the President of URE replied to the appeal, requesting its dismissal. PGNiG filed its response on January 27th 2017, providing additional grounds for the request to present the legal question to the Constitutional Tribunal.

6.4.2. Proceedings before the President of the Office of Competition and Consumer Protection (UOKiK)

Anti-trust proceedings instigated on December 28th 2010

On December 28th 2010, the President of the Office of Competition and Consumer Protection ('UOKiK') instigated ex officio anti-trust proceedings concerning alleged abuse by PGNiG of its dominant position on the domestic natural gas wholesale market, which consisted in inhibiting trade in natural gas against the interests of trading partners or consumers and in impeding the development of market conditions necessary for the emergence or development of competition by refusing to sell gas fuel under a comprehensive supply contract to a business entity that intended to resell the gas, i.e. NowyGaz Sp. z o.o. of Warsaw. In a decision of July 5th 2012, the President of UOKiK found these practices to be anti-competitive, stated that PGNiG had discontinued them on November 30th 2010 and imposed a PLN 60m fine on the Company. On July 24th 2012, PGNiG appealed against the decision to the Competition and Consumer Protection Court at the Regional Court of Warsaw. In its judgment of May 12th 2014, the Regional Court of Warsaw dismissed the appeal. On June 4th 2014, PGNiG appealed against the decision to the Warsaw Court of Appeals. In the judgment of May 29th 2015, the Court of Appeals amended the decision of the President of UOKiK where it referred to the amount of the fine by reducing the fine to PLN 5.5m. The judgment is final. On June 12th 2015, PGNiG paid the penalty imposed by the judgment of the Warsaw Court of Appeals. Both PGNiG and the President of UOKiK filed cassation complaints against the Court of Appeals' judgment to the Supreme Court. PGNiG's cassation complaint seeks to challenge the finding of competition law infringement, whereas the President of UOKiK's cassation complaint seeks to question the Court of Appeals' decision to reduce the penalty imposed on PGNiG.

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 in Warsaw reversed the ruling of the Competition and Consumer Protection Court of May 12th 2014 and remanded the case for re-examination by that court. The first hearing in the case has already been held. The date for the next hearing is yet to be set.

Anti-trust proceedings instigated on April 3rd 2013

On April 3rd 2013, the President of UOKiK instigated anti-trust proceedings concerning an alleged abuse by PGNiG of its dominant position on the domestic wholesale and retail natural gas market, which consisted in impeding the development of market conditions necessary for the emergence or development of competition by:

- Limiting the ability of business customers to reduce the contracted volumes of gas fuel and capacity,
- Limiting the ability of business customers to resell gas fuel,
- Requiring that business customers define the maximum volume of gas fuel purchased for resale in the contract,
- Refusing to grant wholesale customers the right to a partial change of supplier.

In the course of the proceedings, PGNiG submitted a request to the President of UOKiK for an obligation decision, in which it voluntarily agreed to revise certain provisions in its contracts with non-household customers. By virtue of decision No. DOK-8/2013 of December 31st 2013, the President of UOKiK resolved not to impose a fine on the Company and obliged the Company to fulfil its commitment. PGNiG performed its obligations set out in the President of UOKiK's obligation decision within the deadlines specified therein.

On August 1st 2014, PGNiG OD took over the existing retail gas trading business from PGNiG and assumed all rights and obligations arising from the decisions issued by the President of UOKiK under the Act on Competition and Consumer Protection in respect of agreements to which PGNiG OD became a party. PGNiG OD is in the course of performing the obligation (in the part corresponding to its scope of business) imposed under the decision of the President of UOKiK dated December 31st 2013.

On October 17th 2014, the President of UOKiK commenced administrative proceedings to impose a fine under Art. 107 of the Act on Competition and Consumer Protection of February 16th 2007 (Dz.U. No. 50, item 331, as amended) on PGNiG and PGNiG OD for alleged delay in complying with the President of UOKiK's decision of December 31st 2013 where it relates to optional reduction by business customers of gas fuel quantities and capacity contracted for future years. In their response, PGNiG and PGNiG OD presented grounds for their actions and stated that by taking such actions they duly complied with the decision. On September 24th 2015, the President of UOKiK issued decision No. DOK-3/2015 to impose a financial penalty of PLN 10.4m on PGNiG for its delay in compliance with the decision. The President of UOKiK also decided to discontinue the proceedings against PGNiG OD. The President of UOKiK found that PGNiG OD had performed its obligations under the President of UOKiK's decision of December 31st 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. On March 21st 2017, the Regional Court of Warsaw dismissed the appeal filed by PGNiG S.A. against the decision of the President of UOKiK, and ordered the Company to reimburse the costs of the proceedings (PLN 360) to the President of UOKiK. The ruling is not final. On April 18th 2017, the PGNIG appealed against the ruling in its entirety. As at the date of this report, the Court of Appeals in Warsaw had yet to notify the Company of the date of an appeal hearing in the case.

6.4.3. 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 by PST on December 3rd 2016 (the scope of the complaint and request was subsequently extended on March 13th 2017); the General Court of the European Union, with which a complaint and a request for injunctive relief were filed by 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 complaint and the request for injunctive relief filed with the General Court of the European Union are against 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 UE 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 (the complaint and request of December 4th 2016). On May 29th 2017, PST filed its position on the plea of inadmissibility of the complaint raised by the European Commission.

A complaint against the European Commission's decision together with a request for injunctive relief were also filed by PGNiG on March 1st 2017. On July 6th 2017, an application was filed to admit PGNiG as an intervener supporting the Ukrainian company Naftogaz in the case against the decision of the European Commission. On August 21st 2017, PGNiG replied to the plea of inadmissibility raised by the European Commission.

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 for an injunctive relief filed by PGNiG in both cases. On December 14th 2017, the General Court of the European Union rejected PST's complaint on the grounds of inadmissibility and awarded the costs of the proceedings against PST. It was a formal decision, not based on an analysis of validity of the claims made in the complaint. The decision may be appealed and the deadline for an appeal has not yet expired. The plea of inadmissibility of PGNiG's complaint has not yet been examined.

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. 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. from holding 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 March 31st 2017, a statement of reasons for the complaint against the administrative settlement was filed with the Higher Regional Court, containing an in-depth legal argument as a condition to pursuing any further legal remedies.

After an exchange of pleadings, the Higher Regional Court in Düsseldorf, by a decision of July 27th 2017, overturned its decision of December 30th 2016, thus cancelling the previously granted injunctive relief. After a further exchange of pleadings, the Court dismissed the application for an interim order during a hearing on October 11th 2017. A decision to dismiss the application, accompanied by a statement of reasons, was delivered on October 23rd 2017. No further hearings have been scheduled so far.

6.4.4. Other proceedings

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

In 2017, 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

PGNiG received information that on December 13th 2017 the Company received a copy of the sttatement of claim filed by one of the shareholders with the Regional Court in Warsaw to void/revoke Resolution No. 1/IX/2017 of the PGNiG's Extraordinary General Meeting of September 13th 2017.

7. Financial condition of the PGNiG Group in 2017

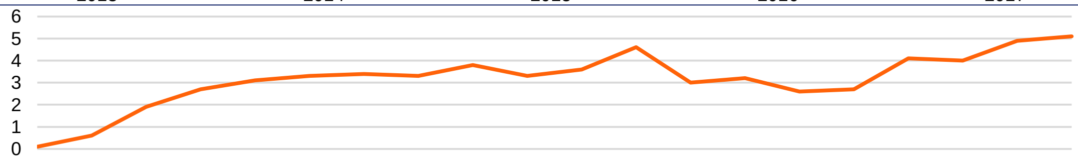
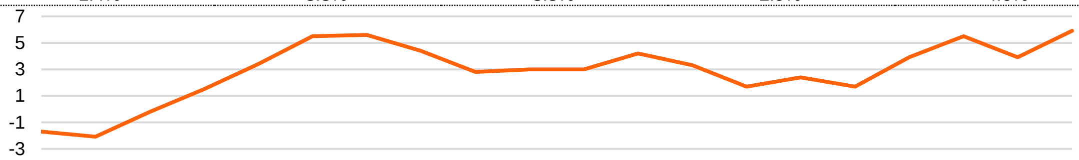
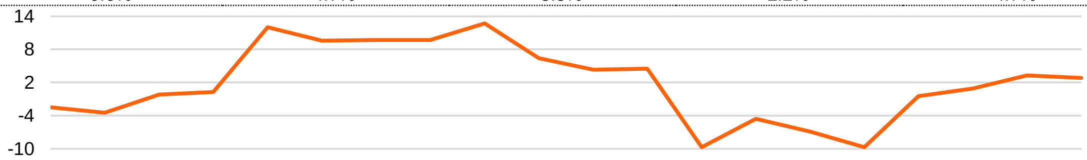
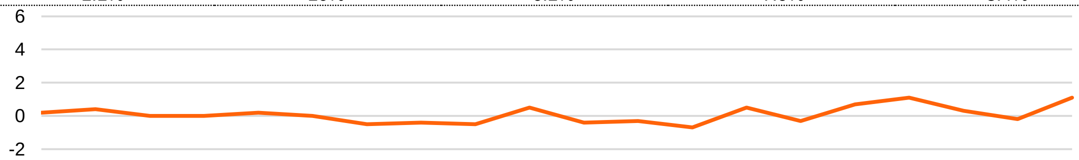
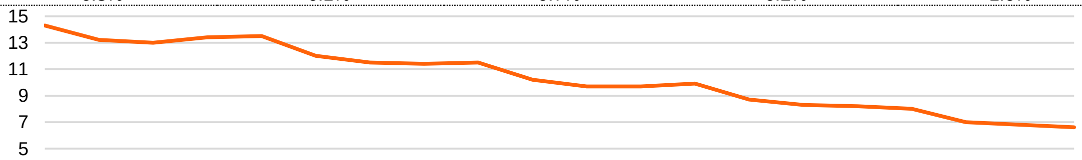
7.1. Fuel prices and currency exchange rates

7.1.1. Macroeconomic environment

According to Eurostat, in 2017 the European Union's GDP grew by 2.5% and was the highest in the last ten years. The positive economic sentiment was attributable to several factors, including the European Central Bank's quantitative easement policy and maintaining interest rates unchanged, increased capital expenditure, and the continued rise of raw material prices. As a result, an inflation rate of 1.8% year on year was recorded, with projections showing that the uptrend will be maintained. An optimistc climate also prevailed on the European labour market, where the number of unemployed fell again and the unemployment rate (7.3%) was at its lowest in more than nine years.

Preliminary GDP estimates published by Poland's Central Statistics Office (GUS) indicate that in 2017 the Polish economy grew by 4.6%, 1.7 pp up on 2016. The higher rate of Poland's economic growth follows from an increase in investment activity (2.8% year on year in Q4), both in the public and private sectors. Domestic demand grew by 5.9% year on year in Q4 2017 on improved private consumption, robust labour market, and launch of government social programmes. According to GUS, at the end of 2017 the unemployment rate was 6.6% (down +1.7 percentage points year on year), among the lowest for over 26 years. According to the consumer price index (CPI) data published in December 2017, the index stood at 1.1% in Q4 2017, with rising commodity prices among the contributing factors. Also the manufacturing sector confirmed its sound condition as the Purchasing Managers Index (PMI), measuring industrial activity in Poland, stood at 54.60 points as at January 1st 2018, close to its value as at January 1st 2017.

Selected macroeconomic indicators in 2013–2017.

Indicator [%]	2013	2014	2015	2016	2017
Gross Domestic Product (quarterly data, change y/y)*					
Change y/y*	1.4%	3.3%	3.8%	2.9%	4.6%
Domestic demand (quarterly data, change y/y)*					
Change y/y*	-0.6%	4.7%	3.3%	2.2%	4.7%
Capital expenditure (gross spending on capital goods) (quarterly data, change y/y)*					
Change y/y*	-1.1%	10%	6.1%	-7.9%	5.4%
Inflation (data as at end of quarter, change y/y/)* (December of previous year)					
Change y/y*	0.8%	0.1%	-0.7%	-0.2%	1.6%
Unemployment rate (at end of quarter)* (year-end data)					
year-end data	13.4%	11.5%	9.7%	8.3%	6.6%

Source: Central Statistics Office.

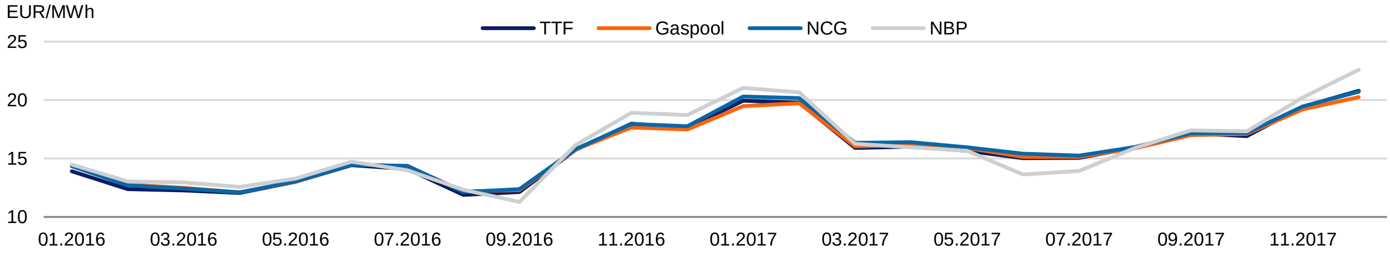
7.1.2. Gas market trends

2017 saw an increase in natural gas prices on European markets. The average price of a month ahead contract on the Dutch TTF hub was by 22% higher relative to 2016.

The air temperature in winter was often lower than the seasonal standard, which boosted the demand for gas for heating purposes. Failures occurred in the gas fields in Norway and the Netherlands, which temporarily limited gas supplies to Western European countries. In the United Kingdom, decision was made to close the Rough gas storage facility, accounting for 70% of UK's gas storage capacity. The rising prices of CO_2 emission allowances and the lower energy ouput from nuclear power plants in France drove up the manufacturing sector's demand for gas. The increase in gas prices in Europe was also driven by scheduled repairs of key transmission infrastructure and a gas explosion at the compressor station in Baumgarten, Austria.

Natural gas prices in 2017

Average monthly spot prices of natural gas at selected European hubs in 2016–2017. GPL and NCG – Germany; NBP – United Kingdom; TTF – the Netherlands.



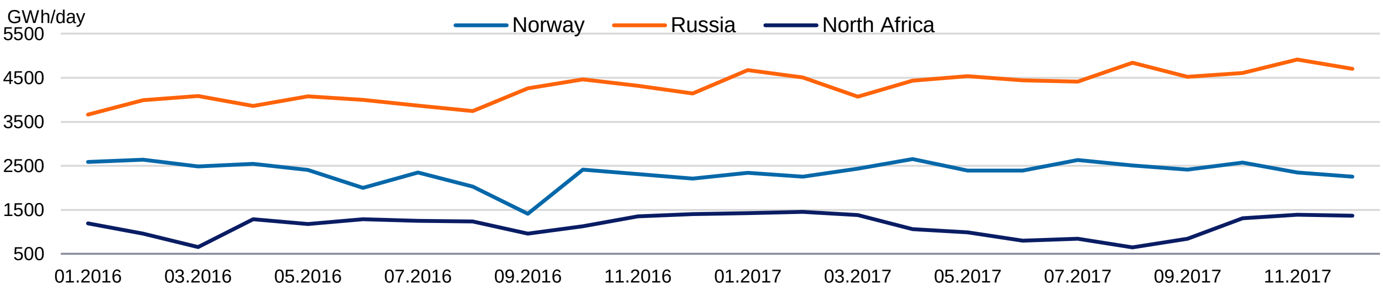
Source: ICE – Intercontinental Exchange, EEX – European Energy Exchange.

In 2017, the average price of natural gas in Europe increased by 21% compared with 2016. The highest growth rate (24%) was recorded at the German NCG hub and the Dutch TTF. The average price of gas on key European markets was EUR 17.34/MWh, compared with EUR 14.06/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. A failure affected also 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, which consequently rendered it necessary to shut down the facility permanently. Reversal of the spread between the NBP and the hubs in the continental part of Europe seen in the first half of 2017 was a consequence of maintenance and repair works on the Interconnector pipeline – the only link for transmitting gas from Great Britain to the European continent. Further strengthening of prices resulted from a spike in the price of oil, to which some of the European gas import contracts are still indexed, as well as numerous failures of Norwegian production infrastructure. A growth in gas demand in the French manufacturing sector in the face of limited energy output from nuclear power unist also contributed to the increases. Demand for gas for generation purposes was also driven by the increase in prices of CO_2 emission allowances. The increase in gas prices at the end of the year resulted from lower temperatures and the explosion at the compressor station in Baumgarten, Austria.

In terms of daily average volumes of gas flow, over 1,663 TWh (152 bcm), representing 56% of last year's European imports via gas pipelines, originated from Russia. The share of Russian imports increased 2 percentage points year on year. Norway emerged as the second largest supplier of gas to Europe, providing 888 TWh (81 bcm), or 30% of total imports. The share of gas imports from Norwegian deposits dipped 1 pp relative to 2016. Exports from North Africa amounted to 410 TWh (37 bcm).

Sources of fuel imports to Europe



Source: Thomson Reuters.

One of the main drivers of fluctuations in the volume of gas imports from the eastern direction in a given period is the price of oil. The flexible structure of purchase contracts linked to crude oil prices allowed European importers to increase imports from the East during the slump on the crude oil market and scale back purchases from other directions (depending on the type of contract and price formula).

Gas inventory levels

At the end of 2017, volumes of gas stored in Polish gas storage facilities amounted to approximately 78% of the capacity and were 1 percentage point higher than at the end of 2016.

Gas storage capacity utilisation as at December 31st 2017

Poland	Gas in storage [GWh]	Utilisation [%]
Austria	58,346	47%
Belgium	3,784	42%
Bulgaria	4,248	68%
Croatia	4,227	75%
Czech Republic	25,258	73%
Denmark	8,887	82%
France	69,444	52%
Germany	154,536	66%
Hungary	37,694	56%
Italy	142,314	74%
The Netherlands	83,861	65%
Poland	25,820	78%
Portugal	1,842	52%
Romania	17,014	50%
Slovakia	25,126	66%
Spain	22,098	70%
United Kingdom	6,988	77%
Ukraine	157,728	47%
Total EUROPE*	691,494	65%

source: GIE – Gas Infrastructure Europe
**Excluding gas storage capacity utilisations for Belarus, Ireland, Latvia and Serbia.*

Progress in implementing infrastructural projects on the European gas market

The Baltic Pipe

The Baltic Pipe project is a strategic infrastructure project aimed at creating a new gas supply corridor on the European market. It is to enable the transmission of gas directly from deposits located in Norway to markets in Denmark and Poland, as well as to consumers in the neighbouring countries. In 2016, GAZ-SYSTEM and the Danish transmission system operator Energinet developed a feasibility study for establishing a new interconnector between two national markets in the form of a two-way offshore pipeline and expanding national transmission networks. Based on the positive results of the study, the annual transmission capacity of the Baltic Pipe was determined at up to 10 bcm to Poland and up to 3 bcm to Denmark and Sweden.

The progress of work on the Baltic Pipe project was as follows:

- In June 2017, the Polish and Danish prime ministers signed a memorandum concerning the gas pipeline, in which they restated their support for the implementation of this project.
- In June 2017, Phase 1 of the Open Season Procedure began. Its purpose was to examine the demand for gas pipeline transmission capacity among gas market players, and thus the advisability of the project. As part of this procedure, market players could submit requests for reservation of required capacity on a given gas pipeline.
- In July 2017, Phase 1 of the Open Season Procedure ended, confirming that the demand for the transmission of natural gas was sufficient to consider the project advisable.
- In September 2017, the operators GAZ-SYSTEM and Energinet commenced Phase 2 of the Open Season Procedure, under which the market players were expected to declare final volumes of reserved capacity and then sign transmission contracts for up to 15 gas years.
- On October 27th 2017, Phase 2 of the Open Season Procedures was completed. Under the procedure, PGNiG made a binding offer for capacity reservation in the period from October 1st 2022 to September 30th 2037. The liability was estimated at PLN 8.1bn.
- In November 2017, both operators obtained positive results of the economic viability test of the project. In the meantime, the Baltic Pipe was included in the third list of Projects of Common Interest (the project was also on the first and second list published in 2013 and 2015, respectively) developed by the European Commission. The inclusion confirmed the importance of construction of this gas pipeline for the EU at large.
- In January 2017, PGNiG signed transmission agreements with GAZ-SYSTEM and Energinet.

According to the project assumptions, by December 1st 2018 GAZ-SYSTEM and Energinet will have taken final investment decisions whose implementation is a precondition for launching gas transmission services via the Baltic Pipe.

Nord Stream 2

In early September 2015, representatives of Gazprom, E.ON AG and BASF-Wintershall, Royal Dutch Shell, Engie (former GdF Suez) and OMV signed a legally binding shareholders' agreement to construct the Nord Stream 2 gas pipeline. Pursuant to the agreement, a company will be formed to first build and operate the gas pipeline, with Gazprom as the majority shareholder with a 51% interest and the remaining shareholders holding minority interests adding up to 49%. Next, an application for the registration of the consortium responsible for building the pipeline was submitted with German and Polish antitrust authorities. In mid-August 2016, the Polish Office of Competition and Consumer Protection concluded that concentration of gas supplies through the pipeline would jeopardise competition on the gas markets of Poland and other CEE countries. As a result, the consortium could not be established and Russia was left with a dilemma on how to finance the project.

In November 2017, the European Commission submitted an amendment to the Gas Directive included in the Third Energy Package. In this way, the Nord Stream 2 project would be subject to the provisions of EU law regarding the obligation to provide transmission capacity to not only the enterprises taking part in the project, but also the other market players. In January 2018, Nord Stream 2 announced on its website that it had obtained consent for the construction and operation of the offshore section of the Nord Stream 2 pipeline in the German territorial waters and in the municipality of Lubmin near Greifswald. According to the project's assumptions, the second line of the gas pipeline connecting Russia with Germany is to be placed in service by the end of 2019.

Turkish Stream

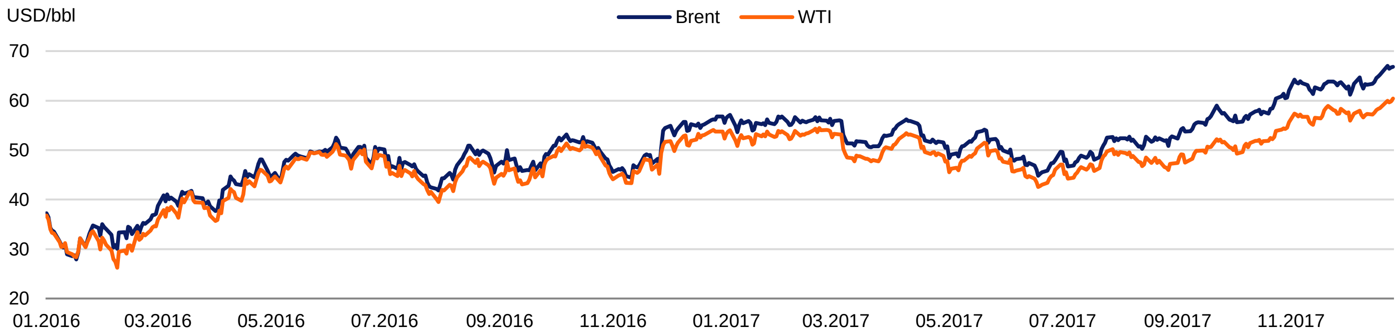
The Turkish Stream project, suspended at the end of 2015, was resumed on October 10th 2016 by Russia and Turkey, which signed an international agreement to construct two lines of the gas pipeline, to be brought on stream in December 2019. The pipeline's planned capacity is approximately 28–30 bcm, two times less than originally assumed. After obtaining the required consents, in May 2017, the commencement of practical implementation phase of the Turkish Stream project, i.e. commencement of construction of the offshore section of the pipeline, was announced.

7.1.3. Trends on the crude oil market

In early 2017, prices of crude oil remained stable. The high oil prices seen in December 2016 continued throughout the first quarter of 2017 as the oil producers involved in a deal to reduce crude oil output (OPEC countries, Russia and other non-OPEC countries) gradually delivered on their commitments. Nevertheless, crude oil prices fell in March over growing concerns among investors that output cuts would not be fully implemented. Saudi Arabia, Kuwait and Angola fully complied with their commitments, while the United Arab Emirates and Venezuela were nowhere near their target. 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 accelerating production of shale oil in North America and a gradual increase in oil stocks in the US mitigated the effect of reduced oil supply from the OPEC countries on its price. 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.

Crude oil prices in 2017

Brent and WTI oil prices in 2016 and 2017 (month ahead contract)



Source: ICE – Intercontinental Exchange.

Despite the lack of solidarity between the countries declaring output limitation, the OPEC group together with partner countries agreed to extend oil production cuts for another nine months. As a result, oil prices rose sharply. However, only a few days later the increase was halted by the news of growing production levels in Libya and Nigeria, which were exempt from the programme due to the consequences of civil wars in those countries. Combined with record-high crude stocks in the US, the production growth rates in Libya and Nigeria undermined investors' confidence in positive effects of reduced supply from OPEC countries in the following nine months. As a consequence, on June 21st the price of crude fell to the year's low of USD 44.82 per barrel.

Starting from July 2017, a steady upward trend was observed, driven by information about the first in 24 weeks drop in the number of active wells in the US as well as Saudi declarations on further reduction of exports and rumors of prolonging OPEC's production curb deal. At the end of August, the US coast was hit by hurricane Harvey, as a result of which the output from US refineries declined by more than 25%. The tense situation in the Middle East due to Kurdistan's independence aspirations, Hurricane Nate, which brought to a standstill facilities accounting for 90% of oil production in the Gulf of Mexico, and further reduction of oil stocks in the US, were other factors fuelling price increases. At the OPEC summit held at the end of November in Vienna, a decision was made to extend the oil output curbs until the end of 2018.

Crude oil demand and supply worldwide

bn bbl	Demand		Supply	
	2016	2017	2016	2017
OECD	46.75	47.20	26.54	27.29
including the US	19.69	19.87	14.85	15.56
non-OECD	50.12	51.30	70.67	70.65

including China	12.81	13.26	4.87	4.78
including former USSR countries	-	-	14.22	14.33
including OPEC	-	-	39.23	39.28
Worldwide	96.87	98.50	97.21	97.94

Source: EIA.

In 2017, average demand for crude oil rose by 1.5% compared with the previous year, to 98.39 million barrels per day. Among the world's largest consumers outside the OECD, the most pronounced increase, of 3.1%, was observed in China. Other Asian countries also recorded a demand increase, on average by 2.8%.

The global oil supply rose in 2017 by 0.8% year on year. The strongest oil output increase was recorded in the United States – by 4.4%, or 0.66 million barrels per day. Crude production grew also in the former Soviet Union countries – by 0.11 million barrels per day. Despite the production cutting deal, a slight output increase of 80 thousand barrels per day was also recorded in the OPEC member countries.

The United States, keeping a close watch on oil market developments, decided to intensify oil production. In 2017, the number of wells rose sharply, reaching a historical high of 768 wells in mid-August. Then the number of active oil wells fell slightly and remained stable. The average daily output in the US was 15.51 million barrels per day, up by 4.5% on 2016. In 2017, the number of gas wells grew by nearly 35%.

7.1.4. Outlook for crude oil and natural gas market

On the last trading day in 2017, prices of crude on fuel exchanges were close to their two-year highs – Brent front month on the ICE market was quoted at above 66 USD/bbl, and WTI front month on the NYMEX exchange – at above 60 USD/bbl. Oil price forecasts for 2018 are highly divergent. Some analysts predict that the price of the commodity may rise even to 80 USD/bbl, citing geopolitical risks and the consequent reduced supply of oil to the market as the basis for their predictions. Others are forecasting a price drop on strong supply of crude from the US. The sharp rise in US shale oil production has for many years been strongly constraining global oil price growth and may result in oil prices on the global exchanges falling below 55 USD/bbl.

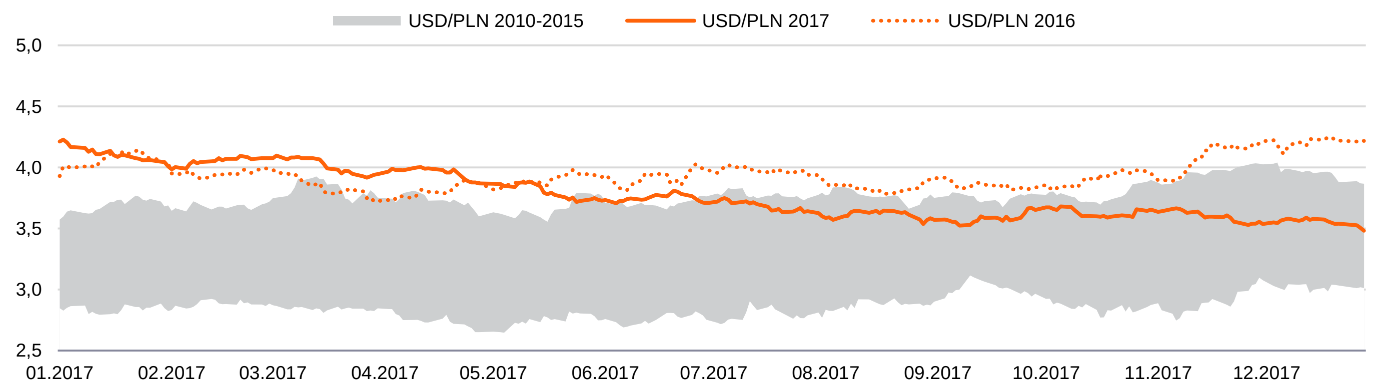
On the last trading day of 2017, natural gas exchanges recorded a drop in spot prices in all observed areas – the price of a spot instrument on GASPOOL was less than 19 EUR/MWh. The prices of all futures contracts in the Netherlands and of most contracts in Germany and the UK were also on a downward trend despite growing prices of contracts for crude oil and coal.

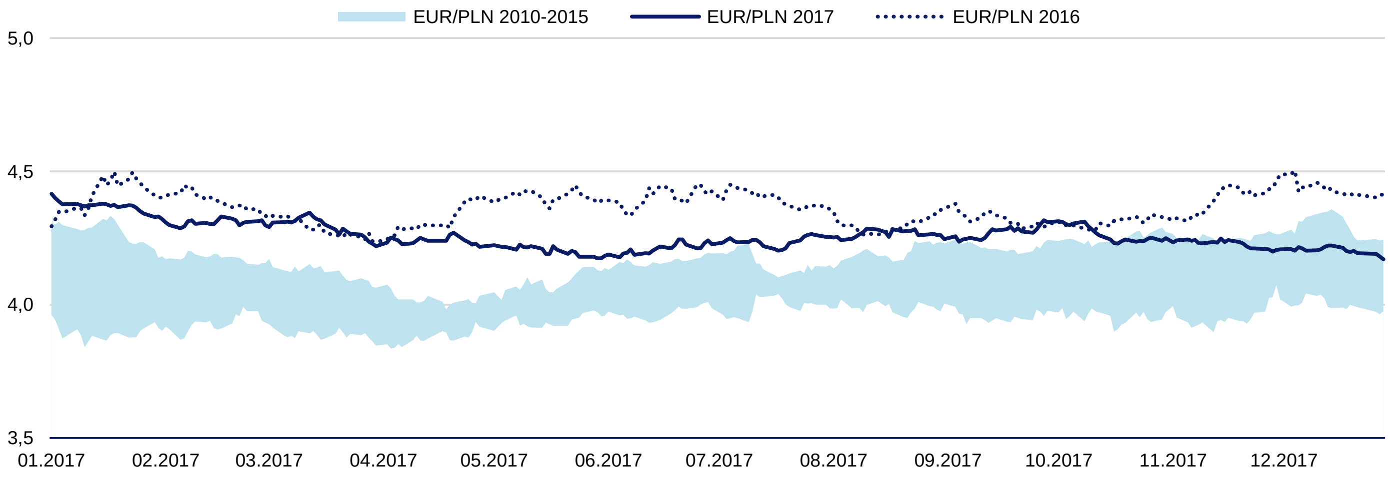
Many analysts are forecasting a further decline of natural gas prices in 2018, not only because of the high crude output levels in the US, but also due to an impressive natural gas production growth across the Atlantic. Based on EIA data, in 2018 alone gas production volumes in the US may grow by nearly 7 bcm.

7.1.5. EUR/PLN and USD/PLN exchange rates

In 2017, the Polish złoty clearly strengthened against the main global currencies, that is the US dollar and the euro. This appreciation of the Polish currency could have been driven by the country's excellent economic situation – the GDP growth in Poland was the highest in five years and unemployment fell to some of the lowest levels in history.

In the international currency markets, in 2017 the US dollar declined in value. On January 4th 2017, the EUR/USD exchange rate was around 1.046 EUR/USD, to reach about 1.2 EUR/USD at the end of the year. According to some analysts, this change was due to solid economic performance of the eurozone, further strengthened by the European Central Bank's policy of interest rate increases. An interest rate increase by the US Federal Reserve System (the Fed) in December 2017 failed to reverse the US dollar price trend, and at the end of the year the currency continued to depreciate against the euro. The future situation of the US currency will depend on the policy pursed by the Fed in 2018, which has announced further interest rate increases. Analysts' predictions as to the Polish currency in 2018 vary. On the one hand, further strong GDP growth in Poland is anticipated and interest rates are expected to be increased, which may be conducive to further appreciation of the Polish currency. On the other hand, though, investors may become more interested in relatively cheaper currencies, as a result of which we may see growing USD/PLN and EUR/PLN exchange rates.





7.2. Financial performance

Summary information on the financial performance of PGNiG and the PGNiG Group in 2017 is presented below.

7.2.1. Financial highlights of PGNiG

Financial highlights of PGNiG (PLNm)

	2017	2016	Change y/y
Revenue	19,061	17,183	1,878
Total operating expenses, including	(17,968)	(15,902)	(2,066)
Depreciation and amortisation	(766)	(767)	1
Operating profit	1,094	1,281	(187)
Profit before tax	2,290	2,851	(561)
Net profit	2,034	2,576	(542)
Net cash from operating activities	862	2,502	(1,640)
Net cash flows from investing activities	(88)	(200)	112
Net cash from financing activities	(4,017)	(2,001)	(2,016)
Net increase/(decrease) in cash and cash equivalents	(3,243)	301	(3,544)
	2017	2016	
Total assets	33,447	35,769	(2,322)
Non-current assets	24,234	25,759	(1,525)
Current assets, including	9,213	10,010	(797)
Inventories	2,231	1,942	289
Total equity and liabilities	33,447	35,769	(2,322)
Total equity	26,033	25,228	805
Total non-current liabilities	2,288	2,144	144
Total current liabilities	5,126	8,397	(3,271)
Total liabilities	7,414	10,541	(3,127)

Profitability

	2017	2016
EBIT operating profit	1,094	1,281
EBITDA operating profit + depreciation/amortisation	1,860	2,048
ROE net profit to equity at end of period	7.8%	10.2%
Net margin net profit to revenue	10.7%	15.0%
ROA net profit to assets at end of period	6.1%	7.2%

Liquidity

	December 31st 2017	December 31st 2016
Current ratio current assets to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	2.0	1.3
Quick ratio current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.5	1.0

Debt

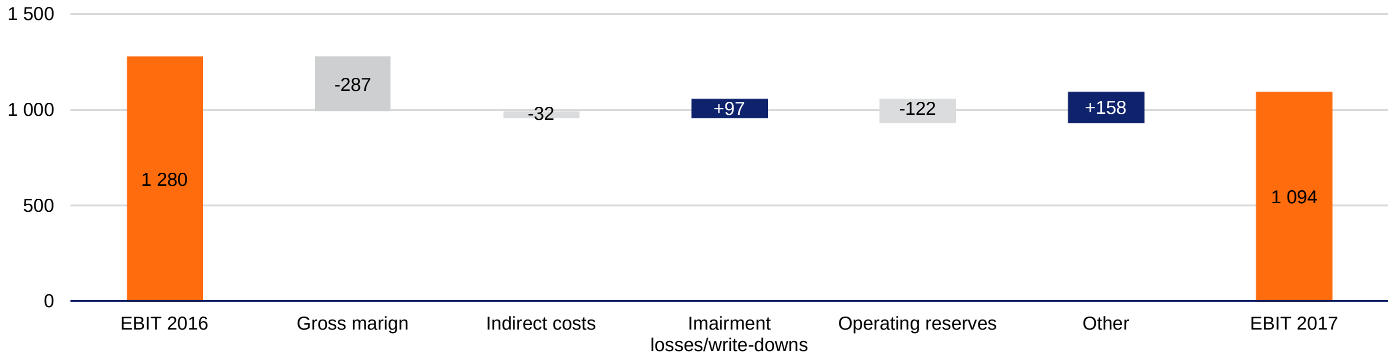
	Dec 31 2017	Dec 31 2016
Debt ratio	22.2%	29.5%

total liabilities to total equity and liabilities		
Debt to equity ratio total liabilities to equity	28.5%	41.8%

Financial performance of PGNiG

In 2017, PGNiG's EBIT came in at PLN 1,094m, down PLN 187m year on year. The chart below shows changes in EBIT from 2016 to 2017.

Change in EBIT: 2016 vs 2017



The PLN 187m yoy decline in EBIT came primarily as a result of:

- lower margin on the sale of high-methane gas, partly offset by higher margins on the sale of nitrogen-rich gases and crude oil,
- higher impairment losses/write-downs and operating provisions.

Margins on the sale of services, merchandise, materials and other products, including electricity, helium, LPG and sulfur, fell slightly on 2016. EBIT was improved by the following factors:

- lower impairment losses/write-downs, in particular on tangible assets and tangible assets under construction,
- higher net gain on forwards/futures.

In 2017, the net balance of finance income and costs was down by PLN 375m year on year as a result of PLN 432m lower dividends received from subsidiaries.

Compared with 2016, there was a significant decrease in the value of non-current assets – their value as at December 31st 2017 was down by PLN 1,525m, which was mainly attributable to a PLN 1,609m drop in long-term loans and credits granted by PGNiG year on year (reclassification to current assest). As at the end of 2017, liabilities amounted to PLN 7,414m, down PLN 3,127m (or 30%) on the end of December 2016. This decrease was mainly due to a PLN 3,271m yoy drop in current liabilities following the repayment of a portion of debt under bonds and loans. In consequence, cash also decreased considerably.

The Company's financial position was reflected in its key financial ratios. ROE, ROA and net margin fell from 10.2% to 7.8%, from 7.2% to 6.1%, and from 15.0% to 10.7%, respectively.

7.2.2. Financial highlights of the PGNiG Group

Financial highlights of the PGNiG Group (PLNm)

	2017	2016	Change y/y
Revenue	**35,857**	33,196	2,661
Total operating expenses, including	(31,947)	(29,836)	(2,111)
Depreciation and amortisation	(2,669)	(2,614)	(55)
Operating profit (EBIT)	3,910	3,360	550
Profit before tax	3,922	3,210	712
Net profit	2,921	2,349	572
Net cash from operating activities	4,816	5,922	(1,106)
Net cash flows from investing activities	(3,863)	(3,842)	(21)
Net cash from financing activities	(4,204)	(2,269)	(1,935)
Net increase/(decrease) in cash and cash equivalents	(3,251)	(189)	(3,062)
	2017	**2016**	
Total assets	48,203	49,672	(1,469)
Non-current assets	36,364	36,236	128
Current assets, including	11,839	13,436	(1,597)
Inventories	2,748	2,510	238
Total equity and liabilities	48,203	49,672	(1,469)
Total equity	33,627	32,016	1,611
Total non-current liabilities	7,004	7,303	(299)
Total current liabilities	7,572	10,353	(2,781)
Total liabilities	14,576	17,656	(3,080)

Profitability

	2017	2016
EBIT operating profit	3,910	3,360
EBITDA operating profit + depreciation/amortisation	6,579	5,974
Adjusted EBITDA operating profit + depreciation/amortisation + impairment losses on property, plant and equipment	7,012	6,811
ROE net profit to equity at end of period	8.7%	7.3%
Net margin net profit to revenue	8.2%	7.1%
ROA net profit to assets at end of period	6.1%	4.7%

Liquidity

	2017	2016
Current ratio current assets to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.8	1.5
Quick ratio current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.4	1.2

Debt

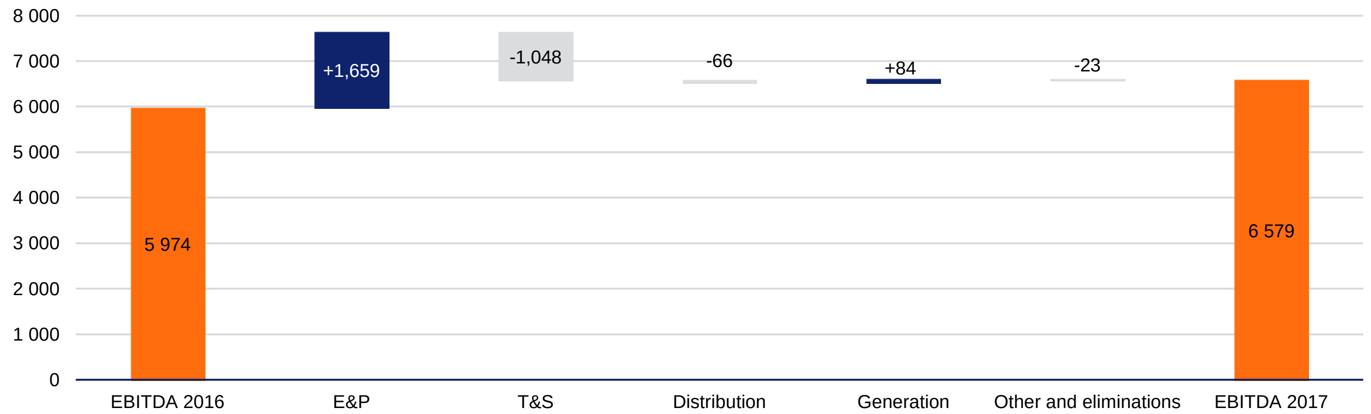
	2017	2016
Debt ratio total liabilities to total equity and liabilities	30.2%	35.5%
Debt to equity ratio total liabilities to equity	43.3%	55.1%

Financial performance of the PGNiG Group

In 2017, the PGNiG Group's revenue was PLN 35,857m, up PLN 2,661m (8%) from PLN 33,196m posted a year earlier. Despite a 7% yoy growth in operating expenses, which amounted to PLN 31,947m, the Group earned consolidated operating profit (EBIT) of PLN 3,910m, up 16% yoy. Operating profit before depreciation and amortisation (EBITDA) came in at PLN 6,579m, which represents an increase of PLN 605m (10%) on the previous year.

The Group generated this performance in an environment characterised by higher prices of crude oil and natural gas on the global markets and progressing deregulation of the Polish gas market. The combination of sales promotions and slightly lower temperatures compared with the previous year (down by 0.2^{O}C) drove the gas volumes sold by the PGNiG Group up from 24.3 bcm in 2016 to 26.8 bcm in 2017.

Change in EBITDA: 2016 vs 2017



**Data restated according to the new segmentation of the PGNiG Group's operations.*

Exploration and Production (E&P)

At the end of 2017, the Exploration and Production segment reported an operating profit of PLN 2,805m, down by PLN 1,667m relative to 2016. At PLN 3,865m, EBITDA was also lower than the year before, by PLN 1,659m (75%). The segment's revenue rose by PLN 829m (16%) year on year, to PLN 6,118m.

In 2017, the volume of crude oil sold was down by 6% year on year, mainly due to shutdowns in Norway: two wells in the Skarv field went offline and there was a technical stoppage in the Vale field. Despite this, the PGNiG Group recorded a PLN 256m (16%) increase in revenue from sale of crude oil in the E&P segment, fuelled by higher oil prices in global markets (in the Polish złoty, the average quarterly price of Brent oil was approximately 18% higher than in the previous year).

The PLN 837m (20%) decrease in the Exploration and Production segment's operating expenses was due to significantly lower impairment losses on property, plant and equipment, which in 2017 amounted to PLN 79m, compared with PLN 771m a year earlier.

Trade and Storage (T&S)

In 2017, the Trade and Storage segment reported an operating loss of PLN -640m, down by PLN 1,045m from the PLN +405m net profit generated in 2016. At the EBITDA level, the segment recorded a loss of PLN -435m, a result lower by PLN 1,049m than in 2016 when the Group generated an EBITDA of PLN +614m. The segment's revenue reached PLN 30,495m, up by PLN 2,315m (8%) year on year.

In 2017, there was a significant increase in the segment's operating expenses, which went up by PLN 3,360m (12%). The segment's poorer performance was attributable to higher prices of crude oil driving up the cost of gas procurement, which translated into lower margins. In addition, the segment's 2017 performance deteriorated by PLN 364m following the recognition of impairment losses on property, plant and equipment (in 2016, the effect of impairment losses was PLN -12m) and by PLN 54m due to inventory write-downs (including on gas inventories in the UGSF)), while in 2016 the reversal of impairment losses/write-downs improved the segment's performance by almost PLN 200m.

At the end of 2017, the stocks of gas owned by PGNiG and held in underground high-methane gas storage facilities stood at approximately 2.3 bcm and remained close to the level recorded at the end of 2016, when they amounted to 2.2 bcm.

Distribution

In 2017, the Distribution segment's operating profit fell by 4% year on year to PLN 1,568m, while EBITDA came in at PLN 2,493m, down by PLN 66m year on year.

In 2017, the segment's revenue went up PLN 22m, while revenue from sale of distribution services rose by PLN 209m, or 5% year on year, with the distribution volume higher by 11.7 bcm (7%) year on year. The expenses incurred in 2017 rose slightly (by PLN 89m, or 3%) year on year, primarily due to higher labour costs (PLN 1,149m in 2017 vs PLN 995m in 2016).

Generation

The segment's operating profit in 2017 was PLN 425m, up PLN 26m in 2016. EBITDA came in at PLN 843m, up PLN 84m, or 11%, year on year. The segment's revenue stood at PLN 2,251m, an increase of PLN 56m compared with 2016. In 2017, the contribution of PGNiG TERMIKA EP (comprising Przedsiębiorstwo Energetyki Cieplnej S.A. and Spółka Energetyczna Jastrzębie S.A.) to the segment's performance was larger than in 2016 – PGNiG TERMIKA EP's contribution to the segment's EBITDA was PLN 96m (2016: PLN 28m).

The segment's performance was driven by higher heat sales volumes (up by more than 6% year on year) and an increase in the volume of electricity (own generation) sold (up by 8% year on year) coupled with a simultaneous rise in the average electricity price during the period by 0.71 PLN/MWh. The growing number of segment companies drove up operating expenses.

Fluctuations in financial performance

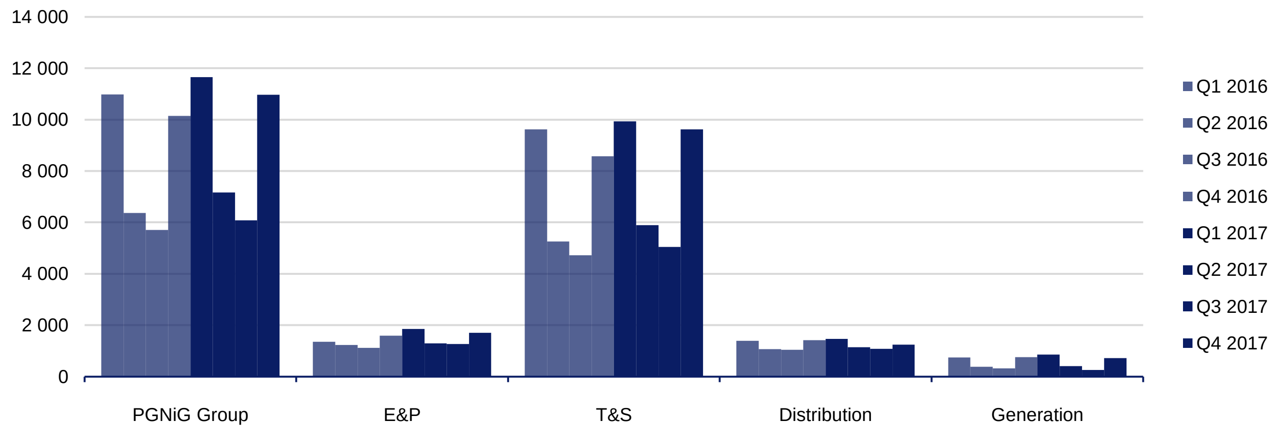
The sale, distribution and storage of gas fuels, as well as cogeneration of heat and electricity, which, in addition to hydrocarbon exploration and production, constitute the core business of the Group, are subject to significant seasonal fluctuations.

Revenue from sale of natural gas and heat in the winter season (Q1 and Q4) is substantially higher than in summer (Q2 and Q3). This is due to the seasonal changes in weather conditions in Poland, and the extent of the fluctuations is determined by temperatures – low in winter and higher in summer. Revenue from gas and heat sales is subject to much greater seasonal changes in the case of households, where gas and heat are used for heating, than in the case of industrial customers.

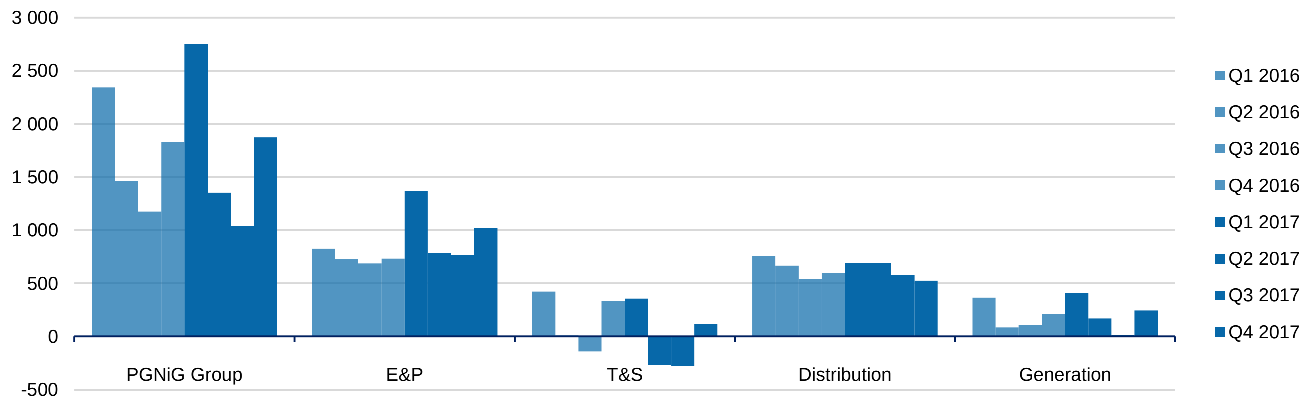
In order to ensure uninterrupted gas supplies in periods of peak demand and to maintain the security of gas supplies, it is necessary to replenish the gas stocks of underground gas storage facilities in summer, and to reserve higher transmission and distribution system capacities for winter.

The performance of individual segments is also subject to significant fluctuations reflecting changes in product prices. Moreover, the performance of the Exploration and Production segment reflects changes in hydrocarbon production profiles.

Fluctuations in revenue of the PGNiG Group in 2016-2017



Fluctuations in the PGNiG Group's EBITDA (adjusted for impairment losses on property, plant and equipment) in 2016-2017



2017

PLNm	PGNiG Group	Exploration and Production	Trade and Storage	Distribution	Generation
Q1 EBITDA	2,769	1,376	358	692	409
Adjusted Q1 EBITDA	*2,750*	*1,371*	*358*	*692*	*409*
Q2 EBITDA	1,408	863	(268)	692	170
Adjusted Q2 EBITDA	*1,352*	*785*	*(268)*	*693*	*170*
Q3 EBITDA	1,079	798	(280)	581	22
Adjusted Q3 EBITDA	*1,039*	*765*	*(280)*	*580*	*17*
Q4 EBITDA	1,323	828	(244)	529	241
Adjusted Q4 EBITDA	*1,872*	*1,023*	*120*	*525*	*244*

2016

PLNm	PGNiG Group	Exploration and Production	Trade and Storage	Distribution	Generation
Q1 EBITDA	2,393	879	422	758	362
Adjusted Q1 EBITDA	*2,344*	*826*	*422*	*758*	*355*
Q2 EBITDA	737	17	8	665	87
Adjusted Q2 EBITDA	*1,463*	*727*	*11*	*665*	*86*
Q3 EBITDA	1,138	654	(140)	542	110
Adjusted Q3 EBITDA	*1,176*	*689*	*(140)*	*544*	*110*
Q4 EBITDA	1,705	656	323	594	200
Adjusted Q4 EBITDA	*1,828*	*734*	*334*	*597*	*211*

Efficiency Improvement Programme (EIP)

From May 2014 to December 2016, the PGNiG Group ran an Efficiency Improvement Programme whose main objective was to optimise operating costs. The measures undertaken throughout the programme implementation in 2014-2016 contributed to a reduction of costs by PLN 831m. At present, measures aimed at enhancing the operational efficiency of the PGNiG Group are implemented in line with the adopted strategy of the PGNiG Group, while the Efficiency Improvement Programme was closed in April 2017.

Statement of financial position

As at December 31st 2017, total assets recognised in the consolidated statement of financial position were PLN 48,203m, down PLN 1,469m (3%) on the end of 2016.

Assets

Property, plant and equipment are the largest component of the PGNiG Group's assets. As at December 31st 2017, this item amounted to PLN 32,452m, having decreased by PLN 697m (2%) relative to December 31st 2016. The balance of impairment losses on those assets rose by PLN 280m year on year. Equity-accounted investees rose by PLN 372m (30%) year on year, following the acquisition of shares in Polska Grupa Górnicza Sp. z o.o. and Polimex-Mostostal S.A.

As at the end of 2017, the Group's current assets were PLN 11,839m, down PLN 1,597m (12%) relative to the end of 2016. The decrease in current assets was mainly attributable to a PLN 3,251m (56%) drop in cash and cash equivalents. At the same time, there was a major increase in receivables, which amounted to PLN 5,781m at the end of 2017, up PLN 1,493 (35%) on the end of 2016.

Equity and liabilities

Equity is the main source of financing of the PGNiG Group's assets. At the end of 2017, the Group's equity stood at PLN 33,627m, up by PLN 1,611m (5%) relative to 2016. The change in equity was primarily attributable to the net profit earned in the reporting period, of PLN 2,921m, and the PLN 1,156m dividend paid for the previous year.

As at the end of 2017, non-current liabilities were PLN 7,004m, down PLN 299m (4%) on the end of December 2016. As at December 31st 2017, the Group's current liabilities amounted to PLN 7,572m, down PLN 2,781m (27%) relative to the end of 2016. The decrease in current liabilities was attributable to PGNiG's repayment in 2017 of its liabilities under fixed-coupon eurobonds (the Company did not contract any new debt through the issue of eurobonds).

In connection with the increase in equity and decrease in current liabilities, the Group saw an improvement in its debt ratio and debt to equity ratio, which fell from 35.5% to 30.2% and from 55.1% to 43.3%, respectively.

As a result of significantly lower liabilities compared with the previous year, the Group reported an increase in its liquidity ratios: the current ratio rose to 1.8, from 1.5 at the end of December 2016, while the quick ratio was 1.4 in the reporting period, compared with 1.2 at the end of the previous year.

Material related-party transactions on non-arm's length terms

In 2017, PGNiG and its subsidiaries did not enter into any material related-party transactions on non-arm's length terms.

7.2.3. Financial highlights of key subsidiaries

PGNiG UN (NOKm)	2017	2016
Revenue	2,463	2,227
EBITDA	1,779	1,348
EBIT	872	455
Net profit/(loss)	21	(55)
Total assets	8,394	8,433
Equity	594	573

PGNiG OD (PLNm)	2017	2016
Revenue	11,934	11,560
EBITDA	432	(36)
EBIT	428	(42)
Net profit/(loss)	346	(30)
Total assets	2,549	2,459
Equity	1,056	714

PST (EURm)	2017	2016
Revenue	1,077	571
EBITDA	(1)	5
EBIT	(2)	5
Net profit/(loss)	(2)	2
Total assets	199	160
Equity	7	9

PSG Group (PLNm)	2017	2016
Revenue	4,937	4,757
EBITDA	2,469	2,460
EBIT	1,535	1,525
Net profit/(loss)	1,250	1,246
Total assets	14,834	14,746
Equity	11,937	11,858

PGNiG TERMIKA (PLNm)	2017	2016
Revenue	1,925	2,033
EBITDA	744	731
EBIT	381	385
Net profit/(loss)	228	241
Total assets	5,718	5,281
Equity	3,418	2,892

7.3. Expected future financial condition

In the coming periods, the financial standing of the PGNiG Group will be materially affected by changes in the prices of hydrocarbons on global commodity markets and fluctuations in foreign exchange rates. These factors will be of particular importance for the PGNiG Group's performance in the Exploration and Production and Trade and Storage segments.

Any changes in hydrocarbon prices affect revenues of the Group entities engaged in production, and determine the demand for seismic and exploration services offered by the Group companies. Rising gas and crude oil prices have a positive effect on performance generated by the Exploration and Production segment. Long-term forecasts of hydrocarbon prices strongly influence projected cash flows from production assets, and as a consequence entail the necessity of revaluation of property, plant and equipment.

On the other hand, in view of the fact that the prices of gas purchased by PGNiG under the Yamal and Qatar contracts are linked to prices of crude oil, the effect of rising oil prices on the performance of the Trade and Storage segment is opposite to the effect that rising oil prices have on the performance of the Exploration and Production segment. Any increase of crude oil prices translates into higher cost of gas purchased by PGNiG. This correlation may change following a ruling by the Stockholm Arbitration Tribunal regarding the price formula used in the Yamal contract.

The PGNiG Group's financial results will also be materially affected by situation on the domestic currency market. Any strengthening of the złoty against foreign currencies (primarily the US dollar) will have a positive effect on performance of the Trade and Storage segment by driving down PGNiG's gas procurement costs, although it must be noted that the effect of exchange rate fluctuations is mitigated by the PGNiG Group's hedging policy.

The PGNiG Group's financial results will also be affected by the President of URE's position regarding the level of 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 the performance of the PGNiG Group's Trade and Storage companies engaged in the provision of gas sale services. Competition for customers has prompted the launch of a number of discount schemes dedicated to customers buying gas from the Group and the change in pricing terms to reflect market prices. These factors may have an adverse effect on the profitability of the Trade and Storage segment by eroding its margins.

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.

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. Legislative changes in this area and fluctuations in market prices of certificates of origin (both red and green) will have a bearing on the segment's financial position. 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 projects involving maintenance of hydrocarbon production rates, as well as projects in the exploration for and appraisal of crude oil and natural gas deposits, and development of the power generation segment.

Capital expenditure[1)] on property, plant and equipment planned by the PGNiG Group in 2018

	PLNm	2018[2)]
I.	Exploration and Production, including:	2,327
1	*Norway*	386
2	*Pakistan*	193
3	*Libya*	6
II.	Trade and Storage	160
III.	Distribution	2,159
IV.	Generation	1,068
V.	Other Segments	183
VI.	Total capital expenditure (I-V)	5,897
	including PGNiG	*2,094*

1) Including capitalised borrowing costs.
2) Planned expenditure does not include expenditure on potential acquisitions.

The above amounts do not include potential expenditure on acquisition of hydrocarbon deposits or acquisitions in the power sector.

When evaluating the feasibility of its investment plans for 2017 and beyond, the PGNiG Group took into account its financial standing, including the available sources of external financing and cash generated by the Group's day-to-day operations. It can thus be concluded that the funds available to the PGNiG Group were found sufficient to finance its investment plans.

7.4. Borrowings

Credit facility agreements executed in 2017

In 2017, the PGNiG Group concluded credit facility agreements totalling PLN 355m. Key credit facility agreements executed by the PGNiG Group as at December 31st 2017:

Bank	Facility amount (million)	Currency	Interest rate	Type	Maturity date
Syndicate of eight banks	400	USD	LIBOR USD/EURIBOR * + 1.55% **	working capital/ investment facility	13.08.2022
Bank Gospodarstwa Krajowego	271	PLN	1M WIBOR + 0.99%	long-term facility	27.08.2027
Deutsche Bank	35	EUR	EONIA+0.0085%	short-term overdraft facility	-
PKO Bank Polski	20	EUR	1M EURIBOR + 0.95%	short-term overdraft facility	31.03.2018

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

Credit facility agreements terminated in 2017

In 2017, the PGNiG Group did not terminate any material credit facility agreements.

Loan agreements executed in 2017

In 2017, the PGNiG Group did not advance any material loans. For detailed information on loans advanced by PGNiG to its subsidiaries and other related entities, see Note 7.4 to the separate financial statements.

7.5. Securities issuance programmes

In 2017, the PGNiG Group was able to issue bonds and notes under the following programmes:

- Note issuance programme of June 10th 2010,
- Note issuance programme of May 22nd 2012,
- Note issuance programme of October 2nd 2014,
- Note issuance programme of December 21st 2017,
- Eurobond programme of August 25th 2011, with bonds issued by PGNiG Finance AB,
- Note issuance programme of July 4th 2012, with notes issued by PGNiG TERMIKA,
- Note issuance programme of October 17th 2013, with notes issued by SEJ (currently PGNiG TERMIKA EP).

For detailed information on the effective terms and utilisation of the programmes, as well as debt outstanding under the notes in issue, see Note 5.2 to the consolidated financial statements.

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

On December 21st 2017, PGNiG S.A. executed the documentation for a PLN 5bn note issuance programme. Under the five-year Programme, PGNiG may issue, for private placement, fixed or floating rate notes with maturities of up to 10 years. The notes may be introduced to trading on the Catalyst multilateral trading facility.

On December 21st 2017, PGNiG TERMIKA terminated the note issuance programme established on July 4th 2012 and obtained consent for increasing the debt limit under a cash pooling arrangement from PLN 75m to PLN 400m. Additionally, on December 28th 2017, repaid interest of PLN 180m accrued over two years on a loan advanced by PGNiG.

Furthermore, pursuant to an agreement of December 1st 2010 (as amended by annexes of 2011 and 2014), in 2017 PGNiG continued to issue short-term discount notes to PGNiG Group companies. Under an annex of August 7th 2015, the programme amount was increased from PLN 3bn to PLN 5bn. For PGNiG, the maximum amount of notes in issue remained at PLN 1bn, with the balance allocated to other PGNiG Group companies. The note issuance programme is designed to facilitate the flow of cash between companies, thus optimising the liquidity management within the PGNiG Group.

In 2017, PGNiG group companies redeemed at maturity the following notes: PGNiG redeemed 5-year domestic notes with a nominal value of PLN 2.5bn with accrued interest; PGNiG Finance AB redeemed 5-year Eurobonds with a nominal value of EUR 500m and paid due interest. The bonds were redeemed with internally generated funds.

As at December 31st 2017, PGNiG's outstanding debt (towards PSG) under the notes in issue was PLN 100m.

7.6. Contingent liabilities and receivables

As at December 31st 2017, the PGNiG Group's most important off-balance-sheet item was contingent liabilities of PLN 4.25bn, as disclosed in the consolidated financial statements (December 31st 2016: PLN 8.7bn). The main reason for the decrease was the lower amount of sureties and guarantees granted (PLN 3.5bn in 2017 against PLN 8bn in 2016), primarily attributable to the expiry of the guarantee for PGNiG Finance AB's performance of obligations to bondholders under the Eurobond issue programme.

8. Risks

Key: Risk materiality level: low ●○○; medium ●●○; high ●●●
Probability that the risk will materialise: low ●○○; medium ●●○; high ●●●
Yoy change in the risk level: increase↗ ; decrease↘ ; no change→

8.1. Operational risk

8.1.1. Risks in the Exploration and Production segment

Resource discoveries and estimates ●●●●●○→Poland ●○○●●●→ Norway

The main risk inherent in exploration activities is the risk of failure to discover hydrocarbons, i.e. exploration risk. This means that not all identified leads and prospects actually have deposits of hydrocarbons which can qualify as an accumulation. The existence of hydrocarbon accumulation depends on the occurrence of a number of geological conditions. In addition, the actual quantity and quality of accumulated hydrocarbons may differ from the estimates. If the results of successful exploration in the form of new proven reserves do not balance production from existing fields, the proven recoverable reserves in PGNiG's fields will gradually decrease as the production continues.

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

Exploration for unconventional deposits of gas ●○○ ●●●→

A risk associated with exploration for unconventional gas in Poland relates to the lack of proved reserves of tight gas and reserves in unconventional Miocene formations. Exploration for shale gas has now been closed, and the experience gained from such projects will allow PGNiG to minimise risks associated with exploration for tight gas. Even if the existence of in-place tight gas resources is confirmed, production may prove uneconomic due to insufficient recovery rates and high investment expenditure necessary to drill wells and construct production facilities. Another material factor is the difficulty of accessing unconventional gas plays given the environmental regulations and the requirement to obtain the landowners' consent for access to the area.

Competition ●○○●○○↘ Poland ●● ○●●○↗ Norway

Both in Poland and abroad there is a risk of competition from other companies seeking licences for exploration and appraisal of hydrocarbon deposits, although it should be noted that this risk has significantly diminished in the Polish market over the past year. Certain competitors of PGNiG, especially those active globally, enjoy strong market positions and have greater financial resources than those available to the Group. Thus, it is probable that such companies would submit their bids in tender procedures and be able to acquire promising licences, offering better terms than PGNiG could offer given its financial and human resources. This competitive advantage of oil majors is particularly important on the international market. On the Norwegian market, there have emerged numerous new players in recent years, interested in buying oil and gas deposits and supported by international investment funds. Consequently, it may be difficult for the company to implement its plans of further acquisitions in Norway.

Delayed work ●●○●●○↘ Poland ●●○●●○→ Norway

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

- local governments' failure to approve local zoning plans or amendments to those already approved;
- obstacles in having investment projects incorporated into the local zoning plans;
- requirement to obtain and comply with administrative or other formal and legal decisions, including environmental decisions or building permits;
- changes in the current concept of an investment project;
- difficulties in obtaining the landowners' consent for access to the area.

These factors materially delay investment activities and entering the area to commence construction work. Further, PGNiG's obligation to comply with the Public Procurement Law frequently protracts tender procedures. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing an entire project. A protracting project exacerbates the risk related to estimation of capital expenditure.

Safety, environmental protection and health regulations ●○○●○○↘Poland ●●●●●○→ Norway

The need to ensure compliance with environmental laws in Poland and abroad may significantly increase PGNiG's operating expenses. Currently, PGNiG incurs significant capital expenditure and costs to ensure compliance of its operations with the ever more complex and stringent regulations concerning safety and health at work, and environmental protection.

The Act of May 18th 2005 Amending the Natural Environment Protection Law and Certain Other Acts (Dz.U. No. 113, item 954 of June 27th 2005) introduced more stringent regulations governing projects which might affect Natura 2000 sites and imposed more stringent obligations with regard to operations in habitats of protected species of plants and animals. Also in countries where the PGNiG Group is engaged in exploration activities, a trend towards tightening environmental regulations is observed.

Cost of exploration ●○○ ●○○↘

Capital intensity of an exploration project depends on prices of energy and materials. Cost of exploratory work is especially sensitive to steel prices, which are passed onto prices of casing pipes and production tubing used in drilling. An increase in prices of energy and materials translates into higher costs of exploratory work. Profitability of foreign exploration projects also depends to a significant extent on prices of oil derivative products and on exchange rates. To reduce drilling costs, in 2011 PGNiG introduced the daily rate system into its procedure for selecting drilling contractors and paying for their work.

Unforeseen events ●●○ ●○○→

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

Other changes in laws and regulations ●●○ ●●○↘

In some countries, exploration and production activities may be hindered by frequent and unexpected changes in legislation, which may create particularly serious risks in countries with authoritarian regimes.

Political and economic situation − PGNiG Group ●○○ ●○○↘

Some countries where the PGNiG Group is conducting exploration are threatened by armed conflicts and terrorist attacks, which may lead to limitation, suspension or even discontinuation of such activities.

The PGNiG Group's operations are also exposed to the risk of social or political unrest in some regions. Changes of governments may result in withholding issuance of petroleum licences. Those countries are also at risk of internal conflicts and civil unrest due to poverty and demographic issues. If these risks materialise, the Company's operations may be limited, suspended or withheld.

In certain countries, operations of exploration companies may be hindered by the absence of adequate infrastructure, which may be an obstacle in transporting equipment, personnel and materials to the sites. Problems may also arise in providing supplies and ensuring appropriate health care. These risks may lead to limitation or suspension of the Company's exploration activities.

8.1.2. Risks in the Trade and Storage segment

Administrative regulation of natural gas prices and deregulation of Polish gas market ●●● ●●●→

Gas trading on the exchange market has been excluded from the tariff regime. Prices of gas paid by end users have also been gradually liberalised as the process of gas market deregulation advances. The first customer groups in respect of which the tariff requirement has been abolished are wholesale and business customers. As regards gas trading on the Polish Power Exchange or direct sales to customers at prices similar to those quoted on the exchange, there is a risk that revenues from such sales will be lower than gas procurement costs due to The growing disconnect between the market prices of gas and of petroleum products, to which gas prices under the long-term import contracts continue to be linked. As a consequence, revenue is subject to forecasting risk. Inaccurate estimates of costs (particularly the cost of gas purchase) may result in a risk of miscalculation of selling prices and charges, which may adversely affect financial results.

Dependence of PGNiG OD's revenue on tariffs approved by the President of URE is the key factor affecting the company's regulated business. Tariffs are crucial to the Company's ability to generate revenue that would cover its reasonable costs and deliver a return on the capital employed. Currently, a significant portion of that revenue depends on the selling prices of gas fuel and is regulated. Inaccurate estimates of demand for gas (affecting the accuracy of projected purchase volumes) and changes in prices of gas purchased on the Polish Power Exchange, which cannot be accurately projected, may have an adverse effect on the financial performance of PGNiG OD.

Disruptions to gas supplies from countries east of Poland ●●● ●●○↗

On June 20th 2017, the dew point of natural gas supplied to and through the territory of Poland over the Yamal gas pipeline changed, which adversely affected the quality of the fuel. As a result, GAZ-SYSTEM 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 PGNiG drew gas from the underground storage facilities to secure continuity of supplies to the PGNiG Group customers.

Apart from the above situation caused by technical reasons, in 2017 there were no disruptions in gas supplies from the east. However, given the continuing political instability in Ukraine, there is a risk of limitation in gas supply, as was the case in the period from September 2014 to March 2015.

Take-or-pay gas supply contracts●●● ●○○→

PGNiG S.A. is a party to two long-term take-or-pay contracts for gas supply to Poland − the Yamal Contract and the Qatar Contract. Assuming that PGNiG's customer portfolio remains unchanged, the volume of gas imports specified in the take-or-pay contracts will limit its purchases of spot gas. If PGNiG loses its market share, there is a risk that it would be forced to look for new ways to utilise the surplus volumes of gas in its portfolio.

Competition ●●● ●●●→

Competitors seek to increase gas fuel sales by offering competitive prices of the fuel or dual fuel (gas and electricity) deals. In 2017, the amendment to the Energy Law took effect, whereby the obligation to have the tariffs for final users, with the exception of households, approved by the President of URE was abolished. Considering the above, in coming years, the gas prices for consumers will be fully liberated, which will undoubtedly affect the situation of the PGNiG Group, in particular that of PGNiG OD. It is to be expected that the liberalisation will in particular result in a reduction of PGNiG's share in the gas market, as has been observed in all countries where consumer gas prices have been deregulated. The mitigate the adverse effects of liberalisation, the PGNiG Group primarily intends to prepare an attractive and competitive offering for customers.

8.1.3. Risks in the Distribution segment

Limited market development in terms of supplying the distribution network●●○●●○↘

Limitations at the entry points to the distribution system result from the limitations of the supply network and insufficient capacity of gas stations. This may have an adverse effect on new customer connections and gas network roll-out. In addition, end users may switch to direct or substitute competitors.

Risk associated with direct competition●○○●○○↘

The activity of companies building and/or operating distribution networks and regasification plants limits the PGNiG Group's growth opportunities and reduces the profitability of constructed networks.

Risk associated with lack of long-term regulatory policy ●●● ●●●→

The risk is related to the lack of the Energy Regulatory Office's approval for freezing the tariff prices. If the risk materialises, it may bring about reductions in tariff rates and difficulties in having each subsequent tariff approved. A protection against materialisation of this risk is the development of a regulatory and econometric model, subsequently agreed with the Energy Regulatory Office.

Claims raised by property owners ● ●○ ●●○→

The risk arises from failure to secure a permanent legal title to property at the stage of project execution and property owners' higher awareness of the related legal aspects. The consequences of materialisation of the risk include excessive (above market prices) claims made by property owners, increase in litigation, litigation costs, claims for removal or alteration of infrastructure, and claims related to extra-contractual use of property.

Sources of gas supply for the distribution system ●●● ●●○→

The limited throughput capacity of the transmission network operated by GAZ-SYSTEM results in a significant delay in the extension of distribution infrastructure by PSG. The risk may affect the pace at which new customers are connected to the PSG network and the volume of distributed gas.

Legislation ●●○●●○↘

This risk may arise in connection with legislative processes aimed at amending the existing or introducing new laws. If materialised, the risk may hinder the preparation and implementation of projects related to amendment of applicable laws and their inconsistency. Additional costs may also arise as it may be necessary to prepare documentation required by new laws or obtain additional consents. Different interpretation of regulations by local authorities may result in a lengthy process of obtaining documents and decisions.

Substitution ●●○●●○↘

The substitution risk is associated with a potential lower cost of using alternative fuels and with unavailability and insufficient capacity of the gas network. The risk may arise from the inability to use a wide range of marketing tools due to the nature of the business (separation of distribution and sales operations), from the direction of changes in the national energy policy, and from fuel prices on commodity exchanges. These circumstances may ultimately result in limited gas network roll-out to new areas, underperformance in terms of revenue and sales volume growth, and reduced efficiency of constructed gas networks.

Lower amount of EU funds allocated for financing gas distribution projects ●○○●●○→

This risk may result from fund allocation priorities set by the institutions responsible for distribution of EU funding. Unfavourable fund allocation may result in unavailability of financing for submitted projects or in low efficiency of investment projects.

8.1.4. Risks in the Generation segment

Coal procurement and supply ●●●●●●↗

Coal is purchased mostly under contracts executed in advance to ensure that strategic coal stocks are maintained above the level required by the Regulation of the Minister of Economy. In addition, coal transport services are purchased in accordance with the Public Procurement Law and in good time before the delivery is due. Counterparties' performance of contracts with the PGNiG Group deteriorated significantly in the third and fourth quarter of 2017, giving rise to a major risk of breach of the required level of emergency stocks of coal at the end of 2017 and in subsequent months of 2018.

Support for cogeneration ●●● ●●●→

The system of cogeneration support in the form of certificates of origin will continue only until the end of 2018. In December 2017, after carrying out analyses in consultation with industry organisations, the Ministry of Energy announced that it adopted the key assumptions for the new support system.

If the announced regulations are adopted, after 2018 the support for the existing cogeneration units will be reduced or withdrawn, in particular for the existing coal-fired units if they fail to demonstrate that in their case cogeneration is unprofitable. In the case of cogeneration units with a capacity of more than 300 MWe (gross), meeting the criteria for support will be additionally reviewed by the European Commission, as part of the individual notification procedure. What may partially offset the potential lack of revenue from the support system for high-efficiency cogeneration units is that cogeneration units will be eligible to participate in the capacity market, with first revenue streams from the sale of capacity expected in 2021. However, the launch of the capacity market in Poland is subject to approval by the European Commission.

More stringent gas and dust emission standards ●●○ ●●○→

In order to meet the emission requirements under the directive on industrial emissions (IED), the generating units of the PGNiG TERMIKA Group have been upgraded in recent years or are currently relying on flexibilities until they are altered or new units are built. However, following the issue of BAT Conclusions for large combustion plants, the PGNiG Group companies are obliged to upgrade their existing generating units to meet the stricter emission requirements that will become applicable to them as of August 17th 2021.

8.2. Regulatory risks

Elimination of administrative price control ●○○●○○↘

In connection with the ruling by the Court of Justice of the EU of September 10th 2015 on the system of regulated gas fuel prices, changes to the regulations on administrative price control were required. PGNiG expressed its opinion that liberalisation of gas prices was the key element of gas market liberalisation. At the same time, the Company emphasised that the process must be conducted in such a manner as to guarantee billing continuity in contracts with customers, as the inability to guarantee continuity of billing is a risk to the Company's business. In view of the expected removal of tariffs, PGNiG took a number of measures to adapt itself to the new regulatory framework, including:

- preparation of new framework agreements and individual contracts, as well as an updated product portfolio and price list to meet the customers' current needs,
- conclusion of contracts with the majority of key industrial customers, with price-setting mechanisms ready for the post-tariff regime.

In 2017, the process of adapting contract terms to the situation that will exist following the elimination of administrative price control was completed.

Obligation to diversify gas imports ●○○ ●○○↘

The Council of Ministers' Regulation of April 24th 2017 on the minimum level of diversification of foreign sources of gas supplies prescribes the maximum share of gas imported from a single country in total gas imports in a given year. In 2017–2022, the share may not exceed 70%.

Upholding of the decision to exempt the OPAL pipeline from the Third Energy Package regime ●●●●●●→

Pursuant to two decisions issued under Art. 36 of Directive 2009/73 of July 13th 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/54 /EC, Opal Gastransport GmbH, the operator of the OPAL pipeline, benefits from the exemption from the need to grant third-party access to transmission capacity. The infrastructure is used by Gazprom, which controls 50% (under a decision from 2009) and *de facto* 100% (under a decision from 2016) of the OPAL pipeline's capacity.

As a result of the recent exemption from the third party access (TPA) rule, Gazprom is able to transmit approximately 55 bcm of natural gas annually to the European Union, bypassing the traditional supply routes (the Yamal and Bratstvo gas pipelines).

The exemption decisions adopted by the European Commission and the German regulator Bundesnetzagentur in 2016 allow the Russian gas major to implement its long-term strategy of preventing the development of supply diversification projects in Central and Eastern Europe and thus make the region dependent on Russian gas. In view of these facts, PGNiG, PST, the Polish government and Naftohaz (a Ukrainian gas trading company) filed complaints against the decision of the European Commission to the General Court of the European Union, requesting an injunctive relief in the form of suspension of decision execution. PGNiG and PST also filed a complaint against the German regulator's decision with a German court in Dusseldorf.

By decisions of December 23rd 2015 and December 30th 2016, the General Court of the European Union and the German court, respectively, granted the injunction preventing Gazprom from using the full capacity of the OPAL pipeline. The injunction was effective for approximately seven months. The General Court of the European Union lifted the injunction on July 21st 2017. As a result, the German court issued a decision to the same effect on July 27th 2017. This opened the door for resumption of additional auctions for the OPAL pipeline capacity and use of the Nord Stream 1 gas pipeline at full capacity, with lower volumes of gas transmitted via Ukraine.

In four proceedings before the General Court of the European Union, on December 14th 2017 one of the complaints filed by PST was found inadmissible due to formal reasons (lack of direct concern). The order is not final and PST has the right to appeal against it. It should be noted that the General Court has not yet issued any ruling concerning the subject matter of any of the proceedings. The proceedings before the German court are also pending.

Winter package (electricity) – Clean energy for all Europeans

On November 30th 2016, as part of the so-called Winter Package, the European Commission announced proposals of new electricity-related regulations. Their objective is to ensure that the European Union is capable of meeting the commitments assumed under the Paris Agreement (COP21) and, after achieving the target, that the EU economy evolves towards a low-emission economy.

Some provisions of the legislative proposals included in the Winter Package pose a significant threat to the PGNiG Group's operations. First of all, the introduction of the emission limit (the currently proposed level of 550g of CO_2 emissions per 1 kWh generated) as a criterion for participation of an installation in the capacity market may constitute a legislative barrier for the PGNiG Group's CHP plants to enter this market.

Another source of risk is the proposed introduction of binding targets for Member States regarding the share of energy from renewable sources, energy efficiency and individual trajectories to achieve these targets (including sectorial ones). The adoption of binding national targets and trajectories proposed by the European Commission may pose a risk to the growth of the PGNiG Group's business.

In order to mitigate these risks, PGNiG takes a number of measures to provide support for its requests. In this respect, PGNiG regularly monitors the legislative process carried out both at the Council of the European Union and the European Parliament, and provides professional support for the parties involved. Concurrently, the Company seeks to achieve compromises and a common ground at the IOGP. The steps taken so far have already brought measurable benefits, including the lack of the IOGP's support for the emission limit as a proposed element of the capacity market design.

Draft amendment to Directive 2009/73

The proposed amendment to Directive 2009/73 (forming a part of the Third Energy Package) announced in the third quarter of 2017 is aimed at confirming the applicability of the directive to the infrastructure associated with imports to the European Union, extending as far as the limits of the European Union's jurisdiction, understood as the limit of territorial seas and exclusive economic zones of Member States. The directive addresses the demands made by some entities operating on the internal market in natural gas, including PGNiG, according to which it is necessary to define the limits of applicability of EU laws. Under the existing legal regulations this is unclear, which disrupts the operation of the internal market in natural gas and adversely affects the integration of Member States.

Since the publication of the proposed amendment to the directive by the European Commission, PGNiG has supported its rapid adoption. The directive will have a positive impact on the internal energy market, ensuring consistency of the legal regime and introducing uniform, transparent and competitive rules applicable to all gas pipelines in the European Union. PGNiG will take steps to clarify some of the provisions of the draft amendment to ensure its maximum effectiveness.

However, considering the complexity of the legislative process in the European Union, there are certain risks that may limit the effectiveness of the directive. It must also be noted that there is a political risk related to the scepticism among some Member States regarding the proposed amendments. There is a risk that some Member States will try to limit the effectiveness of the directive by imposing only illusive obligations on owners of the infrastructure associated with imports to the European Union.

8.3. Non-compliance risk ●●● ●○○ →

PGNiG has an organisationally and functionally separated Compliance unit. The functional separation was effected through the 'PGNiG Compliance Programme', adopted by the Management Board of PGNiG on June 30th 2015. In line with the non-compliance risk management model, each area at risk of non-compliance was assigned a dedicated non-compliance risk area manager (leader), who is in charge of ensuring that compliance standards are met.

The non-compliance risk (risk of breach of compliance standards) may arise in various areas, and pertain to: (i) the financial area, in the form of fines, damages, compensations and other liabilities that may arise for the Company, (ii) the Company's reputation, the loss of which can also have financial ramifications, (iii) the operational area, and (iv) the Company's value for stakeholders, including shareholders.

As part of anti-corruption measures PGNiG has put in place the PGNiG Group's Anti-Corruption and Gift Policy, adopted by the PGNiG Management Board and effective as of July 25th 2017.

8.4. Financial risks

PGNiG and the PGNiG Group are exposed to financial risks, including in particular:

- Credit risk > For more information, see Note 7.3.1 to the consolidated financial statements of the PGNiG Group,
- Market risk > For more information, see Note 7.3.2 to the consolidated financial statements of the PGNiG Group,
- Liquidity risk > For more information, see Note 7.3.3 to the consolidated financial statements of the PGNiG Group.

Assessment of financial resources management

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

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

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

9. Shareholding structure and PGNiG at WSE

9.1. Shareholding structure

As at December 31st 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, a disposal by the Minister of State Treasury of one PGNiG share in accordance with general rules triggered the eligible employees' rights to acquire for free a total of up to 750,000,000 PGNiG shares. 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 December 31st 2017, nearly 60,000 eligible employees subscribed for 728,294 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.

In 2017, there were no changes in the shareholding structure.

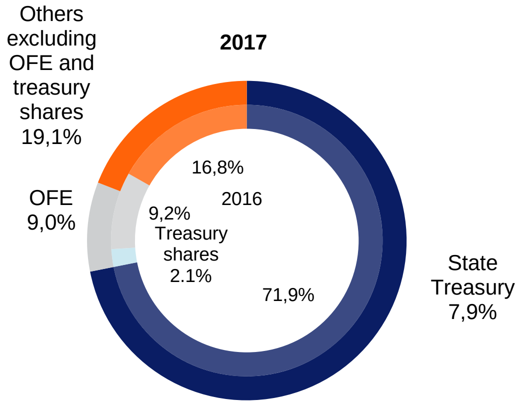
Shareholding structure at the end of 2017

Shareholders	Number of shares/votes attached to the shares as at Dec 31 2016	Percentage of share capital/total voting rights at the GM as at Dec 31 2016	Change in 2017	Number of shares/votes attached to the shares as at Dec 31 2017	Percentage of share capital/total voting rights at the GM as at Dec 31 2017
State Treasury	4,153,706,157	71.88%	-	4,153,706,157	71.88%
Treasury shares[1)]	-	-	-	-	-
Others, including:	1,624,608,700	28.12%	-	1,624,608,700	28.12%
- OFE[2)]	532,390,415	9.21%	-	521,999,228	9.03%
Total	5,778,314,857	100.00%	-	5,778,314,857	100.00%

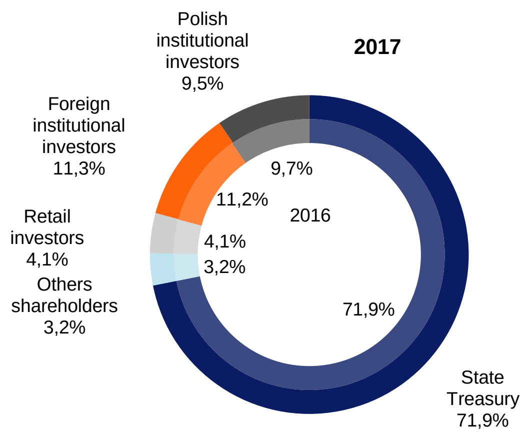
1) >For more information, see Section 9.2.
2) Data based on annual asset specifications of open-end pension funds as at December 29th 2017.

Institutional investors, primarily open-end pension funds (OFE), pension fund management companies, as well as Polish and foreign investment funds, held over one-fifth of all shares issued by PGNiG. Nearly 10% of the Company shares were in the portfolios of Polish investors, and close to 10% were held by foreign institutions – mainly from the United States and Europe. As regards European investors, most PGNiG shares were held by UK entities (over 2%).

Shareholding structure comparison



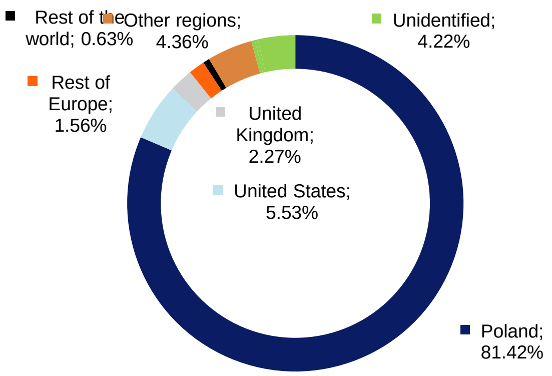
Shareholding structure by investor type



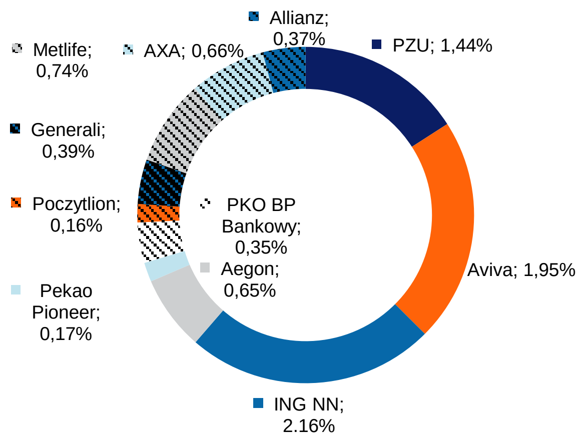
Source: in-house analysis based on annual asset specifications of open-end pension funds as at December 29th 2017.

Major holdings of PGNiG shares were included in the portfolios of open-end pension funds, which at December 29th 2017 held more than 9% of PGNiG's equity, valued at just under PLN 3bn. Relative to 2016, the number of shares held by open-end pension funds declined slightly, by 0.2 pp. Based on the closing price on the last trading day in 2017, the value of PGNiG shares held by open-end pension funds rose nearly PLN 300m relative to 2016.

Shareholding structure by geography



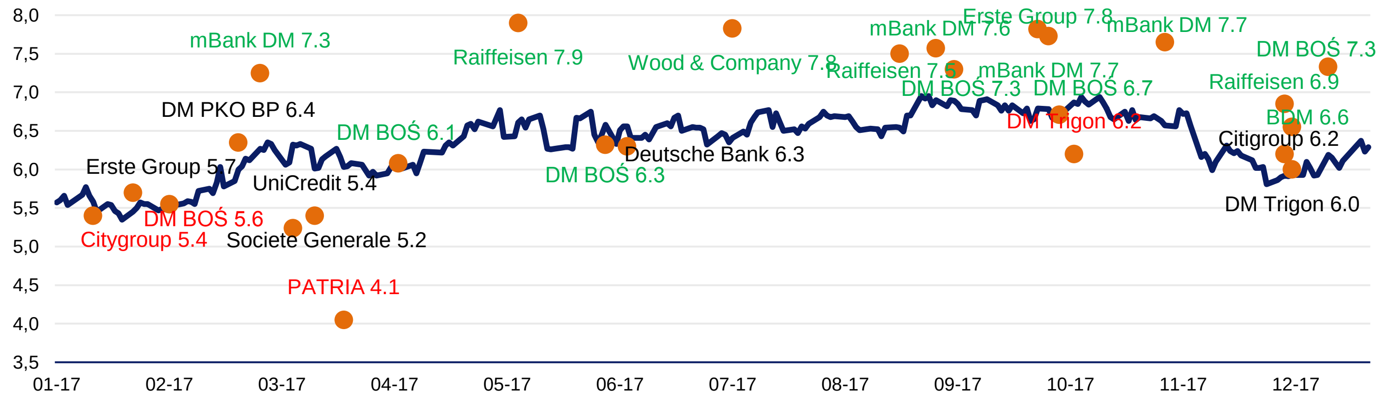
Percentage of PGNiG share capital held by open-end pension funds at the end of 2017



Source: in-house analysis.

Top 3 for Rest of Europe and the World: Sweden 0.34%, Norway 0.29%, the Netherlands 0.27%; Canada 0.30%, Japan 0.27%, China 0.18%

The funds holding the largest equity interests in PGNiG were those managing the largest portfolios of future pensions, that is Nationale-Nederlanden, AVIVA and PZU Złota Jesień. The share of open-end pension funds in the PGNiG shareholder base rose significantly from the IPO in 2005, when it accounted for 3.5% of the share capital (valued at PLN 711m). Pension funds are typically long-term investors whose equity portfolios are characterised by low turnover, especially with respect to large dividend-paying companies, such as PGNiG. They have a stabilising effect on the Company's shareholding structure, while limiting its free float, which can translate into lower trading volumes. In the case of PGNiG shares, the daily trading volume averaged PLN 21.8m in 2017, down by PLN 3.7m compared to 2016.



Source: in-house analysis.

Number of recommendations:

2017	15	buy	2016	13	buy
	4	sell		9	sell
	7	hold		11	hold

Relative to 2016, the Company's coverage by equity analysts fell (by over 21% year on year), mainly due to a lower number of analysts actively providing coverage on the Company. However, there was an increase in 'buy' recommendations (from 13 in 2016 to 15 in 2017), with a clear drop in 'sell' recommendations (from 9 to just 4).

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

Full name	Position	Number of shares/votes attached to the shares as at Dec 31 2016	Par value of shares (PLN)	Number of shares/votes attached to the shares as at Dec 31 2017	Par value of shares (PLN)
Mieczysław Kawecki[1)]	Member of the Supervisory Board	Not applicable	Not applicable	9,500	9,500
Stanisław Sieradzki1[1)]	Member of the Supervisory Board	Not applicable	Not applicable	17,225	17,225
Ryszard Wąsowicz[2)]	Member of the Supervisory Board	19,500	19,500	Not applicable	Not applicable

1) Appointed to the PGNiG Supervisory Board on June 28th 2017.
2) Mr Ryszard Wąsowicz ceased to be a Member of the PGNiG Supervisory Board as of May 30th 2017.

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

9.2. Treasury shares

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 on its treasury shares. The Extraordinary General Meeting of November 24th 2016 resolved to cancel PGNiG's treasury shares. The cancellation of treasury shares and changes to the share capital were registered with the National Court Register on March 2nd 2017.

9.3. Performance of the PGNiG stock

Since September 23rd 2005, the PGNiG stock has been listed in the continuous trading system of the main market on the Warsaw Stock Exchange. The issue price in the Company's public offering was PLN 2.98. In 2017, PGNiG shares were included in the following indices: WIG, WIG20, WIG30, WIG-Poland, RESPECT Index, WIGdiv, and WIG-PALIWA (sectoral index).

Performance of PGNiG shares vs WSE indices

Index / PGNiG stock price*	Value as at Dec 31 2016	Value as at Dec 31 2017	Value low in 2017	Value high in 2017	PGNiG's weight in the index as at Dec 31 2017
WIG	51,754 points	63,746 points	51,908 points	65,734 points	2.95%
WIG20	1,948 points	2,461 points	1,957 points	2,552 points	4.55%
WIG30	2,243 points	2,825 points	2,249 points	2,932 points	4.23%
WIG-Poland	52,584 points	65,184 points	52,741 points	67,224 points	3.02%
RESPECT Index	2,516 points	3,078 points	2,525 points	3,297 points	8.23%
WIGdiv	1,040 points	1,214 points	1,043 points	1,278 points	9.45%
WIG-Paliwa	5,669 points	7,140 points	5,432 points	8,679 points	21.68%
PGNiG	PLN 5.63	PLN 6.29	PLN 5.19	PLN 6.95	-

Source: WSE, www.gpw.pl.
**PGNiG stock price and index values based on closing prices, excluding the ex-dividend day effect.*

The PGNiG share price movements ranged between -17% (the lowest closing price of PLN 5.19 on January 20th 2017) to +12% (the highest closing price of PLN 6.95 on August 28th 2017) from the 2017 average closing price of PLN 6.23. To compare, fluctuations of the WIG20 index ranged between -16% (the lowest value of 1,956.72 points on January 2nd 2017) and +9% (the highest value of 2,551.78 points on October 11th 2017). Compared with 2016, both the PGNiG stock and WIG20 index fluctuated within a much wider range. The probable reasons behind their changes included:

- Fluctuations in Brent crude prices – low prices towards the end of Q2 2017, with the minimum at USD 44.44 per barrel, followed by a rise from mid-Q3 2017 and a maximum in December with USD 71.20 per barrel (up 17.4% from the beginning of the period);
- Drop in prices on PPX in Q2 2017 and a significant rise in Q4 2017 (the average spot price of gas on PPX in 2017 was 9% higher than in 2016);
- Ongoing deregulation of the gas market in Poland.

In the first quarter of 2017, the PGNiG stock slid to the year's low of PLN 5.19 (on January 20th 2017). The most important day in Q1 2017 for PGNiG stock price was February 16th. After the publication of very favourable, from the perspective of market participants, operating result estimates for Q4 2016, the trading volume of PGNiG shares soared to its highest level in 2017. At the close of trade on February 16th 2017, PGNiG stock was priced at PLN 5.85, up by more than 5%. The second major event that occurred in Q1 2017 was the announcement of the PGNiG Group Strategy for 2017−2022 with an Outlook until 2026. With the second largest trading volume in 2017, PGNiG share price retreated by more than 2%. Some investors and analysts were sceptical about the Strategy's assumption regarding the estimated EBITDA to be earned in 2017–2022, given the relatively strong rise in capex. Nonetheless, in Q1 2017 PGNiG share price went up by over 6% (closing price on March 31st 2017 compared with the closing price on January 2nd 2017).

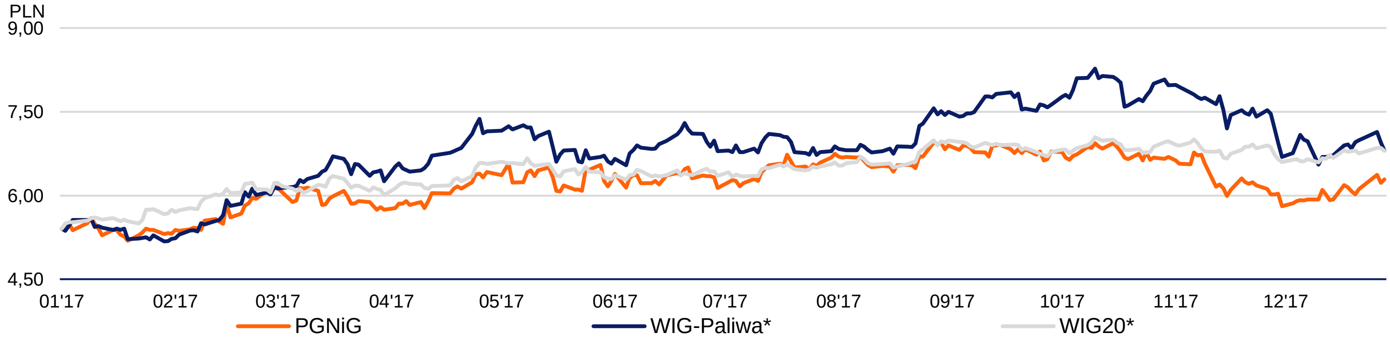
Q2 2017 saw another rally in PGNiG stock. Investors appreciated the earnings guidance published on April 20th. This event sparked an upward trend in the stock price, which reached PLN 6.57 on May 4th 2017 (the quarter's maximum). However, just two weeks later, on May 18th 2017, the closing price fell back to PLN 6.08. This change was mainly due to the general market factors – over the same period WIG20, the Polish blue-chip index, also dropped considerably (down nearly 4% from May 4th to May 18th, based on the closing prices). On June 28th 2017, the Annual General Meeting of PGNiG passed a resolution to distribute profit for 2016. The dividend amount was PLN 1.156bn (PLN 0.20 per share).

The upward trend seen for most of Q3 2017 ended with an all-year high of PLN 6.95 on August 28th 2017. On July 19th, PGNiG published estimated operating results pointing to some positive factors, such as a rise in the volume of gas sold (beneficial to the Trade and Storage and Distribution segments). On the downside, investors noted a relatively low level of hydrocarbon production in Poland. Ultimately, at the close of trade on July 20th 2017, the stock price dropped by almost 2%, to PLN 6.61. The price of PGNiG shares rose again to PLN 6.83 on August 31st, mainly as a result of a positive reaction to, among other things, the expected impact of amendments to the Act on Stocks and the possibility of a favourable resolution of the arbitration proceedings against Gazprom regarding the revision of the pricing formula (under the Yamal contract).

In Q2 2017, the PGNiG stock continued to recede and fell back to below PLN 6 (PLN 5.81 at the close of trading on December 21st 2017).

On December 29th 2017 (the last trading day in the year), the PGNiG stock price closed at PLN 6.29. The price was nearly 111% above the issue price of 2005 and 65% above the closing price on the first day of listing. Factoring in the dividends of PLN 1.66 per share paid in 2005–2017, investors who acquired PGNiG shares at the closing price on the issue date and held them until the end of 2017 saw a profit of 134%.

PGNiG share price vs WIG20 and WIG-Paliwa indices



Source: WSE.
**Rebased to PGNiG share price.*

Rates of return on WSE indices vs PGNiG stock in 2017 and from PGNiG's IPO[1]

Index	Rate of return in 2017	Rate of return from PGNiG's IPO[2] to Dec 31 2017
WIG	23.17%	91.87%
WIG20	26.35%	0.19%
WIG30	25.94%	11.25%[3]
WIG-Poland	23.96%	99.13%
WIG-Paliwa	25.72%	114.92%
RESPECT Index	22.34%	88.82%[4]

PGNiG	11.72%	65.03%[5]

Source: WSE, www.gpw.pl
1) Rates of return do not include dividends paid in 2005−2017.
2) Closing price on September 23rd 2005.
3) Data calculated in relation to the value of the WIG-30 index at the end of its first trading day (September 23rd 2013).
4) Data calculated in relation to the value of the RESPECT Index at the end of its first trading day (November 19th 2009).
5) Relative to the issue price of PLN 2.98, PGNiG shares yielded a rate of return of 111%.

9.4. Trading multiples

Key metrics[1]	Unit	2017	2016	2015	2016/2017 change (%)
Net profit attributable to owners of the parent	PLNm	2,923	2,351	2,134	23.3%
Earnings per share*	PLN	0.50	0.40	0.36	25%
Stock price at the close of trading on last session day in the year	PLN	6.29	5.63	5.14	11.7%
Average stock price in the year	PLN	6.23	5.16	5.94	20.7%
Number of shares outstanding	million shares	5,778	5,778	5,900	-
Capitalisation at year end	PLNm	36,346	32,532	30,326	11.7%
Average daily trading volume	million shares	3.5	4.9	4.7	-28.6%
Average daily trading value	PLNm	21.7	25.5	27.9	-14.5%
Dividend amount[3]	PLNm	1,156	1,062	1,180	46.5%
Trading multiples[2]					
P/E at average share price	-	12.22	12.69	16.41	
P/E at year end	-	12.33	13.85	14.21	
P/BV at year end	-	1.08	1.02	0.99	
EV/EBITDA	-	5.59	5.53	5.02	
Dividend per share[3]	PLN	0.20	0.18	0.2	

Source: WSE, www.gpw.pl
1) Attributable to holders of ordinary shares in the parent (in PLN).
2) Prices at close.
3) Dividend from previous year's profit.
P/E at average share price = average share price in financial year / net earnings per share attributable to owners of the parent
P/E at year end = share price at close of trading on last session day in financial year / net earnings per share attributable to owners of the parent
P/BV at year end = share price at close of trading on last session day in financial year / book value per share
EV/EBITDA = market capitalisation at close of trading on last session day in financial year + net debt at end of financial year / earnings before interests and taxes in financial year + total depreciation and amortisation in financial year
Dividend per share = dividend for previous financial year / number of shares outstanding

9.5. Dividend

The decision on dividend payment by PGNiG is made by the General Meeting. The strategy provides for distribution of up to 50% of consolidated net profit as dividend. In its recommendations on dividend payment, the PGNiG Management Board will always take into account the current financial condition of the PGNiG Group and its investment plans.

Dividend paid

	2016	2015	2014	2013	2012
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 annualise share price (PLN)	5.16	5.94	4.85	5.83	4.06
Dividend yield	3.88%	3.03%	4.12%	2.57%	3.20%

10. Corporate governance

10.1. Management Board

Mr Piotr Woźniak − President of the Management Board

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

On December 19th 2016, Piotr Woźniak was reappointed President of the Management Board of PGNiG S.A. for the three-year term of office beginning December 31st 2016.

President of the Management Board:
- manages the work of the Management Board and coordinates the work of Management Board members in all areas of the PGNiG Group's activity,
- supervises and coordinates the Company's operations, including with respect to:
  - internal control and audit functions,
  - HR strategies, payment schemes and working time, employment and payroll policies,
  - protection of classified information, protection of personal data, protecting and defending the Company's facilities,
  - corporate governance within the PGNiG Group and optimisartion of the PGNiG Group's structure,
  - policy, objectives and programmes related to hydrocarbon exploration and production in Poland and abroad, overseeing all licensing processes related to hydrocarbon exploration, appraisal and production, as well as storage of waste matter in rock mass and non-reservoir storage of substances,
  - formulation of assumptions and technical regulations, norms and standards applicable in the area of oil drilling, operation and safety of production systems and underground storage facilities, standardisation and oversight of uniform quality systems,
  - acquisition of foreign upstream assets,
  - planning, and IT systems development and operation, as well as IT development,
  - comprehensive legal support protecting PGNiG's legal interests, uniform application of general law, issuance of official orders and circulars for the Company,
  - operations of the Geology and Hydrocarbon Production Branch, the PGNiG Branches in Odolanów, Sanok and Zielona Góra, Well Mining Rescue Station in Kraków, and the Company's foreign branches – operations of the Company's representative office in Moscow.

Radosław Bartosik − Vice President, Chief Operating Officer

He graduated from the Faculty of Drilling, Oil and Gas of the AGH University of Science and Technology in Kraków. He also completed a number of post-graduate courses, e.g. in business management, marketing and electricity, heat and gas market. Radosław Bartosik holds an MBA degree and passed the examination for candidates for members of the supervisory boards of state-owned companies. He is a qualified technical supervisor of mining operations. Including a four-year break, he has been with the PGNiG Group since 1997. First, he worked for the PGNiG Zielona Góra Branch, in oil and gas production facilities where he gained experience and developed his career, starting as a Marketing Specialist and then head of the Contract and Tender Department. In 2006, he was appointed Economic and Commercial Director. Three years later he became Deputy Director of PGNiG's Branch Operator Systemu Magazynowania (currently Gas Storage Poland sp. z o.o., a subsidiary of PGNiG S.A.) in Warsaw. He was also Chief Specialist for EU Funds at the PGNiG Head Office. Until the end of 2016, Radosław Bartosik was Deputy Economic Director at the Warsaw Branch of PSG.

On December 19th 2016, he was appointed Vice President, Chief Operating Officer, for the three-year term of office beginning December 31st 2016.

Vice President, Chief Operating Officer, supervises and coordinates the Company's operations, including with respect to:
  - corporate social responsibility (CSR),
  - the Company's and the PGNiG Group's procurement strategy,
  - management of the Company's assets, excluding network assets, extraction assets and underground gas storage facilities,
  - management of the Company's non-production assets, including property,
  - creation and implementation of the sponsorship policy and the Company's image in Poland and abroad,

- cooperation with transmission and distribution system operators.

Łukasz Kroplewski – Vice President, Development

Mr Łukasz Kroplewski holds master's degrees in law and in administration. He also complete executive MBA courses. He gained professional experience by serving in public administration. At the Koszalin University of Technology, he taught intellectual property law. He has close ties with the HR industry, where he worked from 2005 holding managerial positions. He has provided legal and business consultancy support to corporations. From 2009 to 2017, he was a member of the Local Government Board of Appeals. He is one of the founders of the Mediation Centre at the Association of Merchants and Entrepreneurs in Koszalin, where he works as a mediator. Łukasz Kroplewski is a member of the UNECE Group of Experts on Coal Mine Methane. In July 2016, he was appointed Vice President of the Chamber of the Natural Gas Industry, an association of gas industry operators, and became the Chamber's CEO in 2017. Thanks to Łukasz Kroplewski's efforts, PGNiG joined the International Centre of Excellence on Coal Mine Methane (ICE-CMM), where he chairs the Presiding Committee. In 2017, he became a member of the Scientific Council of the Aviation Institute for the term of office from 2017 to 2021. In the same year he became a legal counsel at the Polish Chamber of Commerce.

On December 19th 2016, he was appointed Vice President for Development, for the three-year term of office beginning December 31st 2016.

The Vice President for Development supervises and coordinates such areas as:

- innovation and growth projects involving PGNiG,
- analysing and monitoring opportunities to obtain EU funding for the Company's operations,
- oversight of standardisation activities at the Company,
- development of technical assumptions, rules, norms and standards for the gas area,
- oversight of the Central Measurement and Testing Laboratory and of the PGNiG foreign representative offices in Kiev and Vysokoye.

Michał Pietrzyk – Vice President, Finance

He is a graduate of Finance and Banking at the Kraków University of Economics. He also completed a post-graduate course in law for managers at the Kozminski University. He started his professional career in 1995 in the banking sector. With the PGNiG Group since 2003, he first worked as Head of the Treasury Department of PGNiG and from 2006 to 2016 as Deputy Head of the Economic Department. In February 2016, Mr Pietrzyk became the Head of PGNiG's Economic Department.

On December 19th 2016, he was appointed Vice President for Finance, for the three-year term of office beginning December 31st 2016.

The Vice President for Finance supervises and coordinates such areas of the Company's operations as:

- of the Company's strategic economic and financial objectives,
- preparation and implementation of the Company's Business Plan,
- economic and financial evaluations and analyses of growth and investment projects, planning and overseeing financial aspects of the investment policy, monitoring of the use of financial resources allocated to production, investment and repair work,
- PGNiG's internal settlement procedures and financing operations,
- cash flows of the PGNiG Group, budgeting and control of the Company's costs and revenue, its credit policy, tax policy and tax liabilities,
- financial risk management, economic and financial analyses of new capital projects,
- implementation and development of accounting procedures,
- defining the rules of and overseeing the preparation of financial statements,
- investor relations.

Maciej Woźniak – Vice President, Trade

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

On December 19th 2016, he was reappointed Vice President for Trade, for the three-year term of office beginning December 31st 2016.

The Vice President for Trade supervises and coordinates the functioning of the Company, including with respect to:

- developing a regulatory policy in consultation with government authorities, EU authorities and industry organisations,
- planning and implementing the Company's trade policy, particularly in respect of natural gas and electricity sales, gas, electricity and other products sales policy,
- guiding the development of the gas market, natural gas import policy, also with respect to supply diversification,
- establishing and maintaining long-term relationships with foreign companies, international organisations and foreign government authorities with respect to trade relations, monitoring and analysis of foreign markets,
- collaboration with GAZ-SYSTEM, Polskie LNG, the Maritime Office in Szczecin and the Management Board of Porty Morskie Szczecin i Świnoujście in respect of importing LNG to Poland,
- planning, executing and settling contracts for the provision of gas transmission and distribution services for PGNiG,
- preparing periodic gas fuel balance reports, periodic settlements of gas deliveries, information services, including the receipt of information on events and crises in all areas of the Company's business,
- the Company's tariff policy, liaising with the Energy Regulatory Office in respect of preparing draft tariffs and prices of PGNiG's products and services, and licences,
- the Company's information policy and corporate communication,
- operations of the Wholesale Trading Branch and operations of the Company's foreign representative office in Brussels.

Magdalena Zegarska – Vice President of the Management Board

Magdalena Zegarska graduated from the University of Environmental Sciences in Radom. She completed an MBA oil and gas course and holds a certificate of completion of studies in Management of Large Enterprises from the School of Management and Marketing of the Business Initiatives Association in Warsaw. She completed numerous training programmes and courses in psychology of team management, as well as a course for supervisory board members, completed with a passed exam before the State Treasury Commission. From 2011 to 2014, she served as Secretary of the Employee Council of the second term of office, and from 2010 to 2014 as Secretary of the Coordination Committee of the NSZZ Solidarność trade union at PGNiG. In 2014−2017, she served as a Member of the PGNiG Supervisory Board, as the Board's Secretary and as Deputy Chair of the Audit Committee.

She joined PGNiG in 1998 as an employee of Mazowiecka Spółka Gazownictwa and then worked at the Mazovian Trading Division. From 2013, she held various positions at the Retail Trading Department, Infrastructure Department and Asset and Administration Department of the PGNiG Head Office. At the Asset and Administration Department she was Deputy Director. Since January 2016, she has been Representative of the PGNiG Management Board for the Quality, Health, Safety and Environment (QHSE) Management System. From April 2016 to March 2017, she served as Deputy Director of the QHSE Department, delegated to direct the work of the Department.

On March 6th 2017, Magdalena Zegarska was appointed as Vice President of the Management Board. Until March 6th 2017, the position had been held by Waldemar Wójcik.

The Vice President of the Management Board elected by employees Company supervises and coordinates the Company's operations in such areas as:

- occupational health and safety, fire safety,
- cooperation with trade unions, the Employee Council and other employee organisations where their operations relate to the Company and the PGNiG Group,
- issue of shares to eligible Company employees.

Division of powers between members of the PGNiG Management Board is regulated under Resolution No. 347/2017 of the Management Board of PGNiG, dated June 26th 2017.

10.2. Supervisory Board

Bartłomiej Nowak – Chairman of the Supervisory Board

Bartłomiej Nowak specialises in energy law, business law, competition law, and EU law. In 2007-2009, he worked for Directorate-General for Transport and Energy of the European Commission and as an adviser to the President of the Polish Energy Regulatory Office. In 2010-2014, he was an adviser at the Kancelaria Domański Zakrzewski Palinka sp.k. law firm and member of the Supervisory Board of PTE WARTA S.A. Since 2009, he has worked for the Leon Kozminski University of Warsaw, initially as

Assistant Professor and then Professor at the Law College, as well as Vice-Rector for Economic and Social Studies. Member of the Scientific Council of the National Centre for Nuclear Research.

Bartłomiej Nowak has represented that he meets the independence criteria defined in Art. 36 of the Company's Articles of Association.

Bartłomiej Nowak has served as Chairman of the Supervisory Board since July 27th 2016.

Piotr Sprzączak – Deputy Chairman of the Supervisory Board

Piotr Sprzączak is a graduate of the Maria Curie-Skłodowska University of Lublin and the National School of Public Administration of Warsaw. He began his professional career in 2011 at the Oil and Gas Department of the Ministry of Economy, and then the Ministry of Energy. He is currently Head of the Infrastructure Department at the Ministry of Energy. His main professional focus is security of natural gas supplies to Poland. As part of his job duties, he participated in negotiations on EU legal acts with respect to ensuring security of gas supply and shaping the regulatory environment through the 'Clean energy for all Europeans' package. He coordinates activities relating to international cooperation and Poland's membership in the European Union and international energy organizations and agreements. In 2011−2014, he was involved in preparing and updating the assessment of risk related to security of gas supplies, a prevention plan and an emergency response plan.

Since June 29th 2017, Piotr Sprzączak has been Deputy Chairman of the Supervisory Board. Until June 28th 2017, this position was held by Wojciech Bieńkowski.

Sławomir Borowiec – Secretary of the Supervisory Board

Sławomir Borowiec graduated from the AGH University of Science and Technology in Kraków (Faculty of Drilling, Oil and Gas) in 1992. In the same year he joined Zielonogórski Zakład Górnictwa Nafty i Gazu. In 2001, he graduated from The Jacob of Paradyż University of Applied Sciences in Gorzów Wielkopolski − Institute of Management and Finance, where he completed studies in Management and Marketing. In 2014, he earned a degree from the Koszalin University of Technology, where his principal field of study was Accounting − Accounting of Business Entities. At present, he is Head of the Administrative Centre for Oil and Gas Production Facilities in Drezdenko. Sławomir Borowiec is also a licensed Mine Operations Manager. In 2002, he passed an examination for candidates to supervisory boards of state-owned companies and in 2010 he received a title of Grade II Mining Director.

Until March 5th 2017, the position of Member and Secretary of the Supervisory Board was held by Magdalena Zegarska. Sławomir Borowiec has served as Secretary of the Supervisory Board since March 6th 2017.

Piotr Broda – Member of the Supervisory Board

Piotr Broda is a graduate of the Faculty of Foreign Trade of the Warsaw School of Economics and holder of an Executive MBA degree from the University of Minnesota. He gained professional experience working in leading financial institutions. In 1991, he joined Bank Austria Creditanstalt S.A. of Warsaw. He was Deputy Director of the Treasury Department (1995–1998), and then Director of the Treasury Department and Chairman of the Assets and Liabilities Committee (1998–2000). In November 2000, he took the position of Investment Team Manager at Allianz S.A., and in 2002 was appointed Deputy Director of the Financial Investments Office at PZU S.A. Piotr Broda continued his career with the PZU Group as Director of the Debt and Derivative Instruments Office and Vice President of the Management Board of PZU Asset Management S.A. (2008–2011) and Vice President of the Management Board of PZU TFI S.A. (2009–2013). For over four years (2013–2017), he served as Member of the Management Board of TFI BGK S.A. He has a long experience as a member of supervisory boards, having served in that capacity in 2002–2004 at PZU Asset Management S.A. and PZU NFI Management S.A., in 2005–2006 at Lentex S.A., and in 2006–24007 at Jago S.A. He has authored a number of publications concerned with finance as an expert cooperating with the Sobieski Institute.

Mr Piotr Broda has represented that he meets the independence criteria defined in Art. 36 of the Company's Articles of Association.

Andrzej Gonet – Member

Andrzej Gonet graduated with honours from the Faculty of Drilling, Oil and Gas of the AGH University of Science and Technology in Kraków in 1975. He was then employed at the Faculty and in 1980 he defended with honours his doctoral thesis. In 1989, he was awarded a post-doctoral degree (*doctor habilitatus*) in science. In 1998, he was awarded professorship and is now employed as a full professor at the AGH University of Science and Technology. He has completed several post-graduate programmes run by the AGH University of Science and Technology, Jagiellonian University and Polish Academy of Sciences, as well as a course for candidates to supervisory boards of state-owned companies. He was a member of the Supervisory Boards of ZUN Sp. z o. o. of Krosno (2000–2002) and PNiG Sp z o. o. of Kraków (2011–2013). Andrzej Gonet has authored or co-authored over 300 publications, 260 unpublished research papers, 29 approved and submitted patents and 8 licences. He is a certified environmental impact assessment expert of the Kraków Province Governor, expert of the Polish Association of Oil and Gas Industry Engineers and Technicians, and has extensive professional experience gained in Poland and abroad. He has been a consultant and reviewer of many scientific papers and research projects. He is a member of the Drilling and Borehole Mining Section of the Mining Committee of the Polish Academy of Sciences. Throughout his professional career he has held various positions, including head of the Drilling Department, Deputy Director of the Institute of Drilling, Oil and Gas, two terms of office as Vice-Dean and Dean of the

Faculty of Drilling, Oil and Gas of the AGH University of Science and Technology, which position he now holds for the third term. In addition, Andrzej Gonet was a co-founder of the PWSZ Krosno State College, where he has served as Vice-Rector and Rector.

Mieczysław Kawecki – Member of the Supervisory Board

Mieczysław Kawecki is a graduate of the AGH University of Science and Technology in Kraków, Master of Science in Engineering, principal field of study: well operation. He completed post-graduate studies in underground gas storage, and graduated in Environment Protection in Economy from the AGH University of Science and Technology in Kraków. Mieczysław Kawecki is a licensed mine operations manager and Grade I Mining Director. He started his professional career in 1976 at Sanocki Zakład Górnictwa Nafty i Gazu, working at the Wańkowa crude oil extraction facility. In 1984, he was appointed manager of a new crude oil and natural gas extraction facility in Lublin, and in 1986 he became manager of the Wielopole crude oil extraction facility. From 1991 to 2017, he worked as manager of the Strachocina Underground Gas Storage Facility. Since 2017, Mieczysław Kawecki has been managing the Underground Gas Storage Department of PGNiG's Sanok Branch. He is President of the Management Board of the Sanok Branch of the Polish Association of Oil and Gas Industry Engineers and Technicians (SITPNiG). In 1990–1992, he was a member of the Works Council at Sanocki Zakład Górnictwa Nafty i Gazu and a delegate to the General Assembly of Delegates of PGNiG Warszawa. He was a member of the Works Council of PGNiG Warszawa of the 6th and 7th terms of office from 1994 until it was transformed into a company. Until 1998, he was a member of the consulting group at PGNiG. From 2003 to 2005, Mieczysław Kawecki served as Chairman of the KADRA Trade Union at the Sanok Branch, and member of the Union Coordination Committee. He was first member and then Secretary of the Supervisory Board of PGNiG in 2005–2014.

Stanisław Sieradzki – Member of the Supervisory Board

Stanisław Sieradzki completed studies in stratigraphic and exploratory geology at the University of Wrocław. He also completed post-graduate studies in oil and gas engineering at the AGH University of Science and Technology in Kraków. Stanisław Sieradzki has worked for PGNiG S.A. since 1986, first as independent geologist, then specialist geologist in the Operational Geology Department, and later as Head of the Deposit Appraisal and Documentation Department at PGNiG's Sanok Branch. Upon establishment of the Geology and Hydrocarbon Production Unit, he was appointed Head of the Project Design Centre in Sanok. Currently, he holds the position of Deputy Head of the Project Design Department in Jasło, Sanok office. His work to date has focused chiefly on crude oil and natural gas exploration. Stanisław Sieradzki has received a number of qualifications, including a licence from the Minister of the Environment to perform, supervise and manage category 1 geological work in: exploration for and appraisal of crude oil and natural deposits; he is also a qualified senior technical supervisor of geological operations and mining geologist at facilities extracting mineral deposits through boreholes, licensed by the President of the State Mining Authority. He is also a certified internal management system auditor.

Grzegorz Tchorek – Member of the Supervisory Board

Grzegorz Tchorek graduated from the Faculty of Management of the University of Warsaw. In 2007, he defended his doctoral thesis, which earned him an award of the Prime Minister for the best doctoral theses. Having become a PhD holder, Grzegorz Tchorek started working as an associate professor at the Faculty of Management of the University of Warsaw and as an adviser at the National Bank of Poland (since 2009). Currently his main focus as an expert is analyzing the experiences of euro area countries, assessing the competitiveness of economies and enterprises, global supply chains and the development of electromobility in Poland. It implements research projects related to electromobility, gas-mobility and shared mobility.

Grzegorz Tchorek has represented that he meets the independence criteria defined in Art. 36 of the Company's Articles of Association.

Until June 28th 2017, the Supervisory Board was composed of Wojciech Bieńkowski, Sławomir Borowiec, Mateusz Boznański, Andrzej Gonet, Bartłomiej Nowak, Piotr Sprzączak, and Anna Wellisz. On June 28th 2017, the PGNiG Annual General Meeting removed these persons from the PGNiG Supervisory Board and appointed the following persons to the Board: Sławomir Borowiec, Piotr Broda, Andrzej Gonet, Mieczysław Kawecki, Bartłomiej Nowak, Stanisław Sieradzki, Piotr Sprzączak, and Grzegorz Tchorek.

10.3. Remuneration policy and remuneration of management personnel

PGNiG's remuneration policy

The key internal document governing the remuneration policy at PGNiG is the Collective Bargaining Agreement concluded with trade unions active at the Company on July 15th 2009. The remuneration system is additionally governed by internal rules in place at individual organisational units and by agreements with trade unions.

In line with the adopted remuneration policy, base pay rates are based on job grading. The rate depends on the qualifications required for a given job, type of work performed and professional experience.

The policy also provides for additional components of remuneration, the most important of them being:

- Awards and bonuses under an incentive scheme,
- St. Barbara's Day awards, paid, as a rule, in the amount of a monthly base pay,
- Jubilee benefits and one-off retirement benefits, in amounts depending on the length of service with PGNiG, and
- Annual bonuses, in amounts depending on the Company's performance, negotiated every year with employees.

The key components of remuneration under employment contracts included: base pay, periodic awards, task and project bonuses, St. Barbara's Day awards, annual bonuses, length-of-service awards, retirement severance payments, and payments for unused holidays.

Incentive scheme

At PGNiG, a bonus scheme is in place whose key components include:

- MBO (Management By Objectives) bonus, which applies to management positions responsible for achieving PGNiG's key objectives; the amount of an MBO bonus depends on the quality and progress in the achievement of allocated objectives;
- Discretionary periodic bonus, which covers the remaining employees and is granted on a quarterly basis, based on discretionary assessment of an employee's performance by their superior;
- Discretionary task bonus, paid from a special account placed at the disposal of the PGNiG Management Board and earmarked for discretionary bonuses granted to employees excelling in their work for the Company;
- Discretionary project bonus, for employees who have been involved in the execution of project work; the bonus amount depends on the quality and progress in the execution of specific projects.

Another component of the incentive scheme is a system of retention of PGNiG's key personnel, implemented in 2015. The system is designed to prevent departures of employees whose knowledge, experience and access to PGNiG's sensitive information could be used to the benefit of competitors.

An element supporting the incentive scheme is also the miner's titles and industry badges as well as related financial rewards given on the occasion of the Miners' Day. The titles and badges are awarded for long service as well as for special merits and achievements at work.

Employee benefits

Benefit	Description
Social benefits	It is with utmost care that PGNiG strives to comply with its duties towards employees and their families, especially those related to social welfare, including organisation and co-financing of holidays in Poland and abroad for employees and their children, financial assistance and material support for families facing financial difficulties and health problems, repayable housing assistance, as well as organisation and co-financing of recreation, sports, cultural and educational activities.
Healthcare	Pursuant to Article 13.1 of PGNiG's Collective Bargaining Agreement, employees may take advantage of an additional paid sick leave to receive treatment in sanatoriums and health resorts. Such leave is available to employees who, based on periodic examinations or check-ups, have been diagnosed by an occupational physician with health deterioration or threat, in particular in connection with an accident at work, occupational disease, or performing a job with harmful effects on health or particularly burdensome. Employees and their family members may use comprehensive medical services at POLMED S.A.'s healthcare facilities and the healthcare facilities cooperating with POLMED S.A. throughout the country. The employer covers the costs of purchasing medical service subscriptions for employees (the employees pay the tax, social security and health insurance premiums).
Employee Pension Plan	PGNiG has in place an Employee Pension Plan within the meaning of the Act on Employee Pension Plans of April 20th 2004 (Dz.U. No. 116, item 1207). Every employee who has continuously worked for the Company for at least three months is eligible for the plan.
Employee vouchers	For Easter and Christmas, PGNiG employees receive vouchers with a value determined by the Employer.
Group insurance	An employee may join the group insurance programme for the PGNiG Group employees and their family members. The insurance programme has been prepared and maintained by PZU Życie in cooperation with the insurance broker DONORIA S.A.
Employee holidays	PGNiG organises and co-finances domestic and foreign holidays for employees and their children, as well as its former employees. As part of its social initiatives, the Group purchases summer or winter camp stays and individual holidays for employees' children. Day camps for children and holiday stays for employees are also organised. Employees may also take advantage of co-financing for leisure activities organised on their own.
Financial assistance	PGNiG offers repayable housing assistance to its employees – as part of the Company's social activity, loans are granted for current housing purposes (renovation or modernisation) and for the construction or purchase of a flat or house. There are also non-repayable allowances for chronically ill employees and employees in a difficult financial situation. In addition, financial assistance from the Joint Social Benefit Fund is also provided under an agreement concluded with the PGNiG Group companies.
Sport and recreation	PGNiG supports various forms of active recreation. Employees receive attractively priced MULTISPORT gym cards and OK System cards, as well as co-financing for family picnics or sports competitions.

Remuneration policy for members of the governing bodies of the subsidiaries

PGNiG has in place the rules of remuneration for members of the governing bodies of the subsidiaries.

In 2017, the remuneration policy and the amount of remuneration paid to the management and supervisory board members at the PGNiG Group subsidiaries were modified to meet the requirements stipulated by the Act on Rules of Remunerating Persons Who Manage Certain Companies of June 9th 2016. In most subsidiaries, the remuneration was adjusted in accordance with the general rule set out in the Act. In some subsidiaries, a different method permitted under the Act was used to determine the remuneration upon prior approval from the PGNiG Supervisory Board.

Pursuant to the Act, total remuneration of a member of the governing bodies is composed of a fixed component in the form of a monthly base pay and a variable component representing additional remuneration payable for the company's financial year. The fixed component depends on the scale of the company's business, and the variable component depends on the level of completion of management objectives.

Remuneration policy for PGNiG management and supervisory personnel

On November 24th 2016, an Extraordinary General Meeting of PGNiG passed Resolution No. 9/XI/2016 on the rules of remuneration for members of the Management Board of PGNiG. Pursuant to the resolution, total remuneration of a member of the

Management Board consists of a fixed component in the form of a monthly base pay ('Fixed Remuneration') and a variable component representing additional remuneration payable for PGNiG's financial year ('Variable Remuneration').

The General Meeting authorised the Supervisory Board to define the amounts of Fixed Remuneration of Management Board members, subject to the following conditions:

a) Fixed Remuneration of the President of the Management Board will range from 7x to 15x of the average remuneration in the business sector, net of bonuses paid from profit, in the fourth quarter of the previous year, as announced by the President of the Central Statistics Office of Poland;

b) Fixed Remuneration of other Management Board members will range from 7x to 15x of the average remuneration in the business sector, net of bonuses paid from profit, in the fourth quarter of the previous year, as announced by the President of the Central Statistics Office of Poland.

The General Meeting resolved that Variable Remuneration would depend on the progress in the achievement of Management Objectives and would not exceed 100% of Fixed Remuneration. Detailed Management Objectives are defined by the Supervisory Board.

A Management Board member may not receive remuneration for holding positions on the governing bodies of PGNiG subsidiaries included in its group within the meaning of Art. 4.14 of the Competition and Consumer Protection Act of February 16th 2007.

If PGNiG terminates a Contract for reasons other than a material breach of the Contract, the Management Board member may receive a severance payment of:

a) up to 1x (one time) the Fixed Remuneration, provided that the member has held the position for at least 6 (months) and up to 12 (twelve) months prior to the termination;

b) up to 3x (three times) the Fixed Remuneration, provided that the member has held the position for at least 12 (twelve) months prior to the termination.

In 2016, before the Extraordinary General Meeting of PGNiG passed Resolution No. 9/XI/2016, the remuneration policy for Management Board Members provided for remuneration consisting of a fixed component, in an amount defined under the Supervisory Board's separate resolution, and a variable component in the form of an annual bonus. The annual bonus was of a discretionary nature, granted only if the Management Board Members achieved the objectives specified in their MBO sheets, in an amount reflecting the degree of their completion.

On September 9th 2016, the Extraordinary General Meeting of PGNiG passed Resolution No. 9/VIII/2016 on the rules of remuneration for members of the Supervisory Board of PGNiG.

Pursuant to the resolution, the monthly remuneration of Supervisory Board members equals the average monthly remuneration in the business sector (net of bonuses paid from profit) in the fourth quarter of the previous year, as announced by the President of the Central Statistics Office of Poland, multiplied by the following factors:

- For the Chairman of the Supervisory Board – 1.7;
- For the Deputy Chairman and Secretary of the Supervisory Board − 1.6;
- For other members of the Supervisory Board − 1.5.

Before the Extraordinary General Meeting of PGNiG passed Resolution No. 9/VIII/2016 concerning the rules of remuneration for members of the Supervisory Board, the remuneration of a Supervisory Board Member was determined in accordance with Art. 8.8 of the Act of March 3rd 2000 on Remunerating Persons Who Manage Certain Legal Entities (consolidated text in Dz.U. of 2015, item 2099). Pursuant to the provisions referred to above, the monthly remuneration of Supervisory Board Members could not exceed the average monthly remuneration in the business sector (net of bonuses paid from profit) in the fourth quarter of the previous year, as announced by the President of the Central Statistics Office of Poland.

Remuneration paid to members of management and supervisory bodies of PGNiG

Full name	January 1st – December 31st 2017 Total remuneration, additional benefits and bonuses paid and due in 2017 for holding key positions at PGNiG*	Total remuneration for holding key positions at subordinated entities in 2017	Total remuneration in 2017
	(PLN '000)		
Total remuneration of Management Board members, including:	8,649	1,591	10,240
Piotr Woźniak − President of the Management Board	1,422	375	1,797
Radosław Bartosik − Vice President	895	224	1,119
Łukasz Kroplewski – Vice President	1,242	241	1,483
Michał Pietrzyk – Vice President	909	238	1,147
Maciej Woźniak – Vice President	1,243	276	1,519
Magdalena Zegarska – Vice President [1)]	729	113	842
Violetta Jasińska-Jaśkowiak – Commercial Proxy	554	77	631
Persons who were Management Board members in 2017 but not as at Dec 31 2017:			
Waldemar Wójcik – Vice President [2)]	1,141	47	1,188
Persons who were Management Board members or commercial proxies in 2016 but not as at Dec 31 2016:			
Janusz Kowalski	512	-	512
Bogusław Marzec	2	-	2
Total remuneration of Supervisory Board members, including:	678	-	676
Wojciech Bieńkowski [3)]	42	-	42
Sławomir Borowiec	86	-	86
Mateusz Boznański [3)]	39	-	39
Piotr Broda [4)]	41	-	41
Andrzej Gonet	81	-	81
Mieczysław Kawecki [4)]	41	-	41
Bartłomiej Nowak	92	-	92
Stanisław Sieradzki [4)]	41	-	41
Piotr Sprzączak	83	-	83
Grzegorz Tchorek [4)]	41	-	41
Ryszard Wąsowicz [5)]	34	-	34
Anna Wellisz [3)]	39	-	39
Magdalena Zegarska [1)]	16	-	16
Total	9,325	1,591	10,916

** In the case of management board members providing management services based on a managerial contract, the total amount of remuneration, additional benefits and awards in 2017 paid and due to perform their functions in the Management Board of PGNiG S.A. includes VAT; this does not apply to persons acting as Proxies.*
1) Magdalena Zegarska has served as Member of the Management Board since March 6th 2017. From January 1st to March 5th 2017, she was a Member of the Supervisory Board.
2) Waldemar Wójcik served as Member of the Management Board until March 6th 2017.
3) Supervisory Board Member until June 28th 2017.
4) Supervisory Board Member since June 28th 2017.
5) Ryszard Wąsowicz served as Member of the Supervisory Board until May 30th 2017.

Full name	January 1st – December 31st 2016* Total remuneration, additional benefits and bonuses paid and due in 2016 for holding key positions at PGNiG**	Total remuneration for holding key positions at subordinated entities in 2016	Total remuneration in 2016
	(PLN '000)		
Total remuneration of Management Board members, including:	7,609	3,998	11,607
Piotr Woźniak − President [1)]	1,031	859	1,890
Radosław Bartosik − Vice President [4)]	-	-	-
Łukasz Kroplewski – Vice President [2)]	828	449	1,277
Michał Pietrzyk – Vice President [4)]	-	0.4	0.4
Maciej Woźniak – Vice President [3)]	858	606	1,464
Waldemar Wójcik – Vice President	1,069	498	1,567
Violetta Jasińska-Jaśkowiak – Proxy	508	98	606
Persons who were Management Board members in 2016 but not as at Dec 31 2016:			
Janusz Kowalski [5)]	917	697	1,614
Bogusław Marzec [5)]	878	791	1,669
Persons who were Management Board members in 2015 but not as at Dec 31 2015:			
Mariusz Zawisza [6)]	564	-	564
Jarosław Bauc [7)]	481	-	481
Zbigniew Skrzypkiewicz [7)]	475	-	475
Total remuneration of Supervisory Board members, including:	514	-	514
Wojciech Bieńkowski	61	-	61
Sławomir Borowiec	61	-	61
Mateusz Boznański	59	-	59
Andrzej Gonet	60	-	60
Grzegorz Nakonieczny [10)]	25	-	25
Bartłomiej Nowak [8)]	37	-	37
Krzysztof Rogala [11)]	9	-	9
Piotr Sprzączak [8)]	34	-	34
Ryszard Wąsowicz	60	-	60
Anna Wellisz [9)]	47	-	47
Magdalena Zegarska	61	-	61
Total	8,123	3,998	12,121

** Items adjusted to the amount of costs recognised in a given period while previously presented by maturity.*
*** In the case of management board members providing management services based on a managerial contract, the total amount of remuneration, additional benefits and awards in 2017 paid and due to perform their functions in the Management Board of PGNiG S.A. includes VAT; this does not apply to persons acting as Proxies.*
1) Piotr Woźniak has served as President of the Management Board since February 11th 2016; from December 11th 2015 to February 10th 2016 he was a Member of the Supervisory Board delegated to temporarily perform the duties of President of the Management Board.
2) Łukasz Kroplewski has served as Member of the Management Board since February 11th 2016.
3) Maciej Woźniak has served as Member of the Management Board since February 11th 2016; from December 11th 2015 to February 10th 2016 he was the Company's Proxy.
4) Management Board Member since December 31st 2016.
5) Served as Management Board Member from February 11th to December 30th 2016, and as Commercial Proxy from December 11th 2015 to February 10th 2016.
6) Mariusz Zawisza was President of the Management Board until December 11th 2015.
7) Served as Management Board Member until December 11th 2015.
8) Supervisory Board Member until June 28th 2016.
9) Anna Wellisz has served as Supervisory Board Member since April 1st 2016.
10) Grzegorz Nakonieczny served as Supervisory Board Member until June 28th 2016.
11) Krzysztof Rogala served as Supervisory Board Member until February 25th 2016.

10.4. Statement of compliance with corporate governance rules

Pursuant to Par. 91.5.4 of the Regulation of the Minister of Finance on current and periodic information to be published by issuers of securities and the conditions for recognition as equivalent of information whose disclosure is required under the laws of a non-member state (the 'Regulation'), dated February 19th 2009, the Management Board of PGNiG (the 'Issuer' or the 'Company') hereby presents its statement of compliance with corporate governance rules.

The Issuer's objective is to ensure maximum transparency of its activities, appropriate quality of its investor communications and protection of shareholder rights.

1. Corporate governance code applicable to the Issuer and where the text of such code is publicly available

In 2017, the Issuer was in compliance with the set of corporate governance rules laid down in the 'Best Practice for WSE Listed Companies 2016' (the 'Code of Best Practice'), adopted by the WSE Supervisory Board in its Resolution No. 26/1413/2015 of October 13th 2015. The amended text of the code is publicly available on the Warsaw Stock Exchange's corporate governance website at www.gpw.pl/dobre-praktyki and on the Issuer's website at http://en.pgnig.pl/pgnig/corporate-governance/best-practices.

The Code of Best Practice was developed by experts representing various groups of capital market participants, who are members of the WSE Corporate Governance Consultative Committee. All changes in the Code of Best Practice were introduced in a way ensuring continuity of coverage of the matters addressed in the previous versions of the Code. To ensure clarity of the document and to emphasise the most important matters, a new thematic division of the Code was introduced. Further, a new scheme of the document, compliant with the European Commission's recommendation, was adopted.

2. Corporate governance standards referred to in Section 1 which were not complied with by the Issuer, with a statement of reasons for the non-compliance

In 2017, the Issuer did not comply with four of the rules and two recommendations of the Code of Best Practice:

1. Disclosure Policy and Investor Communications – I.Z.1.15;
2. Management and Supervisory Board – II.Z.3;
3. Management and Supervisory Board – II.Z.2.7;
4. Management and Supervisory Board – II.Z.2.8;
5. General Meeting, Shareholder Relations – IV.R.2;
6. Remuneration − VI.R.4.

Reasons for the non-compliance with these rules and recommendations are presented below.

2.1. Disclosure Policy and Investor Communications – I.Z.1.15

"A company should operate a corporate website and publish on it, in a legible form and in a separate section, in addition to information required under the legislation: information about the company's diversity policy applicable to the company's governing bodies and key managers; the description should cover the following elements of the diversity policy: gender, education, age, professional experience, and specify the goals of the diversity policy and its implementation in the reporting period; where the company has not drafted and implemented a diversity policy, it should publish the explanation of its decision on its website."

Decisions to select members of the Company's governing bodies are made by the owner, taking into consideration the Ministry of Energy's 'Standards of the owner's supervision at state-owned companies in which rights attached to shares are exercised by the Minister of Energy' and 'Rules and procedure for selecting candidates for members of the supervisory boards of state-owned companies in which rights attached to the State Treasury's shares are exercised by the Minister of Energy' – Order of the Minister of Energy of August 4th 2016.

The Company believes there is no need to define a diversity policy for its key managers.

2.2. Management and Supervisory Board – II.Z.3

'At least two members of the supervisory board should meet the criteria of being independent referred to in principle II.Z.4.'

Pursuant to Art. 36.1 of the Issuer's Articles of Association, one of the members of the Supervisory Board appointed by the General Meeting should meet the independence criteria (independent member of the Supervisory Board). The term 'independent member of the supervisory board' means an independent member as defined by the Commission Recommendation of February 15th 2005 on the role of non-executive or supervisory directors of listed companies and the committees of the (supervisory) board (2005/162/EC), with due regard to the provisions of the Code of Best Practice for WSE Listed Companies.

Given the fact that, in accordance with Art. 14 of the Act on Commercialisation and Certain Employee Rights of August 30th 1996 (consolidated text in Dz.U. of 2017, item 1055, as amended), some of the Company's Supervisory Board members are elected by employees, the Issuer cannot ensure a greater number of independent members on its Supervisory Board. Increasing the number of independent members on the Company's Supervisory Board relative to the number currently set out in the Company's Articles of Association would lead to a situation where the State Treasury (the Issuer's majority shareholder) would be unable to appoint the majority of the Supervisory Board members. This in turn would violate the rule stipulating that a shareholder's influence on a company's business should be proportionate to the share capital held by such shareholder.

In the period from January 1st to June 28th 2017, there was one independent member on the Issuer's Supervisory Board – Mr Mateusz Boznański, appointed on December 29th 2015. In the period from June 28th to December 31st 2017, three members of the Issuer's Supervisory Board satisfied the independence criteria, namely Mr Bartłomiej Nowak, Mr Piotr Broda, and Mr Grzegorz Tchorek.

2.3. Management and Supervisory Board – II.Z.7

'Annex I to the Commission Recommendation referred to in principle II.Z.4 applies to the tasks and the operation of the committees of the Supervisory Board. Where the functions of the audit committee are performed by the supervisory board, the foregoing should apply accordingly.'

An Audit Committee operates within the Issuer's Supervisory Board as a standing committee, advising the Supervisory Board on matters within the Committee's remit.

Pursuant to the Best Practice for WSE Listed Companies, with respect to the tasks and the operation of its Supervisory Board committees, the Issuer should apply the rules laid down in Annex I to Commission Recommendation of February 15th 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board. In the case of the Audit Committee, the primary purpose of the rules is to ensure that the Audit Committee performs its role correctly.

The Issuer has complied with all the requirements which guarantee the Audit Committee's involvement in the supervision of the Issuer's business. However, the Issuer did not comply with all the detailed requirements for the operation of the Committee. The requirements which the Issuer did not comply with include:

1. the rule laid down in Section 4.3.2 of Annex I, pursuant to which the management should inform the audit committee of the methods used to account for significant and unusual transactions where the accounting treatment may be open to different approaches;
2. the rule laid down in Section 4.3.8 of Annex I, pursuant to which the audit committee should review the process whereby the company complies with the existing regulations regarding the possibility for employees to report alleged significant irregularities in the company, by way of complaints or through anonymous submissions, normally to an independent director, and should ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.

Given the way in which the Audit Committee currently operates, the Issuer does not consider it necessary to introduce very detailed rules to regulate its operation.

The Issuer will take appropriate steps in the future, if justified by the actual manner of operation of the Audit Committee.

2.4. Management and Supervisory Board – II.Z.8

'The chair of the audit committee should meet the independence criteria referred to in principle II.Z.4.'

In accordance with the Rules of Procedure for the Audit Committee of the PGNiG Supervisory Board, the Audit Committee is composed of at least three Supervisory Board members, of whom at least one has expertise and competence in accounting or auditing of financial statements. Most of the Audit Committee members, including its Chair, are independent of the Company, i.e. they meet the independence criteria referred to in Art. 129.3 of the Act of May 11th 2017 on Statutory Auditors, Audit Firms, and Public Oversight (Dz.U. of 2017, item 1089, dated June 6th 2017). Members of the Audit Committee are appointed by the Supervisory Board from among its members on a rotational basis. Election of the Chair is a discretionary power of the Audit Committee.

Currently, no amendments in this respect are planned to be made to the Rules of Procedure for the Audit Committee. In the Company's opinion, the regulations currently in force are sufficient to ensure proper operation of that Committee.

In the period from January 1st to June 28th 2017, the Audit Committee of the PGNiG Supervisory Board was chaired by Mateusz Boznański, who had been appointed to the Supervisory Board on December 29th 2015 and who satisfied the independence criteria referred to in principle II.Z.4. In the period from August 17th to December 31st 2017, the Audit Committee of the PGNiG Supervisory Board was chaired by Grzegorz Tchorek, who satisfied the independence criteria referred to in principle II.Z.4.

2.5. General Meeting, Shareholder Relations – IV.R.2

'If justified by the structure of shareholders or expectations of shareholders notified to the company, and if the company is in a position to provide the technical infrastructure necessary for a general meeting to proceed efficiently using electronic communication means, the company should enable its shareholders to participate in a general meeting using such means, in particular through:

1st real-life broadcast of general meetings,
2nd real-time bilateral communication where shareholders may take the floor during a general meeting from a location other than the general meeting,
3rd exercise of the right to vote during a general meeting either in person or through a proxy.'

The Company has decided not to comply with Section 2) of the recommendation, as its Articles of Association currently do not provide for shareholders' participation in a General Meeting using electronic communication means. In accordance with the Commercial Companies Code, bringing that recommendation into effect would require a relevant amendment to the Company's Articles of Association.

The Company does not rule out making such amendments in the future. Only after they are made will it be able to comply with the recommendation.

2.6. Remuneration − VI.R.4

'The remuneration levels of members of the management board and the supervisory board and key managers should be sufficient to attract, retain and motivate persons with skills necessary for proper management and supervision of the company. Remuneration should be adequate to the scope of tasks delegated to individuals, taking into account additional functions, for instance on supervisory board committees.'

The Company follows recommendation VI.R.4 on the remuneration levels of the Management Board members and key managers. The recommendation cannot be implemented by the Issuer with respect to members of its Supervisory Board, as their remuneration is regulated by generally applicable laws, namely the Act on Rules for Remunerating Persons Who Direct Certain Companies, dated June 9th 2016 (Dz.U. of 2017, item 2190).

3. Basic features of internal control and risk management systems used by the Issuer in the process of preparation of financial statements and consolidated financial statements

The Issuer's internal control system consists of:

1. Group-wide uniform accounting policies on measurement, recognition and disclosure in accordance with the International Financial Reporting Standards, as well as unified templates for separate and consolidated financial statements;
2. Internal control mechanisms, including separation of duties, multi-stage data verification, accuracy reviews of data received, independent checks, etc;
3. Internal operating procedures implemented under Orders of the President of the Management Board;
4. Definition of accounting, financial reporting and tax settlement responsibilities at the Company, in the task book and in relevant rules approved by the Management Board and the Supervisory Board;
5. Definition of rules on supervision of the flow of financial and accounting documents, including review of the documents in terms of form, substance and accounting correctness;
6. Recording of economic events in an integrated finance and accounting system configured in compliance with the accounting policies in place at the Company, containing controls and checks ensuring data consistency and integrity, such as integrity checks, hardware checks, operating checks, and authority checks;
7. An IT system supporting the consolidation process, enabling the Group to streamline the consolidation process at the level of financial and management reporting, and speed up the preparation of consolidated reports;
8. Uniform rules and procedures for consolidating financial data, ensured through the use of unified reports, automatic validations of the consistency and completeness of reported data, as well as two-stage authentication and approval in the data consolidation system;
9. Formalised procedure for the preparation of financial statements (scheduled tasks with individual deadlines and persons responsible);
10. Multi-stage review and authorisation process for financial statements, involving the Supervisory Board;
11. Assessment of current reporting risk by the PGNiG Group's Internal Audit and Control Department and the Security Department;
12. Independent review of financial statements for reliability and accuracy by an independent external auditor;
13. Progressive development of the Group's internal procedures and regulations designed to ensure uniformity of the reporting processes and their continuous improvement.

At the centre of the accounting and financial reporting controls is a fully integrated financial and accounting system. The system checks recorded transactions for correctness, but also identifies which users have entered and approved individual transactions.

Access to financial information is restricted by an authorisation system. Access authorisation is granted based on an employee's function and responsibilities, and is subject to stringent controls.

An additional level of control was introduced to oversee the Group's financial statements by assigning the preparation of the Issuer's financial statements and the Group's consolidated financial statements to two separate Departments at the Company's Head Office; the financial statements are entered in the integrated IT system with the accounts of other consolidated entities. Data undergoing consolidation is automatically checked for correctness by automatic validation systems and is subject to logical verification procedures carried out by dedicated Group employees.

The PGNiG Group's Accounting Policy ensures compliance of the Issuer's accountancy and financial statements with the relevant regulations, in particular with the International Financial Reporting Standards. The Accounting Policy is regularly updated to ensure its continuing compliance with amended regulations. The most recent update to the Accounting Policy was made in 2017.

To further mitigate the risks associated with financial reporting, financial statements are verified by an independent auditor every three months. The Issuer's auditor selection procedures ensure the auditor's independence in performing its duties (auditors are selected by the Supervisory Board acting on the Audit Committee's recommendation) and high standards of auditing services.

Full-year financial statements are audited, whereas Q1, H1 and Q3 statements are reviewed. The results of both processes are presented by the auditor to the Management Board and to the Supervisory Board's Audit Committee.

In its operations, the Issuer manages its overall financial security using dedicated liquidity, financial risk, budget drafting and control management systems.

The financial reporting process is also reviewed on an ongoing basis through internal audit of individual processes and projects, which consists in reviewing accounting records for specific processes and one-off events in terms of their reliability and completeness, as well as in checking the correctness of the flow of accounting documents. Based on the findings and assessments formulated during operating audits in different areas of accounting, no need to develop a dedicated mechanism for reviewing the preparation process for financial statements has been identified. In particular, there are no reasons to believe that the absence of such a dedicated mechanism poses any threat to the Issuer's business. There is also no reason to believe that this situation is likely to significantly change in the near future. Annual reviews of the internal control and risk management system at the Company level show consistent implementation of recommendations intended to improve the financial reporting components of the system.

Factors mitigating the risks related to financial reporting include constant upgrading of particular modules of the integrated management system and improvement of the practical and specialist skills of employees operating the system.

4. Shareholders holding directly or indirectly major holdings of shares, with an indication of the number of shares and percentage of the share capital held by such shareholders, and the number of votes and percentage of the total voting power that such shares represent at the General Meeting

The Issuer's shares are listed on the Warsaw Stock Exchange, and its share capital is divided into 5,778,314,857 ordinary bearer shares with a par value of PLN 1.00 per share.

In 2017, the State Treasury, represented by the Minister of Energy (Plac Trzech Krzyży 3/5, 00-507 Warsaw), was the only shareholder with a major holding of Issuer shares (more than 5% of the Issuer's share capital).

Issuer's shareholding structure as at December 31st 2017

	Number of shares	Ownership interest	Number of votes at the Issuer's General Meeting	Percentage of the total voting power at the Issuer's General Meeting
State Treasury	4,153,706,157	71.88%	4,153,706,157	71.88%
Treasury shares	-	-	-	-
Other shareholders	1,624,608,700	28.12%	1,624,608,700	28.12%
Total	5,778,314,857	100.00%	5,778,314,857	100.00%

The specification given above takes into consideration EGM's Resolution No. 7/XI/2016 of November 24th 2016 to cancel 121,685,143 treasury shares. Cancellation of the treasury shares was registered with the National Court Register on March 2nd 2017.

As at December 31st 2017, 728,293,842 PGNiG shares, representing 12.60% of the share capital and total voting rights at the General Meeting, were distributed among 59,256 of the 61,516 eligible employees.

5. Holders of any securities conferring special control rights, with a description of those rights

Pursuant to the Articles of Association, as long as the State Treasury holds Issuer shares, the State Treasury, represented by the minister competent for matters pertaining to energy, has the right to appoint and remove one member of the Supervisory Board.

Further, pursuant to the Articles of Association, the State Treasury (as a shareholder) approves in writing: (i) any changes to the material provisions of existing trade contracts for natural gas imports to Poland, as well as execution of such contracts, and (ii) the implementation of any strategic investment projects or the Company's involvement in investment projects which may, permanently or temporarily, impair the economic efficiency of the Company's business activities, but which are necessary to ensure Poland's energy security.

Irrespective of the State Treasury's ownership interest in the Issuer, the State Treasury has the right to demand that the General Meeting be convened and that particular matters be placed on its agenda.

As a shareholder in PGNiG SA, the State Treasury also enjoys other rights under relevant laws and regulations.

6. Restrictions on voting rights, such as limitation of the voting rights of holders of a given percentage or number of votes, time limits on the exercising of voting rights, or provisions under which, with the company's cooperation, equity rights attaching to securities are separated from the holding of the securities

Under PGNiG's Articles of Association, since December 31st 2012 the voting rights of the Company's shareholders have been restricted so that no shareholder (except as specified below) can exercise at a General Meeting more than 10% of the total voting rights existing as at the date of the General Meeting, with the proviso that this restriction is deemed non-existent for the purposes of determining the obligations of buyers of significant holdings of shares.

The voting rights restrictions do not apply to shareholders who were holders of shares conferring more than 10% of total voting rights at the Company on the date of the General Meeting's resolution imposing the restrictions, and to shareholders acting together with shareholders holding shares conferring more than 10% of total voting rights under agreements on voting in concert.

For the purpose of the voting rights restriction, votes of shareholders bound by a parent-subsidiary relationship are aggregated and if the aggregated number of votes exceeds 10% of total voting rights at the Company, it is subject to reduction.

7. Restrictions on the transfer of ownership rights to the Issuer's securities

Under Art. 13.14 of the Act of December 16th 2016 on State Property Management (Dz.U. of 2016, item 2259), shares held by the State Treasury may not be disposed of.

8. Rules governing the appointment and removal of management personnel and such personnel's powers, particularly the power to make decisions on the issuance or buy-back of shares

Pursuant to the Articles of Association, individual members of the Management Board or the entire Management Board are appointed and removed by the Supervisory Board. A member of the Management Board is appointed following a recruitment and selection procedure carried out pursuant to applicable provisions of the Articles of Association and in compliance with the requirements for candidates laid down in Art. 22 of the Act of December 16th 2016 on State Property Management (Dz.U. of 2016, item 2259). The procedure does not apply to Management Board members elected by employees.

As long as the State Treasury holds Issuer shares and the Issuer's annual average headcount exceeds 500, the Supervisory Board appoints to the Management Board one person elected by the employees, to serve for the Management Board's term of office. A person is considered a candidate to the Management Board elected by the employees if, during the election, 50% of valid votes plus one were cast in favour of that person, with the reservation that the election results are binding on the Supervisory Board if at least 50% of the Company's employees participated in the election.

Management Board members are appointed for a joint term of three years.

A member of the Management Board may resign from his or her position by delivering a notice to that effect to the Company, represented by another Management Board member or commercial proxy, with copies to the Chairman of the Supervisory Board and the minister competent for matters pertaining to energy. The resignation must be submitted in writing, or will otherwise be ineffective towards the Company.

The Management Board member elected by the employees may also be removed upon a written request submitted by at least 15% of the Company's employees. The Supervisory Board orders the voting and its results are binding on the Supervisory Board if at least 50% of the Issuer's employees participate in the ballot, and if the percentage of votes cast in favour of the removal is not lower than the majority required for the election of a member of the Management Board by the employees.

The powers of the Management Board are described in Section 11.1.2 hereof.

Pursuant to the Articles of Association, decisions on the issuance or buy-back of shares are adopted by the Issuer's General Meeting.

9. Rules governing amendments to the Issuer's Articles of Association

Pursuant to the Commercial Companies Code and the Issuer's Articles of Association, amendments to the Articles of Association are introduced by virtue of resolutions adopted by the General Meeting with the required majority of votes, and must be recorded in the business register. Any amendment to the Articles of Association must be submitted by the Management Board to the registry court within three months from the date on which the General Meeting adopted the resolution introducing the amendment.

The consolidated text of the Articles of Association is drawn up by the Management Board and then approved by the Supervisory Board.

10. The operation of the General Meeting, its basic powers and description of shareholders' rights, with the procedure for their exercise, in particular the rules stipulated in the Rules of Procedure for the General Meeting, to the extent not prescribed directly by law

10.1. Description of the operation of the General Meeting

The General Meeting operates in accordance with the provisions of the Commercial Companies Code, the Articles of Association and the Rules of Procedure for the General Meeting. The Rules of Procedure for the General Meeting stipulate, in particular, the rules of conducting meetings and adopting resolutions. The Rules of Procedure for the General Meeting are available on the Issuer's website at www.pgnig.pl.

The General Meeting may be convened as either Annual or Extraordinary, and is held at the Issuer's registered office. The General Meeting may only adopt resolutions on matters included in the detailed agenda, unless the entire share capital is represented at the General Meeting and no one present at the meeting objects to the adoption of a resolution which has not been included on the agenda. The agenda is proposed by the Management Board or by the party convening the General Meeting.

Pursuant to the provisions of the Commercial Companies Code, a shareholder or shareholders representing at least 5% of the share capital may request that certain matters be placed on the agenda of the forthcoming General Meeting. Moreover, the State Treasury, as a Company shareholder, is entitled to submit such a request, irrespective of the percentage of its ownership interest in the share capital. A General Meeting is convened by the Management Board, which in this respect acts:

1. On its own initiative;
2. At the request of a shareholder or shareholders representing at least 5% of the share capital, made in a written or electronic form;
3. At the request of the State Treasury as a Company shareholder, irrespective of the percentage of its ownership interest in the Company's share capital, made in a written or electronic form;
4. At the request of a Supervisory Board member appointed pursuant to Art. 36.1 of the Articles of Association (independent member), made in a written or electronic form;
5. at the written request of the Supervisory Board.

If the Management Board does not convene a General Meeting within two weeks from the date of receiving the relevant request, the registry court may authorise a shareholder or shareholders to convene an Extraordinary General Meeting.

Shareholders representing at least 50% of the share capital or at least 50% of the total voting power may convene an Extraordinary General Meeting.

The Supervisory Board may convene an Annual General Meeting if the Management Board fails to do so within the time limit specified in the Commercial Companies Code or the Articles of Association, or an Extraordinary General Meeting, if the Supervisory Board deems it advisable.

General Meetings are convened by publishing a notice on the Company's website and in any other form prescribed for the purposes of current disclosures under the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies.

The notice should be published at least 26 days before the date of the General Meeting.

The Annual General Meeting is convened by the Management Board once a year, no later than within six months following the end of the financial year.

Votes at the General Meeting are cast in an open ballot. A secret ballot is ordered when voting on the election or removal from office of members of the Issuer's governing bodies or on appointment of its liquidator, on bringing members of the Issuer's governing bodies or its liquidator to account, and on personnel matters. Furthermore, a secret ballot is ordered if at least one shareholder present or represented at the General Meeting so demands.

The General Meeting adopts resolutions regardless of the number of shares represented at the meeting, unless the provisions of the Commercial Companies Code or the Articles of Association provide otherwise.

Any shareholder is entitled to object to a resolution of the General Meeting, and in accordance with the Rules of Procedure for the General Meeting, should be given an opportunity to concisely present the reasons for such objection. During the Company's General Meeting, each shareholder may submit draft resolutions concerning items on the agenda.

A General Meeting is opened by the Chairman of the Supervisory Board or the Deputy Chairman of the Supervisory Board, or in the event of their absence, by the President of the Management Board or a person appointed by the Management Board. The person opening the General Meeting should procure that the Chair of the Meeting is immediately elected and should refrain from any decisions on the substance of matters or on procedural issues. The Chair of the General Meeting is elected by secret ballot. The Chair's role is to ensure that the meeting proceeds smoothly and that the rights and interests of all the shareholders are respected. The Chair should not resign from their function without a sound reason, and may not unreasonably delay the signing of the minutes of the General Meeting.

Apart from the shareholders, the following persons are entitled to participate in the General Meeting:

1. Members of the Management Board and Supervisory Board, as well as candidates to the Supervisory Board (if the General Meeting is to deal with the appointment of a member or members of the Supervisory Board). The General Meeting may limit the right of Supervisory Board candidates to speak, to issues related directly to the candidacy;
2. Guests invited by the body convening the General Meeting, as well as experts, including auditors of financial statements and members of the Company's legal support staff, invited to present their opinions on and provide clarification of matters included on the agenda, with the proviso that their right to speak may be limited by the General Meeting to those items on the agenda about which they have been invited;
3. Notaries public drawing up the minutes of the General Meeting.

Short breaks in the meeting (technical breaks), which do not constitute adjournments, may be ordered by the Chair, provided that they are not aimed at hindering the exercise of the shareholders' rights.

10.2. Description of key powers of the General Meeting

The General Meeting is the Issuer's constituent body and has the power to adopt resolutions on the following matters:

1. Review and approval of the financial statements for the preceding financial year and the Directors' Report on the Issuer's operations;
2. Approval of performance of duties by members of the Issuer's governing bodies;
3. Distribution of profit or coverage of loss;
4. Determination of the dividend record date or a decision on payment of dividend in instalments;
5. Appointment and removal of Supervisory Board members;
6. Review and approval of the Group's consolidated financial statements and the Directors' Report on the Group's operations for the preceding financial year;
7. Suspension of members of the Management Board from their duties, or their removal from office;
8. Disposal or lease of the Issuer's business or its organised part, or creation of limited property rights therein;
9. Disposal of non-current assets within the meaning of the Accounting Act of September 29th 1994, classified as intangible assets, property, plant and equipment or long-term investments, including contribution thereof to a company or cooperative, if the market value of such assets exceeds PLN 100,000,000 or 5% of total assets within the meaning of the Accounting Act of September 29th 1994, as determined based on the most recent approved financial statements, as well as granting a third party the right to use such assets for a period of more than 180 days in a calendar year, on the basis of a legal transaction, if the market value of the assets covered by such legal transaction exceeds PLN 100,000,000 or 5% of total assets, with the proviso that if the right to use the assets is granted under:
   a) lease or rental agreements or other agreements for granting rights to use an asset for a consideration by a third party − the market value of the asset is the amount of the consideration for:
   – one year − if the right to use the asset has been granted under an agreement concluded for an indefinite term,
   – the entire term of the agreement − if the right to use the asset has been granted under an agreement concluded for a definite term,
   b) lending agreements or other agreements for granting rights to use an asset free of charge by a third party − the market value of the asset is the amount of the consideration which would have been payable if a lease or rental agreement had been concluded, for:
   – one year − if the right to use the asset is to be granted under an agreement concluded for an indefinite term,
   – the entire term of the agreement − if the right to use the asset has been granted under an agreement concluded for a definite term;
10. Acquisition of non-current assets within the meaning of the Accounting Act of September 29th 1994 if the value of such assets exceeds PLN 100,000,000 or 5% of total assets within the meaning of the Accounting Act of September 29th 1994, as determined based on the most recent approved financial statements;
11. Acquisition of or subscription for shares in another company, if the value of the shares exceeds PLN 20,000,000 or 10% of total assets within the meaning of the Accounting Act of September 29th 1994, as determined based on the most recent approved financial statements, subject to Art. 56.6;
12. Disposal of shares in another company, if the value of the shares exceeds PLN 10,000,000 or 10% of total assets within the meaning of the Accounting Act of September 29th 1994, as determined based on the most recent approved financial statements, subject to Art. 56.6;
13. Conclusion by the Issuer of a loan, borrowing, surety or similar agreements with or for the benefit of a member of the Management or Supervisory Board, a commercial proxy or a liquidator;
14. Increase or reduction of the Issuer's share capital;
15. Issue of convertible bonds or bonds with pre-emptive rights, issue of subscription warrants;
16. Acquisition of the Issuer's own shares for the purpose of offering them to the Issuer's employees or to persons who were employed by the Issuer or its related entities for at least three years;
17. Mandatory buy-back of shares;
18. Creation, use and liquidation of capital reserves;
19. Use of statutory reserve funds;
20. Decisions on claims for redress of any damage caused in connection with the Issuer's formation or the exercise of management or supervisory duties;
21. Merger, transformation or demerger of the Issuer;
22. Relocation of the Issuer's registered office abroad;
23. Establishment of preference on shares;

24. Establishment of an European company (societas Europaea), transformation into or joining such company;
25. Amendments to the Issuer's Articles of Association and changes in its business profile;
26. Dissolution and liquidation of the Issuer;
27. Definition of the rules and amounts of remuneration of Supervisory Board members and the rules of remuneration of Management Board members;
28. Subscription, acquisition or disposal of shares in companies of the PGNiG Group which operate, pursuant to generally applicable laws, as a distribution system operator or storage system operator, including definition of the terms and procedures for the disposal.

10.3. Shareholders' rights at General Meetings and their exercise

Shareholders have the right to participate in General Meetings and to exercise the voting rights attached to their shares.

Each shareholder of the Issuer has the right to participate in General Meetings, with one share conferring the right to one vote.

Only persons who have been the Issuer's shareholders for at least 16 days prior to the date of the General Meeting (the record date for participation in the General Meeting) are entitled to participate in the General Meeting. The record date for participation in the General Meeting is the same for the holders of rights under bearer shares and under registered shares.

Holders of rights under registered shares or provisional certificates as well as pledgees and usufructuaries holding voting rights are entitled to participate in the General Meeting, provided that they are entered in the share register on the record date for participation in the General Meeting.

Bearer shares in certificated form entitle their holders to participate in the General Meeting if the share certificates are submitted with the Company no later than on the record date for participation in the General Meeting and are not collected prior to the end of that day. In place of their shares, a shareholder may submit a document confirming that their shares have been deposited with a notary public, bank or investment firm having its registered office or a branch in the European Union, or in a state which is a party to the treaty on the European Economic Area, as indicated in the notice of the General Meeting. The document should specify the serial numbers of the share certificates and should state that the share certificates will not be released prior to the end of the record date for participation in the General Meeting.

The list of entities entitled to participate in the General Meeting as holders of rights under bearer shares is determined based on the shares submitted with the Company and on a list prepared by Krajowy Depozyt Papierów Wartościowych S.A. (Central Securities Depository of Poland), in accordance with the provisions of the Act on Trading in Financial Instruments.

Shareholders may participate in the General Meetings and exercise their voting rights in person, through a representative or through a proxy. Powers of proxy should be granted in a written or electronic form. A written or electronic document confirming the right to represent a shareholder at the General Meeting is deemed legally valid and needs no other confirmation, unless the Management Board or the Chair of the General Meeting has doubts, prima facie, about its authenticity or validity.

Shareholder(s) representing at least 5% of the Issuer's share capital, as well as the State Treasury (irrespective of the percentage of its ownership interest in the Issuer), may demand that the General Meeting be convened, provided that they submit the request in a written or electronic form. If the Management Board fails to convene a General Meeting at the request of the shareholder(s) within two weeks from the date the request was submitted, the registry court may, after demanding a relevant statement from the Management Board, authorise the shareholder(s) to convene the meeting. Additionally, shareholders representing at least 5% of the Issuer's share capital may request that certain matters be placed on the agenda of the forthcoming General Meeting. The same right is held by the State Treasury, irrespective of the percentage of its ownership interest in the Issuer. Any such request must be made in the Polish language and sent to the Issuer in a written or electronic form. The request should contain the grounds for, or draft resolutions of, the proposed agenda items, and should be submitted to the Management Board no later than 21 days before the scheduled date of the General Meeting. A shareholder or shareholders representing at least 5% of the Issuer's share capital may, before a General Meeting, submit to the Company, in a written or electronic form, draft resolutions on items which have been, or are to be, placed on the agenda of the General Meeting. Any item included on the agenda of the General Meeting may, at the request of the shareholder(s), be removed or abandoned only if a relevant resolution is passed by a majority of three quarters of votes and if all the shareholders that made the request and attend the meeting consent to such removal or abandonment.

The Company's Articles of Association do not provide for the possibility of participating in the General Meeting by means of electronic communication (including speaking at the General Meeting by means of electronic communication), or of exercising voting rights by postal ballot or by means of electronic communication.

At the request of shareholders representing at least 20% of the share capital, the Supervisory Board is elected by way of block voting. Shareholders at the General Meeting representing that portion of the shares resulting from division of the total number of represented shares by the number of Supervisory Board members, may form a block to elect one member of the Supervisory Board, but do not then participate in the elections of other members. Shareholders that belong to a block may exercise their voting rights exclusively within the block, which means that the shares held by them cannot be divided. The number of Supervisory Board members that may be elected within a block is determined by dividing the number of shares represented by the block by the minimum number of shares necessary to form a block. If a position on the Supervisory Board that should be filled by an appropriate block remains vacant, it is filled by the vote of all shareholders not participating in the block voting.

At the General Meeting, the Management Board is required to provide shareholders – at their request – with information on the Issuer, if such information is needed to assess an item on the Meeting's agenda. The Management Board may refuse to provide information if this could adversely affect the Issuer, its affiliate, or its subsidiary company or cooperative, especially through disclosure of any technical, trade or organisational secrets.

A Management Board member may refuse to provide information if this could lead to their criminal, civil or administrative liability.

In justified cases, the Management Board may provide information in writing within two weeks of being requested to do so at the General Meeting.

An answer is deemed to have been given if the relevant information is available on the Issuer's website in the section dedicated to shareholders' questions and answers to the questions.

Information on the Issuer may also be provided outside the General Meeting. Such information, along with indication of when and to whom it was provided, should be disclosed by the Management Board in writing in the materials to be presented at the next General Meeting. These materials need not include information which has been made publicly available, including by way of current reports issued pursuant to Par. 38.1.12 of the Regulation, or provided at the General Meeting.

A shareholder may require that a list of shareholders be sent to him/her free of charge by email, may inspect the book of minutes or demand to be given copies of the resolutions of the General Meetings certified as true copies by the Management Board.

Moreover, a shareholder may request to be provided with certified copies of proposals to the items included on the agenda one week before a General Meeting. Copies of the Directors' Report on the Company's operations and of the financial statements, along with copies of the Supervisory Board's report and the auditor's opinion, are provided to the shareholders at their request, not later than fifteen days before the Annual General Meeting.

At General Meetings, attending shareholders may propose procedural motions, including motions to change the sequence of items on the agenda, or to order a break. Each shareholder may also request that a matter be voted on by way of secret ballot.

The Issuer has its own website, where the following information is made available from the date of the convening of a General Meeting:

1. Notice of the General Meeting;
2. Information on the total number of Company shares and the number of votes attached to such shares as at the notice date, and on types of shares and the number of votes attached to the shares of each type (if such variety exists);
3. Documents to be presented to the General Meeting;
4. Draft resolutions or – if no resolutions are planned to be adopted – comments by the PGNiG Management or Supervisory Board on matters which have been placed on the agenda or are to be placed on the agenda prior to the General Meeting.

11. Composition and activities of the Issuer's management, supervisory and administrative bodies or their committees; changes in their composition during the last financial year

11.1. Operation of management bodies – Management Board

11.1.1. Composition of the Management Board

<u>As at January 1st 2017</u>

1. Piotr Woźniak − President
2. Maciej Woźniak – Vice President, Trade
3. Łukasz Kroplewski – Vice President, Development
4. Michał Pietrzyk – Vice President, Finance
5. Radosław Bartosik − Vice President, Chief Operating Officer
6. Waldemar Wójcik – Vice President.

- On March 6th 2017, the Supervisory Board removed Mr Waldemar Wójcik from the PGNiG Management Board and from his position as Vice President of the Management Board, following the expiry of his term of office;

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

<u>As at December 31st 2017</u>

1. Piotr Woźniak − President
2. Maciej Woźniak – Vice President, Trade
3. Łukasz Kroplewski – Vice President, Development
4. Michał Pietrzyk – Vice President, Finance
5. Radosław Bartosik − Vice President, Chief Operating Officer
6. Magdalena Zegarska – Vice President.

11.1.2. Rules governing the operation of the Management Board

The operation of the Management Board is defined in its Rules of Procedure, adopted by the Management Board and approved by the Supervisory Board.

The Rules of Procedure for the Management Board are available on the Issuer's website at www.pgnig.pl/lad-korporacyjny/zarzad/regulamin.

The Management Board is composed of two to seven members. The number of Management Board members is determined by the Supervisory Board, being the body authorised to appoint individual Management Board members, or the entire Management Board. Management Board members are appointed for a joint term of three years. As long as the State Treasury holds Issuer shares and the Issuer's annual average headcount exceeds 500, the Supervisory Board appoints as a Management Board member one person elected by the employees, to serve for the Management Board's term of office.

The Management Board manages the affairs of the Issuer and represents the Issuer in and out of court. The powers and responsibilities of the Management Board involve management of all of the Issuer's affairs, other than those which the law or the Issuer's Articles of Association reserve for the General Meeting or the Supervisory Board. The Management Board is headed by the President of the Management Board.

The responsibilities of the Management Board particularly include:

1. Preparation of annual business plans, including investment plans, the strategy for the Company and the PGNiG Group, as well as long-term strategic plans, and their submission to the Supervisory Board for approval;
2. Submission, upon each request, of detailed reports on the performance of the activities undertaken with a view to ensuring Poland's energy security to the minister competent for matters pertaining to energy;
3. Submission to the minister competent for matters pertaining to energy, within two months from the closing of the General Meeting approving the financial statements and the Directors' Reports of the Company's subsidiaries and related companies, of annual reports on the matters listed below, with an assessment of their content in the context of Poland's energy security:
   a) Implementation of strategic investment projects or involvement in investment projects that result in a lasting or temporary deterioration of the economic efficiency of such subsidiary or related company but are required for ensuring the energy security of Poland,
   b) Entry by the operator or owner of a distribution system or an interconnection gas pipeline into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a transmission network, distribution network, interconnection gas pipeline or direct gas pipeline, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000;
   c) Entry by the operator or owner of a storage facility into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a storage facility, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000;
   d) Entry by the owner of a generation unit or a cogeneration unit into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a generation unit or cogeneration unit, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000;
   e) Entry into an obligational relationship with a foreign entity for hydrocarbon exploration, appraisal or production, within the meaning of the Polish Geological and Mining Law, if the value of the obligational relationship exceeds the PLN equivalent of EUR 5,000,000,
   - with the proviso that items a) to e) above do not apply to information on credit agreements or maintenance services, including overhauls, geophysical, drilling and well services and projects, nor to services or deliveries under such agreements or projects.
   - item e) does not apply to information on the activities of a foreign subsidiary's contracts and agreements concluded as part of the day-to-day management of the organisational structure, including employment contracts, use of assets where the related liabilities are equal to or less than EUR 5,000,000, and day-to-day administrative expenses;
4. Submission of relevant information to the minister competent for matters pertaining to energy, within 21 days from the closing of the General Meeting of a subsidiary or related company which addressed the following matters:
   a) Strategic investment projects or involvement in investment projects that result in a lasting or temporary deterioration of the economic efficiency of such subsidiary or related company but are required for ensuring the energy security of Poland,
   b) Entry by the operator or owner of a distribution system or an interconnection gas pipeline into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a transmission network, distribution network, interconnection gas pipeline or direct gas pipeline, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,
   c) Entry by the operator or owner of a storage facility into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a storage facility, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,

d) Entry by the owner of a generation unit or a cogeneration unit into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a generation unit or cogeneration unit, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,

e) Entry into an obligational relationship with a foreign entity for hydrocarbon exploration, appraisal or production, within the meaning of the Polish Geological and Mining Law, if the value of the obligational relationship exceeds the PLN equivalent of EUR 5,000,000,

f) Approval of annual budgets, with detailed information on resolutions adopted by the General Meeting of the subsidiary or related company on the matters specified in items a) to f), with an assessment of their implications for the country's energy security,

- the above does not apply to information on credit agreements and maintenance services, including overhauls, geophysical, drilling and well services and projects, as well as services or deliveries under such agreements or projects.
- item e) does not apply to information on the activities of a foreign subsidiary's contracts and agreements concluded as part of the day-to-day management of the organisational structure, including employment contracts, use of assets where the related liabilities are equal to or less than EUR 5,000,000, and day-to-day administrative expenses;

5. preparation of economic and financial reviews of the Company and its subsidiaries acting as distribution or storage system operators in the form defined by the minister competent for matters pertaining to energy, and submission of the same to the minister competent for matters pertaining to energy by the end of the month in which a periodic report was published at the Warsaw Stock Exchange;
6. submission of a report on entertainment expenses, legal costs, marketing costs, public relations and social communication expenses, and costs of management advisory services, along with the Supervisory Board's opinion, to the General Meeting.

The Management Board submits to the Supervisory Board the following documents for assessment: financial statements for the preceding financial year, with the auditor's opinion; the Directors' Report on the Issuer's operations in the preceding financial year, and a proposal for distribution of profit or coverage of loss for that financial year. These documents should be submitted without the Management Board being called upon to do so, and with sufficient time for the Supervisory Board to assess them before they are presented to the General Meeting.

Declarations of intent may be made on behalf of the Issuer by two Management Board members acting jointly or one Management Board member acting jointly with a commercial proxy. Any matters which fall beyond the scope of the day-to-day management of the Issuer's affairs require adoption of a resolution.

In particular, the Management Board adopts resolutions on the following matters:

1. Adoption of the Management Board's rules of procedure;
2. Adoption of organisational rules for the Issuer's business;
3. Establishment and closure of branches;
4. Appointment of commercial proxies;
5. Division of powers between the Management Board members, provided that a relevant resolution of the Management Board must be approved by the Supervisory Board;
6. Appointment and removal from office of members of the governing bodies of the company's subsidiaries or related companies, to the permitted extent of the company's powers;
7. Contracting and extending loans and contracting credit facilities, except where the Articles of Association require the Supervisory Board's approval of or opinion on the transaction;
8. Adoption of annual business plans, including investment plans, subject to their approval by the Supervisory Board;
9. Adoption of the strategy for the Company and the PGNiG Group and long-term strategic plans, subject to the approval of the Supervisory Board;
10. Assumption of contingent liabilities, including extension by the Issuer of guarantees and sureties, as well as issuance of promissory notes, except where the Articles of Association require the Supervisory Board's approval or opinion;
11. Acquisition or disposal of non-current assets, including property, perpetual usufruct rights or interests in property, with a value equal to or higher than the equivalent of PLN 200,000, except where the Articles of Association require the Supervisory Board's approval or a resolution of the General Meeting;
12. Matters to be considered by the Supervisory Board or the General Meeting upon the Management Board's request;
13. Adoption of detailed reports on the performance of tasks undertaken with a view to ensuring the country's energy security, which are submitted, upon each request, to the minister competent for matters pertaining to energy;
14. Formation of another company, subscription for, acquisition or disposal of shares in another company, including definition of the terms and procedures for their disposal, with a proviso that formation of a company with a share capital exceeding the PLN equivalent of EUR 2,000,000, as well as subscription for, acquisition or disposal of shares in another company with a value exceeding the PLN equivalent of EUR 2,000,000, require approval by the Supervisory Board (or an opinion of the same where approval by the General Meeting is required), and with a further proviso that approval by the General Meeting is required for subscription for, acquisition or disposal of shares in companies of the PGNiG Group which, pursuant to generally applicable laws, act as distribution or storage system operators, including definition of the terms and procedure for such disposal;
15. Donations, release of debtors from their debt obligations and entry into other agreements beyond the scope of business defined in the Articles of Association;
16. Execution of sale or purchase transactions and contracts or other disposal agreements, as well as the making of declarations of intent and assumption of liabilities in respect of: gas fuels (including LNG and LNG regasification), crude

oil, natural gasoline, other oil and gas derivatives, electricity, heat, emission allowances for greenhouse gases or other substances; property rights under certificates of origin for electricity, hard coal, lignite, biomass, ancillary control services, other derivative rights based on gas fuels or electricity; other financial instruments and commodities, provision of transmission capacities for electricity, performance of balancing and dispatching services or provision of transmission capacities for gas fuels with a value exceeding 20% of the Issuer's share capital (however, in the case of contracts with a value exceeding the PLN equivalent of EUR 100,000,000, an opinion of the Supervisory Board is required, except where the Articles of Association specifically require the Supervisory Board's approval);

17. Entry into legal transactions other than those listed in items 1 to 16 if their value exceeds the PLN equivalent of EUR 400,000.

In those matters which do not require adoption of a Management Board resolution, each Management Board member attends to the responsibilities assigned to them on an individual basis. During Management Board meetings, each Management Board member has the duty to brief the other Management Board members on their material decisions and the results of their supervisory work, in particular with respect to the Issuer's business units, in accordance with the division of powers between the Management Board members.

Management Board meetings are held as needed. Each Management Board member may submit a request to the President of the Management Board (or acting President) to call a Management Board meeting in connection with matters requiring an urgent decision by the Management Board or for the purpose of presenting information on matters of significance to the Issuer. The Chairman of the Supervisory Board is also entitled to request that a Management Board meeting be called, by providing the President of the Management Board with a written agenda for the meeting. In addition, the Chairman of the Supervisory Board has the right to demand of the President of the Management Board that certain items be placed on the agenda of a Management Board meeting.

In accordance with the Articles of Association of PGNiG, in justified cases votes may be cast by written ballot or by means of remote communication, with the minutes of such voting to be approved at the next meeting of the Management Board.

The Supervisory Board defines the rules and amounts of remuneration for Management Board members, unless applicable mandatory provisions of law state otherwise.

11.1.3. Management Board meetings and resolutions

In 2017, the Management Board held 48 meetings and passed 675 resolutions, of which 31 were passed by circulation (outside of a meeting) under Art. 21.6 of PGNiG's Articles of Association and Section 4.10 of the Rules of Procedure for the PGNiG Management Board. A recess was ordered during 12 meetings of the Management Board.

In 2017, the General Meeting did not assign any tasks to be performed at the Company.

Recommendations issued in 2017 by the Minister of Energy included:

1. Taking measures by the Company's Supervisory Board to review the amount and rationale of expenses related to advisory agreements;
   The Supervisory Board conducted such review in line with the Minister of Energy's recommendations;
2. Conducting a review by the Company's Supervisory Board to evaluate measures taken to ensure compliance with the requirements applicable under the Act on Rules of Remunerating Persons Who Direct Certain Companies to remunerating management and supervisory board members at PGNiG Group companies.
   The Supervisory Board, with the support of the Management Board, has taken the necessary steps to ensure compliance with such rules of remunerating persons who direct certain companies as are applicable to remunerating management and supervisory board members at PGNiG Group companies;
3. Taking measures by the Company's Supervisory Board to review expenditure on sponsorship activities.
   The Supervisory Board conducted a review of expenditure incurred on sponsorship activities in line with the Minister of Energy's recommendations;
4. Taking measures by the Company's Supervisory Board to review claims for redundancy payments.
   The Supervisory Board has undertaken and is continuing a review of claims for redundancy payments.

11.2. Operation of supervisory bodies – Supervisory Board

11.2.1. Composition of the Supervisory Board

<u>As at January 1st 2017</u>

1. Bartłomiej Nowak – Chairman
2. Wojciech Bieńkowski – Deputy Chairman
3. Magdalena Zegarska – Secretary
4. Sławomir Borowiec – Member
5. Mateusz Boznański – Member
6. Andrzej Gonet – Member
7. Piotr Sprzączak – Member
8. Ryszard Wąsowicz – Member

9. Anna Wellisz − Member.

- Ms Magdalena Zegarska resigned as Member of the PGNiG Supervisory Board, with effect from March 5th 2017, following approval of her candidacy for appointment to the PGNiG Management Board.

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

As at May 30th 2017:

1. Bartłomiej Nowak – Chairman
2. Wojciech Bieńkowski – Deputy Chairman
3. Sławomir Borowiec – Secretary
4. Mateusz Boznański – Member
5. Andrzej Gonet – Member
6. Piotr Sprzączak − Member
7. Anna Wellisz − Member.

- On June 28th 2017, in connection with the expiry of the Supervisory Board's term of office, the Annual General Meeting removed the entire Supervisory Board composed of:

1. Bartłomiej Nowak,
2. Wojciech Bieńkowski,
3. Slawomir Borowiec,
4. Mateusz Boznański,
5. Andrzej Goneta,
6. Piotr Sprzączak,
7. Anna Wellisz,

and appointed, for a joint three-year term of office until June 28th 2020, the Supervisory Board composed of:

1. Bartłomiej Nowak,
2. Piotr Sprzączak,
3. Andrzej Gonet,
4. Piotr Broda,
5. Grzegorz Tchorek,
6. Sławomir Borowiec,
7. Mieczysław Kawecki,
8. 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.

As at December 31st 2017:

1. Bartłomiej Nowak – Chairman
2. Piotr Sprzączak – Deputy Chairman
3. Sławomir Borowiec – Secretary
4. Piotr Broda – Member
5. Andrzej Gonet – Member
6. Mieczysław Kawecki – Member
7. Stanisław Sieradzki – Member
8. Grzegorz Tchorek – Member.

11.2.2. Rules governing the operation of the Supervisory Board

The Supervisory Board operates in accordance with the rules set out in the Commercial Companies Code, the Articles of Association and the Rules of Procedure for the Supervisory Board. The Rules of Procedure for the Supervisory Board have been adopted by a Supervisory Board resolution and are available on the Issuer's website at http://pgnig.pl/lad-korporacyjny/rada-nadzorcza/regulamin.

The Issuer's Supervisory Board is composed of five to nine members appointed by the General Meeting. One Supervisory Board member should meet the independence criteria specified in the Articles of Association. As long as the State Treasury holds Company shares, the State Treasury, represented by the minister competent for matters pertaining to energy, has the right to appoint and remove one member of the Supervisory Board. If the Supervisory Board is composed of up to six members, two members are appointed from among the candidates elected by the Issuer's employees. If the Supervisory Board is composed of seven to nine members, three members are appointed from among the candidates elected by the Issuer's employees.

Supervisory Board members are appointed for a joint term of office lasting three years.

The Supervisory Board exercises ongoing supervision of the Issuer's activities in all areas of its operations, and presents its opinions on all matters submitted by the Management Board for consideration to the General Meeting. The powers and responsibilities of the Supervisory Board particularly include:

1. Assessment of the Directors' Report on the Issuer's operations and of the financial statements for the preceding financial year, in terms of their consistency with the accounting books, supporting documentation, and the actual state of affairs;
2. Assessment of the Management Board's proposals concerning distribution of profit or coverage of loss;
3. Submission to the General Meeting of written reports on results of the activities referred to in items 1 and 2;
4. Assessment of the consolidated financial statements with respect to their consistency with the accounting books, supporting documentation, and the actual state of affairs, as well as assessment of the Directors' Report on the Issuer's operations, and reporting to the General Meeting on the results of these assessments;
5. Appointment of an auditor to audit the financial statements;
6. Approval of annual business plans, including investment plans;
7. Approval of the strategy for the Company and the PGNiG Group and long-term strategic plans;
8. Adoption of detailed rules governing the Supervisory Board's operation;
9. Approval of the consolidated text of the Articles of Association, drawn up by the Issuer's Management Board;
10. Approval of the Rules of Procedure for the Management Board;
11. Approval of the organisational rules for the Issuer's business;
12. Approval of the Management Board's resolution on division of powers between the Management Board members;
13. Giving opinions on all matters submitted by the Management Board for consideration to the General Meeting;
14. Giving opinions on detailed reports on the performance of the activities undertaken with a view to ensuring the energy security of Poland to be submitted by the Management Board to the minister competent for matters pertaining to energy;
15. Giving opinions on requests to be submitted to the shareholder State Treasury, represented by the minister competent for matters pertaining to energy, to approve: 1) any changes to the material provisions of existing trade contracts for import of natural gas to Poland, as well as the execution of new trade contracts, 2) any strategic investment projects or the Company's involvement in investment projects which, permanently or temporarily, impair the economic efficiency of the Company's business activities, but which are necessary to ensure Poland's energy security;
16. Granting approval to the Management Board for:

    a) Acquisition of non-current assets, including real property, perpetual usufruct rights or interests in real property with a value of EUR 2,000,000 or more, except where such a transaction requires approval by the General Meeting or has not been provided for in any annual business plans, including investment plans, long-term strategic plans and investment plans for development of the transmission system, previously approved by the Supervisory Board;

    b) Disposal of non-current assets within the meaning of the Accounting Act of September 29th 1994, classified as intangible assets, property, plant and equipment or long-term investments, including contribution thereof to a company or cooperative, if the market value of such assets exceeds PLN 20,000,000, but does not exceed PLN 100,000,000, as well as granting another entity the right to use such assets for a period longer than 180 days in a calendar year, on the basis of a legal transaction, if the market value of the assets covered by such legal transaction exceeds PLN 20,000,000, but does not exceed PLN 100,000,000, with the proviso that if the right to use the assets is granted under:

    i) lease or rental agreements or other agreements for granting rights to use an asset for a consideration by a third party − the market value of the asset is the amount of the consideration for:
    – one year − if the right to use the asset has been granted under an agreement concluded for an indefinite term,
    – the entire term of the agreement − if the right to use the asset has been granted under an agreement concluded for a definite term,
    ii) lending agreements or other agreements for granting rights to use an asset free of charge by a third party − the market value of the asset is the amount of the consideration which would have been payable if a lease or rental agreement had been concluded, for:
    – one year − if the right to use the asset is to be granted under an agreement concluded for an indefinite term,
    – the entire term of the agreement − if the right to use the asset has been granted under an agreement concluded for a definite term,

    c) Assumption of other liabilities in an amount exceeding 20% of the Company's share capital, except where the liability has been provided for in the plans referred to in item 6, approved by the Supervisory Board, or agreements for the provision of gas fuel transmission or distribution services or amendments to gas fuel trading agreements to the extent they refer to the term of such agreements,

    d) Entry into any of the following agreements:

    1) a donation agreement or any other agreement having a similar effect, with a value exceeding PLN 20,000 or 0.1% of total assets within the meaning of the Accounting Act of September 29th 1994, as determined based on the most recent approved financial statements,
    2) an agreement on release from debt or any other agreement having a similar effect, with a value exceeding PLN 50,000 or 0.1% of total assets within the meaning of the Accounting Act of September 29th 1994, as determined based on the most recent approved financial statements,
    3) any agreement for the provision of legal services, marketing services, public relations and social communication services, or management consultancy services, if the total fees for the services to be provided under such agreement exceed PLN 500,000, VAT exclusive, per year,
    4) any agreement for the provision of legal services, marketing services, public relations and social communication services, or management consultancy services where no maximum fees are specified,
    5) any amendments to an agreement for the provision of legal services, marketing services, public relations or other social communication services, or management consultancy services, which would increase the fees under the agreement above the amount specified in item 3);

e) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a transmission network, distribution network, interconnection gas pipeline or direct gas pipeline, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,
f) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a storage facility, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,
g) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a generation unit or cogeneration unit, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,
h) Entry into an obligational relationship with a foreign entity for hydrocarbon exploration, appraisal or production, within the meaning of the Geological and Mining Law, if the value of the obligational relationship exceeds the PLN equivalent of EUR 5,000,000,

- With the proviso that items e) to h) above do not apply to credit agreements or maintenance services, including overhauls, geophysical, drilling and well services and projects, as well as services or deliveries under such agreements or projects,
- Item h) does not additionally apply to the activities of a foreign subsidiary pertaining to contracts and agreements concluded as part of day-to-day management of the organisational structure, including employment contracts, use of assets where the related liabilities are equal to or less than EUR 5,000,000, and day-to-day administrative expenses.

17. Appointment and removal of Management Board members;
18. Definition of rules and amounts of remuneration for Management Board members, unless applicable mandatory provisions of law state otherwise;
19. Suspension of Management Board members from their duties – for valid reasons, and by an absolute majority of votes;
20. Delegation of Supervisory Board members to temporarily replace Management Board members unable to perform their duties;
21. Conduct of the recruitment and selection procedure referred to in Art. 18 of the Act on State Property Management;
22. Granting of permission for establishment and closure of the Issuer's foreign branches;
23. Granting of permission to Management Board members to accept positions in the governing bodies of other companies, where such permission is required by law;
24. Granting of approval for the Company to form another company with a share capital exceeding the PLN equivalent of EUR 2,000,000, or to subscribe for, acquire or dispose of shares in another company with a value exceeding the PLN equivalent of EUR 2,000,000, including definition of the terms and procedure for such disposal. If a transaction requires approval by the General Meeting, the Supervisory Board only issues an opinion concerning the proposal;
25. Monitoring of the Issuer's debt level;
26. Issue of opinions on Management Board recommendations for appointment or removal of the Issuer's representatives on the management and supervisory boards of System Gazociągów Tranzytowych EuRoPol GAZ S.A. and submission of such recommendations for approval to the shareholder State Treasury, represented by the minister competent for matters pertaining to energy;
27. Issue of opinions on the exercise of voting rights by the Issuer's representative at the General Meeting of System Gazociągów Tranzytowych EuRoPol GAZ S.A.;
28. Approval of how the Issuer's representative should vote at the General Meetings of the distribution system operators, with respect to approval of the operators' annual budgets;
29. Approval of how the Issuer's representative should vote at the General Meetings of the distribution system operators, with respect to approval of the operators' long-term strategic plans;
30. Approval of how the Issuer's representative should vote at the General Meetings of the distribution system operators, with respect to:
a) Amendments to the company's articles of association;
b) Increase or reduction in the company's share capital;
c) Merger, transformation or demerger of the company;
d) Sale of company shares;
e) Sale or lease of, or creation of limited property rights in, the company's business or its organised part;
f) Dissolution and liquidation of the company;
g) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a distribution network, interconnection gas pipeline or direct gas pipeline, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000, excluding credit agreements and maintenance services, overhauls, well services and projects, as well as services or deliveries under such agreements or projects.
31. Approval of how the Issuer's representative should vote at the General Meetings of the storage system operators, with respect to:
a) Amendments to the company's articles of association;
b) Increase or reduction in the company's share capital;
c) Merger, transformation or demerger of the company;
d) Sale of company shares;
e) Sale or lease of, or creation of limited property rights in, the company's business or its organised part;
f) Dissolution and liquidation of the company;

g) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a storage unit, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000, excluding credit agreements and maintenance services, overhauls, well services and projects, as well as services or deliveries under such agreements or projects.

32. Approval of how the PGNiG representative should vote at the General Meeting of a company in which the Company holds at least a 50% interest, or which owns a transmission network, a distribution network, an interconnection gas pipeline, a direct gas pipeline, a storage facility, or a generation or cogeneration unit (in the case of companies owning generation or cogeneration units – provided they are engaged in energy trading activities within the meaning of the Energy Law), subject to items 30 and 31, with respect to the following matters:
    a) Amendments to the company's articles of association;
    b) Increase or reduction in the company's share capital;
    c) Merger, transformation or demerger of the company;
    d) Sale of company shares;
    e) Sale or lease of, or creation of limited property rights in, the company's business or its organised part;
    f) Dissolution and liquidation of the company;
    g) Creation of pledges or other forms of encumbrance over company shares;
    h) obligating shareholders to make contributions to equity,
    i) Issue of bonds/notes;
    j) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a transmission network, distribution network, interconnection gas pipeline or direct gas pipeline, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000;
    k) Entry into an obligational relationship with a foreign entity in relation for the planning, analysis, construction, expansion or disposal of a storage facility, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000;
    l) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a generation unit or cogeneration unit, within the meaning of the Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000;
    m) Entry into an obligational relationship with a foreign entity for hydrocarbon exploration, appraisal or production, within the meaning of the Geological and Mining Law, if the value of the obligational relationship exceeds the PLN equivalent of EUR 5,000,000,
    - With the proviso that items j) to m) above do apply to credit agreements or maintenance services, including overhauls, geophysical, drilling and well services and projects, as well as services or deliveries under such agreements or projects,
    - Item m) does not additionally apply to a foreign subsidiary's activities pertaining to contracts and agreements concluded as part of the day-to-day management of the organisational structure, including employment contracts, use of assets where the related liabilities are equal to or less than EUR 5,000,000, and day-to-day administrative expenses.
33. Giving opinions on the Management Board proposals for assumption of liabilities in an amount exceeding the PLN equivalent of EUR 100,000,000.
34. Giving opinions on the Management Board's reports on entertainment expenses, legal costs, marketing costs, public relations and social communication expenses, and costs of management advisory services.

Supervisory Board meetings are convened by the Chairman or Deputy Chairman of the Supervisory Board any time the Issuer's interest so requires, but no less frequently than once every two months. Supervisory Board meetings are also convened at the request of a Supervisory Board member, or at the request of the Management Board. The Supervisory Board express its opinions exclusively in the form of resolutions. The Supervisory Board may adopt resolutions if at least 50% of its members are present at a meeting, and all the members have been invited to participate. The Supervisory Board may only adopt resolutions on matters included on the agenda, which however can be amended if all members are present at a meeting and no member objects to the agenda being amended. The Supervisory Board adopts resolutions in an open vote by an absolute majority of votes. A secret ballot is ordered at the request of a Supervisory Board member or when the matter put to vote concerns personnel matters. Members of the Management Board may be invited to participate in Supervisory Board meetings. In order to be valid, a resolution of the Supervisory Board on appointment of an auditor requires a favourable vote from a member of the Supervisory Board who meets the independence criteria defined in the Issuer's Articles of Association. Except as specified in the Rules of Procedure for the Supervisory Board, the Supervisory Board may adopt resolutions by written ballot or by means of remote communication. Adoption of a resolution using any of these methods must be justified, and a draft resolution must be made available to all Supervisory Board members beforehand.

The Chairman of the Supervisory Board is entitled to request that a Management Board meeting be called, by providing the President of the Management Board with a written agenda for the meeting. The Chairman of the Supervisory Board has the right to demand of the President of the Management Board that certain items be placed on the agenda of a Management Board meeting. The Management Board must submit the following documents to the Supervisory Board for assessment: financial statements for the preceding financial year, with the auditor's opinion; the Directors' Report on the Issuer's operations in the preceding financial year, and a proposal for distribution of profit or coverage of loss for that financial year. These documents should be submitted without the Management Board being called upon to do so, and with sufficient time for the Supervisory Board to assess them before they are presented to the General Meeting.

The Supervisory Board or its members delegated to individually perform certain supervisory functions are authorised to supervise all areas of the Issuer's activity, and in particular to examine all of the Issuer's documents, demand that the Issuer's Management Board and employees produce reports and explanations, or review the Issuer's assets.

The Supervisory Board may appoint standing or ad hoc committees (established as needed), to act as the Supervisory Board's collegiate advisory and opinion-forming bodies. The Supervisory Board also has the right to seek opinions from legal counsels and to engage experts in relevant fields to provide opinions on matters within the Supervisory Board's range of competence.

The amount of remuneration to be received by Supervisory Board members is set by the General Meeting, pursuant to the Act of June 9th 2016 on Remunerating Persons Who Direct Certain Companies (Dz.U. of 2017, item 2190).

For important reasons, the Supervisory Board may delegate individual members to perform certain supervisory functions independently for a specified term. A Supervisory Board member so delegated must submit written reports to the Supervisory Board on all actions taken.

11.3. Committees

In 2017, there was one committee operating at the Company – the Audit Committee. The Audit Committee is composed of at least three Supervisory Board members, of whom at least one has expertise and competence in accounting or auditing of financial statements.

In 2017, the Audit Committee held 6 meetings and passed 12 resolutions. The Committee did not adopt any resolutions by written ballot or by means of remote communication. At three of its meetings, the Audit Committee met with the auditor and at two of those meetings performed a review and assessment of the Company's financial reporting system.

Composition of the Audit Committee

- from January 1st 2017 to March 5th 2017:

1. Mateusz Boznański – Chairman of the Audit Committee
2. Magdalena Zegarska − Deputy Chairman of the Audit Committee
3. Wojciech Bieńkowski – Member of the Audit Committee
4. Bartłomiej Nowak – Member of the Audit Committee
5. Piotr Sprzączak – Member of the Audit Committee.

- from March 6th 2017 to June 28th 2017:

1. Mateusz Boznański – Chairman of the Audit Committee
2. Piotr Sprzączak − Deputy Chairman of the Audit Committee
3. Wojciech Bieńkowski – Member of the Audit Committee
4. Bartłomiej Nowak – Member of the Audit Committee.

- from June 29th 2017

1. Bartłomiej Nowak – Member of the Audit Committee
2. Piotr Broda – Member of the Audit Committee
3. Grzegorz Tchorek – Member of the Audit Committee.

- from August 17th 2017 until the end of 2017:

1. Grzegorz Tchorek – Chairman of the Audit Committee
2. Piotr Broda − Deputy Chairman of the Audit Committee
3. Bartłomiej Nowak – Member of the Audit Committee.

11.3.1. Rules governing the operation of the Audit Committee

The Audit Committee operates within the Supervisory Board as a standing committee, advising the Supervisory Board on matters for which the Board is responsible.

In accordance with the Rules of Procedure for the Audit Committee of the Supervisory Board, the Audit Committee is composed of at least three Supervisory Board members, of whom at least one has expertise and competence in accounting or auditing of financial statements.

Most of the Audit Committee members, including its Chair, are independent of the Company, i.e. they meet the independence criteria referred to in Art. 129.3 of the Act of May 11th 2017 on Statutory Auditors, Audit Firms, and Public Oversight.

Audit Committee members should have expertise and skills specific to the industry in which the Company operates. This requirement is deemed satisfied if at least one Audit Committee member has expertise and skills specific to that industry, or individual members have expertise and skills specific to different aspects of that industry.

Members of the Audit Committee are appointed by the Supervisory Board from among its members on a rotational basis, so as to avoid attaching importance to the presence of any particular persons.

Meetings of the Audit Committee are held as needed, but at least once every six months, and are convened by the Chair of the Committee.

The Chair of the Audit Committee may invite other members of the Supervisory Board to an Audit Committee meeting, as well as members of the Issuer's Management Board, the Issuer's employees, or other persons whose participation in a given meeting is considered important to the performance of the Committee's duties. The Audit Committee may adopt resolutions if at least a half of its members are present at a meeting and all the members have been properly invited. The Committee may adopt its resolutions by written ballot or by means of remote communication. Resolutions of the Audit Committee are adopted by a simple majority of votes cast. In the event of a tied vote, the Chair of the Audit Committee has the casting vote.

Every six months, the Audit Committee submits reports on its activities to the Supervisory Board. Each report is made available to the Issuer's shareholders at the next General Meeting.

The Audit Committee's responsibilities include in particular those set down in Art. 130 of the Act of May 11th 2017 on Statutory Auditors, Audit Firms, and Public Oversight, e.g.:

a) monitoring of:
   - the financial reporting process;
   - effectiveness of the internal control and risk management systems and the internal audit function, including with regard to financial reporting,
   - performance of financial audit tasks, including the audit of financial statements performed by an audit firm, with account taken of all conclusions and findings from an inspection of the audit firm by the Polish Audit Oversight Commission;
b) oversight and monitoring of the statutory auditor's and the audit firm's independence in the context of fee caps on permitted non-audit services provided to the audited Company;
c) informing the Supervisory Board or other supervisory or control body of the Company of the audit findings and explaining how the audit contributed to the reliability of the Company's financial reporting and what role the Audit Committee played in the audit;
d) assessing the auditor's independence and approving the provision of permitted non-audit services by the auditor;
e) developing a policy for selection of an audit firm to perform audits;
f) developing a policy for the provision of permitted non-audit services by the audit firm, its related entities, or members of its network;
g) establishing an audit firm selection procedure for the Company;
h) submitting to the Supervisory Board or other supervisory or control body, or the governing body referred to in Art. 66. 4 of the Accounting Act of September 29th 1994, a recommendation referred to in Art. 16.2 of Regulation (EU) No 537/2014, in accordance with the policies referred to in items e and f;
i) The recommendation on the selection of an auditor should name the audit firm recommended for appointment and include a statement that the recommendation is free from influence by a third party and that the audited public interest entity has not entered into any agreements including clauses referred to in Art. 66.5a of the Accounting Act of September 29th 1994.
j) submitting recommendations to ensure the reliability of the financial reporting process at the Company.

11. Non-financial statement of the PGNiG Group

This statement has been prepared in accordance with the article 49b and 55 of the Accounting Act, which requires public-interest entities to disclose their non-financial data.

This statement covers selected indicators of the G4 Global Reporting Initiative standards and the PGNiG Group's own indicators.

11.1. General information

The statement covers the entire PGNiG Group, i.e. Polskie Górnictwo Naftowe i Gazownictwo S.A. ("PGNiG S.A.") and its 23 subsidiaries. In detail, the business model of the PGNiG Group, the structure of the PGNiG Group and the description of business segments are presented in the following sections of this Directors' Report on the Operations of PGNiG SA and the PGNiG Group.

PGNIG Group's business model › For more information, see Section 2.1.

PGNiG Group's structure › For more information, see Section 2.2. and 6

Business segments › For more information, see Section 5.

11.1.1. PGNiG Group's supply chain

The PGNiG Group is the leader of the Polish natural gas market with modern and efficiently managed organisation controlling almost the entire value chain in the gas sector, and holding assets in the fuel and power generation sectors.

The Group comprises companies with diverse business profiles, placed along the value chain. Each member of the PGNiG Group operating in, or supporting, the four key segments ("Exploration and Production", "Trade and Storage", "Distribution", "Generation") follows its own separate supplier policy. The PGNiG Group cooperates with tens of thousands of suppliers.

The diversified business structure requires a diverse supply chain. Although PGNiG works mainly with suppliers from Poland, the list of its suppliers features companies from almost every country of the world (including the EU member states, Qatar, Norway, the United States, or Russia).

	Supply chain
Exploration and Production	distributors, manufacturers, subcontractors, wholesalers, consultants, service providers, seismic, drilling and well servicing companies, subcontractors, distributors and manufacturers, brokers, consultants, manufacturers of drilling rigs, well and auxiliary services, manufacturers and distributors of spare parts and materials, retailers of small equipment items, warehouses, workshops, providers of freight, transport as well as maintenance and repair services, suppliers of geophysical equipment necessary for production, IT services providers, automotive industry companies, suppliers of ready-to-use machinery and equipment
Trade and Storage	brokers, consultants, contractors, distributors, producers of raw materials, subcontractors, wholesalers commodity exchanges, wholesale companies, gas storage companies, towns, electricity producers, gas suppliers, IT services providers, automotive industry companies, suppliers of ready-to-use machinery and equipment
Distribution	advisers, contractors, distributors, independent contractors, producers, subcontractors, wholesalers
Generation	manufacturers; service providers (e.g. insurance, legal); construction companies; installation and assembly companies; rail and road transport; production companies, IT services providers, automotive industry companies, suppliers of ready-to-use machinery and equipment

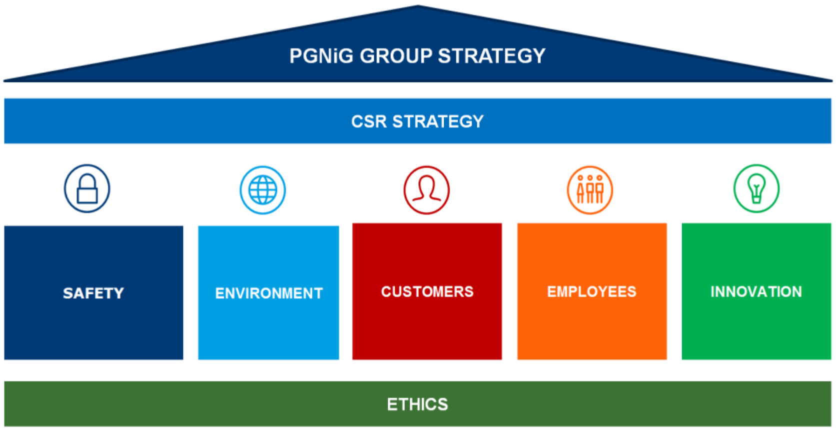
11.2. PGNiG Group Sustainable Development Strategy for 2017−2022

In April 2017, the PGNiG Management Board adopted the PGNiG Group's Sustainable Development Strategy for 2017-2022, which supports and complements the business objectives defined in the PGNiG Group Strategy for 2017-2022.

The PGNiG Group's sustainable development strategy rests on six strategic areas that set sustainable development priorities for the next five years. Considering the nature of business activities conducted by the individual PGNiG Group companies, 13 strategic objectives have been defined under the strategy.

The PGNiG's mission defines the responsibility for ensuring energy security and indicates the concentration of attention on the client and his needs. It also takes into account the specificity of individual and business customers. On the other hand, the vision highlights the innovative nature of the solutions offered by the PGNiG Group.

The awareness of the impact on the environment and responsibility for energy security, rooted in the Group's value system, are the foundations of the new CSR Strategy. Considering safety and innovation, the PGNiG Group companies are committed to meeting the highest standards in terms of transparent corporate culture, relations with employees and customers, pro-social attitudes and environmental protection measures, taking into account the expectations of their interest groups and shareholders.



Area	Subject	Strategic objective
Market	National energy security	Providing customers with access to natural gas, electricity and heat, based on diversified sources and directions of natural gas supplies.
Environment	Environmental protection	Effective care for environmental issues in all business areas. Improving energy efficiency throughout the PGNiG Group's value chain.
	Social capital	Commitment to the development of social and intellectual capital in Poland by opening up to new initiatives and supporting pro bono projects.
	Social communication and dialogue when carrying out investment projects	Dialogue with local communities in accordance with the best standards developed at the PGNiG Group.
Customers	Customer satisfaction	Increasing customer satisfaction by improving service quality and investing in advanced digital communications solutions and tools that meet the needs of various customer groups.
	Development of the offer	Striving to increase the availability of products and services, including through the development of infrastructure in areas not connected to the gas distribution network and tailoring the offering to the highest standards and customer needs.
Employees	Reliable employer	Promoting and implementing good hiring standards by pursuing a professional HR policy and building a friendly workplace.
	Employee development	Development of mentoring and proactive initiatives to ensure the availability of qualified staff.
	Occupational health and safety	Implementation of uniform OHS management standards in order to constantly increase the safety of PGNiG employees, any other persons on PGNiG premises, and the local community.
Innovations	Innovation for development	Active support of the development of cooperation with scientific and research institutions and start-ups or SMEs in order to constantly improve the efficiency of company's operations.
Ethics	System of values	Broadening the employees' knowledge of the ethical values and principles applicable in the work environment. Responsible management of the entire value chain based on transparent cooperation principles taking into account social and environmental criteria as well as human rights.

11.3. Key strategic CSR areas

11.3.1. National energy security

The business activities of the PGNiG Group directly affect Poland's energy security, which in the perspective of sustainable development is reflected in the objective of providing customers with access to natural gas, electricity and heat, based on diversified sources and directions of natural gas supplies. This objective is understood as the PGNiG Group's continuing commitment to the development of natural gas and oil production, gas storage and the provision of diversified sources of supply to customers. In this context of CSR, the key business projects become increasingly important.

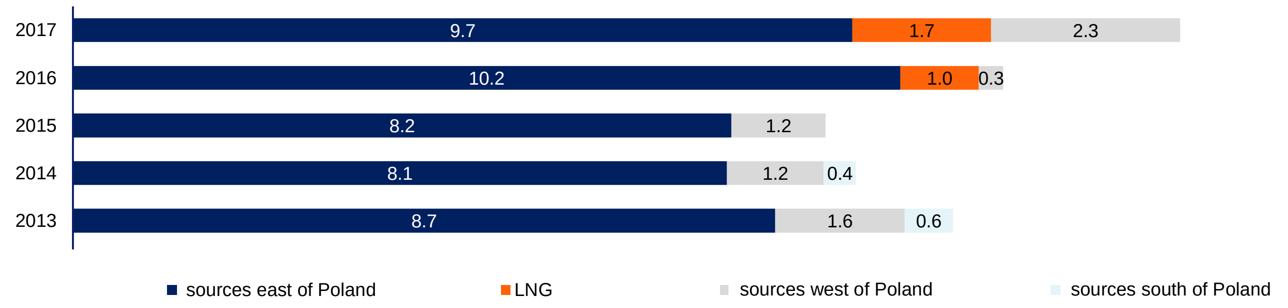
As the leader of the natural gas market in Poland, the PGNiG Group is constantly striving to develop natural gas and crude oil production and gas storage, as well as to provide uninterrupted access to these products to its customers. With this objective in mind, we are diversifying geographical directions of natural gas supplies and conducting exploration and production operations.

Natural gas procurement portfolio

In 2017, PGNiG purchased natural gas mainly under the long-term agreements and contracts as well as short-term gas supply agreements with European suppliers specified below:

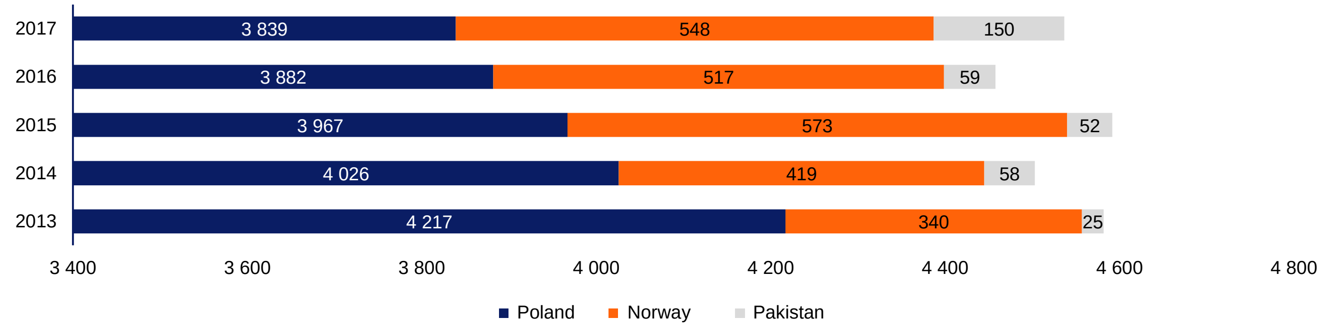
- Contract with OOO Gazprom Export for sale of natural gas to the Republic of Poland, dated September 25th 1996, effective until 2022 (the Yamal Contract);
- Contract with Qatar Liquefied Gas Company Limited (3) for sale of liquefied natural gas, dated June 29th 2009, effective until 2034 (the Qatar Contract).

Imports of natural gas to Poland in 2013-2017 (bcm):



In 2017, purchases of imported gas rose to 13.7 bcm. Gas purchases from the Eastern direction fell by 0.5 bcm compared with 2016. Gas purchases from the Western direction increased to 2.3 mcm. LNG supplies also increased, to 1.7 bcm.

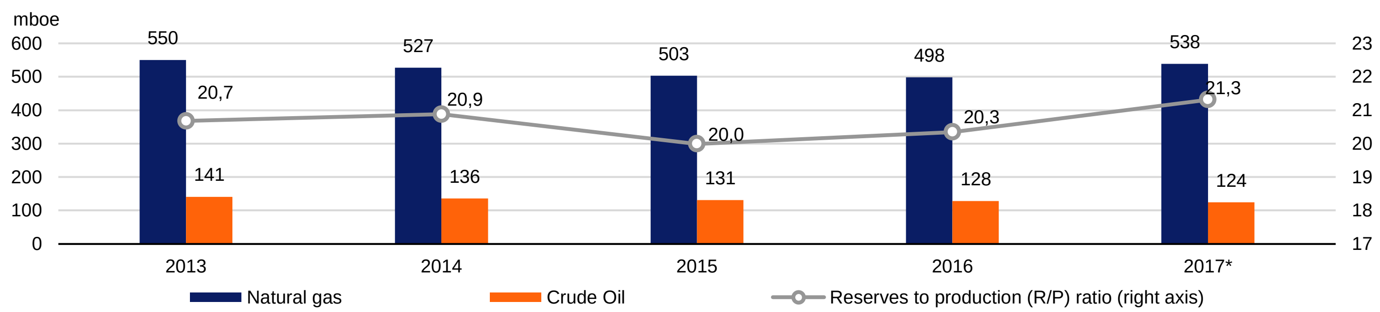
Production of natural gas by the PGNiG Group in million m^3:



Volume and type of estimated reserves

POLAND

Recoverable reserves in Poland in 2013−2017



** Also included are reserve increases specified in the documentation approved by the Commission for Mineral Resources, without the decision of the Minister of the Environment.*

NORWAY

In 2017, there was an increase in proven reserves in Norway, from 78 mboe at the beginning of the year to 83 mboe at the end of 2017 as a result of original underestimation of resources in the Ærfugl and Vilje fields and the acquisition of the Skogul field.

PAKISTAN

Natural gas reserves (nitrogenated): 67.7 million boe (Rehman) and 23.9 million boe (Rizq).

11.3.2. Environment

Taking into consideration contemporary environmental protection challenges related to depletion of natural resources and possible pollution of particular elements of the environment, the PGNiG Group takes steps to minimise any adverse impact on the environment. To support this goal, we develop technical standards for our operations based on applicable legal requirements and best industry practices. We undertake preventive steps in exploration and production, analyse environmental risks and monitor the impact of our activities on the environment. We also use technologies that reduce any adverse environmental impact and maintain management systems within which we implement environmental objectives and tasks seeking to increase environmental efficiency.

The PGNiG Group companies strive to minimise the negative impact of their operations and undertake pro-environmental measures in key areas related to their business activities. Strong commitment on part of the management staff and appropriate preparation of the workforce translate into improved environmental performance of the PGNIG Group, as well as higher quality of its products and services, in compliance with international standards.

Well and extraction pit abandonment

Abandonment of wells and boreholes is performed in accordance with the Geological and Mining Law and applicable secondary legislation. Abandoned wells are permanently marked in the field, in accordance with the Regulation of the Minister of Economy of April 25th 2014 on specific requirements for the operation of mining facilities producing minerals through wells, the Regulation of the Minister of Economy of June 12th 2002 on mining rescue, and with the 'Mine Operations Manager Guidelines on securing, temporary plugging and abandonment of boreholes and wells'.

Environmental protection in drilling operations

Environmental protection initiatives connected with drilling for both conventional and unconventional hydrocarbons are carried out in accordance with the applicable Polish and EU laws, as well as internal good practice documents.

Land reclamation and surveying of non-productive assets

On September 1st 2016, a regulation of the Minister of Environment was adopted concerning the procedure of assessing soil contamination, which necessitated a new approach towards planned remediation of the soil-water environment on non-producing assets where municipal gas production from hard coal in the past caused changes in the environment and local pollution. As part of a remediation plan, priority must be given to tests assessing the state of the environment as well as development of cheaper and more effective methods of removing pollutants.

Underground gas storage facilities

In 2017, environmental monitoring was carried out on the area and in the vicinity of Mogilno CUGSF and Kosakowo CUGSF. The purpose of the monitoring was to determine possible changes in the environment related to the discharged brine on waters of the Puck Bay in the case of Kosakowo CUGSF and the exploitation of the onshore part of the investment in the case of Kosakowo CUGSF and Mogilno CUGSF. The surveys and observations conducted so far indicate that the construction and operation of underground gas storage facilities do not have any negative impacts on the environment.

Mogilno CUGSF continued monitoring of the terrestrial environment, which includes monitoring of surface and underground waters, soil and the tightness of the storage. In 2017, boreholes were drilled and three permanent monitoring probes were installed in the area of three storage chambers.

In the case of Kosakowo CUGSF, environmental monitoring was carried out in the onshore and offshore parts. Monitoring in the onshore part takes into account: monitoring of underground and surface water, soil, land subsidence and storage tightness. In 2017, the concept of a network of replicas was developed to monitor the area subsidence in the Kosakowo CUGSF region. Monitoring in the marine part includes a number of biological, hydrological and technical tests and measurements of the operation parameters of the discharge system.

GSP plans to implement the Integrated Management System ISO 9001, ISO 14001 and OHSAS 18001 in 2018 and to update and/or develop new environmental procedures in line with the new version of the ISO 14001 standard published in 2015. Meeting the requirements of the standard will enable effective achievement of environmental policy objectives and further improvement of the organization in the scope of pro-environmental actions.

GEO-METAN

The GEO-METAN project, launched in 2017, aims to reduce the atmospheric emissions of CH_4. The project assumes that methane will be extracted before hard coal is produced, which in the end will result in lower methane emissions from hard coal mining. In addition, methane is to be used effectively by PGNiG as one of the unconventional sources of natural gas. The research part is scheduled for 10 years.

Raw materials and consumables used (G4-EN1)

Consumption of natural gas, hard coal and lignite at the PGNiG Group in 2015−2017

Total raw materials and consumables used	2017		2016		2015	
	[mln m^3]	[mln Mg]	[mln m^3]	[mln Mg]	[mln m^3]	[mln Mg]
Natural gas	380.3	0	155.1	0	208.1	0
Hard coal	0	2.9	0	2.9	0	2.7
Lignite	0	0	0	0	0	0

Non-renewable raw materials are the basic resource used in the production of electricity and heat at the PGNiG Group. Coal is used to produce electricity and heat mainly in PGNiG TERMIKA Group's CHP plants, while natural gas is used in the other companies for heating buildings, in heat and electricity production (including for electricity production in cogeneration and trigeneration) as well as in technological processes as fuel for oil heaters in desulphurization and desalination, fuel for boilers, gas compression engines, gas turbines, post-combustion of waste gases.

In 2017, gas consumption rose due to combustion on flares during the process of obtaining access to deposits and due to an increase in the number of branches and production facilities of PGNiG TERMIKA EP i PGNiG OD. Most of the companies try to reduce gas consumption by modernising their heating installations.

Energy consumption at the PGNiG Group in 2015−2017 (G4-EN3)

Energy consumption		2017		2016		2015
		PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group
Generated internally from non-renewable sources	Electricity [MWh]	894	74	838	41	824
	Heat [kJ]	4 890 062 269	4 478 730 220	3 961 884 022	3 560 916 000	3 661 657 310
	Steam [kJ]	43 096 683	37 480 683	38 745 305	38 745 305	41 253 529
	Cooling [kJ]	2 193 088	-	2 220 960	-	1 630 496
Generated internally from renewable sources	Electricity [MWh]	27,0	-	19,2	-	1,3
	Heat [kJ]	3,5	-	2,9	-	1,0
	Steam [kJ]	-	-	-	-	-
	Cooling [kJ]	-	-	-	-	-

In 2017, the majority of the PGNiG Group's companies mainly consumed energy generated in-house on the basis of non-renewable raw materials. The other Group members have signed contracts with energy companies. The energy consumption volumes correspond with the growth of the Group. Pro-environmental solutions include cogeneration and trigeneration plants owned and operated by some of the companies. In the case of PGNiG UN, all of the energy the company consumes comes from hydroelectric power plants, which generate no emissions.

Water withdrawal at the PGNiG Group in 2015-2017 by source (G4-EN8)

Water (mln m3)	2017		2016		2015
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group
surface water withdrawn from own intake points	156,2	-	159,5	-	147,0
ground water withdrawn from own intake points	0,3	0,2	0,3	0,3	0,4
rainwater	-	-	-	-	-
purchased from the mains, surface and ground water intakes	1,6	0,1	1,7	0,2	1,0

A downward trend in water withdrawal can be observed in all Group Companies in relation to 2016. The main reasons include modernisation of the installations (closed cycle), investing in environmental programmes and improving employee awareness with regard to water consumption.

Impact on biodiversity (G4-EN12)

In 2017, the PGNiG Group implemented projects that were located near protected and valuable natural areas. All of the work involved in the projects was carried out in accordance with obtained decisions and permits. Additionally, in the areas with extremely sensitive habitats, wildlife inventory taking was completed. In individual cases, derogatory decisions were obtained.

Direct CO_2 emissions from the PGNiG Group installations participating in EU ETS in 2016-2017 (G4-EN15)

EU ETS installation	National Allocation Plan (KPRU) No.	2017 Emission allowances [Mg]*	2017 Emissions in 2017 [Mg]	2017 Remaining/Lacking [Mg]	2016 Emission allowances [Mg]*	2016 Emissions in 2016 [Mg]	2016 Remaining/Lacking [Mg]
Mogilno CUGSF	PL-0898-08	5.1	14.0	(8.9)	5.9	15.5	(9.6)
Odolanów I (boiler house)	0562-05	18.1	30.9	(12.8)	6.0	9.2	(3.2)
Odolanów II (compressor station)	0950-08				15.1	19.4	(4.3)
Lubiatów Oil and Gas Production Facility, Central Facility	PL-1070-13	41.6	55.4	(13.85)	42.4	56.2	(13.8)
Wierzchowice UGSF	PL-1072-13	-	42.6	(42.6)	-	6.6	(6.6)
Kosakowo CUGSF	PL-1076-13	-	2.9	(2.9)	-	3.6	(3.6)
Dębno Oil and Gas Production Facility, Central Facility	PL-0563-05	25.8	29.7	(3.9)	26.3	30.6	(4.3)
Pruszków CHP Plant	PL-0026-05	37.7	133.4	(95.7)	50.8	131.4	(80.6)
Siekierki CHP Plant	PL-0027-05	1 059.3	3 047.2	(1 987.9)	1 468.3	2 969.7	(1 501.4)
Żerań CHP Plant	PL-0028-05	782.8	2 339.0	(1 556.2)	1 064.2	2 303.3	(1 239.1)
Kawęczyn CHP Plant	PL-0124-05	37.1	95.7	(58.6)	43.4	73.2	(29.8)
Wola heating plant	PL-0125-05	0.7	8.6	(7.9)	0.8	1.2	(0.4)
CM Racibórz	0297-05	17.5	50.0	(32.5)	22.8	50.8	(28.0)
CM Wodzisław Śląski	0298-05	11.7	34.7	(23.0)	15.4	34.1	(18.7)
CM Żory	0299-05	13.6	34.6	(21.0)	17.9	34.3	(16.4)
PTEP S.A. „Moszczenica" CHP Plant	0083-05	49.7	77.3	(27.6)	61.4	86.1	(24.7)
PTEP S.A. „Zofiówka" CHP Plant	0084-05	147.1	235.2	(88.1)	167.7	264.0	(96.3)
PTEP S.A. „Pniówek" CHP Plant	0085-05	30.5	77.4	(46.9)	35.9	74.2	(38.3)
PTEP S.A. „Suszec" CHP Plant	0086-05	12.4	34.7	(22.3)	14.2	45.1	(30.9)
Razem		2 290.7	6 343.3	(4 052.6)	3 058.5	6 208.5	(3 150.0)

Currently, 18 installations of the PGNiG Group are included in the EU ETS. In 2017, the volume of carbon dioxide emission amounted to 6,342,330 Mg and was slightly higher than in previous years. PGNiG TERMIKA EP recorded a drop in CO_2 emissions in its heating plants due to higher average annual temperatures during the heating season. PGNiG TERMIKA plans to implement modernisation projects that will improve energy production efficiency and change fuel (transition from coal to gas), which should reduce greenhouse gas emissions. As free allowances of CO_2 emission rights decrease year by year, there is a need to purchase additional emission rights.

Reduction of greenhouse gas (GHG) emissions (G4-EN19)

The PGNiG Group places great emphasis on reducing gas and dust emissions to the air. This applies in particular to installations subject to integrated permits and participating in the EU ETS. In 2017, all required emission standards were met. In addition, The PGNiG Group is systematically reducing the amount of pollutants generated by transportation, combustion processes in heat sources, fuel reloading and technological processes, such as gas combustion at flares, gas venting, emissions from compressor stations and compressors. The methods of reducing emissions of pollutants into the air include on the use of gas as a low-emission fuel, monitoring of fuel consumption, reducing the energy intensiveness of technological processes and modernising or replacing heat sources used for own needs.

NOx, SOx, and other significant air emissions (G4-EN21)

Oil and gas exploration and production activities, gas distribution, and modernisation, maintenance and repair works of the PGNiG Group generate air pollutants such as gases (SO_2, NO_x, CO, CO_2, CH_4), dust, hydrocarbons, aldehydes, alcohols, acids, heavy metals, metallic and non-metallic elements.

In 2017, air emissions of pollutants other than CO and CO_2 were on a decline as a result of using more modern coal combustion technologies.

Air pollutants emitted by the PGNiG Group in 2015−2017

Emissions of gases, particulates and substances (Mg)	2017		2016		2015
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group
CO_2	6 577 924	338 122	6 411 274	270 555	6 194 063
CO_2 biomass combustion	293 710	-	240 323	-	16 738
CH_4	14 424	9 586	18 911	13 876	24 138
SO_2	12 452	1 725	14 152	1 567	14 362
NO_x/NO_2	6 377	355	6 782	290	7 038
CO	2 216	361	2 100	305	2 183
Total particulates	786	2	1 099	2	927
Total hydrocarbons	260	198	264	195	241
H_2S	-	-	-	-	-
Total	6 908 149	350 349	6 694 905	286 790	6 259 690

Total water discharge by quality and destination in 2015−2017 (G4-EN22)

Wastewater [m^3]	2017		2016		2015
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group
Domestic	348 342	7120	276 655	10 438	346 931
Municipal	108 113	90 955	104 183	73 830	85 974
Industrial	6 652 290	15 248	6 311 583	10 939	5 945 205
Rainwater and snowmelt	1 497 638	288 197	1 209 936	280 591	1 319 110
Other	149 839 142	-	154 527 215	22 959	148 599 919

The wastewater generated by the PGNiG Group companies is discharged to the sewage system, surface water or soil based on the water permits obtained. Domestic and industrial wastewater is discharged into the sewage system. Rainwater from plant premises and access roads is discharged into the municipal sewage system, as well as into surface water and soil. The PGNiG TERMIKA Group companies account for a large share in the volume of generated wastewater as they use water for cooling purposes. On the other hand, the policy of economical water management is followed during drilling work and, where possible, wastewater is reused to prepare drilling muds.

In 2017, an increase was seen mainly in the amount of domestic and municipal wastewater following the establishment of new branches and generating units of PGNiG TERMIKA EP and PGNiG OD.

Waste management (G4-EN23)

The production of hazardous and non-hazardous waste is unavoidable in activities related to the production and processing of crude oil and natural gas. In 2017, all PGNiG Group companies reported decreases in the volume of generated waste. The main reason was the introduction of new technologies and the use of environment-friendly materials and products. The companies have also been implementing programmes raising the awareness of the need to sort waste. PGNiG TERMIKA has put in operation an ash separation unit at the Siekierki CHP Plant, for removing ash from non-combusted coal. The project will result in a significant reduction in the volume of generated waste. The volume of drilling waste from exploration work has been on a decline, mainly due to the lower intensity of the work relative to previous years. Moreover, the weight of waste re-used within the Group increased by 30%. The other waste is recycled by specialised external companies.

Waste management methods used at the PGNiG Group in 2015−2017

Other waste excluding municipal waste		Landfilled [Mg]	Recovered, including recycled [Mg]	Disposed of [Mg]	Incinerated [Mg]	Transferred for collection [Mg]	Stored [Mg]
2017							
Hazardous waste	PGNiG Group	-	3 317.4	571.7	38.9	659.9	20.9
	PGNiG	-	3 053.8	389.3	-	10.1	20.9
Non-hazardous waste	PGNiG Group	212.1	568 214.5	3 121.3	11.1	2 186.3	60.0
	PGNiG	189.0	1 159.4	2 824.5	-	4.7	60.0
2016							
Hazardous waste	PGNiG Group	-	1 646.2	584.4	2.7	690.9	49.0
	PGNiG	-	1 061.9	521.4	-	15.2	49.0
Non-hazardous waste	PGNiG Group	342.0	565 664.6	1 909.2	-	5 615.1	47.7
	PGNiG	305.7	4 998.3	1 763.6	-	7.8	47.7
2015							
Hazardous waste	PGNiG Group	-	779.8	587.9	3.5	770.0	25.0
	PGNiG	-	505.3	554.0	-	14.0	25.0
Non-hazardous waste	PGNiG Group	4 835.8	609 314.1	274.4	-	5 392.6	73.5
	PGNiG	4 774.8	2 264.3	92.8	-	0.6	73.5

Method of drilling waste management in 2015–2017

Drilling waste		Stored in waste disposal facilities [Mg]	Recovered [Mg]	Disposed of [Mg]	Reused [Mg]	Stored [Mg]	Stored in rock mass [Mg]
2017							
Hazardous waste	PGNiG Group	-	1 314.1	77.2	-	-	-
	PGNiG	-	1 314.1	77.2	-	-	-
Non-hazardous waste	PGNiG Group	-	92 131.3	9 527.6	-	53.6	3 256.9
	PGNiG	-	47 361.4	9 511.6	-	53.6	3 256.9
2016							
Hazardous waste	PGNiG Group	-	1 459.6	98.0	-	-	-
	PGNiG	-	1 459.6	-	-	-	-
Non-hazardous waste	PGNiG Group	-	67 750.1	189.7	-	-	28 371.8
	PGNiG	-	58 710.9	-	-	-	28 371.8
2015							
Hazardous waste	PGNiG Group	-	2 897.3	331.6	-	-	-
	PGNiG	-	2 897.3	41.3	-	-	-
Non-hazardous waste	PGNiG Group	-	68 523.3	15 399.9	-	-	58 236.9
	PGNiG	-	59 413.5	7 929.2	-	-	58 236.9

Events with environmental impacts (G4-EN24)

In 2017, four environmental events were recorded: leaks of hydraulic oil from vibrating screens working during seismic surveys, in a total of amount of about 100 litres. These events led to minor topsoil contamination. All consequences of the events were remedied. The soil contaminated with hydraulic oil was transferred to authorised waste collectors in line with the Waste Management Plan. In order to prevent similar events in the future, hydraulic hose clamps were checked in all machines operated in the projects underway. In addition, during the work of seismic teams regular training is given to increase the knowledge of procedures to be followed in the event of leakage and in case of other environmental events. The number of inspections of the technical condition of machinery was increased as a preventive measure in order to eliminate potential events.

Penalties for non-compliance with environmental laws (G4-EN29)

Holding valid environmental permits and decisions is a prerequisite in the operations of the PGNiG Group companies. In 2017, a Provincial Inspectorate for Environmental Protection (WIOŚ) imposed a fine of PLN 4 thousands on one of the Group companies for exceeding the permitted sulfur dioxide concentration specified in the integrated permit. However, an appeal was filed to the Chief Environmental Protection Inspector (GIOŚ) and is expected to be examined.

Environmental protection expenditure at the PGNiG Group in 2015−2017 (G4-EN31)

	2017	2016	2015
environmental protection expenditure (including modernisation and repairs) (in mln zł)	26.0	139.5	226.7
PGNiG	3.9	3.5	1.3

The amount of environmental protection expenditures at the PGNiG Group decreased compared with the previous year. Boiler houses were modernised and buildings were thermo-modernised, which directly contributes to air protection. Expenditure was also incurred on water protection and waste management.

The PGNiG TERMIKA Group participates in the National Investment Plan and White Certificate auctions, obtaining free CO_2 emission allowances for electricity production and financial subsidies. This results in a reduction of CO_2 and other pollutants emissions into the atmosphere.

The companies of the PGNiG TERMIKA Group planned outlays for environmental investments in 2019-2021 due to the entry of stricter environmental requirements resulting from the BAT Conclusions in the amount of PLN 1445.6 million. Most of the outlays are planned for the construction of new generating units (steam and gas-fired unit and two gas peak boilers in Żerań CHP Plant and the construction of new sources in Pruszków CHP Plant), which will replace the sources that have been exhausted and do not meet the BAT requirements. The planned investments concerning the existing sources are mainly related to the construction of pollution control devices (nitrogenation, desulphurisation and de-dusting) up to the levels required in BAT.

Moreover, a significant part of the funds was spent on environmental protection training and pro-environmental campaigns. The costs of certification, environmental software and mandatory environmental measurements were also incurred. Several awareness meetings were held for employees in the scope of sustainable transport, waste segregation and minimization of potential negative impact of the industry on the environment.

Grievances (G4-EN34)

In 2017 PGNiG handled a lawsuit for payment for non-contractual use of property, consisting in waste storage and improper reclamation. In the proceedings, the court dismissed the claim and ruled that the costs of legal representation be paid by the plaintiff to PGNiG.

Residents of the village of Kokorzyn submitted three complaints about the noise emitted by the helium recovery membrane on the stream of gas produced by the Kościan-Brońsko Gas Production Facility. Moreover, the Regional Directorate for Environmental Protection in Rzeszów is gathering evidence of land surface contamination resulting from the repair work on the Rzeszów-17 borehole, reported by the owner of the plot.

Environmental management system at the PGNiG Group

The operation of the environmental management system according to the PN-EN ISO 14 001 standard is based on the identification of environmental aspects of the organisation. Streamlining this area is one of the key issues required for carrying out analyses at the PGNiG Group and selecting areas of particular interest to the oil and gas industry in terms of environmental protection.

One of the most frequent material environmental aspects is emission of air pollutants. It occurs both under normal conditions and in emergency situations, as a result of fuel combustion by vehicle engines, industrial machinery and boilers. Emission of particulates and gases, such as nitrogen oxides, sulphur oxides and carbon oxides, have been identified as a key environmental aspect at PGNiG TERMIKA, which produces electricity and heat from coal, natural gas and biomass. Emission of natural gas, including gas containing sulfur compounds, may occur in emergency situations, such as leaking heads or pipelines, or outbursts.

Most of the technological processes involve noise emission to the environment, and in the case of Geofizyka Toruń – also vibrations.

Contaminated soil and groundwater are also frequently identified as a significant environmental aspect. Its occurrence may be explained by the presence of contaminants generated in past activities, as well as spills/leaks of petroleum or hazardous substances during drilling and other technological processes, operation of machinery and equipment, or leaks from storage tanks or pipelines.

11.3.3. Social capital and activity

The nature and scale of the PGNiG Group's operations, and in particular the potential interference of its exploration, production, storage and distribution infrastructure with the lives of local communities, make the Group deeply committed to building relationships with its social environment. We make every effort to build an equal relationship with local communities, authorities, suppliers and contractors in order to pursue common objectives.

The PGNiG Group creates opportunities for cooperation and builds understanding for mutual relations and interdependencies with individual stakeholder groups.

Our influence on local communities is also manifest in our charitable activities for society, carried out in the PGNiG Group mainly by the PGNiG SA Ignacy Łukasiewicz Foundation.

The Foundation's objects include broadly understood support for national culture and heritage; protection of monuments, in particular those related to the gas industry and religious cult; activities for science and education in the field of fundamental and technical research; education with particular focus on historical and patriotic projects, including education of university students; sports, including competition as an educational tool for children and youth; health care, social welfare, and vocational and social rehabilitation for the disabled. The Foundation's activity is based on cooperation with programme partners and implementation of its own projects which allows it to be used effectively and reach the most needy throughout Poland.

In 2017, the Foundation focused on two proprietary programmes – "Być jak Ignacy" ('To Be Like Ignacy') and "Rozgrzewamy Polskie Serca" ('We Warm up Polish Hearts'), and in the third quarter of the year it initiated a new educational programme, entitled "Powietrze bez Śmieci" ('Air without Rubbish').

The Foundation and the PGNiG Group companies also supported nearly 100 initiatives falling with the scope of activities specified above, for instance by donating funds to the Ignacy Łukasiewicz Museum of Oil and Gas Industry Foundation in Bóbrka to support the museum's activities. It also supported the Foundation for Civic Space and Social Policy by providing funding for the 'Recovering Forgotten History' project.

In addition, in 2017 the Foundation began conceptual and design work on the Ignacy Education and Museum Centre. The aim of the project is to build a nursery and pre-school facility for the children of the PGNiG Group employees and revitalise the Gas Industry Museum to modernise it and bring in line with contemporary museum trends.

„Być jak Ignacy" ('To Be Like Ignacy')

The PGNiG SA Ignacy Łukasiewicz Foundation has supported initiatives promoting science, education and history for many years and since 2016 as part of the programme "Być jak Ignacy" which was implemented together with PGNiG.

It is a programme popularising science among primary school students, and at the same time introducing the youngest to the unique figure of the patron of the Foundation along with outstanding Polish scientists. Its main element is a website featuring an interactive comic strip, educational videos showing scientific experiments, and an adventure game.

As part of the programme, the Foundation holds a competition called 'Ignacy's School of Science' to award the Ignaś statuettes. Over 650 schools from all over Poland applied to enter the second edition of the competition. The competition is to select 16 schools (one from each province) which will find the most interesting way to organise and document the work of a specially set up science club and prepare a project. To assist teachers in running such clubs, the Foundation prepared lesson scenarios for 0−3 and 4−6 forms.

The first edition of the programme was summed up by the final gala of awarding prizes to 16 schools from all over Poland.

As part of the programme, the Foundation purchased and equipped a special bus - Ignacy's mobile laboratory, which enjoyed great popularity on a tour with the radio show 'Lato z Radiem'.

The programme "Być jak Ignacy" is run under the honorary patronage of the Ministry of National Education and the Polish Radio is its media partner.

„Rozgrzewamy Polskie Serca" ('We Warm Up Polish Hearts')

„Rozgrzewamy Polskie Serca" – the project run by the Foundation together with PGNiG and other PGNiG Group entities with the aim of raising historical awareness of Poles, preserving national identity and commemorating Polish heroes. As part of the programme, the Foundation supports educational and film making projects, initiatives to aid war veterans, and a variety of cultural activities. A particular focus is placed on reviving the memory and history of the so-called "Cursed Soldiers", heroes that fell into oblivion for decades.

Under the programme, more than 50 projects were implemented and supported, which reached nearly 5 million recipients. As part of the project, we support the Warsaw Insurgents by funding their gas bills for up to PLN 700 a year.

A project Edukacyjna Pasieka – Energia z Miodu (Educational Apiary – Energy from Honey) was established on the premises of the PGNiG Head Office. It is a part of the programme and responses to the need to protect the environment and protect bees from extinction. Currently, the educational apiary has 15 hives and it is planned to double them in 2018 season. This project includes a series of trainings for employees on bees and apiaries in the city, and in the next stage the cycle of workshops will also be adapted for children and youth from Warsaw schools.

„Powietrze bez Śmieci" ('Air without Rubbish')

Since 2017, the Foundation and its subsidiaries from the PGNiG Group have been conducting educational activities to combat the smog problem in Poland. The "Powietrze bez Śmieci" educational programme was initiated, consisting of a campaign informing Poles about the problem of smog, through advertising, social media channels and a website, as well as two contests - the first one addressed to municipalities, where residents can win the construction of a scientific playground in their municipality, and the second one addressed to children of 1-3 primary schools, where they can win the equipment to their nature workshop.

Other CSR PGNiG activities

The CSR activities focused on implementing a new CSR Strategy in the PGNiG Group, supporting the ongoing initiatives, and creating new projects within the scope of the Strategy. Other major CSR projects completed in 2017 included:

- Pogoń dla Pogoni ('Pogoń for Pogoń') is a project combining education, sports and history, and promoting PGNiG as a socially responsible business that supports local communities. As part of the project, the Pogoń Siedlce and Pogoń Lwów football clubs and the communities of both towns worked together towards educating children and youth in history and sports.
- Górnik w przedszkolu i szkole ('Oil Miner at School and Kindergarten') – a voluntary project in which the employees of PGNiG Zielona Góra Branch and the Geology and Hydrocarbon Production Branch take part. The aim is to promote the profession of an oil miner and respond in a structured and organised manner to schools' and kindergartens' need to teach about jobs and professions, and visit these institutions on the occasion of Barbórka – the St. Barbara's Day, the patron saint of miners, falling on December 4th.

Sponsoring

For many years, PGNiG has been involved in a wide range of sponsorship activities leading to the development of social capital. The PGNiG Group focuses on three main areas of standard sponsorship activities: sport, culture and education.

Sport

PGNiG provides comprehensive support to one leading professional sport, namely handball. The company is also a partner of the 'KLUB' programme and together with the Ministry of Sport and Tourism supports the activities of small and medium sports clubs. PGNiG is the founder and donor of Superliga sp. z o.o., the operator of the professional handball league.

Culture

In 2017, the cooperation with the Television Poland and the Television Theatre continued, initiated in 2016. Other key cultural events sponsored by the Company was the concert in memory of the legendary Polish composer and musician Przemysław Gintrowski, entitled "Gintrowski - a jednak coś po nas zostanie."

Apart from supporting high culture, PGNiG is involved in a number of patriotic initiatives.

Education

The Company and the PGNiG Foundation carried on their educational programme 'Być jak Ignacy'. As part of the programme, PGNiG participated in Science Festivals, where its interactive stand attracted thousands of young visitors and their parents.

Social capital in numbers

In 2017, over 120,000 pupils, about 10,000 students and nearly 5,000 scientists were direct recipients or beneficiaries of the social activities of the PGNiG SA Ignacy Łukasiewicz Foundation and the other PGNiG Group entities (including, in particular, PGNiG, PGNiG TERMIKA and PSG). Communications about CSR projects of the PGNiG Group reached over 800,000 users of the Foundation's social media.

Together with the companies of the PGNiG Group, the Foundation supported over 100 initiatives in 2017, compared with nearly 80 in 2016.

11.3.4. Development of the offering

Care for the customers and their satisfaction is one of the key areas of focus for the PGNiG Group companies. Retaining the existing customers and acquiring new ones is possible thanks to the implementation of projects designed to ensure professional and friendly customer service and tailoring the offering to the diverse needs of our customers. Building long-term relationships with customers is also among the commitments made in the PGNiG Group's QHSE Policy and among the requirements for a quality management system.

Number of new customers using electricity, CNG, LNG in 2017.

Company	Number of new customers - electricity (in thousands)	Number of new CNG customers	Number of new LNG customers
PGNiG OD	50,6	-	2
PSG	-	-	419
PST	18,8	-	

Volume of electricity sold to end users (MWh)

Company	Volume of electricity sold to end users (2017)	Volume of electricity sold to end users (2016)	y/y change (%)
PGNiG OD	606 288.24 MWh	274 915.66 MWh	220.54 %
PST	160 731.83 MWh	53 239.53 MWh	301.90 %

Gas network roll-out in Poland/ Number of new connections/ Natural gas distribution volume/ Increase in the number of active connections to end users

Company	Gas network roll-out in Poland	Number of new connections	Natural gas distribution volume	Increase in the number of active connections to end users
PSG	59.6%	54 922	123.44 TWh	90 277

Volume of gas sold via new connections (2017)

Company	Volume of gas sold via new connections (2017)
PSG	1.05 TWh

Change in gas distribution volume (%) in Poland, PSG data

Year	Volume of distributed gas
2016	115.67 TWh
2017	123.44 TWh
Change (%)	6.72%

Increase in assets and new connections

In 2017, PSG built 54,922 new gas connections. The actual number of completed connections is at the level of 118% of the annual target, consistent with PSG's Strategy for 2016-2020, envisaging 46,500 new gas connections.

Number of CNG/LNG stations

Company	Number of CNG stations		Number of LNG stations	
	2017	2016	2017	2016
PGNiG OD	20	20		
PSG			5 (owned by PSG) 3 (leased by PSG)	5 (owned by PSG) 3 (leased by PSG)

Customer satisfaction

The companies providing services to retail customers at the PGNiG Group, such as PGNiG OD and PSG, constantly improve the quality of service and develop online sales channels and modern tools of contact with customers via websites prepared in a mobile version and adapted to the needs of disabled and elderly people. They act in accordance with the principles of the Internet without barriers, which help reduce digital exclusion.

At the same time, efforts are being made to increase customer awareness on the energy market in the context of market liberalisation and fair competition. Handbooks explaining the matters have been prepared and 'Informed Customer' campaigns are under way.

At the beginning of 2017, PGNiG OD, in cooperation with the Millward Brown agency, carried out a satisfaction survey among business customers. It shows that in comparison with the previous survey, carried out in 2013, satisfaction rates increased in each of the analysed areas.

There was a marked increase in one of the most important indicators, the Net Promoter Score, which measures customer loyalty. The company improved the score from minus 23 points to plus 5 points, which represents one of the best results in the entire energy industry in Poland. The overall satisfaction level also rose, from 76% to 86%.

11.3.5. Employee

Employees are an essential asset determining the Group's value and the effectiveness of its development. For this reason we make every effort to create friendly and safe workplaces and to involve employees in the company matters through various forms of dialogue and communication.

Building mutual relations and conducting an open dialogue with trading partners in order to continuously enhance the safety of employees, persons staying on the PGNiG Group's premises and the local communities as well as successful efforts to constantly and permanently improve occupational health and safety are among PGNiG's principal commitments set out in the QHSE Policy, implemented through the Group's health and safety management system.

The PGNiG Group's ambition is to build an effective organisation based on the unique competences and qualifications of its employees. An integral part of pursuing this ambition is a coherent organisational culture based on business ethics and corporate values. The Sustainable Development Strategy contributes to building a culture of employee engagement in the operations and growth of our organisation. Key aspects of care for employees include issues related to intergenerational management, management of employee relations, improvement of intra-Group communication and strengthening the competencies of the management staff.

The PGNiG Group is one of the largest employers in Poland. It employs people with great experience and high qualifications. At the same time, it is often the first place of work for many young people.

Employment at the PGNiG Group by segment

	2017		2016*		2015	2014	2013
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
Exploration and Production	6 998	3 738	7 720	3 714	8 903	10 221	10 754
Trade and Storage	2 961	304	3 520	308	3 462	3 929	4 070
Distribution	11 114	-	10 846	-	10 678	12 173	13 050
Generation	1 785	-	1 870	-	1 071	1 068	1 066
Other activities	1 836	662	1 315	647	1 305	1 605	1 990
Total	24 694	4 704	25 271	4 669	25 419	28 996	30 930

** Data for 2016, after changes in the reclassification of the PGNiG Group's operations in 2017, was moved from the Trading and Storage segment to the Other activities segment.*

As at December 31st 2017, PGNiG Group employed 24 694 staff, 577 (or 2%) fewer than as at December 31st 2016.

In the Exploration and Production segment, a significant drop in employment was recorded. Relative to December 31st 2016, the number of employees fell by 722 (or 9%), owing mainly to the following processes:

- Ongoing liquidation of Geofizyka Kraków, as a result, employment was reduced by 609 persons (out of which 143 were terminated and the remaining employees were not renewed in short-term contracts)
- in Exalo Drilling, the employment restructuring process started in 2016 was continued and a further 195 employees (8%) were made redundant.

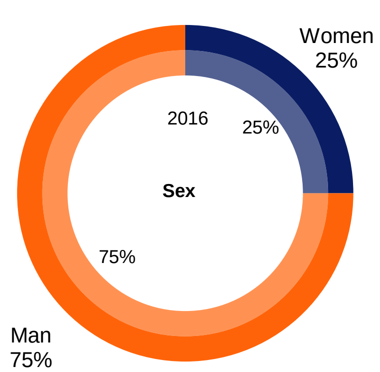
Compared to the situation as at December 31st 2016, employment in the Distribution segment increased by 268 persons (2%). The increase in employment is a consequence of the definition of new business needs and investment processes in PSG, as well as the implementation of the age management policy, which ensures optimal age of employees and an appropriately high level of qualifications.

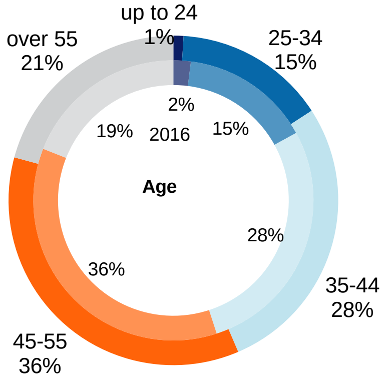
Compared with the situation as at December 31st 2016, in the Generation segment there was a decline in employment by 85 persons (5%), which was influenced by fundamental structural changes. In September 2017, PGNiG TERMIKA EP and PEC were merged (the remaining name was PGNiG TERMIKA EP). This has enabled both companies to optimise their employment and free up 93 FTEs. In order to minimize the social costs of the restructuring process, the company has launched two programs addressed to its employees: a Retirement Leave (UTE Bis - Urlop Terminowy do Emerytury) and a Voluntary Leave Program (PDO - Program Dobrowolnych Odejść).

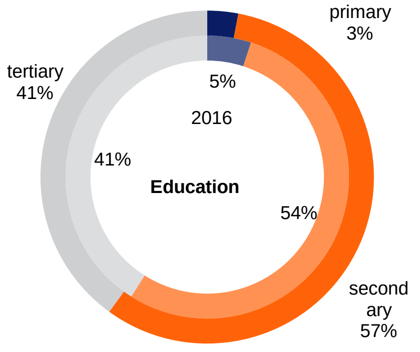
In the Other activities segment, in relation to the situation as at December 31st 2016, there was a decrease in employment by 88 persons (5%), which resulted in a number of changes in particular companies in the segment. The most significant factors affecting the employment status of the segment Other activities should include:

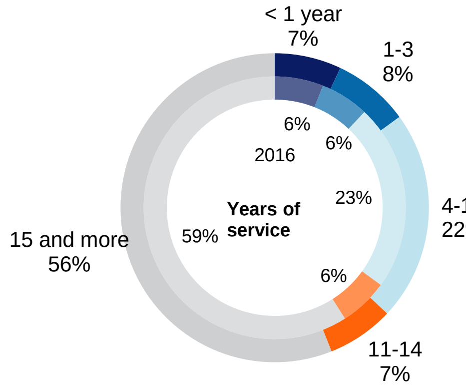
- reduction of employment in PGNiG Technologie by 99 persons (16%) as a result of the market downturn and a decrease in demand for services provided,
- restructuring of employment in Geovita, as a result of which 90 employees were made redundant (28%). The reduction in employment was achieved mainly through the termination of fixed-term contracts,
- increase in employment at PGNiG Serwis by 48 persons, mainly as a result of centralization of shared services within the PGNiG Group,
- establishing a new entity Towarzystwo Ubezpieczeń Wzajemnych - Polski Gaz TUW, whose business will be related to property insurance of the PGNiG Group. As at December 31st 2017, employment in the new company was 29 persons.

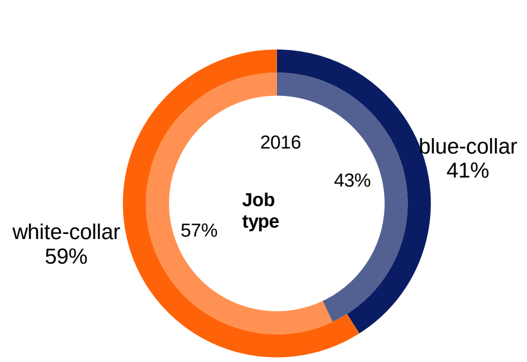
Workforce structure at the PGNiG Group (in persons, as at the end of 2017)











Workforce turnover – new hires/departures (by age and sex, as at the end of 2017)

Age (years)	Number of new hires		Number of departures	
	Women	Men	Women	Men
do 24 lat	35	140	17	217
25-34	291	491	150	355
35-44	207	342	203	423
45-55	116	337	154	528
powyżej 55 lat	45	181	205	524
RAZEM	694	1 491	729	2 047

Employee turnover at the PGNiG Group in 2017

Organisational unit	New employees in 2017 as percentage of total workforce	Employees who left in 2017 as percentage of total workforce
PGNiG	4,02%	3,21%
PGNiG Group	6,91%	6,13%

Parental leaves

PGNiG Group employees on parenting-related leaves (maternity/paternity and parental leave) in 2017

Organisational unit	Total	Women	Men
PGNiG	147	143	4
PGNiG Group	823	595	228

PGNiG Group employees who returned to work after parenting-related leave in 2017

Organisational unit	Total	Women	Men
PGNiG	103	101	2
PGNiG Group	624	403	221

In 2017, the rate of return to work at the PGNiG Group was 91,5%.

In 2017, the rate of return to work at the PGNiG was 89,6%.

The rate of return to work for employees who took parenting-related leave is the quotient of:

- Number of staff who maintained their jobs/continued work after return from parenting-related leave in 2017; and
- Number of staff who returned to work after parenting-related leave in 2017.

Parenting-related leave is any leave to which an employee may be entitled after child birth/adoption, including maternal, additional maternal, paternal, parental and childcare leave.

Remuneration policy

The key internal document governing the remuneration policy at PGNiG is the Collective Bargaining Agreement concluded with the trade unions on July 15th 2009. The remuneration system is additionally governed by internal rules implemented at individual organisational units and agreements with trade unions.

In line with the adopted remuneration policy, base pay rates are based on job grading. The rate depends on the qualifications required for a given job, type of work performed and professional experience.

The policy also provides for additional components of remuneration, the most important of them being:

- Awards and bonuses under an incentive scheme,
- St. Barbara's Day awards, paid, as a rule, in the amount of a monthly base pay,
- Jubilee benefits and one-off retirement benefits, in amounts depending on the length of service with the company, and
- Annual bonuses, in amounts depending on the Company's performance, negotiated every year with employees.

Employee development

Employee potential management – training and development programmes

As the PGNiG Group's subsidiaries are engaged in a wide range of business activities, it is up to each of them to determine the type and extent of their staff training. The training management system in place is a vital tool in developing human resources. Our employees are given opportunities to improve their professional qualifications through a range of training programmes, postgraduate studies, industry conferences, seminars and symposia, and also through occupational training.

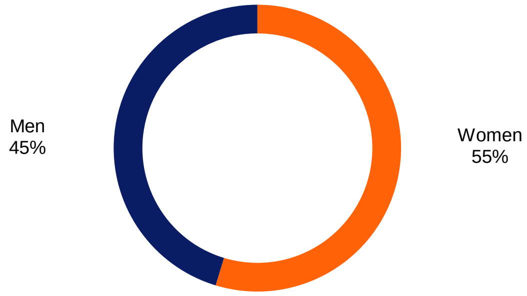
Depending on their respective responsibilities and individual needs, employees can participate in a variety of training courses covering all aspects of a modern business, including risk management, legal environment analysis and customer service. Training courses which focus on soft skills, such as communication, teamwork, team management and task management, are also an important part of the process.

In June 2016, the Organization's Talent Identification System (SITO – System Identyfikacji Talentów Organizacji) was launched, initiating the Academy of Future Leaders (ALP – Akademia Liderów Przyszłości). The aim of the SITO Programme is to select employees with a high potential (talent) who can then be covered by the Academy of Future Leaders (ALP) development programme, preparing them to perform further functions in the organization, including managerial functions.

The number of training hours per PGNiG employee in 2017 was 32.

The number of training hours per PGNiG Group employee in 2017 was 24.

Number of training hours, by sex



Number of training hours, by type of job

Student internships and work placement programmes

PGNiG offers a number of work placement opportunities and competitions to select candidates to be offered internships and traineeships with the Company. Its work placement programmes are an attractive opportunity to gain professional experience, develop new skills, and learn more about working in the oil and gas industry. In 2017, PGNiG had in place the following internship and education programmes:

GeoTalent

It is PGNiG's proprietary internship and education programme for students of the AGH University of Science and Technology in Kraków, the Faculty of Geographical and Geological Sciences of the Adam Mickiewicz University of Poznań and the Faculty of Geology of the Warsaw University. It seeks to identify and attract the best students and graduates who want to pursue their professional careers in the oil and gas industry.

June 2017 saw the end of the fourth edition of the GeoTalent Programme. In the 2016/2017 academic year we organised, for the first time, the GeoTalent Conference, during which students and graduates had the opportunity to present their theses to the audience including PGNiG's management and academics from the cooperating universities. 15 specialist workshops, 3 social skill development workshops, GeoTurniej (GeoTournament) and the Polish Geology Championship were organised.

Under the GeoTalent Summer Internship Programme, 47 students and recent graduates had the opportunity to gain experience in the exploration and production industry. 25 ambassadors and 21 mentors were involved in the Programme.

Thanks to the GeoTalent Programme, PGNiG can acquire qualified graduates with basic practical knowledge, much needed at the beginning of a young employee's career. The programme also supports the Company's recruitment process as it provides an opportunity to learn more about potential future employees.

Energia dla Przyszłości (”Energy for the Future”)

Energia dla Przyszłości is an internship programme run by the Company jointly with two other groups under the Ministry of Energy's patronage. It aims to find the most talented students and graduates of faculties relevant to the Polish energy sector. Each participating student will have a chance to gain hands-on experience and skills in the areas of interest. Currently, the number of interns enrolled is 21.

Złoża Kariery (“Deposits of Career”)

The Złoża Kariery programme offers students and graduates of all faculties (except oil and gas engineering, covered by GeoTalent) an opportunity to gain professional experience at a large, stable company with a long tradition, included in the WIG 20 stock-exchange index listing the largest Polish companies. Its participants can complete an internship and take part in educational events to support career building.

Internships are also offered by PGNiG outside the programmes discussed above. In 2017, a total of 116 persons took advantage of internship and work placement opportunities.

Internship with TERMIKA

Eleven students took part in the ‘Internship with TERMIKA' programme in 2016 and ten in 2017. From July to September, these students completed internships in seven (2016) and eight (2017) organisational units. The ‘Internship with TERMICA' programme is addressed mainly to students and graduates of technology universities, and its main goal is to provide the participants with specialist knowledge and test their existing knowledge in practice, show them how a large organisation functions, and improve their teamwork skills.

Number of internship and work placement participants in the PGNIG Group in 2016–2017

Organisational unit	Number of internship and work placement participants in 2017		Number of internship and work placement participants in 2016	
	Secondary school students	University students	Secondary school students	University students
PGNiG	7	109	10	117
PGNiG Group	225	258	208	312

Performance assessment

Twice a year, employees are evaluated based on the Performance Assessment System in place at PGNiG. In the process, particular emphasis is placed on targets assigned to individual employees, which are linked to strategic objectives of the Company.

Percentage of employees subject to the performance assessment process:

- 100.0% of PGNiG employees in 2017;
- 79.0% of all PGNiG Group emloyees in 2017.

Recruitment

PGNiG's recruitment policy is focused on employing top-class specialists whose expertise and competence, combined with the experience and professionalism of the Company's other staff, will ensure continuity and high standard of business processes. Priority in filling vacancies at the PGNiG Group is given to internal recruitment, to best use the potential of the current employees.

Cooperation with trade unions

There are a number of trade unions active at PGNiG. Considerable importance is attached by the Company to maintaining constructive links with the trade unions, making sure that social dialogue is based on the independence of all parties, legal compliance, as well as trust, willingness to compromise, and adherence to rules.

Main activities in 2017 according the cooperation with trade unions:

- In March 2017, an agreement was reached to agree on the remuneration growth rate, the principles for its distribution and the amount of commodity bonds at PGNiG in 2017. The remuneration growth rate, set at 4%, was applied to all employees employed as on March 1st 2017, excluding the senior management. The salary increase was granted from January 1st 2017.
- In April 2017, an agreement was concluded to set the annual bonus ratio for 2016 and 2017 at 8% of the annual bonus base per employee each year, with PLN 1 000 being paid to eligible employees as a fixed amount and the remainder as a percentage of the annual bonus base.

There were no collective redundancies or disputes at PGNiG in 2017.

11.3.6. Occupational health and safety

The companies of the PGNiG Group manage the following areas: quality, environmental protection and health and safety at work based on a single and unify QHSE (Quality Management, Occupational Safety, Health and Environmental Protection) Policy defined and adopted by the Company's Management Board. The policy defines the objectives and directions of activities of the PGNiG Group companies in the above scope and is an obligation of the Group companies to meet the quality requirements for products and services, build positive customer relations, operate in accordance with legal requirements, continuously improve the effectiveness of the Quality Management System, environmental protection and occupational safety. It is also a commitment to pro-active measures to prevent injuries and occupational diseases of workers and pollution and environmental damage.

The PGNiG Group performs its tasks on a systematic basis, in accordance with the best standards laid down in the international norms ISO 9001:2015,14001:2015 and OHSAS 18001:2007, taking into account the best industry practice. The performed tasks result from the commitments declared by the Company's Management Board in the QHSE Policy and the need to implement and maintain the Company's Quality Management, Occupational Safety, Health and Environmental Protection System.

In addition, the resources, responsibilities and powers of the management staff as well as the employees, strictly defined and documented in the Systems, translate into the ability to demonstrate and improve the results of the activities conducted at the PGNiG Group companies, their products and services in compliance with the requirements of international standards.

Main OHS tasks performed in 2017:

- Selection of an IT tool to identify the Law Requirements for, among others, OSH related to the activities of the PGNiG Group, which will provide access to updated legal requirements and thus contribute to the facilitation of work and broaden knowledge about the current legislative requirements,
- Implementation of tasks of the OHS service at the Company's Head Office, Geology and Hydrocarbon Production Branch, Wholesale Branch, Central Measurement and Testing Laboratory and Borehole Mining Rescue Station,
- participation in the assessment of assumptions and documentation of new investments, preparation of modernization plans and handing over for use of newly constructed or reconstructed building structures in the scope of taking into account OHS requirements at the Company's Head Office, Geology and Hydrocarbon Production Branch, Wholesale Branch, Central Measurement and Testing Laboratory and Borehole Mining Rescue Station,

- supervising compliance with regulations and rules in the field of OHS at the Head Office and Branches of the Company,
- analysis of OHS at work and monitoring the basic activities aimed at preventing life and health risks and improving working conditions at the PGNiG Group,
- joint prophylactic activities under the Policy, which improve safety in the working environment in the PGNiG Group,
- cooperation with services and inspections monitoring compliance with OHS and fire protection regulations,
- implementation, maintenance and improvement of the unified integrated QHSE Management System at PGNiG's Head Office and supervision over the system at PGNiG Branches in in terms of OHS.

Accident reporting facilitates analysis of the causes of injuries and diseases arising from accidents at work, helping to work out and adopt preventative measures. As a result, it helps raise the staff's awareness and foster a work safety culture.

All employees have access to OHS training and extensive medical care. Each employee has been instructed about the occupational risk level at their workplace. The training courses are conducted regularly, and their frequency depends on the job and related risks. Increasing the level of safety is also the subject of annual meetings organised by the Company's Head Office, devoted to OHS conditions and experience sharing, and attended by representatives of external bodies, such as the National Labour Inspectorate.

The Company builds a safe work culture among employees, which translates into their safe behaviour, attitudes and actions. We undertake measures aimed at continuous improvement of safety of all persons staying in our premises, including visitors.

Work safety metrics

Safety-related activities are monitored continuously by way of:

- proactive monitoring - consists in monitoring the effectiveness of implementation of procedures and measures designed to eliminate or minimise risk, defined at the planning phase. Its purpose is to assess the effectiveness of preventive measures.
- reactive monitoring - provides information on loss events (accidents, failures and occupational diseases) and facilitates drawing appropriate conclusions and improving OHS management. It is a post-event preventive measure, designed to eliminate similar loss events in the future.

All accidents, events and conditions which are related to the Group's operations and which result in a loss or could potentially result in a loss are required to be reported. This applies to the operations of both the PGNiG branches and the PGNiG Group companies, as well as contractors and suppliers carrying out work for the Group.

The table below presents selected work safety metrics.

Metric	PGNiG	PGNiG Group
Number of near misses	25	**350**
Number of employee reports aimed at improving safety or promoting positive behaviours (e.g. as part of the Awareness and Behaviour Improvement Programme, STOP® System or other)	151	**142 632**
Number of test alarms, including evacuation drills	59	**856**
Number of other safety events: occurring naturally or as a result of work processes, technical failures that may create a significant risk to employee or public safety	49	**137**
Number of work safety inspections at contractors working for the Company	61	**6 002**

Number of accidents at work at the PGNiG Group

In the PGNiG Group, the number of accidents at work fell by 2.5% in relation to 2016. The number of persons who were injured in accidents at work decreased by 1.9%. The following tables present detailed information on the accidents that occurred at the PGNiG Group and other OHS issues.

Total number of accidents at the PGNiG Group in 2017.

Organisational unit	Total accidents	Casualties	including persons injured:		Number of group accidents in total number of accidents		Type of injury			Days lost	Indicators	
			in accidents at work	in accidents treated as accidents at work	number of accidents	number of persons	death	severe bodily injury	minor bodily injury		incidence rate per 1,000 employees	severity rate (days of absence per accident)
Head quarter PGNiG	3	3	3	-	-	-	-	-	3	9	4,9	3,0
Geology and Hydrocarbon Production Branch	1	1	-	1	-	-	-	-	1	14	1,9	14,0
Sanok Branch	4	4	4	-	-	-	-	-	4	241	2,7	60,3
Zielona Góra Branch	7	7	7	-	-	-	-	-	7	345	3,9	49,3
Odolanów Branch	-	-	-	-	-	-	-	-	-	-	-	-
Central Measurement and Testing Laboratory	1	1	1	-	-	-	-	-	1	7	23,3	7,0
Borehole Mining Rescue Station	-	-	-	-	-	-	-	-	-	-	-	-
Wholesale Branch	-	-	-	-	-	-	-	-	-	-	-	-
PGNiG	**16**	**16**	**15**	**1**	**-**	**-**	**-**	**-**	**16**	**616**	**3,4**	**39**
GEOFIZYKA Toruń	7	7	7	-	-	-	-	-	7	585	7	84
EXALO	27	27	27	-	-	-	-	-	27	2 136	14	79
PGNiG Technologie	9	9	9	-	-	-	-	-	9	449	16	50
PSG	124	130	128	2	6	12	1	2	127	6 647	11	54
PGNiG Serwis	1	1	-	1	-	-	-	-	1	22	5	22
GEOVITA	6	6	6	-	-	-	-	-	6	404	26	67
PGNiG TERMIKA	5	5	4	1	-	-	-	-	5	454	5	91
PGNiG OD	9	9	8	1	-	-	-	-	9	305	3,6	33,9
GSP	-	-	-	-	-	-	-	-	-	-	-	-
TOTAL PGNiG Group	**204**	**210**	**204**	**6**	**6**	**12**	**1**	**2**	**207**	**11 618**	**9,0**	**5**

F, SR, LDR, IR for the PGNiG Group in 2017

Organisational unit	Accident frequency (F)			Severity rate (SR)			Lost day rate (LDR)			Injury rate (IR)		
	W	M	total	W	M	total	W	M	total	W	M	total
PGNiG	**3**	**4**	**3**	**7,0**	**45,8**	**38,5**	**3**	**20**	**16**	**0**	**0**	**0**
GEOFIZYKA Toruń	-	7,9	7,0	-	83,6	83,6	-	81,63	72,99	-	0,98	0,87
EXALO	-	16,4	14,5	-	79,1	79,1	-	146,75	131,79	-	1,86	1,67
PGNiG Technologie	13,9	15,8	16,4	-	56,1	49,9	-	107,27	95,04	1,86	1,91	1,90
PSG	3,1	15,0	11,8	45,8	51,6	51,1	22,70	82,80	70,02	0,50	1,61	1,37
PGNiG Serwis	-	8,3	4,3	-	22,0	22,0	-	22,96	11,68	-	1,04	0,53
GEOVITA	32,6	0,0	25,9	67,3	-	67,3	200,70	-	143,60	2,98	-	2,13
PGNiG TERMIKA	-	5,7	4,7	-	90,8	90,8	-	63,79	53,23	-	0,70	0,59
PGNiG OD	3,2	4,4	3,6	40,8	25,3	33,9	16,12	13,74	15,25	0,40	0,54	0,45
GSP	-	-	-	-	-	-	-	-	-	-	-	-
PGNiG Group	**1,07**	**11,17**	**9,00**	**43,48**	**56,92**	**55,32**	**22,59**	**71,19**	**59,26**	**0,52**	**1,25**	**1,07**

W – women / M – men

Diagnosed occupational diseases at the PGNiG Group in 2017

Organisational unit	Total number of diseases	Occupational disease certificates issued by the National Sanitary Inspectorate			
		Occupational loss of hearing	Vibration syndrome	Pneumoconiosis	Other
PGNiG	**1**	**-**	**-**	**-**	**-**
GEOFIZYKA Toruń	-	-	-	-	-
EXALO	-	-	-	-	-
PGNiG Technologie	-	-	-	-	-
PSG	2	-	-	1	1
PGNiG Serwis	-	-	-	-	-
GEOVITA	-	-	-	-	-
PGNiG TERMIKA	-	-	-	-	-
PGNiG OD	-	-	-	-	-
GSP	-	-	-	-	-
Total PGNiG Group	**3**	**-**	**-**	**1**	**1**

OHS-related initiatives (e.g. number of employees who received OHS training) in 2017

Organisational unit	OHS training					Number of OHS meetings with technical and operational staff
	Induction training for new employees	Periodic	First aid training	Other	Total	
PGNiG	**226**	**1 716**	**531**	**264**	**2 737**	**72**
GEOFIZYKA Toruń	217	508	725	301	1 751	ad hoc
EXALO	87	1 159	108	58	1 412	12
PGNiG Technologie	21	218	0	0	239	7
PSG	-	6 948	227	44	7 219	173
PGNiG Serwis	77	89	7	0	173	-
GEOVITA	107	36	11	7	59	1
PGNiG TERMIKA	88	635	15	-	738	34
PGNiG OD	308	516	-	-	824	-
GSP	13	35	-	-	-	-
Total PGNiG Group	**1 144**	**11 860**	**1 624**	**674**	**15 152**	**299**

11.3.7. Innovation for development

In response to current challenges, PGNiG is looking for new technological solutions and supports the work and development of innovators. PGNiG believes that the experience of an international corporation combined with the innovative thinking of young entrepreneurs, scientists and employees can change the face of the energy sector in Poland and globally.

Investment in innovation and modern solutions increase the efficiency of operations, contribute to the growth of the PGNiG Group's business potential and help minimise the adverse impact of the Group's operations on the environment. Innovation based on a solid foundation, laid on knowledge, education and R&D activities, can trigger the growth of an organisation. That is why one of our priorities is to develop cooperation with the world of science, as well as to support and initiate the development of start-ups as well as small and medium-sized enterprises.

In 2017, the Group continued the intensification of research, development, and innovation (R&D&I) activities initiated in 2016. The Group assumes that in two or three years innovation will be among the key drivers of its competitive advantage on a liberalising market.

Below we present the most important innovative projects in which the PGNiG Group entities were involved as the initiators, executors or beneficiaries.

No.	Project	Executor	Brief project description	Target group
1.	InnVento	PGNiG	The InnVento business incubator is the first initiative of this type in the energy sector, targeted at young entrepreneurs and scientists and dedicated to innovative solutions for the energy sector. InnVento is an office space equipped with the latest equipment and offering access to PGNiG Group's mentors and experts. For more information, see: innvento.pl/	start-ups at an early stage of development
2.	PGNiG Polskie Innowacje Polish Innovation	PGNiG	Project addressed to students of Polish universities. The project was aimed at promoting the Company as an innovative enterprise supporting new solutions for the industry. During regular meetings, students had the opportunity to learn more about the Company's activities and talk to experts.	university students
3.	Pilotaż Energy Management System	Krajowa Agencja Poszanowania Energii S.A. – the consortium leader, Consus Carbon Engineering Sp. z o.o., CONSTRUCTORS Spółka Cywilna, Jarosław Klubowicz, Andrzej Górski	The objective of the Pilotaż Energy Management System project is to introduce the Energy Management System at selected PGNiG facilities. A systemic approach to energy management (electricity, heating, cooling and gas) will ensure that energy management in a company is a controlled process. The project will help set new directions in implementing energy efficiency solutions and supporting systems. The project is also intended to increase the efficiency of sharing experience and good practices applied within PGNiG, which will translate into a standardized approach to planning and implementing investment tasks relating to energy efficiency, as well as into cost and project optimisation.	PGNiG's Head Office, Sanok Branch, Zielona Góra Branch
4.	Crowdsourcing platform	Elastic Cloud Solutions	The platform supports sharing ideas for the company's development and solving existing problems. It operates in accordance with the principles of crowdsourcing. Simply put, this means sourcing knowledge and ideas from employees.	PGNiG employees
5.	SORGE	unspecified at this stage of the project	The objectives of the project are as follows: to improve the margin on sale of electricity generated from dispersed sources thanks to the possibility of combining electricity streams from multiple dispersed sources into one product; to meet all of the PGNiG Group's electricity requirement with electricity generated from dispersed sources in order to maximise the sales volume for electricity generated by PGNiG TERMIKA's grid power sources; to enable the PGNiG Group to provide the electricity demand reduction service.	Zielona Góra Branch
6.	Energy audit	Echo Energy and Safety Sp. z o.o., Zakłady Pomiarowo-Badawcze Energetyki Energopomiar Sp. z o.o., Krajowa Agencja Poszanowania Energii S.A.	The aim of the project is to perform enterprise energy audits and prepare audit reports in a manner that guarantees the fulfilment of the obligation laid down in the Energy Efficiency Act of May 20th 2016. The audits will also produce analyses (recommendations) serving as the basis for assessing overall energy consumption by PGNiG facilities. This will be the basis for planning investments aimed at rational energy management at PGNiG S.A.	PGNiG: Head Office, Odolanów Branch, Sanok Branch, Zielona Góra Branch, Geology and Hydrocarbon Production Branch
7.	GEO METAN	PGNiG GHPB	The aim of the project is to build demonstration capture facilities for methane from surface directional wells in coal deposits and to run long-term production tests.	Mining industry
8.	MIT Enterprise Forum Poland Acceleration Programme	PGNiG Head Office, Innovation and Business Development Division	The involvement of several large enterprises from various industries supports several acceleration paths (Energy, Health, Commodities, and FinTech). The accelerator programme is based on a proven acceleration pattern, supported with the individual approach of those behind the Polish version of the programme. The programme is co-financed by the Polish Agency for Enterprise Development (PART) under the ScaleUP programme, which is part of the Start in Poland programme.	Technology start-ups
9	Młodzi Innowacyjni dla PGNiG (Young Innovators for PGNiG)	PGNiG	The third edition of the competition for young scientists preparing research and development projects for the PGNiG Group. The competition was launched in 2015. About 80 projects were submitted for the competition and many of them were highly innovative. Its aim is to search for innovative R&D projects falling within the PGNiG Group's business scope, including in particular: hydrocarbon exploration and production; distribution of gas fuels; power generation; new applications of natural gas; environmental protection; gas user service, including safety issues and promotion of the PGNiG brand.	PGNiG Group, young scientists, university students and PhD students
10	Annual assessment of PGNIG TERMIKA's impact on air quality in the Warsaw agglomeration	PGNiG TERMIKA	The aim of the project is to show PGNiG TERMIKA's impact of on air quality in Warsaw.	PGNiG TERMIKA
11	Bank Inicjatyw (Bank of Initiatives)	PGNiG TERMIKA	The main goal of the Bank of Initiatives is to search for and implement innovative ideas of employees. In 2017, 132 innovative ideas were submitted. The Innovation Team recommended 63 projects for implementation.	PGNiG TERMIKA
12	Implementation of the GSPnet Platform	GSP	The GSPnet project is an intranet platform for creating a knowledge base within the company, implemented in the SharePoint technology. It will support a broad integration, in the form of modules, with existing and future systems of GSP.	GSP.
13	KAWERNA 3D (3-D CAVERN)	GSP	The purpose of the project is to develop a product for commercial application in order to provide a comprehensive service consisting in the design and construction of a cavern/cavern field in an optimal way to ensure the highest possible geometric volume, that is a maximum working capacity under particular reservoir conditions. In addition, 3-D modelling will enable optimal management of halite deposits.	Companies building salt mines, underground hydrocarbon storage cavern facilities
14	Pomysł na Innowacje (Innovative Idea)	PSG	The key business goal of the project is to develop and implement a solution which would support the creation of corporate culture and a climate favourable for the development of innovation within PSG.	PSG employees
15	Barents Sea Exploration Collaboration (BaSEC)	PGNiG UN	A joint industry project to increase knowledge about the development of hydrocarbon production in the Barents Sea.	Oil and gas companies applying for licences in the Barents Sea

11.3.8. The value system as a basis for action

The objective of ethics programme is to ensure compliance with ethics principles and strengthen PGNiG's corporate culture by identifying behaviors that are desirable within the company, as well as those that will not be accepted. The rules of ethics are defined in the PGNiG Code of Ethics and in the Principles of Good Practice of the PGNiG Group Manager.

The PGNiG Code of Ethics describes standards in four categories: responsibility, partnership, credibility and quality. These are also the values which PGNiG employees indicated as the most important ones in the satisfaction survey. The system of values at the PGNiG Group is supported by the Ethics Officer employed at PGNiG, who explains ethics matters to the entities that do not have an ethics officer and recommends steps to be taken by the management of those entities. In addition, it formally responds to any concerns or doubts raised by the PGNiG Group employees. At PGNiG, no official reports on breach of ethics were submitted.

The Ethics Programme Management System and the Ethics Committee have also been in place for several years. The Committee consists of directors and managers of key areas who are responsible for implementing ethical standards. Meetings of the Ethics Committee are held at least twice a year. The PGNiG Group companies also have their own codes of ethics and ethics officers.

The Ethics Officer is responsible for promoting PGNiG's ethical behaviour, and monitors compliance with the Code of Ethics by receiving and evaluating reports of ethics violations and liaising with the Ethics Committee and the Ethics Officers of the PGNiG Group. The PGNiG Group has 10 persons to perform this function.

The PGNiG Group ethics officers supervised ethics training covering over 3,000 Group employees, with particular focus on workplace harassment and ethical awareness. The need was also stressed to involve managers in transferring ethics knowledge to their subordinates.

The PGNiG Code of Ethics is a set of moral principles and ethics relevant to PGNiG corporate culture, which provides a strong foundation for building lasting and transparent relationships with all stakeholders. It also describes the core values which are expected to facilitate the process of developing an ethical environment and a culture of trust at the PGNiG Group.

At PGNiG, no official reports on breach of ethics were submitted. The same was true in the majority of Group companies with ethics. PSG, which has the largest number of employees in the PGNiG Group, registered 60 applications throughout the year. In accordance with the Company's Ethics Principles and the Code of Ethics, issues were dealt with by two full-time ethics officers directly or by appointed Ethics Committees depending on the subject and scope of the issues raised.

Human rights and ethics

Human rights aspects are taken into account in the Codes of Ethics and the Group’s procedures for preventing workplace harassment and discrimination, which are founded, in particular, on the principles of the Constitution of the Republic of Poland:

- the principle of legal equality and prohibition of discrimination (Art. 32 of the Constitution of the Republic of Poland);
- the principle of gender equality (Art. 33);
- freedom of religion and belief (Art. 53–54);
- the right to privacy (Art. 47); and
- the right to protection of personal data (Art. 51)

11.4. Description of policies

11.4.1. Compliance policy

PGNiG Group is aware of the importance of ensuring compliance with the applicable laws and other regulations, including in particular industry-specific and corporate ones, as well as with the standards of conduct, including the ethical standards, adopted by PGNiG. The steps taken with a view to ensuring compliance of the entire organisation with external and internal standards reduce business risk and are a manifestation of the Company's responsible attitude towards its shareholders, trading partners, employees and other stakeholders. Active and comprehensive management of compliance risk is a prerequisite for sustainable and safe operation of PGNiG. At the same time, the organisation’s approach to compliance risk management is focused on building relationships within the Company and within its environment in a way that reflects its respect for human rights in the broad sense of the term.

The Compliance Risk Management System defined in the PGNiG Compliance Programme was implemented in 2015.

The system ensures compliance of all activities undertaken across the organisation with the applicable internal and external standards. The implementation of the Compliance Programme has helped reduce business risk and enhance the Company's competitiveness and market position as a result of introducing transparent rules for cooperation within the Company and with its environment, facilitating contacts with other business operators and improving the Company's image, thus boosting potential contractors’ trust in relations with the Company. One of the aims of the Compliance Programme implementation is also to make both the management and employees aware that a system ensuring compliance of the entire organisation with the national and international legal and regulatory frameworks is an essential element of any modern business.

The solutions used in the implemented Compliance Risk Management System will be tailored to the needs and organisational structure of the entire Company. In accordance with the approach to compliance risk management adopted by PGNiG, organisational and procedural solutions will be put in place that will support ongoing identification of relevant laws and regulations, assessment of the level of compliance risk, definition and application of solutions ensuring compliance with identified requirements, taking steps aimed at identifying cases of non-compliance, as well as periodic reporting within the organisation.

The Company defines compliance risk as the risk of potential legal sanctions, financial losses or loss of reputation or credibility as a result of any failure by PGNiG, its employees or entities acting on its behalf to comply with the law or the internal regulations or standards of conduct, including ethical norms, adopted by PGNiG.

The Compliance Programme provides for certain regular obligations, such as periodic reporting on compliance standards, compliance risks (and their assessment in terms of materiality/consequences and probability of occurrence), and risk response (risk management method and cost of response). Moreover, the programme imposes certain permanent obligations, which consist mainly in monitoring changes in compliance standards and reporting material risks.

Each employee, trading partner or external stakeholder can report any suspected irregularity/misconduct through the 'compliance line' established under the programme.

11.4.2. Anti-corruption policy

One of the overriding principles of the PGNiG Group's policy is to act in a fair and ethical manner. PGNiG and the PGNiG Group companies are respected for their fairness, both in their management practices and in dealings with trading partners and customers, and it is essential that this reputation be maintained.

The Group companies require their employees to adhere to the standards of ethics, honesty and integrity in any activities they undertake, including in business transactions and in relations with any persons or organisations.

The anti-corruption policy of the PGNiG Group imposes a strict requirement to observe any and all applicable anti-corruption laws and regulations, including international ones and those effective in the countries where the PGNiG Group is present, including (where applicable) the US Foreign Corrupt Practices Act (FCPA).

Each employee, regardless of their position, is required to act in accordance with local, national and international laws, including any anti-corruption regulations, also those contained in the Code of Ethics applicable at the Group.

The purpose of the PGNiG Group's Anti-Corruption and Gift Policy is to define the obligations of PGNiG and the other Group companies, as well as of their employees and contractors, with regard to preventing corrupt practices, and to provide the employees and contractors with information and guidelines on how to identify corrupt practices and what to do in the event of identifying such practices.

11.4.3. The QHSE (Quality, Health, Safety, Environment) Policy and operation of the QHSE Management System at the PGNiG Group

Following consultation with the governing bodies of the PGNiG Group companies, in 2016 the Management Board of PGNiG developed the PGNiG Group QHSE Policy which defines objectives and directions of operations and ensures the highest standards of quality, health, safety and environmental protection to meet the requirements and expectations of our stakeholders.

The Policy is reviewed periodically to evaluate its usefulness and relevance. At PGNiG, the QHSE Policy is implemented through the ISO 9001:2015, ISO 14001:2015 and OHSAS 18001:2007 compliant QHSE Management System, as well as through good HSE practices.

Objectives of the QHSE Policy:

- To identify, supervise and ensure the effectiveness of the QHSE processes
- To build lasting relationships with PGNiG customers
- To identify and ensure compliance with applicable laws and other requirements
- To implement norms and standards that follow from good practices, to promote safe solutions
- To identify various risks, including near misses, in order to prevent accidents at work, occupational diseases, incidents and failures
- To identify and mitigate environmental impacts
- To build a competent, informed and committed workforce

Most of the PGNiG Group companies carry out activities related to quality, environmental protection and occupational health and safety based on the single QHSE Policy.

Organisational unit	System (IMS, EMS, QCS, OHSMS, EMAS etc.)	Certified (Yes/No)	Date		Certifying entity
			Certification date	Recertification date	
PGNiG	**IMS QHSE**	**No**	**-**	**-**	
PGNiG Sanok Branch*	IMS	Yes	First certification in 2004	Nov 25 2016 Last surveillance audit in October 2017	DNV GL Business Assurance
PGNiG Odolanów Branch*	IMS	Yes		Dec 31 2015 (9001, 14001), Jan 7 2017 (18001)	LRQA
PGNiG Central Measurement and Testing Laboratory*	MS compliant with PN-EN ISO/ IEC 17025:2005+Ap 1:2007, PN-EN ISO/IEC 17065:2013	Yes			PCA
Exalo	**IMS**	**Yes**	**Mar 13 2017**	**2020**	**TÜV SÜD**
Geofizyka Toruń	**IMS QHSE**	**Yes**	**Mar 18 2011**	**Mar 18 2017**	**LRQA**
PGNiG OD		**No**			
PGNiG Technologie	**IMS**	**Yes**	**2013**	**2018**	**UDT**
PGNiG TERMIKA	**OHSMS** **EMS**	**Yes** **Yes**	**Oct 22 2007** **Dec 5 2007**	**Sep 23 2016** **Sep 23 2016**	**PCBC**
PSG	**IMS**	**Yes**	**Dec 16 2016**	**Nov 17 2017**	**TÜV NORD**

**) As the QHSE Management System is planned to be certified in June 2018, some branches that already operate their own management systems have separately carried out surveillance/recertification audits to ensure continuity of certification.*
The Central Measurement and Testing Laboratory has in place a documented quality management system that is certified by the Polish Centre for Accreditation for compliance with the international and European standards PN-EN ISO/IEC 17025: 2005.

Overview of activities aimed at ensuring compliance with the PGNiG Group QHSE Policy.

The PGNiG Group QHSE Policy regarding quality was implemented at the Group companies through the following measures:

- Ensuring quality, continuity and timeliness of delivery of natural gas, crude oil and other products and storage services to PGNiG customers
- Process identification, supervision and monitoring
- Using feedback from employees, customers and other stakeholders for process improvements
- Raising employee awareness and qualifications
- Identifying and ensuring compliance with applicable laws and other requirements
- Setting and pursuing improvement goals relating, for instance, to the application of state-of-the-art technology
- Conducting audits and implementing corrective measures
- Managing risks and opportunities across business processes
- Implementing employee support programmes (new employee mentoring, Trainer Academy internal training programmes).

The PGNiG Group QHSE Policy regarding environmental protection was implemented through the following measures:

- Identifying, supervising and monitoring of environmental aspects
- Identifying and ensuring compliance with applicable laws and other requirements
- Setting and pursuing improvement goals to minimise external and environmental impacts and keep a balance between business growth and environmental protection
- Applying environmentally-friendly technologies
- Monitoring the environmental impacts of operations
- Using fuels and natural resources in an efficient way
- Implementing remediation and reclamation measures
- Supervising contractor operations
- Constantly raising employee awareness and qualifications in the area of environmental protection.

The PGNiG Group QHSE Policy regarding health and safety was implemented through the following measures:

- Identifying hazards and conducting job and workplace risk assessments
- Identifying and ensuring compliance with applicable laws and other requirements
- Setting improvement goals
- Implementing corrective measures
- Applying state-of-the-art safeguards and process solutions designed to prevent accidents, mechanical failures and occupational diseases
- Building relationships with contractors
- Identifying and reporting near misses
- Promoting and implementing safety improvement and safe behaviour awareness programmes.

Key QHSE objectives, progress of implementation or metrics used to measure the progress

At the Group, we have set QHSE objectives and tasks to ensure product and service compliance, increase customer satisfaction and prevent injuries and occupational diseases, relating them to major environmental aspects and workplace hazards. The objectives have been formulated in line with the principles of SMART goal setting:

- S (specific) – they clearly define an area
- M (measurable) – their outcomes can be measured
- A (attainable) – they can be accomplished
- R (relevant) – they are relevant to the area being managed
- T (timescale) – they include a reasonable deadline.

The objectives are short- and long-term, with deadlines of one to three years. They are incorporated into programmes run by the individual PGNiG Group entities, set up or updated once a year.

In 2017, the vast majority of the PGNiG Group entities accomplished all pre-set tasks and objectives. Some of the objectives, due to their complexity and cost of implementation, have not yet been completed but are pursued as scheduled.

Internal audits in 2017

Internal audits, in addition to reviews carried out by senior management, serve as the main control mechanism for businesses as they make it possible to evaluate compliance with legal requirements and standards as well as the effectiveness of management systems.

In 2017, just as in the previous year, 179 internal audits were carried out at the PGNiG Group. The largest number of audits were performed at PSG, which has a multi-branch structure.

Due to the ongoing work on implementation of management systems, in 2017 some of the PGNiG Group's units (such as PGNiG's Head Office, PGNiG OD, GAZ) were not subject to internal audits.

The most common irregularities were related to supervision of documents, internal and external communication, procurement of resources, planning and supervision of operations, monitoring and measurements, as well as post-failure and post-accident follow-up measures.

Corrective actions included steps aimed at raising awareness of the reported issues among employees (through training, talks) and clarifying IMS documentation to ensure that similar non-compliance is avoided in the future. Where appropriate, minor corrections were made by providing missing records/documents (e.g. MSDS, scope of activities).

Best practice in promoting and improving the management system:

- organisation of competitions on occupational health and safety, fire protection and first aid for employees,
- organisation of consultation meetings of the PGNiG Group's staff responsible for environmental protection and OHS issues,
- organisation of and participation in technical conferences and seminars on environmental protection and work safety,
- publication of information materials on management systems, including leaflets for visitors at facilities, as well as information in trade magazines and newsletters,
- participation in the Polish Quality Award competition, in which PSG won the first place.

11.4.4. Corporate governance

The PGNiG Group attaches great importance to the proper implementation of corporate governance principles. The company treats all shareholders in a fair, equal and reliable manner, making every effort to build the best possible relations between investors and PGNiG's organs.

As a listed company, PGNiG is subject to the principles of the Code of Best Practice, within the scope of which it presents to current and future shareholders an annual Statement on Compliance with Corporate Governance Rules. The content of the statement on PGNiG's corporate governance compliance in 2017 is available on the company's corporate website under Corporate Governance / Good Practices.

› For more information, see Section 10.4

11.5. Risks idnentified in key strategic areas of the PGNiG GROUP's sustainable growth from social perspective

Area	Risk	Risk management measures taken by the PGNiG Group
NATIONAL ENERGY SECURITY	Delay in exploration and production operations	• Ongoing monitoring of project progress • Taking necessary corrective action by the licence operator
	Disruptions to gas supplies	• Constant monitoring of gas supplies • Efforts aimed at ensuring real diversification of gas supplies in terms of suppliers and countries
ENVIRONMENT	Negative impact of operations on the natural environment	• Implementation of the QHSE Policy and environmental management systems • Environmental education of employees • Implementation of energy management system • Submitting reports to competent authorities and institutions responsible for environmental management
SOCIETY	Risks related to relations with local communities	• Ongoing communication of and education on executed projects • Cooperation with non-governmental organisations • Addressing real problems of local communities (programmes, projects, support for local initiatives) • Cooperation with local authorities
CUSTOMERS	Risks related to relations with customers	• Review of agreements in terms of legal compliance • Provision of customer service training to employees • Compliance with the Code of Ethics • Rules and regulations applicable to customer relations • Development of modern channels of communication with customers
EMPLOYEES	Departures of highly qualified staff	• Clear rules of employee remuneration • Regular employee training to improve qualifications • Periodic employee assessment by superiors • Employee surveys / opinion polls • System of social and other benefits for employees
	Occupational health and safety risk	• OHS and first aid training for employees • Compliance with the requirement of pre-employment and periodic medical examinations of employees • Compliance with internal OHS procedures reflecting external regulations • Compliance with the QHSE Policy • Ongoing proactive and reactive monitoring
	Risk related to social dialogue – relations with trade unions	• Periodic meetings of management staff with representatives of trade unions • Ethics programme management system • Rules of meeting employee benefit obligations • Social agreements, Company Collective Bargaining Agreements
ETHICS	Risk of misconduct (bullying, harassment)	• Training for employees and management staff • Ethics programme management system • Code of Ethics with examples of ethical behaviour • Ethics officers in the PGNiG Group, including at PGNiG
	Risk of corruption	• Compliance with the Code of Ethics • Implementation of the Anti-Corruption and Gift Policy • Relevant staff training • Ongoing monitoring and analysis of external regulations and their incorporation in internal rules
	Risk of irregularities in public procurement processes	• Staff training on procurement procedures and liability of employees involved in procurement process • Internal rules, including the Anti-Corruption and Gift Policy • Supervision of procurement documentation by qualified personnel
	Risk related to relations with suppliers and counterparties	• Compliance with the Code of Ethics and the QHSE Policy • Employment of qualified staff • Requiring contractors and suppliers to comply with the PGNiG Group's internal regulations

12. Representation of the PGNiG Management Board and authorisation of the report

The Management Board of PGNiG represents that to the best of its knowledge this Directors' Report on the operations of PGNiG S.A. and the PGNiG Group gives a fair view of the Company's and the Group's condition and includes a description of key threats and risks.

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, March 12th 2018