DIRECTORS' REPORT ON THE OPERATIONS OF THE PGNIG GROUP IN 2013

PGNiG

Polskie Górnictwo Naftowe
i Gazownictwo SA

Warsaw, February 19th 2014

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Section I: PGNiG Group

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

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

On May 24th 2005, the Polish Securities and Exchange Commission admitted PGNiG shares to public trading. The Company floated its shares on the Warsaw Stock Exchange on September 23rd 2005. PGNiG shares have been listed on the Warsaw Stock Exchange since October 20th 2005. Currently, the share capital of PGNiG S.A. amounts to PLN 5.9bn and is divided into 5,900,000,000 shares with a par value of PLN 1 per share.

The PGNiG Group holds the leading position in most segments of the Polish gas sector, i.e. in oil and gas exploration and production, gas fuel storage, natural gas trading and natural gas distribution. The Group's oil and gas upstream operations, carried out primarily in Poland and on the Norwegian Continental Shelf, provide it with a competitive advantage on the liberalised gas market. The Group's trade and storage operations focus on selling natural gas imported from other countries or produced from domestic fields, and on providing gas supplies at times of peak demand. The distribution operations involve the supply of gas to customers via the distribution network, as well as extending and upgrading of the gas network. One of the PGNiG Group's priorities is to gradually transform the Group into a modern energy conglomerate, offering a comprehensive range of energy products and services. In 2012, the PGNiG Group expanded its operations to include electricity and heat generation and sale.

1. Group structure

As at December 31st 2013, the Group comprised PGNiG S.A. (the Parent), and 30 production and service companies, including:

- 22 direct subsidiaries of PGNiG S.A.
- 8 indirect subsidiaries of PGNiG S.A.

The list of the PGNiG Group companies as at December 31st 2013 is presented in the table below.

Companies of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	Ownership interest held by PGNiG S.A.	% of total voting rights held by PGNiG S.A.
	Direct subsidiaries of PGNiG S.A. – first tier				
1	Exalo Drilling S.A.	981,500,000.00	981,500,000.00	100.00%	100.00%
2	GEOFIZYKA Kraków S.A.	64,400,000.00	64,400,000.00	100.00%	100.00%
3	GEOFIZYKA Toruń S.A.	66,000,000.00	66,000,000.00	100.00%	100.00%
4	PGNiG Upstream International AS (NOK)[1)]	1,092,000,000.00	1,092,000,000.00	100.00%	100.00%
5	Polish Oil and Gas Company - Libya B.V. (EUR)[1)]	20,000.00	20,000.00	100.00%	100.00%
6	PGNiG Sales & Trading GmbH (EUR)[1)]	10,000,000.00	10,000,000.00	100.00%	100.00%
7	Operator Systemu Magazynowania Sp. z o.o.	15,290,000.00	15,290,000.00	100.00%	100.00%
8	Polska Spółka Gazownictwa Sp. z o.o.	10,454,206,550.00	10,454,206,550.00	100.00%	100.00%
9	Geovita S.A.	86,139,000.00	86,139,000.00	100.00%	100.00%
10	Biogazownia Ostrowiec Sp. z o.o. w likwidacji (in liquidation)	165,000.00	165,000.00	100.00%	100.00%
11	PGNiG Technologie S.A.	182,127,240.00	182,127,240.00	100.00%	100.00%
12	BUD-GAZ PPUH Sp. z o.o. w likwidacji (in liquidation)	51,760.00	51,760.00	100.00%	100.00%
13	Polskie Elektrownie Gazowe Sp. z o.o. w likwidacji (in liquidation)	1,212,000.00	1,212,000.00	100.00%	100.00%
14	PGNiG TERMIKA S.A.	670,324,950.00	670,324,950.00	100.00%	100.00%
15	PGNiG Finance AB (SEK)[1)]	500,000.00	500,000.00	100.00%	100.00%
16	PGNiG Serwis Sp. z o.o.	9,995,000.00	9,995,000.00	100.00%	100.00%
17	PGNiG Obrót Detaliczny Sp. z o.o.	1,000,000.00	1,000,000.00	100.00%	100.00%
18	PGNiG SPV 5 Sp. z o.o.	250,000.00	250,000.00	100.00%	100.00%
19	PGNiG SPV 6 Sp. z o.o.	250,000.00	250,000.00	100.00%	100.00%
20	PGNiG SPV 7 Sp. z o.o.	250,000.00	250,000.00	100.00%	100.00%
21	B.S. i P.G. Gazoprojekt S.A.[2)]	4,000,000.00	900,000.00	22.50%	22.50%
22	NYSAGAZ Sp. z o.o.	9,881,000.00	6,549,000.00	66.28%	66.28%
	Indirect subsidiaries of PGNiG S.A. – second tier	Share capital (PLN)	Value of shares held by PGNiG S.A.'s subsidiaries (PLN)	Ownership interest held by PGNiG S.A.'s subsidiaries	% of total voting rights held by PGNiG S.A.'s subsidiaries
23	Powiśle Park Sp. z o.o.	81,131,000.00	81,131,000.00	100.00%	100.00%
24	XOOL GmbH (EUR)[1)]	500,000.00	500,000.00	100.00%	100.00%
25	Oil Tech International F.Z.E. (USD)[1)]	20,000.00	20,000.00	100.00%	100.00%
26	Zakład Gospodarki Mieszkaniowej Sp. z o.o.	1,806,500.00	1,806,500.00	100.00%	100.00%
27	Poltava Services LLC (EUR)[1)]	20,000.00	19,800.00	99.00%	99.00%
28	Ośrodek Badawczo - Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000.00	2,565,350.00	85.51%	85.51%
29	GAZ Sp. z o.o.	300,000.00	240,000.00	80.00%	80.00%
30	PT Geofizyka Toruń Indonezja LLC w likwidacji (in liquidation) (IDR) [1)3)]	8,773,000,000.00	4,825,150,000.00	55.00%	55.00%

[1)] In foreign currencies
[2)] PGNiG S.A. has the right to appoint the majority of the company's Supervisory Board members. Also, PGNiG S.A. holds a 52.50% indirect interest in the company through PGNiG Technologie S.A.
[3)] Paid-up capital: USD 40,687.13

Changes in the PGNiG Group's structure in 2013:

- On January 2nd 2013, the Extraordinary General Meeting of BUD-GAZ PPUH Sp. z o.o. resolved to wind up the company and place it in liquidation.
- On February 1st 2013, the merger of PGNiG Poszukiwania S.A. (now Exalo Drilling S.A.) with PNiG Kraków S.A., PNiG NAFTA S.A., PNiG Jasło S.A., PN Diament Sp. z o.o. and ZRG Krosno Sp. z o.o. was effected and registered with the National Court Register.
- On February 6th 2013, the change of PGNiG Poszukiwania S.A.'s name to Exalo Drilling S.A. was registered with the National Court Register.
- On May 23rd 2013, an amendment to the Articles of Association of PGNiG Norway AS, which involved a change of the company's name to PGNiG Upstream International AS, was registered with the National Court Register.
- On April 15th 2013, INVESTGAS S.A. acquired 307 shares in Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.; INVESTGAS S.A.'s interest in the company's share capital increased from 85% to 85.51%.
- On May 14th 2013, the General Meeting of Biogazownia Ostrowiec Sp. z o.o. resolved to wind up the company and place it in liquidation.
- On July 1st 2013, the merger of PGNiG SPV 4 Sp. z o.o. (acquiring company) with six gas distribution companies (target companies), i.e. Mazowiecka Spółka Gazownictwa Sp. z o.o., Wielkopolska Spółka Gazownictwa Sp. z o.o., Karpacka Spółka Gazownictwa Sp. z o.o., Pomorska Spółka Gazownictwa Sp. z o.o., Dolnośląska Spółka Gazownictwa Sp. z o.o. and Górnośląska Spółka Gazownictwa Sp. z o.o., was effected pursuant to Art. 492.1.1 of the Commercial Companies Code; as a result, the share capital of PGNiG SPV 4 Sp. z o.o. was increased by PLN 10,453,211,550, to PLN 10,454,206,550; the merger and the share capital increase were registered with the National Court Register on July 1st 2013; the company name was changed to Polska Spółka Gazownictwa Sp. z o.o.; the change of the company name was registered with the National Court Register on September 12th 2013.
- On July 1st 2013, the merger of Operator Systemu Magazynowania Sp. z o.o. (acquiring company) with INVESTGAS S.A. (target company) was effected pursuant to Art. 492.1.1 of the Commercial Companies Code; as a result, the share capital of Operator Systemu Magazynowania Sp. z o.o. was increased by PLN 10,290,000, to PLN 15,290,000; the merger and the share capital increase were registered with the National Court Register on July 1st 2013.
- On July 23rd 2013, the merger of PGNiG S.A. (acquiring company) with PGNiG Energia S.A. (target company) without a share capital increase was effected pursuant to Art. 492.1.1 of the Commercial Companies Code; the merger was registered with the National Court Register on July 23rd 2013.
- On August 22nd 2013, the Extraordinary General Meeting of Polskie Elektrownie Gazowe Sp. z o.o. resolved to wind up the company and place it in liquidation.
- On October 31st 2013, a new company under the name of PGNiG Obrót Detaliczny Sp. z o.o. was established; the company's share capital is PLN 1,000,000 and is divided into 10,000 shares with a par value of PLN 100 per share; PGNiG S.A. holds a 100% equity interest in PGNiG Obrót Detaliczny Sp. z o.o.; the company was registered with the National Court Register on December 3rd 2013.
- On November 21st 2013, a new company under the name of PGNiG SPV 5 Sp. z o.o. was established; PGNiG S.A. holds a 100% equity interest in PGNiG SPV 5 Sp. z o.o. (PLN 250,000; 2,500 shares with a par value of PLN 100 per share); the company was registered with the National Court Register on December 13th 2013.
- On November 21st 2013, a new company under the name of PGNiG SPV 6 Sp. z o.o. was established; PGNiG S.A. holds a 100% equity interest in PGNiG SPV 6 Sp. z o.o. (PLN 250,000; 2,500 shares with a par value of PLN 100 per share); the company was registered with the National Court Register on December 11th 2013.
- On November 21st 2013, a new company under the name of PGNiG SPV 7 Sp. z o.o. was established; PGNiG S.A. holds a 100% equity interest in PGNiG SPV 7 Sp. z o.o. (PLN 250,000;

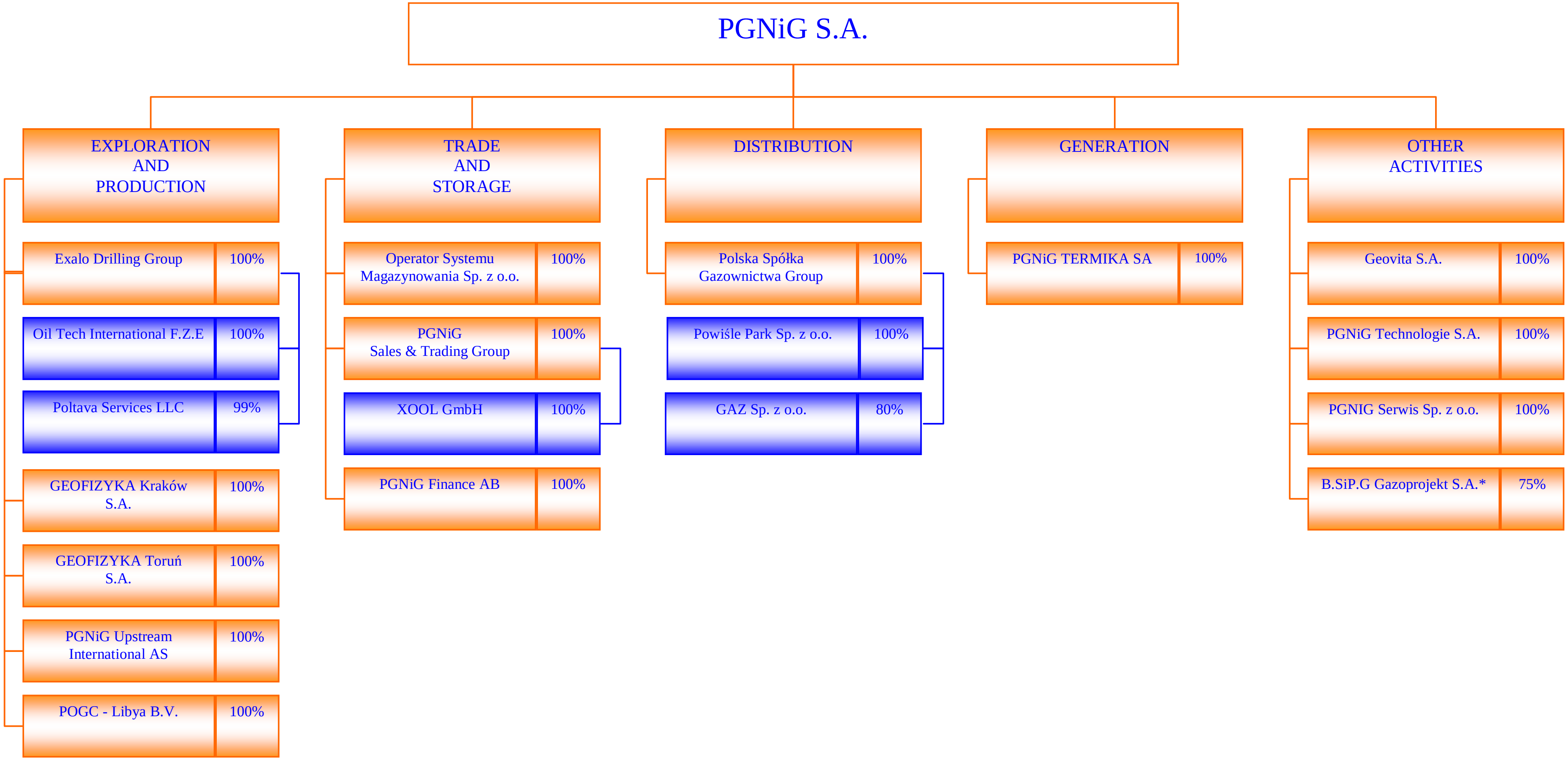
2,500 shares with a par value of PLN 100 per share); the company was registered with the National Court Register on December 9th 2013.

Changes in the Group companies' share capital in 2013:

- Registration of a share capital increase at Biogazownia Ostrowiec Sp. z o.o. by PLN 60,000, to PLN 165,000, by way of an issue of 1,200 new shares with a par value of PLN 50 per share; the new shares were acquired by PGNiG Energia S.A., the company's sole shareholder, and paid for with cash. The share capital increase was registered with the National Court Register on March 5th 2013;
- Increase in the share capital of PGNiG SPV 4 Sp. z o.o. by PLN 990,000, to PLN 995,000, by way of an issue of 19,800 new shares with a par value of PLN 50 per share, which were subscribed for by PGNiG S.A. and fully paid for with cash; the increase was registered with the National Court Register on March 6th 2013;
- Increase in the share capital of PGNiG TERMIKA S.A. by PLN 33,984,000, to PLN 896,300,000, by way of an issue of 3,398,400 Series D shares; all the new issue shares were subscribed for by PGNiG S.A.; PGNiG S.A.'s interest in the company's share capital increased to 72.52%; the increase was registered with the National Court Register on March 22nd 2013;
- Reduction of the share capital of PGNiG TERMIKA S.A. by PLN 246,300,000, to PLN 650,000,000, by way of retirement of all of the company's 24,630,000 treasury shares without consideration (i.e. 24,629,609 shares in respect of which the company did not exercise the voting rights, and 391 shares acquired from non-controlling shareholders under Art. 418 of the Commercial Companies Code); PGNiG S.A. holds a 100% interest in PGNiG TERMIKA S.A.'s share capital and voting rights; the reduction was registered with the National Court Register on May 27th 2013; the court also registered PGNiG S.A. as the sole shareholder in the company;
- Increase in the share capital of PGNiG Technologie S.A. by PLN 15,213,240, to PLN 182,127,240; all the new shares were subscribed for by PGNiG S.A. and fully paid for with a non-cash contribution in the form of 21,000 shares in B.S.i P.G. Gazoprojekt S.A.; PGNiG S.A.'s direct interest in the share capital of B.S. i P.G. Gazoprojekt S.A. was reduced to 22.50%, while its indirect interest through PGNiG Technologie S.A. is 52.50%; the changes were registered with the National Court Register on June 21st 2013;
- Increase in the share capital of PGNiG TERMIKA S.A. to PLN 670,324,950, by way of an issue of 2,032,495 Series E shares with a par value of PLN 10 per share; all the shares were fully covered with a non-cash contribution in the form of 14,100,000 registered non-preference shares, with a par value of PLN 1 per share, in Elektrociepłownia Stalowa Wola S.A. of Stalowa Wola; the increase in PGNiG TERMIKA S.A.'s share capital was registered with the National Court Register on November 20th 2013.

The chart below presents the consolidated companies of the PGNiG Group as at December 31st 2013 (by segments).

CONSOLIDATED COMPANIES OF THE PGNiG GROUP



* PGNiG SA has the right to appoint the majority of the company's Supervisory Board members.
PGNiG SA's direct interest in the share capital of B.SiP.G Gazoprojekt S.A. is 22.50%, while its indirect interest through PGNiG Technologie S.A. is 52.50%.

Changes in management policies

In 2013, the PGNiG Group reorganised the trade, storage, and distribution segments. The purpose of this effort was to improve the efficiency of the Group's operations and ensure that it stays competitive in a deregulated gas market.

PGNiG S.A. merged with PGNiG Energia S.A., whose operations consisted mainly in electricity trading. Furthermore, PGNiG S.A. established the Wholesale Trading Division, which is to take over all wholesale trading processes and manage the Group's product mix, i.e. natural gas, crude oil, and electricity. This is to ensure that the Group maintains its competitive edge in the changing market environment.

As part of the storage segment's reorganisation, the Mogilno Underground Gas Storage Cavern Facility and Wierzchowice Underground Gas Storage Facility were established, while INVESTGAS S.A. was merged with Operator Systemu Magazynowania Sp. z o.o. The management and supervisory processes in the storage segment were centralised in OSM Sp. z o.o., which is to improve long-term efficiency.

In 2013, PGNiG SPV 4 Sp. z o.o. (later to be renamed Polska Spółka Gazownictwa Sp. z o.o.) was merged with six regional gas distribution companies, whose core business was gas distribution, as well as management and development of the distribution infrastructure. This will allow to introduce uniform standards and procedures across the Group, help optimise the distribution costs and enhance customer service.

2. Ownership interests in other related entities

The list of other related entities of the PGNiG Group as at December 31st 2013 is presented in the table below.

Related entities of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	Ownership interest held by PGNiG S.A.	% of total voting rights held by PGNiG S.A.
	Related entities of PGNiG S.A. – first tier				
1	System Gazociągów Tranzytowych EUROPOL GAZ S.A.	80,000,000.00	38,400,000.00	48.00%	48.00%
2	GAS-TRADING S.A.	2,975,000.00	1,291,350.00	43.41%	43.41%
3	InterTransGas GmbH (EUR) [1)]	200,000.00	100,000.00	50.00%	50.00%
4	Dewon Z.S.A. (UAH)[1)]	11,146,800.00	4,055,205.84	36.38%	36.38%
5	Sahara Petroleum Technology llc w likwidacji (in liquidation) (OMR)[1)]	150,000.00	73,500.00	49.00%	49.00%
6	PFK GASKON S.A.	13,061,325.00	6,000,000.00	45.94%	45.94%
7	GAZOMONTAŻ S.A.	1,498,850.00	677,200.00	45.18%	45.18%
8	ZRUG Sp. z o.o. (Poznań)	3,781,800.00	1,515,000.00	40.06%	41.71%
9	ZWUG INTERGAZ Sp. z o.o.	4,700,000.00	1,800,000.00	38.30%	38.30%
10	ZRUG TORUŃ S.A. w upadłości likwidacyjnej (in bankruptcy by liquidation)	5,150,000.00	1,300,000.00	25.24%	25.24%

Related entities of the PGNiG Group - contd.

	Related entities of PGNiG S.A. – second tier	Share capital (PLN)	Value of shares held by PGNiG S.A.'s subsidiaries (PLN)	Ownership interest held by PGNiG S.A.'s subsidiaries	% of total voting rights held by PGNiG S.A.'s subsidiaries
1	NAFT-STAL Sp. z o.o. w upadłości likwidacyjnej (in bankruptcy by liquidation)	667,500.00	450,000.00	67.40%	67.40%
2	Elektrociepłownia Stalowa Wola S.A.	28,200,000.00	14,100,000.00	50.00%	50.00%
3	Al Mashariq – Geofizyka Torun Limited Company (SAR)[1)] w likwidacji (in liquidation)	500,000.00	250,000.00	50.00%	50.00%
4	Gazobudowa Kraków Sp. z o.o.	79,500.00	37,500.00	47.20%	47.20%
5	Geotermia Sp. z o.o.	4,000.00	1,000.00	25.00%	25.00%

[1)] In foreign currencies

On August 7th 2013, Przedsiębiorstwo Badawczo-Usługowe Petromin Sp. z o.o. w likwidacji (in liquidation) was deleted from the National Court Register. Exalo Drilling S.A.'s interest in that company's share capital was 40%.

Equity investments outside the group of related entities

As at the end of 2013, the total par value of the PGNiG Group's equity interests held outside the group of related entities was PLN 12.7m. In 2013, the PGNiG Group made no material equity investments outside the group of related entities.

3. Employment

The table below presents employment at the PGNiG Group as at December 31st 2013, by segments. Employment at the PGNiG Head Office is presented in the Trade and Storage segment.

Workforce by segments (no. of staff)

	2013	2012
Exploration and Production	10,754	10,990
Trade and Storage	4,070	4,397
Distribution	13,050	13,255
Generation	1,066	1,069
Other Activities	1,990	2,327
Total	30,930	32,038

Compared with December 31st 2012, the number of employees at the PGNiG Group fell by 1,108. The change was mainly attributable to the launch in H2 2012 of the voluntary termination programme for PGNiG employees. Most of the employees who participated in the programme terminated their employment contracts with effect as of December 31st 2012, which resulted in a substantial reduction of the staffing level in 2013.

Since January 2009, the Group has operated the Programme for Workforce Streamlining and Redundancy Payments to Employees of the PGNiG Group for 2009–2011 (Stage 3). The Programme remains operational until its expiry on December 31st 2015, but its duration may be shortened if it is terminated by one of the parties. The Programme is operated on a stand-by basis. It may be implemented in extraordinary circumstances and requires all companies to follow a procedure which is uniform across the Group.

In 2013, the Programme was implemented in three companies of the PGNiG Group: PGNiG Technologie S.A., GEOFIZYKA Kraków S.A. and PNiG Jasło S.A. (now Exalo Drilling S.A.), and covered 206 former employees of those companies. The one-off redundancy payments to the terminated employees were financed with PGNiG S.A.'s Central Restructuring Fund reserve.

Section II: Parent's Governing Bodies

1. Management Board

Pursuant to PGNiG S.A.'s Articles of Association, its Management Board is composed of two to seven members. The number of Management Board members is determined by the Supervisory Board. Individual members or the entire Management Board are appointed for a joint three-year term of office.

A member of the Management Board is appointed following a qualification procedure carried out pursuant to the Regulation of the Polish Council of Ministers of March 18th 2003 concerning qualification procedures for members of management boards of certain commercial-law companies (Dz. U. No. 55, item 476, as amended). The Regulation does not apply to Management Board members elected by employees.

As long as the State Treasury remains a shareholder of the Company and the Company's average annual headcount exceeds 500, the Supervisory Board appoints one person elected by the Company's employees to serve on the Management Board during its term. The Supervisory Board adopts the rules governing election and removal from office of the Management Board member representing the employees, and the rules of by-elections.

Each member of the Management Board may be removed from office or suspended from their duties by the Supervisory Board or the General Meeting.

As at January 1st 2013, the composition of the PGNiG Management Board was as follows:

- Grażyna Piotrowska-Oliwa – President
- Radosław Dudziński – Vice-President, Trade
- Sławomir Hinc – Vice-President, Finance
- Mirosław Szkałuba – Vice-President, Procurement and IT

On January 22nd 2013, Mr Sławomir Hinc tendered his resignation from the position of Vice-President of the PGNiG S.A.'s Management Board for Finance, with effect as of March 31st 2013. The reason of the resignation was his appointment as President (CEO) of PGNiG Norway AS (now PGNiG Upstream International AS).

On February 27th 2013, the PGNiG Supervisory Board appointed, with effect as of April 1st 2013, Mr Krzysztof Bocian to the position of Vice-President of the Management Board for Exploration and Production, and Mr Jacek Murawski to the position of Vice-President of the Management Board for Finance, for the joint term of office expiring on March 13th 2014.

On March 30th 2013, the PGNiG Management Board was notified that Mr Krzysztof Bocian had submitted a declaration to avoid the legal consequences of his acceptance of the position of Vice-President of the PGNiG Management Board for Exploration & Production. As a result, Mr Krzysztof Bocian could not take the position. On April 2nd 2013, the PGNiG Supervisory Board repealed the resolution to appoint Vice-President of the PGNiG Management Board for Exploration & Production.

On April 29th 2013, the PGNiG Supervisory Board removed Ms Grażyna Piotrowska-Oliwa, CEO and President of the Management Board, and Mr Radosław Dudziński, Vice-President of the Management Board for Trade, from the PGNiG Management Board and their respective positions. The reason of the removal was that the PGNiG Supervisory Board had lost trust in those members of the Management Board. At the same time, the PGNiG Supervisory Board delegated Mr Mirosław

Szkałuba, Vice-President of the Management Board, to coordinate the Management Board's work until a new President is appointed.

On May 6th 2013, the PGNiG Supervisory Board initiated a qualification process for the positions of President of the Management Board and Vice-President of the Management Board for Trade.

On June 11th 2013, the PGNiG Supervisory Board appointed Mr Jerzy Kurella as Vice-President of the PGNiG Management Board for Trade, with effect as of June 14th 2013, for a joint term of office expiring on March 13th 2014. The PGNiG Supervisory Board also resolved to close the qualification procedure for the position of President of the PGNiG Management Board without selecting a candidate.

On September 16th 2013, Mr Zbigniew Skrzypkiewicz was delegated by the PGNiG Supervisory Board to temporarily serve as Member of the PGNiG Management Board for Corporate Affairs in the period from September 16th 2013 to December 16th 2013.

On December 20th 2013, Mr Mirosław Szkałuba tendered his resignation as Member of the Management Board of PGNiG S.A., effective from the same date.

On December 30th 2013, the PGNiG Supervisory Board removed the Company's Management Board, including Jerzy Kurella – Vice-President, and Jacek Murawski – Vice-President.

On December 30th 2013, the PGNiG Supervisory Board appointed the following persons to serve on the Management Board for a joint term of office beginning December 30th 2013 and ending December 30th 2016:

- Jarosław Bauc, as Vice-President of the Management Board, Finance (effective from December 30th 2013)
- Jerzy Kurella, as Vice-President of the Management Board, Trade (effective from December 30th 2013)
- Andrzej Parafianowicz, as Vice-President, Corporate Affairs (effective from December 31st 2013)
- Zbigniew Skrzypkiewicz, as Vice-President, Exploration and Production (effective from December 31st 2013)
- Mariusz Zawisza, as President (effective from January 1st 2014).

As at December 31st 2013, the composition of the PGNiG Management Board was as follows:

- Jarosław Bauc – Vice-President, Finance
- Jerzy Kurella – Vice-President, Trade
- Andrzej Parafianowicz – Vice-President, Corporate Affairs
- Zbigniew Skrzypkiewicz – Vice-President, Exploration and Production.

<u>Changes in the Management Board subsequent to the end of the reporting period</u>

As at January 1st 2014, the composition of the PGNiG Management Board was as follows:

- Mariusz Zawisza – President
- Jarosław Bauc – Vice-President, Finance
- Jerzy Kurella – Vice-President, Trade
- Andrzej Parafianowicz – Vice-President, Corporate Affairs
- Zbigniew Skrzypkiewicz – Vice-President, Exploration and Production.

In January-February 2014, elections were held to choose the employees' nominee to the Management Board. As at the date of this report, no employee representative was elected.

Contracts with Management Board members

Contracts were concluded with all members of the PGNiG Management Board whereby they are to receive compensation in the event of their resignation or removal from office without a valid reason, or when their resignation or removal from office is caused by acquisition of the Company and its merger into another company.

The Company was a party to an employment contract and non-competition agreement with Sławomir Hinc, Vice-President of the Management Board, Finance. On March 27th 2013, a settlement was reached to terminate the non-competition agreement following Mr Hinc’s resignation, by mutual agreement, from the PGNiG Management Board, effective as of March 31st 2013.

The Company executed managerial contracts and non-competition agreements with Grażyna Piotrowska-Oliwa, President of the Management Board, as well as Radosław Dudziński, Jacek Murawski and Mirosław Szkałuba, Vice-Presidents of the Management Board.

The Company executed managerial contracts and non-competition agreements with Mariusz Zawisza, President of the Management Board, and Jarosław Bauc, Jerzy Kurella, Andrzej Parafianowicz and Zbigniew Skrzypkiewicz, Vice-Presidents of the Management Board.

2. Supervisory Board

Pursuant to the Articles of Association of PGNiG S.A., the Supervisory Board is composed of five to nine members, appointed by the General Meeting for a three-year joint term of office.

As long as the Polish State Treasury holds an equity interest in the Company, the State Treasury, represented by the minister competent for treasury matters, acting in consultation with the minister competent for economic matters, has the right to appoint and remove one member of the Supervisory Board.

In accordance with the Articles of Association, the General Meeting appoints one independent member of the Supervisory Board. The independent Supervisory Board member is elected in separate voting.

Written nominations of candidates for the position of an independent Supervisory Board member may be submitted to the Chairman of the General Meeting by the shareholders present at the General Meeting whose agenda includes the election of such a Supervisory Board member. Any such written proposal should be submitted along with a written representation by a given candidate to the effect that the candidate agrees to stand for the election and meets the criteria for an independent member of the Supervisory Board. If no candidates for the position are proposed by the shareholders, such candidates are nominated by the Supervisory Board.

If the Supervisory Board is composed of up to six members, two members are appointed from among candidates elected by the Company’s employees. If the Supervisory Board is composed of seven to nine members, three members are appointed from among candidates elected by the Company’s employees.

As at January 1st 2013, the composition of the PGNiG Supervisory Board was as follows:

- Wojciech Chmielewski – Chairman of the Supervisory Board
- Marcin Moryń – Deputy Chairman of the Supervisory Board

- Mieczysław Kawecki – Secretary of the Supervisory Board
- Agnieszka Chmielarz – Member of the Supervisory Board
- Józef Głowacki – Member of the Supervisory Board
- Janusz Pilitowski – Member of the Supervisory Board
- Mieczysław Puławski – Member of the Supervisory Board
- Ewa Sibrecht-Ośka – Member of the Supervisory Board
- Jolanta Siergiej – Member of the Supervisory Board.

On June 26th 2013, the Extraordinary General Meeting of PGNiG S.A. removed Mr. Mieczysław Puławski from the Supervisory Board and appointed Mr. Zbigniew Skrzypkiewicz as a new member of the Board.

On September 16th 2013, Mr Zbigniew Skrzypkiewicz was delegated by the PGNiG Supervisory Board to temporarily serve as Member of the PGNiG Management Board, Corporate Affairs, in the period from September 16th 2013 to December 16th 2013.

On December 30th 2013, Mr Zbigniew Skrzypkiewicz resigned as Member of the PGNiG Supervisory Board.

As at December 31st 2013, the composition of the PGNiG Supervisory Board was as follows:

- Wojciech Chmielewski – Chairman of the Supervisory Board
- Marcin Moryń – Deputy Chairman of the Supervisory Board
- Mieczysław Kawecki – Secretary of the Supervisory Board
- Agnieszka Chmielarz – Member of the Supervisory Board
- Józef Głowacki – Member of the Supervisory Board
- Janusz Pilitowski – Member of the Supervisory Board
- Ewa Sibrecht-Ośka – Member of the Supervisory Board
- Jolanta Siergiej – Member of the Supervisory Board.

In January-February 2014, elections were held to choose the employees’ nominees to the Supervisory Board. As at the date of this report, no employee representatives were elected.

Remuneration of management and supervisory personnel

For information on the remuneration paid to management and supervisory personnel, see the annual consolidated financial statements for the year ended December 31st 2013 (Note 38.5).

Section III: Shareholder structure

As at December 31st 2013, the share capital of PGNiG S.A. amounted to PLN 5,900,000,000 and was divided into 5,900,000,000 shares with a par value of PLN 1 per share. The Polish State Treasury was the only shareholder with a large direct holding of PGNiG shares. The shares of all series, that is Series A, A1 and B, were ordinary bearer shares and each share conferred the right to one vote at the General Meeting. The shareholder structure of PGNiG S.A. as at December 31st 2013 is presented in the table below.

Shareholder structure

Shareholder	Number of shares as at Dec 31 2013	% ownership interest as at Dec 31 2013	Number of voting rights conferred by shares held	% of total voting rights at GM as at Dec 31 2013
State Treasury	4,271,740,477	72.40%	4,271,740,477	72.40%
Other shareholders	1,628,259,523	27.60%	1,628,259,523	27.60%
Total	5,900,000,000	100.00%	5,900,000,000	100.00%

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

The table below presents PGNiG shares held by the management and supervisory personnel as at December 31st 2013.

PGNiG shares held by the management and supervisory personnel

Name	Position	Number of shares	Par value of shares (PLN)
Mieczysław Kawecki	Secretary of the Supervisory Board	19,500	19,500
Jolanta Siergiej	Member of the Supervisory Board	9,425	9,425

Agreements which may give rise to future changes in the interests held by the existing shareholders or bondholders

As at the date of this report, PGNiG S.A. was not aware of any agreements which could lead to future changes in the equity interests held in the Company by its existing shareholders.

Performance of the PGNiG stock

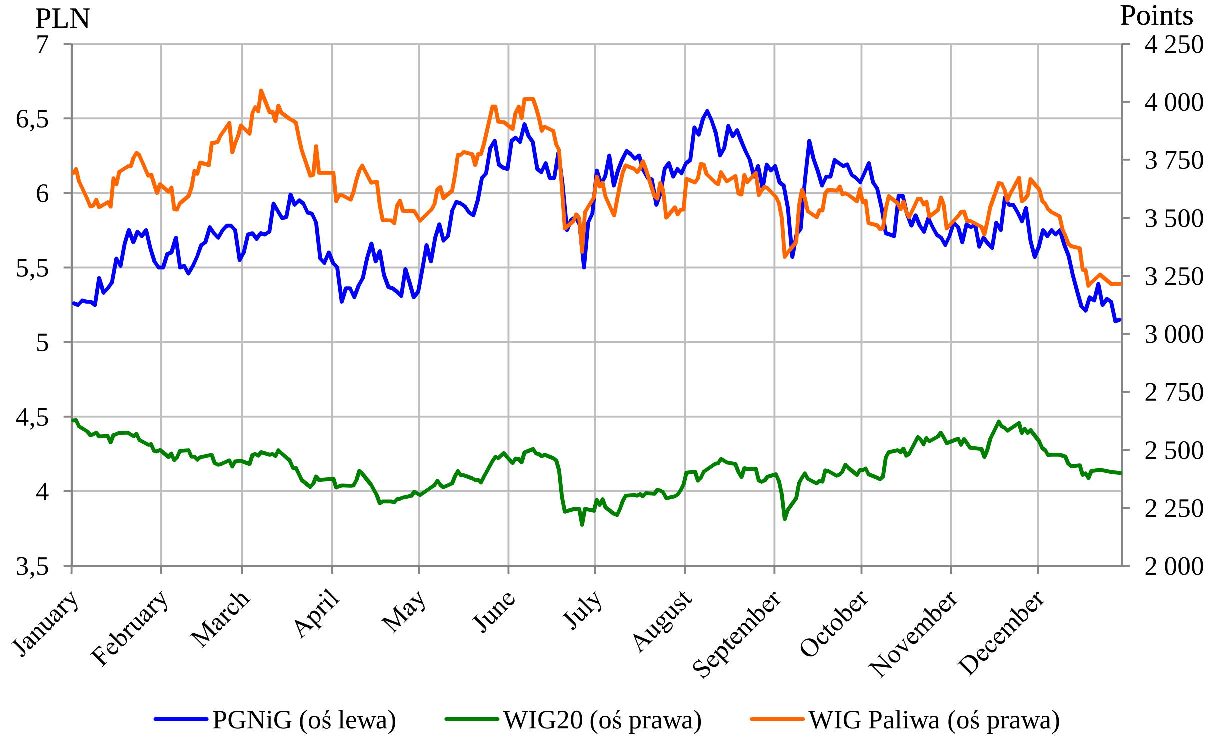
PGNiG shares have been listed at the Warsaw Stock Exchange since September 23rd 2005. As at December 31st 2013, the Company was included in the following indices listed at the WSE:

- WIG – all-cap index
- WIG20 – blue-chip index of the 20 largest and most liquid companies
- WIG30 – new index of the 30 largest companies listed at the WSE, launched on September 23rd 2013
- WIG-Paliwa – index of the fuel sector companies
- WIG-Poland – index of Polish companies
- Respect Index – index of socially responsible companies.

The rate of return on the PGNiG stock in 2013 was -2.1%. In the period from PGNiG's first listing to December 31st 2013, the rate of return was 35.2%. Investors who acquired PGNiG shares on the WSE at their issue price earned a 72.8% return (excluding dividends).

The following figure presents the relative performance of the PGNiG stock against the WIG 20 and WIG Paliwa indices. The table presents the values of the WSE indices and the PGNiG share price in 2013.

PGNiG share price vs. the WIG 20 and WIG Paliwa indices



Performance of WSE indices and PGNiG stock (in points)

Index	Value/price as at Dec 28 2012	2013 high	2013 low	Value/price as at Dec 30 2013	PGNiG's weight in the index as at Dec 30 2013
WIG	47,461	55,246	43,160	51,284	2.98%
WIG20	2,583	2,628	2,177	2,401	4.69%
WIG-Paliwa	3,571	4,049	3,207	3,215	34.17%
Respect Index	2,591	2,854	2,251	2,559	9.25%
PGNiG S.A.	PLN 5.21	PLN 6.55	PLN 5.14	PLN 5.15	-

Source: gpwinfostrefa.pl

Section IV: PGNiG Group's development directions

In the coming years, the PGNiG Group's activities will focus on the three strategic objectives, which are to:

- Intensify commercially-viable hydrocarbon production
- Optimise the mix of gas supply sources with a view to maximising the PGNiG Group value
- Prepare the Group to operate in a deregulated market so as to maximise its market shares.

Exploration and Production

The PGNiG Group expects to sustain its hydrocarbon production in Poland at current levels, and intends to steadily build up its portfolio of international production projects. In its Exploration and Production segment, the Group is also planning to intensify production from conventional fields in Poland, by applying state-of-the-art technologies, accelerating the development of hydrocarbon reserves and increasing the recovery rates.

Furthermore, the Group will continue to explore for unconventional hydrocarbons in Poland. In order to mitigate the exploration risk, the PGNiG Group will try to find external industry partners to carry out such projects with, and will seek to draw on the know-how of companies experienced in extracting gas from unconventional deposits.

The Group also wants to expand its foothold in exploration outside of Poland. The PGNiG Group intends to continue its efforts to acquire commercially-viable hydrocarbon assets outside of Poland in order to increase its crude oil and natural gas production and to hedge its exposure to the volatility in gas prices.

Trade and Storage

The PGNiG Group is the leader of the retail gas sales market. The Group's objective is to ensure that the Group companies remain the preferred suppliers for customers in a deregulated market. The PGNiG Group intends to achieve its objective by enhancing the efficiency of sales and introducing a modern, multi-channel customer service model.

The Group is planning to expand sales in foreign markets, mainly in Germany. The purpose is to maximise its gas trading margin and diversify revenue sources, as well as to guarantee the off-take of gas in order to meet its obligations under long-term contracts with a take or pay clause.

Furthermore, the PGNiG Group intends to optimise the management of its natural gas portfolio by adjusting the structure of purchases, production and storage to the fast-changing market conditions, thanks to greater flexibility of pricing and supply terms, with the guaranteed security of supply expected by customers.

In addition, acting in accordance with the EU regulations and rules governing the implementation of projects financed with EU funds, the PGNiG Group has embarked on a reorganisation of its gas storage business. The objective of this effort is to integrate the capabilities for the operation of underground gas storage facilities, which will help enhance revenue in this area.

Distribution

The merger of the gas distribution companies will generate substantial synergies within the PGNiG Group and improve the Distribution segment’s efficiency. Furthermore, their consolidation will help to better coordinate and standardise the key processes and activities within Polska Spółka Gazownictwa Sp. z o.o.

Generation

The PGNiG Group intends to diversify its business by further expanding its power generation segment, mainly in terms of high efficiency co-generation of electricity and heat. While supporting demand for natural gas as the fuel for the new power generation sources, this expansion will also help the Group achieve a more stable and diversified revenue stream in the long term.

Section V: Operating review of the PGNiG Group

1. Operating data

Financial performance of the PGNiG Group in 2011-2013

	Unit	2013	2012	2011
Revenue	PLNm	32,120	28,730	23,004
Operating expenses, including:	PLNm	(28,971)	(26,190)	(21,132)
depreciation and amortisation	PLNm	(2,463)	(2,069)	(1,574)
EBIT (operating profit)	PLNm	3,149	2,540	1,872
EBITDA (operating profit + depreciation/amortisation)	PLNm	5,612	4,609	3,446
Net profit (loss)	PLNm	1,920	2,240	1,755
Number of shares	million shares	5,900	5,900	5,900
Earnings per share (net profit/number of shares)	PLN	0.33	0.38	0.30
Dividend yield per share (dividend per share/price per share*)	PLN	0.02	0.00	0.03
Price/earnings (share price*/(net profit/number of shares))		17.9	10.7	13.3

* average share price in a given year

In 2013, the PGNiG Group reported revenue of PLN 32.1bn, 78% of which was derived from sales of natural gas.

Revenue (PLNm)

	2013	2012	2011
Natural gas, including:	24,970	23,698	20,269
- high-methane gas	23,540	22,309	19,052
- nitrogen-rich gas	1,430	1,389	1,217
Crude oil	2,757	1,263	1,100
Helium	183	161	58
Electricity	1,360	842	11
Heat	1,069	978	0
Geophysical and geological services	252	339	448
Drilling and well services	653	610	578
Construction and assembly services	243	123	132
Connection charge	110	106	97
Other sales	523	610	311
Total	32,120	28,730	23,004

In 2013, the PGNiG Group sold 16.2bcm of natural gas, with 95% of that amount representing sales from the transmission and distribution systems and the balance – direct sales from gas fields.

Natural gas sales volume (mcm)

	2013	2012	2011
Trade and Storage	15,465.4	14,189.2	13,595.7
Exploration and Production	748.6	723.3	681.7
Total	16,214.0	14,912.5	14,277.4

The PGNiG Group produced a total of 4.6bcm of natural gas (measured as high-methane gas equivalent), of which 92% was produced from the fields in Poland, and the balance – from the fields on the Norwegian Continental Shelf and in Pakistan.

Natural gas production volume (mcm)

	2013	2012	2011
Poland	4,211.2	4,317.3	4,329.4
Abroad	371.1	0.0	0.0
Total	4,582.3	4,317.3	4,329.4

In 2013, 92.2% of the electricity produced by the Group's Generation segment was electricity co-generated with heat.

Electricity and heat production volumes

	Unit	2013	2012	2011
Electricity	GWh	4,435.5	4,389.7	
Heat	TJ	40,540.2	40,567.8	

2. Events in 2013

January	At the transition of 2012 into 2013, the Group launched production from the Lubiatów, Międzychód and Grotów oil and gas fields in Poland, and from the Skarv field on the Norwegian Continental Shelf. With wells in the above fields coming on stream, the Group's production of oil and gas rose considerably.
February	The merger of PGNiG Poszukiwania S.A. (now Exalo Drilling S.A.) with PNiG Kraków S.A., PNiG NAFTA S.A., PNiG Jasło S.A., PN Diament Sp. z o.o. and ZRG Krosno Sp. z o.o. was registered.
April	The Mogilno Underground Gas Storage Cavern Facility Branch in Palędzie Dolne was established, as part of a wider reorganisation of the gas storage business within the PGNiG Group. The PGNiG Supervisory Board removed Ms Grażyna Piotrowska-Oliwa, CEO and President of the Management Board, and Mr Radosław Dudziński, Vice-President of the Management Board for Trade, from the PGNiG Management Board and their respective positions.
May	The Wholesale Trading Division in Warsaw was established. The new branch will handle all wholesale trading processes and manage the Group's product portfolio.
June	The PGNiG Supervisory Board appointed Mr Jerzy Kurella as Vice-President of the PGNiG Management Board, Trade, with effect from June 14th 2013. PGNiG S.A. started test production of natural gas in Pakistan. PGNiG Upstream International AS acquired 40% interests in each of the PL702 and PL703 licences, a 30% interest in the PL707 licence and a 20% interest in the PL711 licence. The new licence areas are located in the Norwegian Sea (PL702 and PL703) and in the Barents Sea (PL707 and PL711).
July	PGNIG SPV 4 Sp. z o.o. (later renamed Polska Spółka Gazownictwa Sp. z o.o.) merged with the six regional gas distribution companies. In this way, the PGNiG Group's gas distribution business became concentrated within a single entity. Operator Systemu Magazynowania Sp. z o.o. was merged with INVESTGAS S.A., and the storage area management was centralised within OSM Sp. z o.o. The PGNiG Supervisory Board appointed Mr Jerzy Kurella, Vice-President, as acting President of the Management Board of PGNiG S.A. PGNiG S.A. merged with its subsidiary PGNiG Energia S.A. PGNiG S.A. completed the LMG project, which consisted in developing and bringing on stream the Lubiatów, Międzychód and Grotów oil and gas fields.

August	PGNiG Upstream International AS and its partners relinquished licence PL521 on the Norwegian Continental Shelf.
November	PGNiG S.A. became the first direct member of the gas market at the Polish Power Exchange. The Company also agreed to act as a market marker in the natural gas futures market. PGNiG S.A. made a decision to abandon further exploration work in Egypt and to terminate its Egyptian licence.
December	The President of the Energy Regulatory Office (URE) approved the new PGNiG Gas Fuel Tariff. (Part A – Gas Fuel Supply Tariff No. 6/2014) for the period January 1st−July 31st 2014. On average, the prices and charge rates for the supply of high-methane gas type E, and nitrogen-rich gas types Lw and Ls were increased by 1.5%, 4.7% and 7.3%, respectively. PGNiG TERMIKA S.A. completed the construction of a SCR system for four unit boilers at the Siekierki CHP Plant. The system will reduce the content of nitrogen oxides (NO_x) in flue gases emitted by the CHP plant to the required levels. The PGNiG Supervisory Board appointed a new Management Board to serve for a joint term of office beginning December 30th 2013 and ending December 30th 2016.

Section VI: Regulatory environment

PGNiG S.A.'s activities are regulated by the following laws:

- Polish Energy Law of April 10th 1997 (consolidated text in Dz. U. of 2012, item 1059) with secondary legislation, to the extent it governs gas fuel trading, distribution and storage, as well as foreign trade in natural gas.
- Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, and on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market, dated February 16th 2007 (consolidated text in Dz. U. of 2012, item 1190) with secondary legislation, to the extent it governs gas fuel storage and foreign trade in natural gas.
- Polish Geological and Mining Law of June 9th 2011 (Dz. U. of 2011, No. 163, item 981, as amended), to the extent it governs production and sale of gas.

1. Polish Energy Law

The activities of the PGNiG Group companies in the area of gas fuel trading, distribution and storage, electricity trading and generation, as well as heat generation, transmission and distribution are quite heavily regulated, and require a licence granted by the President of the Energy Regulatory Office.

On September 11th 2013, the Act Amending the Energy Law and certain other acts, dated July 26th 2013 (the so-called 'Small Three Pack') came into force. The most important change it has introduced is the requirement to sell a specific portion of high-methane gas volumes fed into the transmission network in a given year on commodity exchanges. In the period September 11th−December 31st 2013, the obligation covered 30% of the sales volume. In 2014, it will cover 40% of the sales volume, and will further increase to 55% as of January 1st 2015. Also, the 'Small Three Pack' clarifies the procedure for a change of gas fuel supplier, defines the procedure for handling complaints, and introduces a procedure for certification of the Transmission System Operator's independence.

On July 25th 2013, the Regulation of the Minister of Economy on detailed rules for determining and calculating tariffs for gas fuels and on settlement of transactions in gas fuels trading (the Tariff Regulation) came into force. The new Tariff Regulation introduces, among other things, settlements by energy units instead of volume units, full separation of transmission and distribution services from trading, *entry-exit* transmission tariffs, rules for calculation of charges for short-term and intermittent services and for virtual reverse flow services provided by transmission and distribution system operators, as well as rules for calculation of charges for storage services rendered on a packaged or stand-alone basis by the Storage System Operator. The Tariff Regulation also provides for the possibility of offering transmission services under an auction system in the case of interconnections between transmission systems within the EU, and for passing along the costs of gas fuel transport to the tariffs of other energy utilities. Another purpose of the Tariff Regulation is to bring its provisions fully in line with the provisions of the Gas System Regulation.

1.1. Licences

As at December 31st 2013, PGNiG S.A. held the following licences granted by the President of the Polish Energy Regulatory Office (URE) under the Energy Law:

- one licence to trade in gas fuels
- one licence to trade in natural gas with foreign partners
- one licence to trade in liquid fuels
- one licence to produce electricity
- one licence to trade in electricity.

On June 14th 2013, the President of the Energy Regulatory Office approved an amendment to the licence for co-generation of electricity. The amendment extends the scope of activities covered by the licence to include another co-generation unit, situated at the oil production facility in Nosówka, in the Rzeszów Province.

In connection with the merger of PGNiG S.A. and PGNiG Energia S.A., the rights under decisions to grant PGNiG Energia S.A. licences for gas fuels and electricity trading were transferred, by way of universal succession, to PGNiG S.A. PGNiG S.A. applied for expiry of those licences. In administrative decisions dated September 30th and October 16th 2013, the President of the Energy Regulatory Office granted PGNiG's request.

1.2. Tariff policy

Dependence of PGNiG S.A.'s revenue on tariffs approved by the President of the Energy Regulatory Office is one of the key factors affecting its regulated business. Tariffs are crucial to the Company's ability to generate revenue that would cover its reasonably incurred costs, while delivering a return on capital employed and reasonable margin. Gas prices and charges are directly connected with the applied tariff preparation methodology,

whereby such prices and charges are determined against forecast costs and gas sales targets. In accordance with the applicable regulatory policies, the calculation of gas fuel prices takes into account the cost of gas acquisition from all sources, that is of both imported and domestically produced gas. What this means in practice is that both imported and domestically produced gas is subject to price regulation. Given that the current prices of imported gas are higher than those of domestically produced gas, the inclusion of the cost of domestically produced gas in the cost basket used for the purpose of price calculations resulted in a situation where the tariff prices (applicable in settlements with customers) were set below the cost of acquisition of imported gas.

Settlements with customers with which PGNiG S.A. had concluded sale agreements were based on the rules, prices and charges specified in successive tariffs approved by the President of the Energy Regulatory Office.

1.3. Changes in PGNiG S.A.'s tariffs

In 2013, the amendment to Gas Fuel Supply Tariff No. 5/2012, approved by decision of the President of the Energy Regulatory Office dated December 17th 2012, was in effect. On average, the prices and charge rates for the supply of high-methane gas type E, and nitrogen-rich gas types Lw and Ls were reduced by 6.7%, 8.0% and 10.9%, respectively.

On January 25th 2013, the President of the Energy Regulatory Office approved an amendment to Gas Fuel Supply Tariff No. 5/2012. The approved amendment related to the rules of classifying customers to the tariff groups for the supply of nitrogen-rich gas over the distribution network of the Poznań Branch of Polska Spółka Gazownictwa Sp. z o.o. It was required in order to bring PGNiG S.A.'s tariff in line with the tariff of WSG Sp. z o.o., and concerned the S-8 and Z-8 tariff groups.

On August 30th 2013, PGNiG S.A. applied to the President of the Energy Regulatory Office for an amendment of Gas Fuel Supply Tariff No. 5/2012. The amended tariff submitted for approval included: the contract year definition (compliant with the provisions of the Distribution Grid Code), provisions necessary to introduce an exemption from the obligation to submit wholesale gas trading tariffs for approval, as well as provisions that would allow for the expiry, as of November 1st 2013, of statutory excise duty exemptions for customers receiving gas for heating purposes and as an automotive fuel.

The President of the Energy Regulatory Office issued decisions partially approving the amendment to Gas Fuel Supply Tariff No. 5/2012, which included:

- introduction of the contract year definition and extension of the tariff term until December 31st 2013 (decision dated September 16th 2013);
- adjustment of the tariff provisions to allow for the expiry, as of November 1st 2013, of statutory excise duty exemptions for customers receiving gas for heating purposes and as an automotive fuel (decision dated October 17th 2013);
- adjustment of the wording to the applicable regulations (decision dated October 25th 2013).

The proceedings with respect to the provisions necessary to introduce an exemption from the obligation to submit wholesale gas trading tariffs for approval have not yet been completed.

On July 18th 2013, PGNiG S.A. applied to the President of the Energy Regulatory Office for approval of a new PGNiG Gas Fuel Tariff. (Part A – Gas Fuel Supply Tariff No. 6/2013), which was to be effective from October 1st 2013 to September 30th 2014. Due to the prolonged approval proceedings, the number of the Tariff was changed to 6/2014. Finally, on December 17th 2013, the President of the Energy Regulatory Office approved the new PGNiG Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 6/2014) for the period January 1st−July 31st 2014. On average, the prices and charge rates for the supply of high-methane gas type E, and nitrogen-rich gas types Lw and Ls were increased by 1.5%, 4.7% and 7.3%, respectively.

The following tables present the average rates (PLN/cubic metre) applicable in 2013 in settlements with customers purchasing gas fuels, by fuel type and place of delivery. The tables do not take into account the excise duty introduced on November 1st 2013.

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Wrocław Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.7648	2.4969	-9.7%
W-2.1	2.2036	1.9816	-10.1%
W-3.1	2.0209	1.8029	-10.8%
W-4	1.8905	1.6693	-11.7%
W-5 - W-7C	1.7507	1.7071	-2.5%
W-8A - W-10C	1.5063	1.4651	-2.7%

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
S-1	2.0010	1.7900	-10.5%
S-2	1.5888	1.4044	-11.6%
S-3	1.4625	1.3013	-11.0%
S-4	1.3384	1.1801	-11.8%
S-5 - S-7B	1.2677	1.2338	-2.7%
S-8 - S-9	1.1566	1.1225	-2.9%

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
Z-1	1.5830	1.4156	-10.6%
Z-2	1.4510	1.2888	-11.2%
Z-3	1.3004	1.1623	-10.6%
Z-4	1.2209	1.0841	-11.2%
Z-5 - Z-7B	1.2088	1.1793	-2.4%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Zabrze Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.7337	2.4726	-9.6%
W-2.1	2.2672	2.0440	-9.8%
W-3.1	1.9883	1.7660	-11.2%
W-4	1.9183	1.6909	-11.9%
W-5 - W-7C	1.7732	1.7314	-2.4%
W-8A - W-11C	1.5121	1.4681	-2.9%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Tarnów Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.6153	2.3594	-9.8%
W-2.1	2.1797	1.9590	-10.1%
W-3.1	1.9319	1.7288	-10.5%
W-4	1.8829	1.6843	-10.5%
W-5 - W-7BC	1.7796	1.7355	-2.5%
W-8A - W-10C	1.4811	1.4310	-3.4%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Warsaw Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.9951	2.7039	-9.7%
W-2.1	2.0888	1.8693	-10.5%
W-3.1	1.8913	1.6877	-10.8%
W-4	1.8787	1.6755	-10.8%
W-5 - W-7C	1.7536	1.7086	-2.6%
W-8A - W-10C	1.4219	1.3669	-3.9%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Gdańsk Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.8368	2.5658	-9.6%
W-2.1	2.2265	2.0058	-9.9%
W-3.1	2.0013	1.8006	-10.0%
W-4	1.9399	1.7451	-10.0%
W-5 - W-7C	1.7992	1.7606	-2.1%
W-8A - W-10C	1.4953	1.4601	-2.4%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Poznań Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.8611	2.5856	-9.6%
W-2.1	2.1348	1.9143	-10.3%
W-3.1	1.9954	1.7881	-10.4%
W-4	1.9050	1.7032	-10.6%
W-5 - W-7C	1.7169	1.6715	-2.6%
W-8A - W-10C	1.4576	1.4140	-3.0%

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
S-1	2.0115	1.8046	-10.3%
S-2	1.5505	1.3774	-11.2%
S-3	1.4196	1.2602	-11.2%
S-4	1.3447	1.1889	-11.6%
S-5 - S-7B	1.2699	1.2365	-2.6%

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
Z-1	1.8231	1.6422	-9.9%
Z-2	1.3904	1.2408	-10.8%
Z-3	1.2569	1.1208	-10.8%
Z-4	1.1900	1.0570	-11.2%
Z-5 - Z-7B	1.1446	1.1157	-2.5%

Customers connected to the transmission grid of OGP GAZ-SYSTEM S.A.

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
E-1A - E-2C	1.3713	1.3302	-3.0%
Lw-1 - Lw-2	1.0582	1.0196	-3.6%
Ls-1 - Ls-2	0.8827	0.8537	-3.3%

Exemption from the obligation to submit wholesale gas tariffs for approval

On February 19th 2013, the President of the Energy Regulatory Office announced an exemption of energy utilities holding gas fuel trading licences from the obligation to submit wholesale gas trading tariffs for approval. However, energy utilities must individually apply to the President of the Energy Regulatory Office for the exemption.

On August 30th 2013, PGNiG S.A. applied to the President of the Energy Regulatory Office to be exempted from the obligation to submit wholesale gas trading tariffs for approval. As at the date of this report, the proceedings were still pending.

Furthermore, on October 23rd 2013, PGNiG S.A. applied to the President of the Energy Regulatory Office to be exempted from the obligation to submit for approval tariffs for high-methane natural gas (E) traded at a virtual gas trading point (*OTC* market). As at the date of this report, the proceedings were still pending.

2. Act on Stocks of Crude Oil, Petroleum Products and Natural Gas

The Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market regulates matters related to ensuring the national fuel security, and sets the rules for building up, maintaining, and financing stocks of natural gas by those energy companies whose business involves international trade in natural gas or which import gas for their own needs. With respect to the business activity of PGNiG S.A., the Act:

- specifies the volume of mandatory stocks, which since October 1st 2012 is equivalent to 30 days' average daily imports of gas (for the period from April 1st of the previous year to March 31st of the current year, calculated based on the figures contained in the Company's statistical reports);
- provides that the return on capital employed in the storage business should be at least 6%;
- stipulates that the cost related to maintaining, releasing and restocking the mandatory stocks represents a justified operating cost within the meaning of Art. 3.21 of the Polish Energy Law;
- introduces the possibility of storing mandatory stocks in another EFTA member state, upon fulfilment of certain conditions set forth in the Act;
- introduces the possibility of exempting an energy company whose business involves international trade in natural gas or an entity which imports natural gas from the obligation to build and maintain mandatory stocks, if the number of their customers does not exceed 100 thousand and the natural gas volume imported in a calendar year does not exceed 100mcm·

On September 11th 2013, the amended Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market, provided for in the so-called 'Small Three Pack', came into force. The amendment introduced the possibility of storing mandatory stocks in another European Union member state, upon fulfilment of certain conditions set forth in the Act.

3. Polish Geological and Mining Law

The Polish Geological and Mining Law of June 9th 2011 regulates:

- geological work;
- extraction of minerals from deposits;
- storage of waste matter in rock mass, including in worked-out caverns;
- protection of mineral deposits, underground waters and other components of the environment in connection with geological works and extraction of minerals.

Furthermore, under the Act, a tender procedure was introduced to award licences for exploration or appraisal of hydrocarbons and for production of hydrocarbons, superseding the previous tender procedure for establishment of mineral extraction rights.

The provisions of the Geological and Mining Law also govern business activities in the area of tankless storage of substances in rock mass, including in worked-out caverns.

Business activities involving exploration for and appraisal of mineral deposits, extraction of minerals from deposits, tankless storage of substances and storage of waste matter in rock mass, including in worked-out caverns, require licences.

Geological and mining activities are subject to supervision by competent geological and mining supervision authorities. The Geological and Mining Law provides for criminal sanctions for a failure to comply with its regulations, and specifies the upper and lower limits of royalty fees.

In 2013, the Ministry of Environment extended the terms of PGNiG S.A.'s 20 licences for exploration and appraisal of crude oil and natural gas deposits, while 11 licences were allowed to expire. In addition, the Company was granted three licences for extraction of crude oil and natural gas, while four of its licences were amended, and one licence was allowed to expire. In 2013, one licence for underground gas storage was granted and one licence was allowed to expire. The licence for appraisal of the Goleniów salt deposit for the purpose of underground gas storage was allowed to expire.

As at December 31st 2013, PGNiG S.A. held the following licences, granted pursuant to the Geological and Mining Law:

- 84 licences for exploration and appraisal of crude oil and natural gas deposits
- 227 licences for production of crude oil and natural gas from deposits
- 9 licences for storage of gas in underground facilities (underground gas storage facilities)
- 3 licences for storage of waste.

4. Regulatory risks

Polish Energy Law

In 2013, work was still under way on a set of three bills to regulate the energy sector: the Gas Law, the Energy Law and the Law on Renewable Energy Sources (the so-called 'Large Three Pack'). On September 11th 2013, the Act Amending the Energy Law and certain other acts (the so-called 'Small Three Pack') came into force. The amendment introduced a number of changes in the regulatory regime governing the natural gas market, relating, in particular, to the need to harmonise Polish legislation with the provisions of the 3rd energy package, as well as the necessity to deregulate the gas market, especially by imposing the requirement to sell gas on the exchange market.

The requirement to sell gas on the exchange market, which has been imposed on the Company, is aimed to deregulate the Polish gas market and boost competition. The mechanism improves the market's transparency and allows market participants to purchase products on equal terms. On the other hand, it may cause PGNiG to gradually lose its market share. However, the actual rate at which PGNiG S.A.'s market share might shrink will depend on the number and size of new players entering the gas market and the price differentials between the OTC and exchange markets.

Furthermore, the amendments to the Polish Energy Law provide that an end user may terminate the agreement with a utility company for the supply of gas fuels without incurring any expenses or having to pay any compensation other than those stipulated in the agreement. Taking into account the costs of purchasing gas (which include the cost of transmitting it to Poland and associated transaction costs) and the security of supply, customers will seek to optimise their purchase portfolios, acquiring gas on or outside of the exchange market.

Meeting the requirement to sell gas on the exchange market

While PGNiG S.A. is prepared to fulfil this statutory obligation in terms of supply, the low demand for gas on the exchange market may prevent it from selling the amounts it is required to sell via this channel. The Group has taken steps to boost demand on the Polish Power Exchange.

Energy Efficiency Act

The Energy Efficiency Act came into force on August 11th 2011. The Act implements Directive 2006/32/EC of the European Parliament and of the Council of April 5th 2006 on energy end-use efficiency and energy services. The Energy Efficiency Act establishes a national target for economical energy use, according to which savings of end-use energy by 2016 should be no less than 9% of the annual national consumption of energy. Since January 1st 2013, PGNiG, as a trading company, has been obliged to purchase energy efficiency certificates or else to pay the buy-out price. This obligation will drive up the cost of regulated activities and, consequently, inflate the price of gas for customers.

Act on Stocks of Crude Oil, Petroleum Products and Natural Gas

Meeting the statutory requirements related to mandatory stocks exposes PGNiG S.A. to balancing and technology risks, and threatens the performance of its contractual obligations.

The balancing risk is related to the Company's inability to meet peak demand for natural gas in autumn and winter months. During longer spells of low temperatures, it may happen that – despite maximum gas supplies under long-term contracts and from underground gas storage facilities (remaining at the disposal of PGNiG S.A.) – the demand for gas will exceed the volumes which the Company is able provide. This risk may arise even assuming the maximum use of import capacities. To note, given the legally required technical parameters necessary to deliver mandatory gas stocks to the system, a significant portion of the stocks had to be placed at the Mogilno underground gas storage cavern, which is a peak-demand storage facility. As a result, the mandatory stocks significantly limit the commercial use of the facility's storage capacity and deliverability.
As gas from mandatory stocks may be withdrawn only upon the Minister of Economy's consent and only after gas supply limits have been introduced for users, the Group may fail to ensure continuity of gas supplies to consumers. Notwithstanding the above, withdrawal of gas from stocks may lead to a situation where users face gas supply limits despite high volumes of gas held in storage.

The technology risk follows from the fact that the need to maintain mandatory stocks has a negative impact on the operating parameters of underground storage facilities. In a longer run, if gas is not drawn from water-drive storage facilities (such as the Husów Underground Gas Storage Facility), gas will migrate to the reservoir section with poorer porosity and permeability, which will lead to a decrease in gas withdrawal capacity. This will make gas withdrawal more difficult at the end of the withdrawal process, and will reduce withdrawal capacity in the next cycle. In order to restore the operating parameters of the facility, it may be necessary to inject more gas to increase buffer volumes, which will in turn entail additional costs.

Another consequence of maintaining mandatory stocks is that the storage capacities remain partially filled after the winter season is over, which reduces the injection capacities in the summer. In the 2013/2014 season, nearly a half of the total underground gas storage capacities are filled with mandatory stocks and base gas enabling mandatory stocks to be withdrawn by the statutory deadline. Injection of gas into storage during the summer season, when demand for gas is low, enables the Company to meet the summer minimum volume to be imported under the Yamal contract, as it increases total demand for natural gas. Consequently, PGNiG may not be able to meet its contractual obligations concerning supply of imported gas if the gas volumes in storage are high at the beginning of the summer season.

Geological and Mining Law

In 2013, legislative work was under way on a fundamental change in the regulatory regime for the exploration and production segment, comprising two bills: the draft act amending the Geological and Mining Law and certain other acts, and the draft act on the special hydrocarbon tax, and on amendment to the act on the tax on production of certain minerals and certain other acts. The draft acts provide for increasing the fiscal burden on production of minerals and for a change to the existing licensing system. In future, the amendments will adversely affect the profitability of PGNiG S.A.'s operations.

Tariff calculation

PGNiG's ability to cover the costs of its core operating activities depends on the prices and charge rates approved by the President of the Energy Regulatory Office. However, the President of the Energy Regulatory Office does not always agree with the assumptions made by PGNiG S.A. with respect to the main cost drivers and profit targets allowing for business risks. Consequently, the prices and charge rates applied for by PGNiG S.A. and set in the tariff might adversely affect the Company's profitability.

In previous years, the President of the Energy Regulatory Office unilaterally extended the effective tariff periods. The Company is of the opinion that such actions by the President of the Energy Regulatory Office create the risk of a tariff being set below costs, as it does not account for the cost of gas fuel supplies in the period by which the tariff's effective period is so extended. As a result, it should be expected that in the next rounds of tariff approval, this factor may be taken into consideration in the tariff calculation. Moreover, the President of the Energy Regulatory Office may protract the tariff approval proceedings, with tariffs approved at later dates than those originally requested by PGNiG S.A.

Demand for natural gas

The current methodology for calculation of prices and charge rates is based on demand forecasts; accordingly, revenue is exposed to forecasting risk. Inaccurate estimates of demand, affecting the accuracy of forecast purchase and supply volumes, as well as costs upon which the determinations of prices and charge rates are based, may adversely affect the Group's financial performance.

Purchase prices of imported gas

Prices of imported gas are denominated in USD or EUR and are based on indexation formulae reflecting the prices of petroleum products and/or natural gas prices quoted on western markets. Changes in foreign exchange rates and prices of petroleum products have a material effect on the cost of imported gas. Material changes in prices of fuels on the international market affect the prices of imported gas. Any precise forecast of changes in natural gas prices carries a high risk of error. There is a risk that, despite the legal possibility of adjusting the prices already approved for a tariff term, an increase in the prices of imported gas will not be fully passed on to customers, or that changes in gas sale prices will lag behind changes in its import prices.

Take-or-pay gas delivery contracts

PGNiG S.A. is a party to four long-term take-or-pay contracts for gas fuel deliveries to Poland, of which the most important are contracts with Gazprom Eksport and Qatargas Operating Company Ltd. Assuming that PGNiG S.A.'s customer portfolio remains unchanged, the volume of gas imports specified in the take-or-pay contracts will limit its purchases of spot gas, currently the most attractively priced. If PGNiG S.A. loses its market share, there is a risk that the Company will have to look for new opportunities to sell or utilise surplus gas to avoid payment of penalties for the uncollected quantities under the take-or-pay contracts, or to sell the surplus with a negative margin.

There is also a risk that if Polskie LNG S.A. fails to place the LNG Terminal in operation by December 31st 2014, PGNiG S.A. will have to pay penalties for uncollected quantities of liquefied natural gas, as required under the take-or-pay contract with Qatargas Operating Company Ltd. Another risk is that with the existing contract terms and market conditions, the tariffs approved by the President of the Energy Regulatory Office will not cover PGNiG S.A.’s weighted average cost of gas acquisition.

Section V: Exploration and Production

The segment's business focuses on extracting hydrocarbons from deposits and preparing products for sale. The segment comprises the entire process of oil and gas exploration and production, from geological analyses, to geophysical surveys and drilling work, to field development and hydrocarbon production. It relies on storage capacities available at the Daszewo and Bonikowo Underground Gas Storage Facilities.

1. Exploration

Exploration in Poland

In 2013, PGNiG S.A. was engaged in exploration for both conventional and unconventional gas (shale gas and tight gas). In Poland, PGNiG S.A. carried out exploration and appraisal work, both on its own and jointly with partners, in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands. Drilling work in Poland was performed on 27 exploratory wells, including 7 research boreholes and 6 appraisal wells.

In 2013, 16 wells were tested, including 7 wells drilled in previous years. The tests confirmed the presence of gas in 9 wells: 4 exploratory wells and 5 appraisal wells. 7 wells did not flow hydrocarbons at commercial rates.

2 wells were tested in search for unconventional deposits. Drilling work was performed on 8 wells, with 6 reaching the target depths.

As at December 31st 2013 (i.e. as at the reporting date – although, in accordance with the Geological and Mining Law, the final calculation of reserves is made in March), the Group's recoverable reserves were:

- 85.5bcm of natural gas measured as high-methane equivalent,
- 19.2m tonnes of crude oil with condensate.

Exploration abroad

In 2013, PGNiG S.A. conducted exploration work within Egypt's Bahariya licence area (Block 3) under an *Exploration and Production Sharing Agreement* (*EPSA*) executed with the government of Egypt on May 17th 2009. The Company holds a 100% interest in the licence. In 2013, two exploration wells were drilled, but the wells were abandoned as they did not flow hydrocarbons at commercial rates. The Bahariya licence's potential was re-evaluated based on newly acquired geological data, which proved that further work was not economically viable. Therefore, a decision was made to terminate the licence and liquidate the Egypt branch.

2. Joint ventures

In 2013, the PGNiG Group conducted joint operations with other entities in licence areas awarded to PGNiG S.A., FX Energy Poland Sp. z o.o., and San Leon Energy PLC (the company acquired licence interests from the former partner, Aurelian Oil & Gas PLC). Furthermore, the PGNiG Group collaborated with other entities in carrying out exploratory work in Pakistan, Norway and Libya.

2.1 Joint ventures in Poland

In 2013, PGNiG S.A., Tauron Polska Energia S.A., KGHM Polska Miedź S.A., PGE Polska Grupa Energetyczna S.A. and Enea S.A. held negotiations to work out the detailed terms of their cooperation under the framework agreement of July 4th 2012 (concerning exploration for and production of shale gas and oil within the Wejherowo licence area). The framework agreement expired on December 31st 2013 due to non-fulfilment of certain conditions defined therein.

On August 14th 2013, PGNiG S.A. and LOTOS Petrobaltic S.A. signed an agreement for joint operations within the Kamień Pomorski licence area. The performance of the agreement will be possible upon fulfilment of certain conditions precedent, i.e. if positive tax interpretations are obtained from the Ministry of Finance and sub-lease of the mining usufruct (mineral extraction rights) is approved by the Ministry of Environment. By the end of 2013 not all of the conditions precedent had been fulfilled.

Under the licences awarded to PGNiG S.A., work continued in the following areas:

- “Płotki” – under the agreement for joint operations dated May 12th 2000; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%;
- “Płotki” – “PTZ” (the Extended Zaniemyśl Area) – under the Operating Agreement dated October 26th 2005; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 24.5%, Calenergy Resources Poland Sp. z o.o. – 24.5%;
- “Poznań” – under the agreement for joint operations dated June 1st 2004; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%;
- “Bieszczady” – under the agreement for joint operations dated June 1st 2007; licence interests: PGNiG S.A. (operator) – 51%, Eurogas Polska Sp. z o.o. – 24%, and Energia Bieszczady Sp. z o.o. – 25%;
- “Sieraków” – under the agreement for joint operations dated June 22nd 2009; licence interests: PGNiG S.A. (operator) – 51%, Orlen Upstream Sp. z o.o. – 49%;

Under licences awarded to FX Energy Poland Sp. z o.o., work was conducted in the following areas:

- “Warszawa-Południe” (blocks 254 and 255) – under the agreement for joint operations dated May 26th 2011; licence interests: FX Energy Poland Sp. z o.o. (operator) – 51%, PGNiG S.A. – 49%;
- “Ostrowiec” – under the agreement for joint operations dated February 27th 2009; licence interests: FX Energy Poland Sp. z o.o. (operator) – 51%, PGNiG S.A. – 49%;
- “Kutno” – under the agreement for joint operations dated September 30th 2010; licence interests: FX Energy Poland Sp. z o.o. (operator) – 50%, PGNiG S.A. – 50%.

Under licences awarded to San Leon Energy PLC, work was conducted in the following areas:

- “Karpaty Zachodnie” − under the agreement for joint operations dated December 17th 2009, concluded with Energia Karpaty Zachodnie Sp. z o.o. Sp. k. (a subsidiary of San Leon Energy PLC); licence interests: Energia Karpaty Zachodnie Sp. z o.o. Sp. k. (operator) – 60%, PGNiG S.A. – 40%;

- "Karpaty Wschodnie" − under the agreement for joint operations dated December 17th 2009, concluded with Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (a subsidiary of San Leon Energy PLC); licence interests: Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (operator) – 80%, PGNiG S.A. – 20%.

2.2. Joint ventures abroad

Pakistan

PGNiG S.A. conducts exploration work in Pakistan under an agreement for hydrocarbon exploration and production in the Kirthar licence area executed between PGNiG S.A. and the government of Pakistan on May 18th 2005. Work in the Kirthar block is conducted jointly with Pakistan Petroleum Ltd., with production and expenses shared in proportion to the parties' interests in the licence: PGNiG S.A. (operator) – 70%, PPL – 30%. In 2012, the operator decided to move to the second exploration stage on the Kirthar licence, as part of which a new exploration well is to be drilled by July 2014. In 2013, the construction of pipelines and temporary surface installations was completed and test production from the Rehman-1 and Hallel X-1 wells began. The gas produced is sold to the Pakistani transmission system. Also in 2013, preparatory work began for drilling of the Rizq-1 exploration well, which is scheduled for 2014.

Norway

PGNiG Upstream International AS (formerly PGNiG Norway AS), a PGNiG Group company, holds interests in exploratory and production licences on the Norwegian Continental Shelf, in the Norwegian Sea and in the Barents Sea. Jointly with its partners, the company is developing the Skarv, Snadd, and Idun fields. PGNiG Upstream International AS holds a 12% interest in the licence; the other interest holders are British Petroleum (operator, 24%), Statoil (36%) and E.ON (28%). In the other licence areas, the company is engaged in exploration projects.

On December 31st 2012, the company and its partners launched production of crude oil and natural gas from the Skarv and Idun fields (Skarv project) on the Norwegian Continental Shelf. Between January and October 2013, the field underwent start-up works, including well cleanout and testing, as well as bringing individual wells on stream. Following this phase, the field is being operated through a total of 16 wells. Hydrocarbons are produced using a new floating production, storage and offloading vessel (*FPSO*), which is moored in the vicinity of the field.

The company has been selling the extracted hydrocarbons since January 2013. The oil is sold directly from the FPSO vessel to Shell International Trading and Shipping Company Ltd. and transported by the trading partner's fleet of shuttle tankers. The produced gas is transmitted over the Gassled Area B System gas pipeline to the onshore terminal in Kårsto, and then redirected to Germany over the Gassled Area D System gas pipeline, where it is received by PGNiG Sales & Trading GmbH. In 2013, the company produced a total of 284 thousand tonnes of crude oil and other fractions (measured as tonnes of crude oil equivalent) and 340mcm of natural gas.

Also in 2013, the company continued work on the development of the Snadd field and other exploration licence areas. Evaluation of the prospectivity of the PL599, PL600, PL646, and PL648S licences was also carried out.

In 2013, following the conclusion of a licensing round, PGNiG Upstream International AS acquired:
- a 40% interest in each of licences PL702 and PL703; the operatorship of the licences was awarded to OMV Norge (a 60% interest)
- a 30% interest in licence PL707; the operatorship of the licence was awarded to Edison International (a 50% interest)

- a 20% interest in licence PL711, the operatorship of the licence was awarded to Respol Exploration Norge (a 40% interest).

The new licence areas are located in the Norwegian Sea (PL702 and PL703) and in the Barents Sea (PL707 and PL711).

Geological and geophysical analyses were performed on the PL521 licence area, on the basis of which the exploration risk was assessed as high, and so the company and its partners relinquished the licence. As at December 31st 2013, PGNiG Upstream International AS held interests in 13 exploration and production licences on the Norwegian Continental Shelf.

In January 2014, another licensing round was concluded, as a result of which PGNiG Upstream International AS was granted the PL756 operator licence in the Norwegian Sea. As the operator, the company acquired a 50% interest in the licence. PGNiG Upstream International's licence partners are Idemitsu Petroleum Norge AS and Rocksource Exploration Norway AS, with a 25% interest each. The PL756 licence is located in a well appraised area, close to a number of producing fields, including the large Aasgard field. This licence is the second operator licence granted to PGNiG Upstream International AS on the Norwegian Continental Shelf.

Libya

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

In 2013, the company completed preparatory work and commenced the first round of drilling, which consisted in drilling four exploration wells. The first exploratory well yielded a natural gas discovery, which was recognised by the company's Libyan partner – National Oil Corporation. The drilling and production tests on the second well ended in December 2013. Also in 2013, the company completed preparatory work on the third well, while second-stage 3D seismic surveys originally scheduled for 2013 were postponed for future years.

Based on an analysis of the project's economics, and in particular:

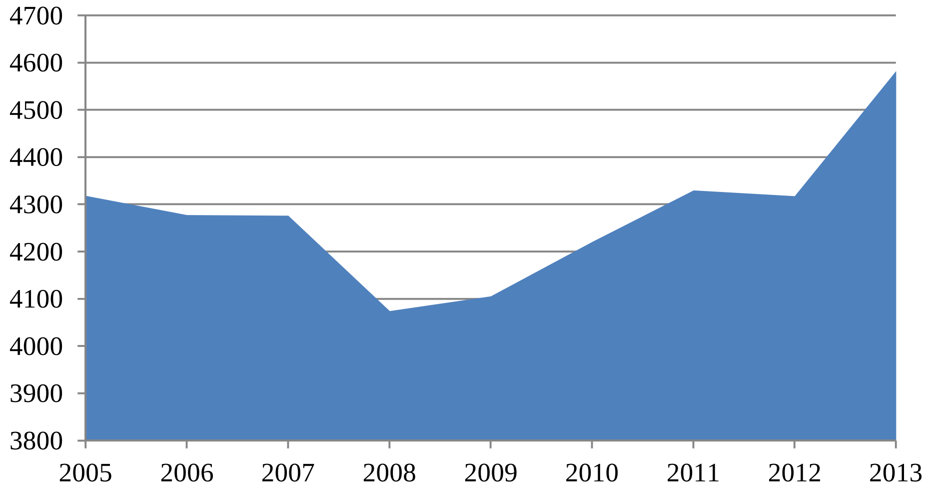
- reassessment of the estimates of hydrocarbon resources of the Libyan licence,
- assessment of future capital expenditure on, and operating costs of, continued exploration work,
- changes in the project schedule,
- effects of the political situation in Libya and uncertainty concerning the extension of the licence, due to expire in September 2014,

as at December 31st 2013 PGNiG S.A. decided to recognise a one-off impairment loss on its interest and contributions to equity in POGC Libya BV (a wholly-owned subsidiary of PGNiG S.A.), and a provision for the outstanding licence obligations under the Murzuq project in Libya. The impairment loss and provision recognised in PGNiG's separate financial statements were PLN 420m and PLN 137m, respectively, while the corresponding amounts recognised in the PGNiG Group's consolidated financial statements were PLN 291.7m and PLN 137m, respectively.

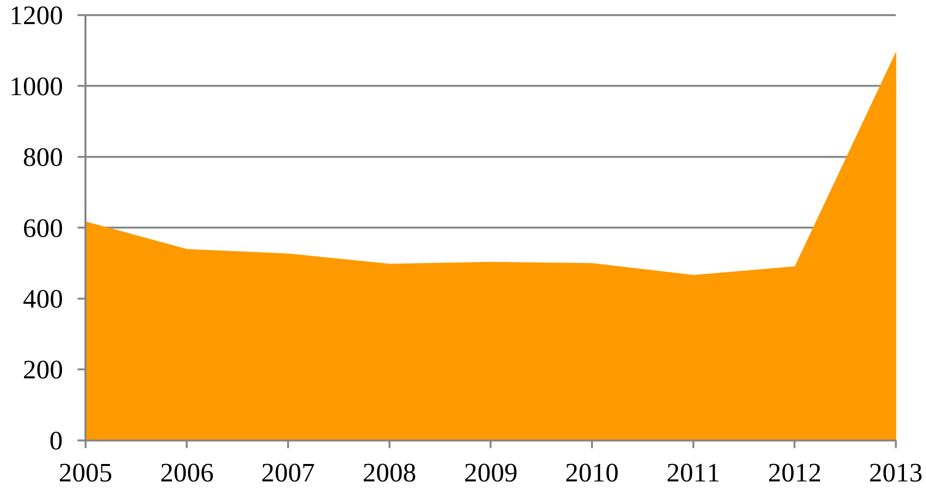
3. Production

In 2013, there was a substantial increase in the Group's hydrocarbon production relative to previous years. The rise in natural gas output, up to 4.6bcm, followed from launch of production from the Norwegian Continental Shelf. The Group's crude oil production also went up, by some 124%, chiefly following launch of Lubiatów, Międzychów and Grotów (LMG) fields, as well as the field on the Norwegian Continental Shelf. The charts below present natural gas and crude oil production in 2005-2013.

Natural gas production volume (mcm)



Crude oil production (million tonnes)



Natural gas and crude oil in Poland is extracted by two branches of PGNiG S.A.: the Zielona Góra Branch and the Sanok Branch. In 2013, the number of production facilities was reduced following their merger. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 22 sites, including 13 gas production facilities, 6 oil and gas production facilities and 3 oil production facilities. The Sanok Branch produces high-methane and nitrogen-rich natural gas and crude oil at 38 sites, including 20 gas production facilities, 12 oil and gas production facilities and 6 oil production facilities. In 2013, the Group commenced production of natural gas from the Norwegian Continental Shelf and the Rehman field (tight gas) in Pakistan.

In the same period, PGNiG S.A. produced a total of 4,582.3 mcm of natural gas (high-methane gas equivalent), of which 4,211.2 mcm was produced from fields in Poland, and 371.1 mcm from fields abroad.

The PGNiG Group produced 1,098.7 thousand tonnes of crude oil, including other fractions. Since 2013, crude oil and condensate production have been presented jointly, which is why production forecasts had to be adjusted accordingly (see Current Report No. 166/2013). Natural gas and crude oil production volumes are presented in the table below.

Production volumes

	Product	Unit	2013	2012
1.	Natural gas, including:	mcm	4,582.3	4,317.3
a.	high-methane gas, including:	mcm	1,890.5	1,607.6
	- Zielona Góra Branch	mcm	0.0	0.0
	- Sanok Branch	mcm	1,550.5	1,607.6
	- Norway	mcm	340.0	0.0
b.	nitrogen-rich gas, including:	mcm*	2,691.8	2,709.7
	- Zielona Góra Branch	mcm*	2,574.1	2,625.6
	- Sanok Branch	mcm*	86.6	84.1
	- Pakistan Branch	mcm*	31.1	0.0
2.	Crude oil, including:	thousand tonnes	1,098.7	491.6
	- Zielona Góra Branch	thousand tonnes	766.4	442.0
	- Sanok Branch	thousand tonnes	49.0	49.6
	- Norway	thousand tonnes	283.3	0.0

* Measured as high-methane gas equivalent.

In 2013, in the Sanok Branch area ten new gas wells were brought on stream (including two wells on test production). The total addition to gas production capacity from the new wells is approximately 3.9 thousand cubic metres of gas per hour (high-methane gas equivalent). In the Zielona Góra Branch area, six new oil wells were brought on stream, with an aggregate production capacity of 620 tonnes per day; as well as two gas wells, with an aggregate capacity of 6.4 thousand cubic metres per hour (high-methane gas equivalent). In addition, the Winna Góra and the Lisewo gas fields, with an aggregate production capacity of 5.5 thousand cubic metres per hour (high-methane gas equivalent), were also brought on stream in partnership with FX Energy Poland Sp. z o.o.

Underground gas storage facilities

In 2013, the Exploration and Production segment used the working capacities of the Daszewo and Bonikowo nitrogen-rich gas storage facilities. Storage capacities used to meet the needs of the Production segment are not storage facilities within the meaning of the Polish Energy Law.

The table below presents the working capacities of the underground storage facilities used by the Exploration and Production segment as at December 31st 2012 and December 31st 2013.

Working capacities of the underground storage facilities used by the Exploration and Production segment (mcm)

Nitrogen-rich gas	2013	2012
Daszewo (Ls)	30.0	30.0
Bonikowo (Lw)	200.0	200.0

4. Sales of key products

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

In 2013, the Group's sales of natural gas totalled 748.6 mcm, of which 717.8 mcm was sold in Poland, and 30.8 mcm was sold in Pakistan. Following the launch of production from the Lubiatów, Międzychów and Grotów (LMG) fields and the fields on the Norwegian Continental Shelf, sales of crude oil were up 128%. The table below presents volumes of natural gas (including LNG) sold directly from the fields, and volumes of crude oil and other fractions, as well as other products sold to third-party customers.

Sales of key products

		Unit	2013	2012
1	Natural gas, including:	mcm	748.6	723.3
	- high-methane gas	mcm	72.1	71.9
	- nitrogen-rich gas*	mcm	676.5	651.4
2	Crude oil	thousand tonnes	1,105.5	484.6
3	Helium	mcm	2.9	3.3
4	Propane-butane	thousand tonnes	29.9	22.6
5	Nitrogen	thousand kilograms	424.9	455.7
6	Sulfur	thousand tonnes	38.1	25.3

*Measured as high-methane gas equivalent.

In Poland, the largest amounts of natural gas were sold to industrial customers, accounting for 80% of the total sales volume. In 2013, the Group sold crude oil to Rafineria Trzebinia S.A., Rafineria Nafty Jedlicze S.A., TOTSA TOTAL OIL TRADING S.A. and BP Europe SE. The crude oil produced on the Norwegian Continental Shelf was sold directly from the FPSO vessel to Shell International Trading and Shipping Company Ltd.

The Group's foreign customers accounted for 49.8% of the total crude sales in volume terms, and for 85.8% of helium sales and 22.5% of sulfur sales. Crude oil was exported through the Druzhba pipeline to a German refinery. Most of the helium was sold to EU customers, and the sulfur was sold to customers in Germany and the Czech Republic.

On October 3rd 2013, PGNiG S.A. and PGE Górnictwo i Energetyka Konwencjonalna S.A. signed an agreement for supply of nitrogen-rich gas from the local wells to the new CCGT unit at the Gorzów CHP plant. The term of the agreement is 20 years from the beginning of gas deliveries. The deliveries will commence once the new unit is placed in operation. The value of the agreement over its entire term is estimated at approximately PLN 3bn.

Also in 2013 PGNiG S.A. executed the following crude oil sales agreements:

- Short-term agreement with TOTSA TOTAL OIL TRADING S.A. for test deliveries of crude oil from the Lubiatów field;
- Annex to the agreement with TOTSA TOTAL OIL TRADING S.A., executed indefinite term; the value of the agreement in the period from November 2013 to December 2015 is approximately PLN 1.4bn; the crude is delivered to the buyer from the Lubiatów and Dębno facilities via the Druzhba pipeline;
- Agreement with BP Europe SE for the period from November 13th 2013 to December 31st 2014; the value of the agreement is approximately PLN 420m; the crude is delivered to the buyer from the Lubiatów facility via the Druzhba pipeline;
- Agreement with Grupa LOTOS S.A., for 2015-2019, with an option of its extension for indefinite period; the estimated value of the agreement is approximately PLN 3.2bn; the crude oil, to be delivered to the Gdańsk refinery from January 1st 2015, will be collected by the buyer from PGNiG's railway terminals at the PGNiG Zielona Góra Branch.

5. Service activities

In 2013, the Exploration and Production companies were engaged in drilling exploration, appraisal, research, production and ventilation boreholes, as well as performance of specialist well services and geophysical services. These services were mainly provided to third-party customers.

Exploration, appraisal and research wells were drilled in search for hydrocarbons, copper, and geothermal waters. Drilling services were rendered in Poland and abroad for both the PGNiG Group and for third-party customers. In Poland, contracts were performed for companies exploring for:

- conventional gas deposits, e.g. for PGNiG S.A. and FX Energy Poland Sp. z o.o.
- unconventional gas deposits, e.g. for Orlen Upstream Sp. z o.o., Chevron Polska Energy Resources Sp. z o.o., Wisent Oil &Gas Sp. z o.o. and PGNiG S.A. (exploration for shale gas)
- copper deposits, for KGHM Polska Miedź S.A., Zielona Góra Copper Sp. z o.o. and Mozów Copper Sp. z o.o.
- geothermal water, for PEC Geotermia Podhalańska S.A.

On foreign markets, drilling was conducted in exploration for conventional hydrocarbons for third-party customers in Georgia, Egypt, Ukraine and Lithuania, and for the PGNiG Group in Libya and Egypt. Further, the segment carried out contracts for production well drilling operations, which were primarily performed abroad and for third-party customers – mainly in Africa (Uganda, Ethiopia, Egypt), Asia (Kazakhstan, Georgia, Pakistan), and Europe (Ukraine).

The segment also performed specialist well services consisting in reservoir measurements; application of enhanced recovery techniques; mud, cementing and *datawell* services; major remedial treatments; workovers and well abandonment services. The well services were performed mainly for the PGNiG Group and, to a minor extent, for third-party customers. In Poland, the main third-party customer was PEC Geotermia Podhalańska S.A., for which cementing services were performed. Services provided abroad included application of enhanced recovery techniques (Russia), as well as remedial treatments and well interventions (the Czech Republic).

In 2013, the Exploration and Production companies provided geophysical services involving field seismic work, seismic survey planning, seismic data acquisition, as well as seismic data processing and interpretation. The segment was also engaged in well logging, geological and drilling work.

In Poland, the main types of services performed by the Group included exploration services, 2D and 3D seismic data acquisition for PGNiG S.A., and logging services. For third-party customers in Poland, including Orlen Upstream Sp. z o.o., FX Energy Poland Sp. z o.o., Lane Energy Poland Sp. z o.o. and Cuadrilla Poland Sp. z o.o., the Exploration and Production segment mainly performed exploration services (seismic data acquisition and processing) and logging services.

On foreign markets, the Group performed seismic field work for customers in Germany, Austria, the Czech Republic, Slovakia, Denmark, India, Georgia, Pakistan and Hungary, as well as processing and interpretation of seismic data for customers in France, Germany, Slovakia and Israel.

6. Planned activities

<u>Exploration in Poland</u>

In 2014, PGNiG S.A. will continue exploratory geophysical work and drilling in Poland on a number of prospects in the Carpathian Mountains, Carpathian Foothills and the Polish Lowlands. The work will be conducted by PGNiG S.A. on its own and jointly with partners. The exploration for conventional reserves in less-well appraised area of the Carpathian Mountains will include continuation of drilling the deep Fredropol-1 well.

As part of these activities, PGNiG S.A. also intends to pursue projects focused on exploring new potential opportunities offered by unconventional resources (*shale gas/oil* and *tight gas*), where little appraisal has so far been made. In Pomerania, the PGNiG Group plans well testing on Opalino-3 and drilling several new wells in the Wejherowo, Kartuzy Szemud and Stara Kiszewa licences. In the Lublin Province, the Company will continue to drill the Kościaszyn-1 well.

<u>Exploration abroad</u>

In 2014, the PGNiG Group will also continue its exploration work in Pakistan and Norway. Exploration activities in Libya may also be continued.

In Pakistan, in order to verify the potential of the structure located to the north of the Kirthar discovery, the PGNiG Group plans to drill the Rizq-1 well.

On the Norwegian Continental Shelf, the PGNiG Group will carry out appraisal and documenting work in the Snadd field. The company will also participate, as a partner, in drilling of an exploration well in the PL558 licence area. The Group also intends to acquire new licence areas by participating in annual licensing rounds and by acquiring interests from other entities. In future, the Group may participate, as a partner, in drilling projects in deep-sea waters (below 1,000 metres) and in the Arctic Zone. This is connected with its interests in two licences (PL702 and PL702) in the Vøring Basin in the Norwegian Sea shelf, where sea depth exceeds 1,000 metres, and two licences (PL707 and PL711) in the Barents Sea shelf, in the Arctic Zone.

Natural gas production

The PGNiG Group is implementing an investment programme aimed at increasing, in a long-term perspective, its natural gas production capacity. As part of the programme, the PGNiG Group plans to develop new deposits and wells, modernise and expand the existing gas production facilities, build new underground gas storage facilities and expand the existing ones.

Plans for 2014 provide for an annual natural gas production volume of approximately 4.63 bcm of high-methane gas equivalent with a calorific value of 39.5 MJ/cm. Within the Sanok Branch area, plans for 2014 include launch of production from new wells on the Przemyśl, Księżpol and Lubliniec-Cieszanów producing fields, as well as launch of production from the new Wola Rokietnicka and Pogwizdów fields. Within the Zielona Góra Branch area, it is planned that in 2014 the production will be launched from new wells on the Radlin, Daszewo, Zaniemyśl, Wilków and Lisewo producing fields. Launch of production from the new Komorze field is also planned. The project will be executed in partnership with FX Energy Poland Sp. z o.o.

Crude oil production

In 2014, the PGNiG Group plans to produce 1,185 thousand tonnes of crude oil. The higher output follows the launch of production from the Lubiatów and Grotów fields in Poland, and from the field on the Norwegian Continental Shelf.

Service activities

In 2014, the PGNiG Group plans to provide drilling services in Poland and abroad. In Poland, the Group will conduct drilling for PGNiG S.A. and for third-party customers. Services will also be rendered abroad, in Lithuania, Ukraine, Uganda, Ethiopia, Kenya, Kazakhstan, Georgia, and Pakistan.

Specialist well services will be rendered mainly for PGNiG S.A. in Poland, and for foreign customers in Russia, Ukraine, the Czech Republic, Slovakia, and Lithuania.

Also, in Poland the PGNiG Group will provide 2D and 3D seismic data acquisition, processing, and interpretation services for PGNiG S.A. and third-party customers, as well as seismic acquisition and well logging services for PGNiG Group companies. On foreign markets, the PGNiG Group plans to provide geophysical services in Oman, Pakistan, Kenya, India, Georgia and EU countries.

7. Risks related to exploration and production

Resource discoveries and estimates

The main risk inherent in exploration activities is the risk of failure to discover resources, i.e. exploration risk. This means that not all the identified potential deposit sites actually have deposits of hydrocarbons which can qualify as an accumulation.

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

Each downgrade of the size of the reserves or production quantities may lead to a lower revenue and adversely affect PGNiG S.A.'s financial performance.

Exploration for unconventional deposits of gas

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

Delayed work

Under the applicable Polish legal regulations, obtaining a licence for exploration for and appraisal of crude oil and natural gas deposits lasts from one to one and a half years. On foreign markets, such procedures may take even two years from the time that the winning bid is awarded in a licensing tender for until the relevant contract is ratified. Prior to the commencement of field work, the Company is also required to make a number of arrangements, including obtaining formal and legal permits and approvals for entering the area, meeting environmental protection-related requirements and, in some cases, requirements related to protection of archaeological sites, and abiding by the regulations governing tenders held to select a contractor, which delays execution of an agreement with a contractor by another few months. Frequently the waiting time for customs clearance of imported equipment is very long. These factors create the risk of delays in the start of exploration work.

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

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

These factors significantly delay implementation of investment projects and commencement of on-site construction work. Further, PGNiG S.A.'s obligation to comply with the Public Procurement Law frequently protracts the tender procedure. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing an entire project. A protracted investment process exacerbates the risk related to estimation of capital expenditure.

Cost of exploration

Exploratory work is capital intensive, given the prices of energy carriers and materials. Cost of exploratory work is especially sensitive to steel prices, which are passed onto prices of casing pipes and lifting casing used in drilling. An increase in prices of energy and materials translates into an increase in the cost of exploratory work. Moreover, profitability of foreign exploration projects depends to a significant extent on the prices of oil derivative products and on exchange rates. To reduce drilling costs, PGNiG S.A. introduced the *daily rate* system into its drilling contractors selection procedure in 2011.

Qualified personnel

The presence of foreign companies on the Polish market has intensified competition for highly qualified employees with extensive professional experience. This risk of losing experienced personnel is especially high with respect to oil and gas exploration professionals. In countries where PGNiG S.A. operates, highly qualified staff is difficult to recruit.

Competition

Both on the Polish market and abroad there is a risk of competition from other companies in the area of acquisition of licences for exploration for and appraisal of hydrocarbon deposits. Certain competitors of PGNiG S.A., especially those active globally, enjoy strong market positions and have greater financial resources than those available to PGNiG S.A. 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 S.A. could offer given its financial and human resources. This competitive advantage is particularly important on the international market.

Safety, environmental protection and health regulations

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

Changes in laws and regulations

Frequent changes in laws and regulations (especially in countries with authoritarian regimes) may cause difficulties for entities involved in exploration activity.

Political and economic situation in the regions where the PGNiG Group operates

In some countries where the PGNiG Group conducts exploration activities there is a number or risks, which may lead to a limitation, suspension or even discontinuation of the exploration and production activities. These risks include armed conflicts, terrorist attacks, social or political unrest, internal conflicts and civil disturbance.

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

In certain countries, operations of exploration companies may be hindered by the lack 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 a limitation or suspension of the Company’s exploration activities.

Unforeseen events

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

Section VI: Trade and Storage

The segment sells both imported and domestically-produced natural gas. Imported natural gas is purchased chiefly from markets east of Poland. Sale of natural gas through the distribution and transmission network is regulated by the Polish Energy Law, and gas prices are determined based on tariffs approved by the President of the Energy Regulatory Office. The segment also trades in electricity, certificates of origin for electricity, and CO_2 emission allowances. The segment operates six underground gas storage facilities (Brzeźnica, Husów, Mogilno, Strachocina, Swarzów and Wierzchowice).

1. Gas purchases

In 2013, the PGNiG Group purchased gas from abroad and, to a limited extent, from domestic suppliers. The purchases were handled by two PGNiG Group companies: PGNiG S.A. and PGNiG Sales & Trading GmbH.

PGNiG S.A. bought natural gas mainly under the agreements and contracts specified below, i.e. the long-term contract with OOO Gazprom Export and short- and medium-term gas supply contracts with European suppliers:

- Contract with OOO Gazprom Export for sale of natural gas to the Republic of Poland, dated September 25th 1996, effective until December 31st 2022;
- Individual Agreement with Vitol S.A. for sale of natural gas, dated May 13th 2011, effective until October 1st 2014;
- Agreement with VNG-Verbundnetz Gas AG for sale of Lasów natural gas, dated August 17th 2006, effective until October 1st 2016.

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

In 2013, to fulfil its trading obligations, the PGNiG Group purchased a total of 12,295.7 mcm of natural gas. The table below presents the structure of natural gas purchases from suppliers, measured as high-methane gas equivalent.

Structure of the PGNiG Group’s natural gas purchases, by supply sources (mcm)

	2013	%	2012	%
Foreign suppliers:	11,906.0	96,8%	11,334.8	98.9%
- Gazprom Export	8,733.3	73,4%	9,017.3	79.6%
- Other foreign suppliers	3,172.7	26,6%	2,317.5	20.4%
Domestic suppliers	389.7	3,2%	127.2	1.1%
Total	12,295.7	100.0%	11,462.0	100.0%

On November 6th 2013, PGNiG S.A. and NAK Naftogaz Ukrainy signed an arrangement to terminate the agreement for supplies of natural gas of October 26th 2004. This was due to the fact that on January 1st 2011 NAK Naftogaz Ukrainy suspended gas deliveries via the Zosin cross-border point on the Polish-Ukrainian border. The decision to terminate the agreement will not preclude any future cooperation with the Ukrainian partner on new terms. PGNiG customers in the Hrubieszów area receive natural gas from the Polish transmission system through the Lubaczów-Krasnystaw gas pipeline.

New contracts

In 2013, PGNiG S.A. and PGNiG Sales & Trading GmbH executed short-term contracts for the supply of ca. 1,210.3 mcm of natural gas, including 760.3 mcm using the reverse flow service on the Yamal Pipeline.

2. Sales

In 2013, PGNiG S.A. executed contracts for the supply of gas fuel, both from the transmission system and from the distribution system, to 86.9 thousand new customers.

The key products sold by the Trade and Storage segment are high-methane gas and nitrogen-rich gas. The PGNiG Group sold gas to customers in Poland and Germany, and the power exchanges in those countries. The sales structure of the Trade and Storage segment in 2013 is presented in the table below.

Sales structure of key products

		Unit	2013	2012
1	Natural gas, including:	mcm	15,465.4	14,189.2
	- high-methane gas	mcm	14,939.6	13,684.5
	- nitrogen-rich gas*	mcm	525.8	504.7
2	Propane-butane	thousand tonnes	1.3	1.2

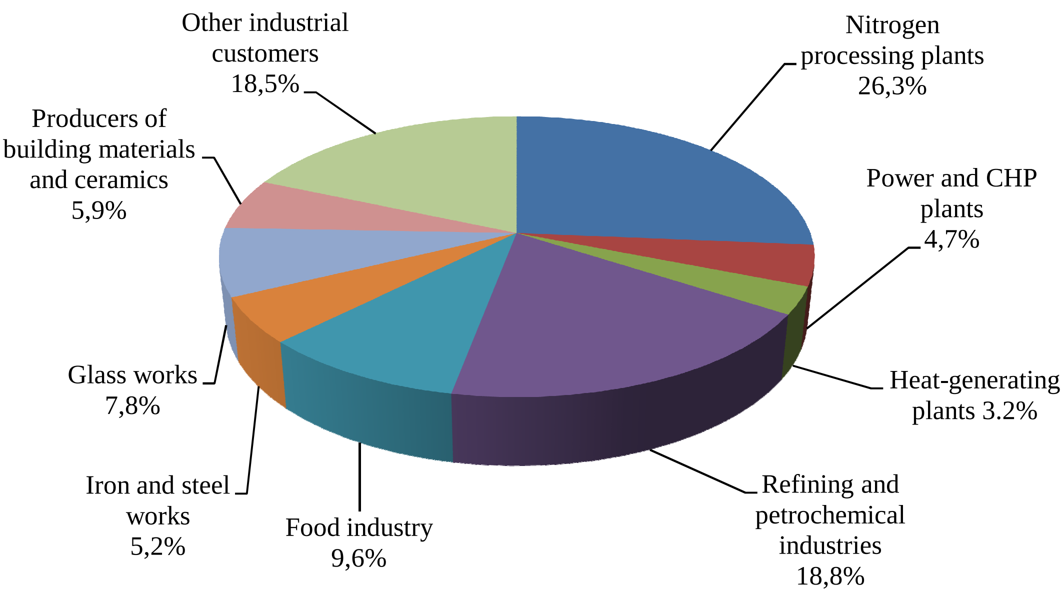
*Measured as high-methane gas equivalent.

PGNiG S.A. delivered natural gas to customers in Poland. Gas was purchased primarily by industrial customers (mainly in the chemical, oil refining, petrochemical and metallurgical sectors) and by households. The latter were identified as the largest customer group (approximately 6.5m), accounting for 97% of the entire PGNiG customer base. Compared with 2012, the volume of gas sales to this customer group rose by about 2%. Industrial customers had the largest share in the sales volume, though sales to this group fell by approximately 3% on 2012. PGNiG S.A. began selling gas on the Polish Power Exchange, where it sold 66 mcm of gas in 2013. The table below presents the structure of natural gas sales by PGNiG S.A. (measured as high-methane gas equivalent), by customer groups.

Sales of natural gas (mcm)

	2013	%	2012	%
Industrial customers	8,081.7	57.4%	8,268.2	59.6%
Trade and services	1,700.5	12.1%	1,523.3	11.0%
Households	3,919.3	27.8%	3,851,7	27.8%
Wholesale customers	230.9	1.6%	222.4	1.6%
Exports	83.9	0.6%	0.0	0.0%
Exchange	66.3	0.5%	0.0	0.0%
Total	14,082.6	100.0%	13,865.6	100.0%

Structure of natural gas sales in 2013 {sp} to industrial customers



In September 2013, PGNiG S.A. became a member of the London-based ICE Futures exchange, thanks to which it can now enter into transactions on the European largest platform for trading in emission allowance futures contracts.

On November 1st 2013, PGNiG S.A. became the first direct member of the gas market at the Polish Power Exchange. Earlier, the Company had executed trades at the exchange through commodity brokers. The Company also agreed to act as a market maker in the natural gas futures market, and to regularly place both sell and buy orders on this market. The market maker's key role is to enhance the market's liquidity and transparency.

PGNiG Sales & Trading GmbH sold natural gas to end users, mainly on the German market. Its customers in Germany included households, small and medium-sized enterprises, institutional buyers, industrial buyers and gas trading companies. In Poland, the company sold gas to industrial buyers, on DAF (delivery at frontier) terms.

New contracts

On October 25th 2013, PGNiG S.A. executed a framework agreement with Ukraine-based DTEK Trading for supply of natural gas to evaluate the possibility of natural gas transmission across Poland to the Polish transmission system's exit point in Hermanowice. Three individual gas supply transactions were executed under the agreement, for the following periods: from October 28th to October 31st 2013, from November 6th to November 12th 2013 and from November 9th to December 1st 2013. The aggregate volume of gas supplied was 83.9 mcm.

On January 30th 2014, PGNiG S.A. and KGHM Polska Miedź S.A. signed an annex to the comprehensive gas fuel supply contract of July 30th 2010 for period until June 30th 2033. Under the annex, the annual volume of gas supplies was reduced from 266mcm to 41.5mcm. The change follows from a decision by KGHM to reduce the output of co-generated electricity and heat due to changes in the co-generation support mechanisms in 2013 and low prices of electricity. The estimated value of the annexed contract is approximately PLN 830m. The parties may restore the original supply volume in future. The parties also signed annexes to the three other contracts for gas fuel supplies to KGHM, i.e. the contracts of September 25th 2001, January 4th 1999, and October 1st 1998. The annexes changed only the duration of the contracts, from indefinite term to the period until June 30th 2033. The estimated aggregate value of the three contracts over their entire term is approximately PLN 2.8bn.

PESO project

In 2013, PGNiG S.A. continued a project consisting in LNG-based distribution of gas fuel to customers in Ełk and Olecko. This project is a part of an initiative to switch Pisz, Ełk, Suwałki and Olecko to high-methane gas (PESO project). The project involves construction of an LNG regasification station and two-step pressure reduction, metering and odorising stations in Ełk and Olecko, and switching customers in those towns to high-methane gas. In 2013, the Company commenced construction of an LNG regasification station and pressure reduction and metering stations in Ełk and Olecko.

Consolidation of trading operations

On May 27th 2013, the Wholesale Trading Division was established. The Branch's operations involve wholesale trade in natural gas, electricity, heat, certificates of electricity origin and CO_2emission allowances. Then, on July 23rd 2013 PGNiG S.A. merged with PGNiG Energia S.A. As a result, wholesale trading in electricity and related products was consolidated within the Wholesale Trading Division.

3. Electricity

In 2013, PGNiG S.A. engaged in wholesale trading in electricity and related products in Poland and Germany. In Poland, the Company traded on the OTC market (under EFET (European Federation of Energy Traders) standard agreements and through brokers) and on the Polish Power Exchange. In Germany, the Company engaged in spot contract trading on the *EPEX (European Power Exchange)* Spot market, and in the inter-system Poland-Germany exchange (between the areas covered by PSE and *50 Hertz Transmission*).

PGNiG Sales & Trading GmbH engaged in electricity trading in Germany on the EPEX Spot, EEX Power Derivatives and OTC markets.

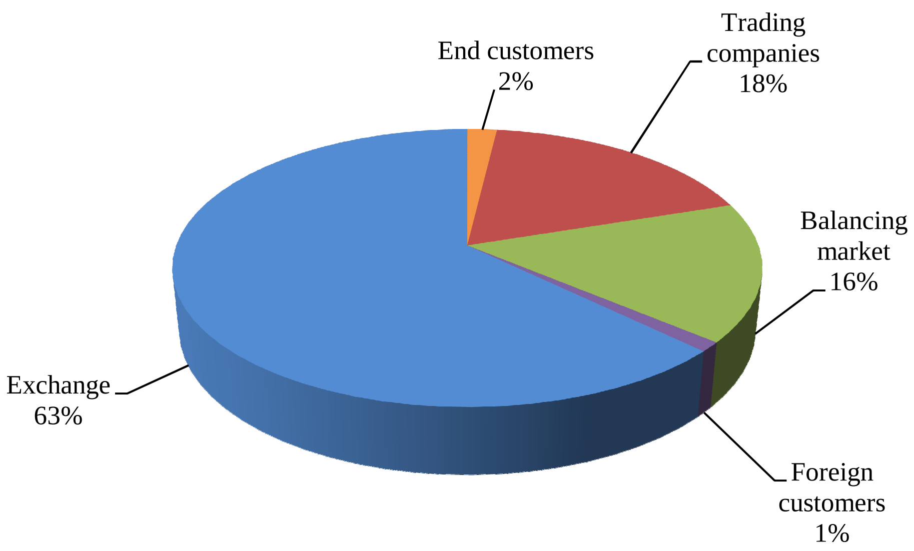
Sales of electricity

PGNiG S.A. expanded its offering by launching sales of electricity to business customers (tariff groups A, B and C). The Company also began preparations to launch sales of electricity to households (tariff group G).

PGNiG S.A. sells electricity with fixed price guarantee (for periods as long as until 2016) and offers full balancing of customers' electricity requirements. In October 2013, PGNiG S.A. launched a promotional campaign "Energia w dwupaku", ("Energy double play"), as part of which it offers to subsidise its customers' electricity bills. This offer is addressed primarily to small and medium-sized companies which already buy gas from the Company or want to sign gas-supply contracts with PGNiG S.A.

In 2013, the Trade and Storage segment of the PGNiG Group sold 7,231.6 GWh of electricity, of which 73% was sold on the Polish market. The chart below presents the structure of electricity sales by PGNiG S.A., by customer groups.

Sales of electricity by customer groups



PGNiG Sales & Trading GmbH sold electricity to end users, mainly on the German market. Its customers included mainly small and medium-sized companies, as well as households.

4. Storage

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

Short-term peak fluctuations in demand for natural gas are balanced by the supplies from the Mogilno facility, where gas is stored in worked-out caverns. The capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica facilities are used to minimise the effect of changes in demand for natural gas in the summer and winter seasons, to meet the obligations under the *take-or-pay* import contracts, to ensure the continuity and security of natural gas supplies, and to meet the obligations under contracts for gas deliveries to customers' premises.

The capacities of the Wierzchowice, Husów, Mogilno and Strachocina facilities are also used by the Group to meet its obligation to maintain mandatory stocks, imposed by the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on the Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market, dated February 16th 2007.

An amendment to Gas Fuel Storage Tariff No. 1/2012, approved by the President of the Energy Regulatory Office on December 17th 2012, has been in effect since January 1st 2013. This amendment covers charges for storage services, service quality, and settlement methods under short-term contracts. By virtue of a decision of April 30th 2013, the President of the Energy Regulatory Office extended the effective term of the Tariff until September 30th 2013.

On July 12th 2013, Operator Systemu Magazynowania Sp. z o.o. applied to the President of the Energy Regulatory Office for extension of the term of the Tariff until March 30th 2014. The President of the Energy Regulatory Office granted the Company's request in his decision of September 16th 2013.

As part of the reorganisation of the PGNiG Group's storage business, the Mogilno Underground Gas Storage Cavern Facility Branch was established on April 9th 2013. The Branch will be responsible for the development and maintenance of operations of the Mogilno Underground Gas Storage Cavern Facility and will be responsible for settlements at the physical, inter-operator entry and exit points in the transmission system. On July 1st 2013, Operator Systemu Magazynowania Sp. z o.o. was merged with INVESTGAS S.A. The purpose of the storage business reorganisation is to consolidate the Group's storage assets and technical and management capabilities within OSM Sp. z o.o., which will improve the operating efficiency of the Trade and Storage segment.

As at December 31st 2013, the PGNiG Group made available a total of 1,817.5 mcm of working storage capacity for third party access and for OGP GAZ-SYSTEM S.A.; of this volume, 1,796.0 mcm was made available under long-term agreements and 21.5 mcm – under short-term agreements. 0.39 mcm is allocated for the Mogilno cavern facility's own needs. The table below presents working capacities of the underground storage facilities as at December 31st 2012 and December 31st 2013.

Working capacities of the storage facilities used by the Trade and Storage segment (mcm)

	Dec 31 2013*	Dec 31 2012
Brzeźnica underground gas storage facility	65.0	65.0
Husów underground gas storage facility	350.0	350.0
Mogilno underground gas storage cavern facility	407.9	411.9
Strachocina underground gas storage facility	330.0	330.0
Swarzów underground gas storage facility	90.0	90.0
Wierzchowice underground gas storage facility	575.0	575.0
Total	1,817.9	1,821.9

*0.39 mcm of the working storage capacity is used by the Mogilno cavern facility's for its own needs, while 1,817.5 mcm is used for trading purposes and for the needs of OGP GAZ-SYSTEM S.A.

The working storage capacity of the Mogilno cavern facility was reduced from 411.9 mcm to 407.9 mcm as a result of the process of convergence (tightening) of the salt rock mass. On April 11th 2013, the President of the Energy Regulatory Office changed the gas fuel storage licence granted to Operator Systemu Magazynowania Sp. z o.o. to reflect the 4 mcm reduction in the Mogilno facility's working storage capacity.

5. Planned activities

Purchases of natural gas

In 2014, the PGNiG Group will continue to purchase imported gas under the long-term contract with OOO Gazprom Export and short- and medium-term gas supply contracts with European suppliers. With a view to optimising the costs of gas purchases, the Company will purchase natural gas on the German market, under short-term contracts. The gas will be delivered using the virtual reverse flow service on the Yamal gas pipeline.

Electricity

In 2014, PGNiG S.A. plans to launch electricity sales to retail customers, and to add energy products to its offering for business customers.

Storage

Starting from August 1st 2014, transactions in energy will have to be settled in units of energy. Therefore, Operator Systemu Magazynowania Sp. z o.o. will be obliged to develop a new model of storage services, introduce a number of changes in the products offered and harmonise its Rules of Provision of Storage Services with the amended legal regulations.

In 2014, the PGNiG Group will continue work on extending the Mogilno cavern facility and the Husów facility. The Group will also continue the construction (begun in 2007) of the Kosakowo storage cavern for high-methane gas.

6. Risks related to Trade and Storage

Obligation to diversify imported gas supplies

The maximum share in total gas imports of gas importable from one country in a given year is determined in the Council of Ministers' Regulation of October 24th 2000 on the minimum level of diversification of foreign sources of gas supplies. In 2012, the President of the Energy Regulatory Office instigated administrative proceedings to impose a fine on PGNiG S.A. for its failure to comply with the obligation to diversify supplies of imported gas in 2010 and 2011 – on May 11th and December 5th, respectively. Similar administrative proceedings were instituted by the President of the Energy Regulatory Office concerning PGNiG S.A.'s failure to comply with the obligation to diversify supplies of imported gas in 2007, 2008 and 2009. The 2009, 2010 and 2011 proceedings were suspended ex officio until the conclusion of the 2007 and 2008 proceedings, held before the Court of Competition and Consumer Protection.

On October 10th 2013, the Regional Court of Warsaw – the Court of Competition and Consumer Protection amended the decision issued by the President of the Energy Regulatory Office on December 16th 2010 (concerning a failure to comply with the obligation to diversify supplies of imported gas in 2007 and 2008), by reducing the imposed fine from PLN 2,000,000 to PLN 1,500,000, taking into consideration the narrow margin of failure. The court also awarded an amount of PLN 115 from the Energy Regulatory Office as reimbursement of the cost of proceedings. In the remaining part, the appeal was dismissed. On January 21th 2014, PGNiG S.A. appealed against the decision to the Warsaw Court of Appeals.

On November 6th 2013, the President of the Energy Regulatory Office instigated administrative proceedings to impose a fine on PGNiG S.A. for its failure to comply with the obligation to diversify supplies of imported gas in 2009, 2010 and 2011. On November 19th 2013, PGNiG S.A. filed a complaint against those proceedings.

In order to avoid a similar situation in the future, in 2011 PGNiG S.A. submitted an inquiry to the Constitutional Court concerning the compliance of the Council of Ministers' Regulation of October 24th 2000 on the minimum level of diversification of foreign sources of gas supplies with the Polish Constitution.

If the Regulation is not amended, the President of the Energy Regulatory Office may continue imposing fines on the Company for failing to comply with the diversification requirement until gas starts to be supplied from other sources (e.g. through the LNG terminal).

Deregulation of gas prices

PGNiG S.A. is the largest supplier of natural gas in Poland. However, the pending gas market deregulation in Poland is bound to trigger major changes, in the market itself and in the related legal framework. In 2012, a natural gas market was launched on the Polish Power Exchange. Under a decision of the President of the Energy Regulatory Office, natural gas trading handled by PGNiG S.A. on the exchange is exempt from the tariff obligation. In 2012, PGNiG S.A. also started work on liberalisation of gas prices for customers. This will be implemented gradually, with gas prices for large industrial customers to be liberalised first. As a result of the expected changes, the Company's share in the natural gas market may fall, to the benefit of both existing and new gas trading entities.

Section VII: Distribution

1. Core business

The segment's core business consists in the transmission of high-methane and nitrogen-rich gas, as well as of small amounts of propane-butane and coke-oven gas over the distribution network. Also, the segment is engaged in extending and upgrading the gas network and connecting new customers to the existing network and to new sections of the network.

Until June 30th 2013, natural gas distribution was the business of the six gas distribution companies. On July 1st 2013, as a part of the Distribution segment consolidation process, PGNIG SPV 4 Sp. z o.o. acquired all assets of the six gas distribution companies, which were transformed into regional branches. The name of the company was then changed to Polska Spółka Gazownictwa Sp. z o.o.

Polska Spółka Gazownictwa Sp. z o.o. was appointed as the Distribution System Operator and the Natural Gas Liquefaction System Operator until December 31st 2030. The President of the Energy Regulatory Office also granted the company a licence to distribute gas fuels and a licence to liquefy natural gas and regasify LNG at LNG regasification plants until December 31st 2030.

In the period from January 1st to December 31st 2013, settlements with customers using the services of the gas distribution companies were provided based on Tariffs for Gas Fuel Distribution Services, approved by the President of the Energy Regulatory Office on December 17th 2012.

On December 17th 2013, the President of the Energy Regulatory Office approved the new Tariff for Gas Fuel Distribution Services and LNG Regasification Services for the period from January 1st 2014 to July 31st 2014. The new tariff was adjusted to accommodate the 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 trading, as well as provisions of the Act Amending the Energy Law and certain other acts, dated July 26th 2013. The Tariff is uniform for the entire company, while the charge rates for distribution and regasification services vary by the areas covered by individual branches.

The Distribution Grid Code for Distribution System Operators approved on December 5th and 6th 2012 by the President of the Energy Regulatory Office was in effect from January 1st 2013 to January 1st 2014. On December 23rd 2013, the President of the Energy Regulatory Office approved the uniform Distribution Grid Code for Polska Spółka Gazownictwa Sp. z o.o., which came into effect on January 1st 2014 (from 6:00 am).

In 2013, Polska Spółka Gazownictwa Sp. z o.o. continued 18 projects involving construction, extension and modernisation of its distribution networks, for which, in previous years, the gas distribution companies concluded agreements for EU co-financing under the Infrastructure and Environment Operational Programme. The key projects included:

- Construction of a high-pressure gas network connecting Szczytno, Młynowo and Muławki near Kętrzyn, and distribution network roll-out in the municipalities; in 2013, project design documents were completed for the high-pressure gas pipeline from Rybno to Młynowo, as well as pressure reduction stations in Mikołajki and Muławki near Kętrzyn; project design documents were drafted for stage II of construction of the high-pressure gas pipeline from Szczytno to Rybno, the high-pressure gas pipeline from Rybno to Młynowo, the high-pressure gas pipeline from Młynowo to Muławki; construction work was launched on the high-pressure gas pipeline from Rybno to Młynowo, pressure reduction stations in Mikołajki and Muławki near Kętrzyn, and was continued on grid connections (Project VIII);

- Construction of the south-eastern gas supply line for the city of Gdańsk, and distribution network roll-out in Wiślinka and Wyspa Sobieszewska; in 2013, work continued on design documentation for the distribution network roll-out in the Wiślinka and Żuławy communes and in Wyspa Sobieszewska; construction work was carried out in Wiślinka, Wyspa Sobieszewska, and the Pruszcz Gdański commune; an underground Martwa Wisła river crossing was drilled, to enable the network roll-out in Wyspa Sobieszewska;
- Construction of the DN 300 high-pressure gas network connecting Brodnica, Nowe Miasto Lubawskie and Iława, and distribution network roll-out. The project involves construction of high-pressure gas pipelines from Brodnica to Nowe Miasto Lubawskie with a pressure reduction station, and from Nowe Miasto Lubawskie to Iława, as well as medium-pressure gas pipelines in Nowe Miasto Lubawskie and Kurzętniki; in 2013, project design documents were completed and construction was begun for the high-pressure gas pipeline from Brodnica to Nowe Miasto Lubawskie (stage I), work continued on the design and cost estimate documentation for the high-pressure gas pipeline from Brodnica to Nowe Miasto Lubawskie (stage II) with a pressure reduction station in Kurzętnik, and for the high-pressure gas pipeline from Nowe Miasto Lubawskie to Iława, as well as for medium-pressure gas pipelines in Nowe Miasto Lubawskie and Kurzętnik; also, grid connections were carried out in the project area; the project was also extended to include construction of a medium-pressure pipeline from Dziarny to Iława;
- Distribution network roll-out in Blachownia, Herby, Wręczyca Wielka, Kłobuck, Opatów and Krzepice. The project involves construction of three pressure reduction stations, a 21 km high-pressure gas pipeline, a 45 km medium-pressure pipeline for Herby and Blachownia, a 31 km medium-pressure pipeline in Kłobuck, a 16 km medium-pressure pipeline in Wręczyca Wielka, a 20 km medium-pressure pipeline in Krzepice and a 22 km medium-pressure pipeline in Opatów; in 2013, the design work was continued;
- Distribution network roll-out in the Włodawa area. The project comprises construction of a 58 km high-pressure gas pipeline from Kamień to Włodawa, with a 43 km medium-pressure gas network and three pressure reduction stations; the project is scheduled for completion in 2015; in 2013, the construction of high- and medium-pressure gas pipelines with auxiliary infrastructure (stage I, II and III) was continued, as well as the design work on stage IV of the project, including a distribution network in the region of Włodawa, Wola Uhruska, Hańsk and Ruda Huta; project design documents were completed and relevant permits were obtained for construction works in Włodawa; the project was extended to include the construction of an additional 20.4 km of medium-pressure pipeline;
- Distribution network roll-out in the Włoszczowa and Małogoszcz communes; the project comprises construction of a 44 km high-pressure gas pipeline with pressure reduction stations, and a 35 km medium-pressure gas pipeline network with eight gas governor stations; the project is scheduled for completion in 2015; in 2013, construction and assembly work was launched for stage I of the project, design work was completed and relevant permits obtained for stage II of the project;
- Distribution network roll-out in the Chęciny and Sitówka Nowiny communes; the project comprises construction of a 4.5 km high-pressure gas pipeline with a pressure reduction station, and a 63 km medium-pressure gas pipeline network with connections and gas governor stations; the project is scheduled for completion in 2015; in 2013, work continued on the construction of stage I of the project, which included construction of high- and medium-pressure pipelines with auxiliary infrastructure; at the same time, design work was performed on stage II;
- Natural Gas – Energy for Future Generations project, distribution network roll-out in the Osiek and Rypin communes; the project involves construction of a medium-pressure gas pipeline, with a total length of ca. 50 km, running through the Osiek and Rypin communes; in 2013, final acceptance documents were signed for the medium-pressure gas pipeline connecting Brodnica, Osiek and Rypin, the metering station in Brodnica, and connection to the MPEC Rypin CHP; work also continued on design documents for the pipelines delivering gas to Rypin; the project was extended to include the construction of an additional 2.3 km of medium-pressure pipeline in the Rypin commune (stage II);

- Distribution network roll-out in selected localities in the Strzelin and Wiązów communes, Strzelin county. The project involves construction of high-pressure and medium-pressure gas pipelines with connections, two pressure reduction stations, as well as connections and a pressure reduction station for a key customer; in 2013, work continued on design of the high-pressure gas network and a building permit was obtained for the entire project.

In 2013, the Company also directly financed projects itself. Key among these were:

- Lease of the gas network connecting KGZ Kościan to KGHM Polkowice/Żukowice pursuant to a lease agreement between PGNiG S.A. and PSG Sp. z o.o. (formerly WSG Sp. z o.o.);
- Continued design work on the upgrade of a 61 km high-pressure gas pipeline from Sandomierz to Ostrowiec Świętokrzyski; the project completion date was rescheduled to 2016;
- Continued work on the upgrade of the Łódź Ring, including the upgrade of the high-pressure gas pipeline from ul. Konstantyna to Meszcze. The project involves a series of tasks whose execution will enable the technical condition of the gas network to be improved, and also provides for the reconstruction of ca. 52 km of gas pipelines, overhaul and upgrading work on gas stations on the gas pipelines of the Łódź Ring and the construction of high-pressure regulating stations; execution of the individual stages of the project is scheduled until 2018; in 2013, the construction of the high-pressure station Szczecińska was completed and work on the Brzezińska and Olechów stations continued; work continued on the design of the Łódź–Smulsko high-pressure gas station;
- Continued design work on the upgrade of a 37 km high-pressure gas pipeline from Parszów to Kielce. The project is scheduled for completion in 2015;
- Continued design work on the upgrade of a 21 km section of the high-pressure gas pipeline from Lubienia to Parszów;
- Continued design work on the upgrade of a 5 km Jasło section of the high-pressure gas pipeline from Warzyce to Gorlice; construction and assembly work on the remaining 14.2 km of the pipeline was completed;
- Completion of construction work on stage I of the distribution network roll-out in Długołęka, Domaszczyn, Kamień and Szczodre in the Długołęka commune. The project involved construction of a medium-pressure pipeline and a pressure reduction station; construction of the remaining networks is contracted gradually under separate projects, as necessitated by new connection requests;
- Distribution network roll-out in Przasnysz and Chorzele. The project involves construction of a high-pressure reduction station, two increased medium-pressure reduction stations, a 65 km increased medium-pressure pipeline and a 7 km medium-pressure pipeline; in 2013, the design work on the stations and increased medium-pressure pipelines commenced.

The table below presents segment's key operating data.

	Unit	Dec 31 2013
Volume of gas transmitted via the distribution system*	mcm	9,849.3
- high-methane gas	mcm	9,053.9
- nitrogen-rich gas	mcm	478.1
- propane-butane-air and decompressed propane-butane	mcm	1.4
- coke gas	mcm	315.9
Length of network, excl. connections**	km	122,691.0
No. of customers	('000)	6,774.9
No. of new customers connected to the network	('000)	70.6

*Measured as high-methane gas equivalent.
**Own and third-party networks.

2. Planned activities

In 2014, Polska Spółka Gazownictwa Sp. z o.o. will continue working on projects for which EU co-financing agreements were signed by individual gas distribution companies. Work will also continue on other projects for which the Company will use its own funds. The most important of these are:

- Construction of the high-pressure gas network connecting Szczytno, Młynowo and Muławki near Kętrzyn, and distribution network roll-out in the municipalities;
- South-eastern gas supply line for the city of Gdańsk, and distribution network roll-out in Wiślinka and Wyspa Sobieszewska;
- Construction of the Iława DN 300 high-pressure gas network connecting Brodnica, Nowe Miasto Lubawskie and Iława, and distribution network roll-out;
- On-going construction and assembly work on distribution network roll-out in the Włodawy region, Włoszczowa and Małogoszcz;
- Roll-out of the gas network in Herby, Blachownia, Komprachcice, and Dąbrowa;
- On-going design work for the upgrade of the high-pressure gas pipelines from Sandomierz to Ostrowiec Świętokrzyski and from Parszów to Kielce;
- Upgrade of the Łódź Ring;
- On-going design, construction and assembly work for the upgrade of the Jasło section in the high-pressure gas pipeline from Warzyce to Gorlice.

In the coming years, Polska Spółka Gazownictwa Sp. z o.o. will also focus on maintaining its market position and further increasing the volumes of transmitted gas by taking the following measures:

- Extending the pipeline infrastructure to reach new customers,
- Ensuring adequate transmission capacity and securing sources of gas supply for the gas distribution system,
- Upgrading high-, medium- and low-pressure networks,
- Deploying new LNG-based gas distribution systems,
- Improving the quality of customer service,
- Using EU funds to refinance the extension of distribution systems.

3. Risks related to distribution

<u>Direct competition</u>

Liberalisation of the gas market is contributing to intensified competition in the segment. Companies distributing natural gas are progressively expanding their gas networks and attracting new customers. Additionally, companies have emerged which offer LNG distribution services. The market entry barriers are significantly lower here, as LNG distribution involves much lower capital expenditure and does not require a connection to the gas system or adequate reserve capacity to be maintained in the transmission and distribution networks. Another issue which affects the segment's competitive position is the tariff policy of the Energy Regulatory Office, which makes it difficult for the PGNiG Group to operate a flexible pricing policy for some groups of customers. With the lack of flexible pricing, competitors' offers may prove to be an attractive alternative to the PGNiG Group's customers.

<u>Legislation</u>

The complex provisions of the Construction Law and regulations governing implementation of investment projects impose the obligation to prepare extensive project and legal documentation, which is an integral part of any investment process. Preparation of the documentation protracts the time needed for project preparation and thus may significantly delay project execution and expose the company to the risk of cost overruns caused by potential delays in contract performance, as well as to the risk of lower revenues.

Sources of gas supply for the distribution system

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

Claims raised by property owners

More and more frequently, the PGNiG Group is facing excessive financial claims raised by owners of land plots where the gas network was developed in the past. Under applicable laws, Polska Spółka Gazownictwa Sp. z o.o. does not hold clear legal title to use these land plots – no transmission easements have been established. Transmission easement serves as a basis for determining the extent of the use of third-party property by a transmission company, for which relevant consideration is due to the owner. The owners' claims give rise to additional, frequently considerable costs, and thus may adversely affect the financial performance of the segment.

Tariff policy

By setting tariffs, the President of the Energy Regulatory Office, citing social considerations, limits the growth of regulated revenue, which is the basis for calculation of charge rates. Furthermore, the protracting tariff approval proceedings result in tariffs becoming effective later than as requested by PGNiG, leading to lower revenue from provision of distribution services.

Section VIII: Generation

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

1. Segment's operations

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

Heat and electricity are generated at the company's six production plants:

- Siekierki CHP Plant
- Żerań CHP Plant
- Pruszków CHP Plant
- Kawęczyn Heating Plant
- Wola Heating Plant
- Regaty Heating Plant.

Licences

As at December 31st 2013, PGNiG TERMIKA S.A. held an electricity trading licence valid until December 31st 2030, as well as the following licences, each valid until December 31st 2025:
- for production of heat
- for transmission and distribution of heat
- for production of electricity.

Tariffs

Until June 2013, a tariff of May 30th 2012 was applicable to PGNiG TERMIKA S.A.'s sales of heat generated at the Żerań CHP, Siekierki CHP, Pruszków CHP, Wola Heating Plant and Kawęczyn Heating Plant; and to the transmission and distribution of heat via the heating network supplied from the Pruszków CHP plant.

The company was also bound by tariffs for transmission of heat through the heating networks in:

Marsa Park – tariff approved on November 14th 2011,
Annopol – tariff approved on April 2nd 2012,
Marynarska – tariff approved on April 5th 2012,
Chełmżyńska – tariff approved on April 5th 2012,
Jana Kazimierza – tariff approved on July 13th 2012.

Production of heat at the Regaty Heating Plant and transmission of the heat via the network in the Regaty residential estate was subject to a separate tariff of October 31st 2012.

On July 1st 2013, the tariff approved by the President of the Energy Regulatory Office on June 12th 2013 came into force with respect to the heat produced by PGNiG TERMIKA S.A.'s generating units (the Żerań CHP, Siekierki CHP, Pruszków CHP, Wola Heating Plant and Kawęczyn Heating Plant), and for the transmission and distribution of heat via the heating network supplied from the Pruszków CHP plant. The tariff introduced new, higher prices and rates for the contracted heat capacity and for the production of heat.

Also on July 1st 2013, new tariffs came into force changing the prices and rates for the transmission and distribution of heat in the areas of Marsa Park, Annopol and Chełmżyńska. As of September 1st 2013, new tariffs were also introduced for the Marynarska and Jana Kazimierza regions.

Production

PGNiG TERMIKA S.A.'s key products are heat and electricity. In 2013, 92.2% of total electricity output was electricity cogenerated with heat. The table below presents PGNiG TERMIKA S.A.'s production volumes.

Electricity and heat production volumes

Product	Unit	2013	2012
Electricity	GWh	4,435.5	4,389.7
Heat	TJ	40,540.2	40,567.8

The company also provided Network Constrained Generation services under an agreement with PSE Operator S.A., pursuant to which the company maintains a long-term plant margin and keeps a specific number of generating units available, so as to overcome limitations in the operation of power sources in the national power system and to ensure Warsaw's energy security. PGNiG TERMIKA S.A. is required to generate electricity whenever so instructed by the Transmission System Operator. In performance of the agreement, by December 31st 2013 the company had generated 197.9 GWh of electricity.

Sales

In 2013, PGNiG TERMIKA S.A. sold 40,174.6 TJ of heat. PGNiG TERMIKA S.A. sold heat mainly to Dalkia Warszawa S.A. (formerly Stołeczne Przedsiębiorstwo Energetyki Cieplnej S.A.), which purchased 97.3% of the heat generated by the company. In 2013, Dalkia Warszawa S.A. contracted 3.6 GW of PGNiG TERMIKA's heat generation capacity. The balance of the produced heat was sold to local customers, mainly in Pruszków and the surrounding areas.

In 2013, PGNiG TERMIKA S.A. sold 3,772.2 GWh of electricity. The company's key customers in 2013 were PGNiG S.A. and Alpiq Energy SE, whose aggregate share in the company's electricity sales volume was 99%. The company also sold electricity to smaller customers.

In 2013, the company sold property rights attached to certificates of origin for electricity produced by cogeneration (red certificates) and generated from renewable sources (green certificates) on spot markets or under forward contracts. Certificates of origin for electricity were sold chiefly to PGNiG S.A., RWE Polska, Obrót Axpo Trading, and TAURON Polska Energia S.A., as well as on the Polish Power Exchange.

Construction of CCGT Unit in Stalowa Wola

In 2013, as part of the Stalowa Wola CCGT project (a joint project between Tauron Polska Energia S.A. and Elektrownia Stalowa Wola S.A.), financing agreements for the CCGT unit were concluded and the construction works began. These works included construction of an electricity switching substation with control room, and foundations for the unit’s main installations. Foundations for the recovery boiler and gas turbine were laid, and work continued on foundations for the steam turbine. The load-bearing structure for the gas turbine building was completed and construction of the building was begun. Also the first phase of works at the San river weir was completed.

2. Planned activities

In 2014, PGNiG TERMIKA S.A. will seek to roll out the heating distribution system, both in partnership with Dalkia Warszawa S.A. and on its own, by entering into heat sale contracts directly with end customers on a third-party-access (*TPA*) basis.

In 2014, following expiry of the contracts with Alpiq Energy SE, PGNiG S.A. will become the key customer for electricity generated at PGNiG TERMIKA S.A. PGNiG S.A.’s share in the PGNiG TERMIKA S.A.’s electricity sales volume will be approximately 99%.

In 2014, management of the electricity portfolio and commercial balancing for PGNiG TERMIKA S.A. will be performed through PGNiG Energia S.A., which enters into dated power purchase contracts on the Commodity Derivatives Market.

3. Generation risks

More stringent gas and dust emission standards

In order to meet the more stringent gas and dust emission standards expected to be implemented in 2016, producers will have to modernise their power and CHP plants and may be forced to shut down a number of generating units (to a total capacity 4,000-6,000 MWe by 2020) where installation of expensive flue gas treatment systems is not economically viable. In order to meet the more stringent emission standards, PGNiG TERMIKA S.A. has gradually been modernising its generating assets.

Expiry of co-generation support mechanisms

Expiry of support mechanisms for gas and coal co-generation is a material risk factor affecting the electricity and heat generation sector. There is also no policy in place, which would be transparent and stable over the long term, to support investments in renewable energy sources and co-generation. These factors fundamentally affect development decisions by PGNiG TERMIKA S.A. and create a significant risk of deterioration of the company financial standing.

Moreover, at current price levels, the expiry of the support system for electricity and heat produced in high efficiency co-generation, based on the so-called yellow certificates, makes generation of heat and electricity from natural gas unprofitable, which in turn results in lower demand for gas from some CHP plants.

Maintaining share in the municipal heat market

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

Marketing efforts conducted jointly with Dalkia Warszawa S.A., and connecting further western districts of Warsaw to the municipal heating network should significantly reduce potential future decline in the volume of energy produced at PGNiG TERMIKA S.A.'s generating plants. To maintain its share in the municipal heat market, the company also offers "green" heat generated at biomass-fired units, continues to sell energy at competitive prices, and takes advantage of the TPA rule to gain access to new end users.

Section IX: Other Activities

The Other Activities segment provides services involving the design and construction of infrastructure for the production and transport of hydrocarbons. The segment is also engaged in the manufacture and repair of machinery and equipment for the mining and power industries, as well as catering and hospitality services.

1. Segment's operations

In 2013, the segment's companies conducted work involving construction and assembly of gas transmission pipelines, gas compressor stations, and distribution and metering nodes, as well as development of hydrocarbon deposits. They were also involved in production of drilling equipment, repair of coal mining equipment, design of gas transport systems, and provision of hotel, restaurant and spa centre services.

The services offered by the segment were provided to both third-party customers and related PGNiG Group companies. The key projects executed in 2013 included construction and assembly of high-pressure gas pipelines, gas distribution and metering nodes and gas compressor stations, as well as production of drilling equipment and spare parts for drilling rigs and drillships.

The key projects executed for third-party customers included:

- Construction of the 175.2 km DN 700 high-pressure gas pipeline from Rembelszczyzna to Gustorzyn, for OGP GAZ-SYSTEM S.A.
- Construction of a 20.1 km section of the DN 700 high-pressure gas pipeline from Trojane to Vodice, for Plinovodi d.o.o. (Slovenia)
- Construction of a 64 km section of the DN 700 high-pressure gas pipeline from Szczecin to Gdańsk (Stage I: Płoty–Karlino section) for OGP GAZ-SYSTEM S.A.
- Construction of the Jeleniów II Gas Compressor Station for OGP GAZ-SYSTEM S.A.
- Upgrade of the Hermanowice distribution and metering node for OGP GAZ-SYSTEM S.A.
- Development of the Komorze natural gas field for FX Energy Poland Sp. z o.o.
- Production of drilling rig and drillship equipment parts for Aker Solutions (Norway)
- Assembly of HDPE pipelines, valves and hydrants under the Polish LNG Project for Saipem S.P.A. S.A. Polish Branch
- Production of construction equipment parts for EXACTA Sp. z o.o.
- Construction of the Hermanowice distribution and metering node – extension of the process part for OGP GAZ-SYSTEM S.A.

For third-party customers, the segment also performed design work for gas transmission systems, manufactured and repaired coal mining equipment, and provided hotel, restaurant and spa centre services.

For PGNiG S.A., the segment completed the performance of construction and assembly contracts, including:

- Construction of the 55.4 km DN 300 high-pressure gas pipeline between the Wierzbno terminal and the Paproć gas production facility
- Extension of the Kościan node
- Construction of a gas compressor station for the Mirocin gas production facility.

The segment's work for PGNiG S.A. also included continued assembly of a new compressor at the Husów Underground Gas Storage Facility, changes in the configuration of compressors for the Wierzchowice Underground Gas Storage Facility and construction of a gas compressor station for the Hurko gas production facility.

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

- Construction of the 12.6 km Jasło-Skołyszyn section of the DN 300 high-pressure gas pipeline from Warzyce to Gorlice
- Installation of 4 nodes and 10 block/bleed systems for the DN 700 high-pressure gas pipeline from Gustorzyn to Odolanów
- Construction work on the 23.9 km DN 300 high-pressure gas pipeline from Rybno to Młynowo.

In addition, the segment's work for the related PGNiG Group companies included preparation of design documents for gas transmission systems.

2. Planned activities

In 2014, the segment will continue its ongoing construction and assembly projects, including the construction of high-pressure gas pipelines and gas compressor stations, and the installation of nodes and block/bleed systems for high-pressure gas pipelines. It will also start to perform new construction and assembly contracts, the most important of them being contracts for the construction of a 17.5 km section of the DN 700 high-pressure gas pipeline from the Lasów node to the Jeleniów Gas Compressor Station and a 41.7 km section of the DN 500 high-pressure gas pipeline from the Gałów node to the Kiełczów node for OGP GAZ-SYSTEM S.A. The segment's companies intend to maintain their market positions in the manufacturing of drilling equipment, including well surface equipment for conventional and unconventional deposits, drilling platforms, and equipment for oil and gas production facilities; and also in the gas system design, construction and assembly services for oil and gas facilities.

3. Risks related to Other Activities

<u>Legislation</u>

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

<u>Competition</u>

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

Economic environment

The deepening economic crisis on the Polish and foreign markets adversely affects investment activity and increases competition. PBG S.A.'s insolvency and delays in payments from several other trading partners had a negative effect on the profitability of the segment companies.

Qualified personnel

Increasing competition from local and foreign companies on the Polish market has intensified the process of their acquiring highly qualified employees with extensive professional experience.

Section X: Investments

In 2013, capital expenditure incurred by the PGNiG Group on property, plant and equipment and intangible assets was PLN 3,326m, having gone down by ca. 13% year on year. The table below presents expenditure in the individual segments.

Capital expenditure (PLNm)

	2013	2012
Exploration and Production	1,446	1,793
Trade and Storage	472	582
Distribution	1,139	1,144
Generation	257	241
Other Activities	12	47
Total	3,326	3,807

Below are described the key capex projects implemented by the PGNiG Group in 2013.

Exploration

The capital expenditure of PLN 626m incurred by PGNiG S.A. on exploration work was incurred chiefly on geophysical surveys, nine wells drilled with positive results and wells on which work is still under way.

Norwegian Continental Shelf

The project involves exploration for and production of crude oil and natural gas on the Norwegian Continental Shelf. In 2013, work continued to complete the last stage of the development of the Skarv field. The work mainly included the continuation of the drilling campaign and technical acceptance of the floating production, storage and offloading (FPSO) vessel. The expenditure incurred in 2013 was PLN 225m.

Lubiatów-Międzychód-Grotów project

The objective of the project is to develop the Lubiatów-Międzychód-Grotów ("LMG") oil and gas field and to enable the transport, storage and sale of crude oil, natural gas, liquid sulfur and propane-butane from the LMG Oil and Gas Production Facility. The LMG project involves:

- Construction of the LMG Central Facility to serve as a hub for collection, distribution and treatment of reservoir fluids
- Construction of the Dispatch Terminal in Wierzbno (sub-project completed in previous years)
- Construction of a gas pipeline to the Grodzisk nitrogen rejection unit to provide for transmission of surplus gas from the LMG Oil and Gas Production Facility to the Grodzisk nitrogen rejection unit.

In 2013, the LMG Central Facility was placed in service and construction of the high-pressure gas pipeline from the Wierzbno terminal to the Paproć gas production facility was completed. With its completion, the entire project was also completed, at a total capex of ca. PLN 1,627m.

Other investment projects in the Exploration and Production segment

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

- Upgrade and extension of the existing gas production facilities
- Commencement of upgrade of the processing line at the Zielin oil and gas production facility and development of the Różańsko field
- Completion of development of wells in the Wola Różaniecka field
- Development of the Lisewo gas field
- Drilling work and development of a well in the Radlin field
- Drilling work and development of a well in the Daszewo field
- Completion of drilling work and commencement of the Księżpol 19 well development.

Trade and Storage

In 2013, capital expenditure of the Trade and Storage segment amounted to PLN 472m, of which PLN 402m was spent on underground gas storage facilities. Major projects in the area of underground gas storage facilities included:

- Completion of the construction of the surface section of the Wierzchowice Underground Gas Storage Facility and launch of the gas injection and withdrawal cycle, as well as completion of technical acceptance of the storage facility
- Completion of the construction of the surface section and a leaching installation along with pipeline for brine discharge, completion of the leaching process of two of the first five caverns at the Kosakowo Underground Gas Storage Cavern Facility, and launch of trial operation of the facility to establish its technical parameters and operating profile
- Continued leaching work at the Mogilno Underground Gas Storage Cavern Facility (caverns Z-15, Z-16, and Z-17) and hydraulic leakage testing of the Z-13 cavern
- Extension of the Husów Underground Gas Storage Facility up to 500mcm of storage capacity.

Furthermore, the construction of the surface part and a leaching installation along with pipeline for brine discharge, as well as the leaching process of two of the first five caverns, were completed in 2013. Also, the trial operation of the facility was launched to establish its technical parameters and operating profile. In December 2013, the final acceptance of the storage facility (consisting of two caverns with an approximate capacity of 61mcm) took place. The expenditure incurred in 2013 was close to PLN 139m. The project was co-financed by the EU.

Distribution

Capital expenditure incurred by the PGNiG Group in the Distribution segment amounted to PLN 1,139m. The capex budget was spent on upgrading and extending the gas network and on connecting new customers. For a discussion of key projects in the Distribution segment, see Section VII Distribution.

Generation

Capital expenditure of the Generation segment amounted to PLN 257m, of which approximately PLN 52.2m was spent on environmental protection projects. In 2013, the segment completed three such projects:

- Construction of an SCR system for four unit boilers at the Siekierki CHP Plant; in 2013 an SCR unit for boilers 14 and 15 was placed in service; the project involved bringing the boilers in line

with the requirements of the Industrial Emissions Directive (*IED*) using the SCR method, i.e. reducing the content of nitrogen oxides (NO_x) in flue gases to the required levels; the project, completed at a total capex of approximately PLN 154m, was co-financed by the EU
- Upgrade of the rotary air pre-heaters together with boiler blowers for boilers 10, 11, 14, and 15 at the Siekierki CHP Plant; in 2013, assembly works and adjustment run for boilers 14 and 15 were commenced and completed; the project, designed to ensure the correct operation of the deNox unit for the Siekierki CHP Plant unit boilers, was completed at a total capex of approximately PLN 41m
- Myśliborska project – construction of a process wastewater treatment plant at the Żerań CHP Plant; the plant was placed in service in December 2012; in order to improve the operation of the wastewater treatment plant at the Żerań CHP Plant, in 2013 work aimed to expand the support systems for waste management was carried out, i.e. the plant's system of presses and feeders was adapted to support long containers and a chemical-resistant tank was fitted under the palette container; the construction of a wastewater treatment plant facilitated the discharge of treated wastewater to the Wisła river and the management of drained sediment in compliance with the applicable environmental laws; the project was completed at a total expenditure of approximately PLN 21m.

Furthermore, the Generation Segment continued some of the investment projects commenced in previous years. The most important of these were:

- Construction of a CCGT unit with an electrical capacity of approximately 450MW at the Żerań CHP Plant; in 2013, work continued on the drafting of tender documentation for the unit's construction and agreements were signed to connect the unit to the transmission network of OGP GAZ-SYSTEM SA and to prepare a design (as well as obtain a building permit) for the cooling-water discharge pipeline for the Żerań CCGT unit
- Conversion of the K1 boiler at the Siekierki CHP Plant into a biomass-fuelled unit; in October 2013, an agreement for the project execution was signed.

Furthermore, in 2013 the segment commenced some new investment projects, including:

- Construction of a gas- and oil-fired peak-load and reserve boiler house at the Żerań CHP Plant
- Upgrade of dust collectors of KFA and KFB fluidised bed boilers at the Żerań CHP Plant;
- Upgrade of PTWM K8 and K9 boilers at the Siekierki CHP Plant and upgrade of PTWM K2, K3, and K4 boilers at the Wola heating plant.

In 2013, the Generation Segment also commenced construction works at the Pruszków CHP Plant to increase co-generation based on gas engines and reduce the consumption of coal by reconstructing the water boilers.

<u>Other Activities</u>

In 2013, the Other Activities segment incurred capital expenditure on property, plant and equipment and intangible assets of PLN 12m. Major investment projects included purchase of production plant and equipment, computer software, buildings and structures, and vehicles.

Section XI: Environmental protection

Well and extraction pit abandonment

Pursuant to the Polish Geological and Mining Law, PGNiG S.A. is required to properly abandon worked-out extraction pits, eliminate the danger and repair any damage caused by mineral extraction, and restore the land to its original condition. Plugging of wells and pits prevents leakage of crude oil and natural gas to the surface and into water courses. Furthermore, if gas wells remain unplugged, there is a risk that escaping gas could accumulate, posing a fire hazard. In 2013, a total of 25 wells and 18 extraction pits were abandoned.

Carbon credit trading system

In 2013, PGNiG TERMIKA S.A. (the Siekierki, Żerań and Pruszków CHP plants and the Kawęczyn and Wola heating plants), the Zielona Góra Branch and the Odolanów Branch, as well as the Mogilno Underground Gas Storage Cavern Facility and the LMG oil and gas production facility were covered by the carbon dioxide emission trading scheme (ETS). The LMG oil and gas production facility joined the ETS scheme in October 2013. The facility has not yet been allocated free carbon dioxide emission allowances, and PGNiG S.A. will only be able to apply for them after the annual reports on carbon dioxide emissions for 2013 are reviewed. In 2013, emissions from the installations were 6,082,799 Mg CO_2.

Land reclamation and non-productive asset surveying

Pursuant to the Environmental Protection Law, PGNiG S.A. conducts diagnostic tests, surveys and land reclamation work in areas polluted in the course of past activities, with a view to restoring them to the condition required under the environmental quality standards. In 2013, the Company carried out reclamation work on properties with a total area of 665 m^2 in Kargowa, Radków and Łabiszyn, and commenced reclamation work on a property in Warsaw. The land reclamation work involves decommissioning of tar pits and removal of local soil contaminations (most often found near reservoirs) through their extraction and neutralisation by operators contracted by the Company. In 2013, work was performed to analyse the soil environment of a property in Działdów. The Company also monitored the soil-water environment of the reclaimed landfill site in Zabrze-Biskupice, and a property in Zabrze.

REACH and CLP

In 2013, PGNiG S.A. was supervising the compliance by its subcontractors using chemical substances for well treatments with the regulations of the European Parliament and of the Council of the European Union on safe use of chemicals (*REACH*) and on the classification, labelling and packaging of substances and mixtures (*CLP*). The Company also drew up contractual provisions, to be included in its hydraulic fracturing agreements, concerning the use of chemical substances and mixtures, which would facilitate the control of related hazards and ensure compliance with all requirements imposed by Polish and EU laws.

Environmental Management System

In 2013, PGNiG S.A. completed the first stage of the implementation of an Environmental Management System at its trading divisions. As part of the work, an environmental review was performed.

Reclamation of the fuel ash landfill site

PGNiG TERMIKA S.A. is carrying out reclamation of the Myśliborska fuel ash landfill site for the Żerań CHP plant. The project is designed to reclaim the land as green areas (Cells No. 1 and 2) and for residential and commercial development (Cell No. 3). In 2013, reclamation work was carried out primarily on Cell No. 3, which was demolished along with its embankment, and 30 trees were felled. Further, technical reclamation of Cell No. 2 commenced, and technical infrastructure across the entire landfill was being disassembled. All of the reclamation work is scheduled to be completed in 2016.

Fulfilment of the requirements of the Industrial Emissions Directive

In 2013, in an effort to meet the environmental standards provided for in Directive 2010/75/EU of the European Parliament and of the Council on industrial emissions (*IED*), PGNiG TERMIKA S.A. continued to work on the construction of NOx selective catalytic reduction (*SCR*) units for four unit boilers at the Siekierki CHP Plant. In 2013, an SCR unit for the last two boilers was placed in service. After the project is completed, units representing 60% of the Siekierki CHP Plant's generating capacity will be equipped with SCR units.

The execution of the project is partially financed with funds available under the Infrastructure and Environment Operational Programme of the National Environmental Protection and Water Management Fund, under a co-financing agreement concluded by PGNiG TERMIKA S.A.

Noise reduction project at the Siekierki CHP Plant

In 2013, a noise barrier wall was constructed along the eastern boundary of the CHP plant. As part of the same project, noise barrier walls are being constructed around coal unloading points located at the hump tracks on the plant's premises. The purpose of the project is to reduce the risk of exceeding the permitted noise levels during the execution of future projects at the Siekierki CHP Plant. The project is scheduled to be completed in H1 2014.

Biomass supplies

In order to fulfil the requirements of Directive 2009/28/EC on the promotion of the use of energy from renewable sources and use of biomass other than forest biomass, that is biomass from plantations and energy plant crops at commercial power plants (Regulation of the Minister of Economy dated October 18th 2012), PGNiG TERMIKA S.A. procures the fuel under long-term contracts for the supply of biomass from energy willow plantations. Currently, the company procures biomass from plantations with a total area of ca. 386 ha. Thanks to the use of biomass as a fuel, CO_2 emissions were reduced by 104,834 Mg in 2013.

Section XII: Other information

Distribution of the 2012 profit

On May 22nd 2013, the Annual General Meeting of PGNiG S.A. adopted a resolution on the distribution of the 2012 net profit of PLN 1,918.5m. The profit was distributed as follows:

- PLN 1,151.5m was allocated to the Company's statutory reserve funds
- PLN 767.0m was allocated for dividend payments (dividend per share of PLN 0.13).

In addition, retained earnings of PLN 625.9m were allocated to the Company's statutory reserve funds.

The Annual General Meeting of PGNiG S.A. set July 20th 2013 as the dividend record date and October 3rd 2013 as the dividend payment date.

Discharge granted to Management Board and Supervisory Board members in respect of their duties

On May 22nd 2013, the Annual General Meeting of PGNiG S.A. approved the financial statements and the Directors' Report on the operations of PGNiG S.A., as well as the consolidated financial statements and the Directors' Report on the operations of the PGNiG Group, and granted discharge to members of the Management and Supervisory Boards of PGNiG S.A. in respect of performance of their duties in the financial year 2012.

Legal actions against PI GAZOTECH Sp. z o.o.

Proceedings concerning PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to repeal or declare the invalidity of resolutions adopted by the Extraordinary General Meeting of PI GAZOTECH Sp. z o.o. on April 23rd 2004, including the resolution obliging PGNiG S.A. to pay an additional equity contribution in the amount of PLN 52m, were held in turn before the Regional Court of Warsaw, the Warsaw Court of Appeals and the Supreme Court. On June 25th 2010, the Regional Court granted PGNiG S.A.'s claims and declared the resolution concerning retirement of shares and the resolution concerning the additional equity contributions invalid. On November 12th 2010, PI GAZOTECH Sp. z o.o. filed an appeal with the Regional Court, together with a request for a court fee waiver. On December 14th 2011, the Court of Appeals dismissed PI GAZOTECH Sp. z o.o.'s appeal. The judgment is final. On April 24th 2012, PI GAZOTECH Sp. z o.o. filed a cassation complaint. By virtue of its decision of March 13th 2013, the Supreme Court refused to examine the cassation complaint. Thus the proceedings in this case were concluded.

Proceedings based on PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to repeal or declare the invalidity of the resolution adopted by the Extraordinary General Meeting of PI GAZOTECH Sp. z o.o. on January 19th 2005, whereunder PGNiG S.A. was obliged to pay an additional equity contribution in the amount of PLN 25,999,998, were held before the Regional Court of Warsaw and the Warsaw Court of Appeals. By virtue of its ruling of October 18th 2010, the Regional Court of Warsaw invalidated the resolution. On November 12th 2010, PI GAZOTECH Sp. z o.o. filed an appeal with the Regional Court, together with a request for a court fee waiver. By virtue of its decision of June 22nd 2012, the Warsaw Court of Appeals dismissed PI GAZOTECH Sp. z o.o.'s appeal. The judgment is final. On October 30th 2012, PI GAZOTECH Sp. z o.o. filed a cassation complaint. On August 14th 2013, the Supreme Court issued a decision refusing to examine the cassation complaint. Thus the proceedings in this case were concluded.

Proceedings before the President of the Polish Office of Competition and Consumer Protection (UOKiK)

On December 28th 2010, the President of the Polish Office of Competition and Consumer Protection ("UOKiK") instigated, ex officio, anti-trust proceedings concerning alleged abuse by PGNiG S.A. of its dominant position on the domestic natural gas wholesale market, which consisted in inhibiting sale of gas against the interests of other business players or consumers and in impeding the development of market conditions necessary for the emergence or development of competition by refusing to sell gas fuel under a comprehensive supply contract to an entrepreneur that intended to further resell the gas, i.e. NowyGaz Sp. z o.o. of Warsaw. In its decision of July 5th 2012, the President of the UOKiK found these practices to be anti-competitive, concluded that PGNiG S.A. had discontinued those practices as of November 30th 2010, and imposed on the Company a fine of PLN 60,016,474.40. On July 24th 2012, PGNiG S.A. filed an appeal against the decision of the President of the UOKiK with the Competition and Consumer Protection Court at the Regional Court of Warsaw. As at the date of this report, the Competition and Consumer Protection Court had not notified PGNiG S.A. of a hearing date.

On February 9th 2012, the President of the UOKiK instigated anti-trust proceedings concerning alleged employment by PGNiG S.A. of practices infringing collective consumer interests. The President of the UOKiK accused PGNiG S.A. of using, in comprehensive gas fuel supply contracts, a provision classified as an abusive clause. In the course of the proceedings, PGNiG S.A. voluntarily agreed to revise certain contractual provisions. By virtue of a decision of August 10th 2012, the President of the UOKiK resolved not to impose a fine on PGNiG S.A. and obligated the Company to fulfil its commitment. On September 11th 2013, PGNiG S.A. notified the President of the UOKiK that it had fully complied with the obligation imposed on it by virtue of the above decision.

On February 22nd 2013, the President of the UOKiK instigated anti-trust proceedings concerning alleged employment by PGNiG S.A. of practices infringing collective consumer interests. The President of the UOKiK accused PGNiG S.A. of using provisions classified as abusive clauses in contract forms based on which comprehensive gas fuel supply contracts are concluded. PGNiG S.A. voluntarily agreed to revise the above contract forms with respect to the questioned clauses. By virtue of a decision of June 28th 2013, the President of the UOKiK resolved not to impose a fine on PGNiG S.A. and obliged the Company to fulfil its commitment. PGNiG S.A. is in the process of fulfilling this obligation.

On April 3rd 2013, the President of the UOKiK instigated anti-trust proceedings concerning alleged abuse by PGNiG S.A. of its dominant position on the domestic wholesale and retail natural gas market, which consisted in impeding the development of market conditions necessary for the emergence or development of competition by:

- limiting the ability of business customers to reduce ordered volumes of gas fuel and contractual capacity,
- limiting the ability of business customers to resell gas fuel,
- requiring that business customers define the maximum volume of gas fuel purchased for resale in the contract,
- refusing to grant wholesale customers the right to a partial change of supplier.

In the course of the proceedings, PGNiG S.A. voluntarily agreed to revise certain provisions in contracts with its non-household customers. By virtue of a decision of December 31st 2013, the President of UOKiK resolved not to impose a fine on the Company and obliged the Company to fulfil its commitment. PGNiG S.A. is in the process of fulfilling this obligation.

Proceedings with a value in excess of 10% of the Company's equity

In 2013, neither PGNiG S.A. nor its subsidiaries were engaged in any proceedings before a court, arbitration tribunal or administrative authority concerning liabilities or claims whose value (whether in any single case or in two or more cases jointly) would represent at least 10% of the Company's equity.

Section XIII: Financial performance

1. Financial performance in 2013

The separate financial statements of PGNiG S.A. and the consolidated financial statements of the PGNiG Group for 2013 are audited by PKF Consult Sp. z o.o. The agreement with the auditor was signed on February 5th 2013, for three years (2013-2015). Detailed information on the auditor’s fees has been provided in the consolidated financial statements of the PGNiG Group for 2013 (Note 38,6).

1.1. Key financial and business data

The consolidated financial statements of the PGNiG Group have been prepared in accordance with the International Financial Reporting Standards (IFRS) as endorsed by the European Union (“EU”) as at December 31st 2013.

The accounting policies applied in preparing the consolidated financial statements are presented in the consolidated financial statements of the PGNiG Group for 2013 (Note 2).

In 2013, the PGNiG Group posted a net profit of PLN 1,920m, down by PLN 320m year on year.

Summary information on the PGNiG Group’s financial standing in 2013 relative to 2012 is presented below in the financial statements prepared in accordance with the International Financial Reporting Standards, which comprise:

- statement of financial position,
- income statement,
- statement of cash flows,
- selected financial ratios.

Consolidated statement of financial position (PLNm)

ASSETS	Dec 31 2013	Dec 31 2012	Jan 1 2012
Total non-current assets	36,239	37,096	31,317
Property, plant and equipment	33,033	33,784	29,319
Investment property	9	11	7
Intangible assets	1,164	1,146	343
Investments in equity-accounted associates	727	771	598
Financial assets available for sale	51	48	56
Other financial assets	191	124	10
Deferred tax assets	993	1,136	936
Other non-current assets	71	76	48
Total current assets	10,905	10,833	7,523
Inventories	3,378	3,064	2,082
Trade and other receivables	4,086	5,374	3,378
Current tax assets	48	150	164
Other assets	171	84	78
Financial assets available for sale	-	-	22
Derivative financial instrument assets	307	105	285
Cash and cash equivalents	2,827	1,948	1,505
Assets held for sale	88	108	9
Total assets	47,144	47,929	38,840

Consolidated statement of financial position (PLNm) – contd.

LIABILITIES AND EQUITY	Dec 31 2013	Dec 31 2012	Jan 1 2012
Total equity	28,453	27,197	25,151
Share capital	5,900	5,900	5,900
Share premium	1,740	1,740	1,740
Accumulated other comprehensive income	(49)	(152)	41
Retained earnings	20,856	19,705	17,463
Equity attributable to owners of the parent	28,447	27,193	25,144
Equity attributable to non-controlling interests	6	4	7
Total non-current liabilities	10,853	11,119	5,843
Borrowings and other debt instruments	5,385	5,509	1,382
Employee benefit obligations	502	381	351
Provisions	1,405	1,792	1,358
Deferred income	1,533	1,448	1,160
Deferred tax liabilities	1,970	1,936	1,572
Other non-current liabilities	58	53	20
Total current liabilities	7,838	9,613	7,846
Trade and other payables	4,033	3,667	3,236
Borrowings and other debt instruments	2,276	4,702	3,617
Derivative financial instrument liabilities	124	393	417
Current tax liabilities	184	24	58
Employee benefit obligations	375	356	238
Provisions	645	350	185
Deferred income	186	101	95
Liabilities associated with assets held for sale	15	20	-
Total liabilities	18,691	20,732	13,689
Total liabilities and equity	47,144	47,929	38,840

Consolidated income statement (PLNm)

	2013	2012
Revenue	32,120	28,730
Total operating expenses	(28,971)	(26,190)
Raw material and consumables used	(19,512)	(17,603)
Employee benefits	(3,214)	(3,047)
Depreciation and amortisation expense	(2,463)	(2,069)
Services	(3,245)	(3,060)
Work performed by the entity and capitalised	983	1,006
Other income and expenses	(1,520)	(1,417)
Operating profit	3,149	2,540
Finance income	69	216
Finance costs	(465)	(380)
Share in net profit/loss of equity-accounted entities	(44)	173
Profit before tax	2,709	2,549
Income tax	(789)	(309)
Net profit	1,920	2,240
Attributable to:		
Owners of the parent	1,918	2,242
Non-controlling interests	2	(2)
	1,920	2,240
Earnings and diluted earnings per share attributable to holders of ordinary shares of the parent (in PLN)	0.33	0.38

Consolidated statement of cash flows (PLNm)

	2013	2012
Net cash flows from operating activities	7,813	2,552
Net cash flows from investing activities	(3,060)	(6,149)
Net cash flows from financing activities	(3,874)	4,040
Net change in cash	879	443
Cash and cash equivalents at beginning of the period	1,947	1,504
Cash and cash equivalents at end of the period	2,826	1,947

Financial ratios

Profitability

	2013	2012
EBIT (PLNm) operating profit	3,149	2,540
EBITDA (PLNm) operating profit + depreciation/amortisation	5,612	4,609
ROE net profit* to equity at end of the period	6.7%	8.2%
NET MARGIN net profit* to revenue	6.0%	7.8%
ROA net profit* to assets at end of the period	4.1%	4.7%

* net profit for the financial year attributable to owners of the parent

Liquidity

	Dec 31 2013	Dec 31 2012
CURRENT RATIO current assets (net of other assets) to current liabilities	1.4	1.1
QUICK RATIO current assets (net of other assets) less inventories to current liabilities	0.9	0.8

Debt

	Dec 31 2013	Dec 31 2012
DEBT RATIO total liabilities to total equity and liabilities	39.6%	43.3%
DEBT/EQUITY RATIO total liabilities to equity*	65.7%	76.2%

* equity attributable to owners of the parent

1.2. Financial standing

Year on year, the PGNiG Group's operating profit (EBIT) rose by PLN 609m. The Group's financial position strengthened chiefly on the doubling of volumes of oil and gas production and sales on non-regulated markets (sales of gas produced from the Skarv field).

Exploration and Production

Operating profit of the Exploration and Production segment was PLN 2,331m, up PLN 977m on 2012. This improvement was achieved thanks to the completion of major investment projects at the Group, including the Lubiatów-Międzychód-Grotów (LMG) Oil and Gas Production Facility project and the project involving production of crude oil and natural gas from the Skarv field on the Norwegian Continental Shelf. As a result, the volume of crude sold grew by 128%, or 621 thousand tonnes, relative to 2012. The expansion of the segment's business resulted in a 32% increase in operating expenses, mainly due to higher amortisation and depreciation. The growth in expenses was also attributable to the recognition of an impairment loss on the Group's exploration assets in Libya of PLN 292m and of a provision for the outstanding licence obligations in the region in the amount of PLN 137m, which followed an analysis of the project's economics and uncertainty concerning extension of the licence.

Trade and Storage

The Trade and Storage segment's operating result was down PLN 340m year on year, to PLN -8m. The deterioration in the segment's performance was driven by a lower margin on high-methane gas sales in 2013. The negative margin of -2% was due to the fact that the tariff price was insufficient to cover the cost of gas sold.

The Trade and Storage segment's revenue grew by PLN 1,945m (8%) relative to 2012, largely driven by gas and electricity sales in Germany. The year-on-year increase in the cost of gas sold was attributable to the reduced gas purchase cost in 2012, resulting from the recognition in the Q4 figures of the financial effect of the annex to the Yamal contract, which changed the pricing terms of gas supplies.

A significant factor behind the PGNiG Group's financial performance were conditions prevailing on the currency markets. The US dollar, the main currency used in settlements of gas imports, depreciated relative to 2012. Currency appreciation or depreciation is the key macroeconomic factor behind the Company's financial performance. PGNiG S.A. has adopted a hedging policy to minimise this risk.

Distribution

The Distribution segment's operating profit was PLN 739m, down PLN 141m year on year. The deterioration in the segment's performance was driven by a year-on-year increase in indirect costs, resulting mainly from the remeasurement of provisions for length-of-service awards and retirement severance payments due to changes in the pension system, and the revision of other assumptions, producing an aggregate year-on-year change in costs amounting to approximately PLN 138m.

Generation

The segment's revenue from sale of heat and electricity reached PLN 2,063m, having increased by PLN 106m relative to 2012. Thanks to a 1% reduction in operating expenses, the segment's operating profit was PLN 144m, up by PLN 129m year on year. The segment's strong performance was attributable to a 9% increase in the heat tariff price as of July 2013 combined with a reduced cost of fuels for heat and electricity generation, thanks to a reduction of biomass co-burning and some other factors, as well as lower amortisation costs of the CO_2 emission allowances identified at the time of acquisition of PGNiG TERMIKA S.A.

Financial data of the PGNiG Group's segments for 2013 (PLNm)

2013	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to third-party customers	4,656	25,341	165	1,658	300	-	32,120
Inter-segment sales	1,605	318	4,085	405	124	(6,537)	-
Total segment revenue	6,261	25,659	4,250	2,063	424	(6,537)	32,120
Segment expenses	(3,930)	(25,667)	(3,511)	(1,919)	(489)	6,545	(28,971)
Operating profit/loss	2,331	(8)	739	144	(65)	8	3,149
Net finance costs	-	-	-	-	-	-	(396)
Share in net profit/loss of equity-accounted entities	-	(44)	-	-	-	-	(44)
Profit before tax							2,709
Income tax	-	-	-	-	-	-	(789)
Net profit							1,920

Financial data of the PGNiG Group's segments for 2012 (PLNm)

2012	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to third-party customers	3,121	23,354	153	1,893	209	-	28,730
Inter-segment sales	1,204	360	3,430	64	237	(5,295)	-
Total segment revenue	4,325	23,714	3,583	1,957	446	(5,295)	28,730
Segment expenses	(2,971)	(23,382)	(2,703)	(1,942)	(474)	5,282	(26,190)
Operating profit/loss	1,354	332	880	15	(28)	(13)	2,540
Net finance costs	-	-	-	-	-	-	(164)
Share in net profit/loss of equity-accounted entities	-	173	-	-	-	-	173
Profit before tax							2,549
Income tax	-	-	-	-	-	-	(309)
Net profit							2,240

The result on financing activities was down by PLN 449m on 2012. The decrease was attributable to higher foreign exchange losses on liabilities under Eurobonds and the credit facility contracted by PGNiG Upstream International AS, as well as to the negative effect of remeasurement of shares in SGT EUROPOL GAZ S.A. to PLN 44m, down PLN 217m year on year.

In 2013, the PGNiG Group's net profit came in at PLN 1,920m and was by PLN 320m lower than in 2012. The decrease resulted from the PLN 480m increase in tax burden in 2013, related mainly to the realisation of deferred tax assets connected with investment tax credits in Norway.

The PGNiG Group's financial position is reflected in its key financial ratios. While the Group's operating profit improved by 24% in 2013 relative to 2012, its adjustment by the negative result on financing activities and tax burden drove the 2013 financial ratios based on net profit below their respective 2012 values. Return on equity (ROE) went down to 6.7% in 2013 from 8.2% in 2012. Return on assets (ROA) was 4.1%, against 4.7% in 2012, and net margin fell from 7.8% to 6% in 2013.

As at December 31st 2013, total assets recognised in the consolidated statement of financial position were PLN 47,144m, down PLN 785m on the end of 2012.

Deferred tax assets

Property, plant and equipment represent the largest component of the Group's assets. As at the end of 2013, they amounted to PLN 33,033m, having decreased 2% relative to December 31st 2012, due primarily to an increase in impairment losses on exploration assets in Poland and Libya.
Deferred tax assets decreased by PLN 143m (13%) on realisation of the tax credits in Norway, which have been accounted for since the launch of gas production from the Skarv field. The related deferred tax asset in 2013 was PLN 193m.

Trade and other receivables fell by PLN 1,288m (24%) relative to the end of 2012. The change was primarily driven by an inflow, in 2013, of cash from settlements under the annex to the Yamal contract, whereby the pricing of gas supplies had been amended.

As at December 31st 2013, the Company's inventories grew by PLN 314m year on year. The inventories disclosed in the statement of financial position comprise mainly gas stored in underground storage facilities. As at the end of 2013, the volume of gas stored was by over 300 mcm higher than at the end of 2012, having reached its record high of almost 2.1 bcm.

As at December 31st 2013, the Group's cash and cash equivalents stood at PLN 2,827m, up PLN 879m relative to the end of 2012. The increase was attributable to the excess of cash flows from operating activities (improved margin and inflow of receivables from settlements under the annex to the Yamal contract), totalling PLN 7,813m, over the PLN -3.874m cash flows from financing activities (including redemption of debt and dividend paid out) and the PLN -3,060m cash flows from investing activities.

The value and structure of current assets held by the Group guaranteed its ability to settle all liabilities in a timely manner. The current ratio was 1.4 compared with 1.1 as at the end of December 2012, while the quick ratio rose from 0.8 to 0.9.

Equity and liabilities

Equity is the primary source of financing of the PGNiG Group's assets. Relative to the end of 2012, the Group's equity rose by PLN 1,256m. The increase was primarily driven by the 2013 net profit, reduced by dividend for 2012 paid out in an amount of PLN 767m.

As at December 31st 2013, non-current liabilities were PLN 10,853m, down PLN 266m on the end of December 2012. The change was primarily attributable to a decrease in provisions for well decommissioning costs (a higher discount rate and a lower average decommissioning cost) and repayment of debt under debt securities, which also affected the current portion of financial liabilities, amounting to PLN 2,276m as at December 31st 2013, down 52% relative to the end of December 2012.

As at December 31st 2013, the PGNiG Group carried current liabilities of PLN 7,838m, down PLN 1,755m year on year. Apart from the factors described above which materially reduced financial liabilities, the change in current liabilities was driven by the recognition of a provision for the exploration licence obligations in Libya in an amount of PLN 137m and a provision for the buy-out price on energy efficiency certificates (white certificates) in an amount of PLN 134m.

Due to a decrease in external financing used by the PGNiG Group, the ratios of equity to liabilities changed. Debt to equity was down from 76.2% to 65.7% as at December 31st 2013. Debt ratio (total liabilities to total equity and liabilities) fell from 43.3% to 39.6%.

Material off-balance-sheet items

As at December 31st 2013, the PGNiG Group's most important off-balance-sheet item was contingent liabilities of PLN 10,735m. The key items of contingent liabilities included:

- a guarantee securing performance of the obligations of PGNiG Finance AB (a subsidiary of PGNiG S.A.) towards bondholders, in connection with the Eurobond programme (PLN 6,220.8m);
- a bond securing performance of the licence and legal obligations of PGNiG Upstream International AS (a subsidiary of PGNiG S.A.) towards the state of Norway (PLN 2,602.6m);
- a bond securing performance of the obligations of POGC-Libya B.V. (a subsidiary of PGNiG S.A.) towards National Oil Corporation of Libya (PLN 325.3m).

Feasibility of investment plans

In 2014, the PGNiG Group intends to maintain a high level of capital expenditure. The spending will focus on:

- Natural gas and crude oil exploration and production, including exploration for unconventional deposits
- Development of distribution infrastructure
- Execution of power and heat generation projects
- Continuation of projects commenced before 2014 and relating to the construction of storage facilities.

The PGNiG Group intends to finance investments both from its own funds and using external financing, e.g. raised through the issuance of notes and bonds.

Transactions concluded on non-arm's length terms

In 2013, PGNiG S.A. and its subsidiaries did not enter into any material related-party transactions on non-arm's length terms.

Explanation of differences between the actual results and forecasts for 2013

In 2013, the Group did not publish any financial forecasts.

Key equity investments and capital placements at the PGNiG Group

The PGNiG Group's key equity investments in 2013 included:

- Payment of new tranches of the NOK 398.8m loan advanced to PGNiG Upstream International AS by PGNiG S.A.; the loan was granted to finance capital expenditure related to the Norwegian Continental Shelf project

- Disbursement of an EUR 3.5m loan granted to PGNiG Sales & Trading GmbH; the loan was advanced to finance the company's day-to-day operations
- Disbursement of a PLN 30m loan to Pomorska Spółka Gazownictwa Sp. z o.o. (currently Polska Spółka Gazownictwa Sp. z o.o.); the loan was advanced to finance capital expenditure related to gas network extension
- Issue of short-term notes offered to PGNiG Group companies; as at December 31st 2013, PGNiG S.A.'s outstanding debt under the notes was PLN 564m
- Equity increase of USD 18m at POGC Libya B.V., effected without issuing new shares, applied towards financing of the company's day-to-day operations
- Equity increases at subsidiaries PGNiG SPV 4 Sp. z o.o. (currently Polska Spółka Gazownictwa Sp. z o.o., an increase of PLN 10,453m following consolidation of the gas distribution companies), Operator Systemu Magazynowania Sp. z o.o. (an increase of PLN 10.3m following acquisition of INVESTGAS S.A.), PGNiG TERMIKA S.A. (an increase of PLN 33.9m following conversion of a portion of a loan from PGNiG S.A.); furthermore, PGNiG TERMIKA S.A. received an non-cash contribution of PLN 20.3m-worth of shares in Elektrociepłownia Stalowa Wola S.A. and PGNiG Technologie S.A. received a non-cash contribution of PLN 15.2m-worth of shares in B.S. i P.G. Gazoprojekt S.A.

2. Financial management

In 2013, PGNiG S.A. placed new issues of short-term notes under its issuance programme agreement of May 22nd 2012. Under the programme, the Company may issue (for private placement) fixed or floating rate notes with maturities of up to 10 years, for up to PLN 4.5bn. In 2013, the Company issued a PLN 2.1bn tranche of short-term notes under the programme. As at December 31st 2013, the debt outstanding under the programme was PLN 3.5bn.

In 2013, PGNiG S.A. also placed new issues of short-term notes under the issuance programme agreement of June 10th 2010 (as amended under two annexes of 2011). Under the programme, PGNiG S.A. may issue discount notes and coupon-bearing notes with maturities ranging from one month to one year, for up to PLN 7bn. The total nominal value of notes issued in 2013 was PLN 6.3bn. As at December 31st 2013, no outstanding debt was recognised by PGNiG S.A. under the programme.

In 2013, PGNiG TERMIKA S.A. placed new issues of short-term notes under its issuance programme agreement of July 4th 2012. As part of the programme, effective through December 29th 2017, PGNiG TERMIKA S.A. may issue (in private placements) discount and coupon-bearing notes for up to PLN 1.5bn, with maturities ranging from one month to one year and interest rates based on WIBOR+margin. In 2013, the company placed 10 issues of notes with a nominal value of PLN 540m. As at December 31st 2013, the nominal value of the notes totalled PLN 300m, including PLN 70m of coupon-bearing notes and PLN 230m of discount notes. Proceeds from the issues allow the company to finance investment projects, including the construction of a CCGT unit at the Żerań CHP plant, as well as its day-to-day operations.

No Eurobonds were issued by PGNiG Finance AB in 2013. As at December 31st 2013, PGNiG Finance AB's nominal debt outstanding under the Eurobonds issued in 2012 was EUR 500m.

The PGNiG Group used proceeds from the issues of notes and bonds to finance its capital expenditure projects involving exploration for conventional and unconventional oil and gas deposits, field development, construction and extension of underground gas storage facilities and the distribution network, including new connections. The issue proceeds were also used to finance power projects and the Group's operating activities.

Furthermore, pursuant to the agreement of December 1st 2010 (as amended under an annex of 2011), in 2013 the Company continued to issue short-term discount notes to PGNiG Group companies. In 2013, the Company issued notes for a total nominal value of PLN 7.4bn. The note programme is designed to enable the flow of cash from the companies with excess liquidity, thus optimising the liquidity management within the Group. As at December 31st 2013, PGNiG S.A.’s outstanding debt under the notes in issue was PLN 564m.

Assessment of financial resources management

The funds available to the PGNiG Group ensure that it is able to timely finance all current and planned expenditure related to its core business and investing activities. Its liquidity is under no threat. The Group has adopted an efficient model under which PGNiG S.A. financially supports its subsidiaries in the execution of investment projects. External financing is raised mainly through debt securities issue programmes. PGNiG S.A. also has a liquidity reserve in the form of overdraft facilities (PLN 250m in total).

2.1. Short-term investments

The financial investments made by the PGNiG Group in 2013 were short-term, with maturities of up to three months, and they included notes issued under the intra-Group notes programme and bank deposits. Such placements were consistent with PGNiG S.A.’s financial investment policy adopted by the Company’s governing bodies, and with the Issue Prospectus.

2.2. Borrowings

Credit facility agreements executed in 2013

In 2013, the PGNiG Group entered into credit facility agreements for a total amount of PLN 557.9m, EUR 20m and USD 5.5m in order to finance its day-to-day operations. The table below presents detailed information on key credit facility agreements executed by the PGNiG Group in 2013.

Key credit facility agreements executed by the PGNiG Group

Bank	Facility amount (m)	Currency	Interest rate	Type	Maturity date
Bank Pekao S.A.	130	PLN	1M WIBOR + 1.00%	working capital facility	Apr 24 2014
Deutsche Bank AG Munich	20	EUR	1M EONIA + 0.85%	working capital facility	Mar 12 2014
Bank Handlowy w Warszawie S.A.	65	PLN	1M WIBOR + 0.95%	working capital facility	Jun 30 2014
Bank Handlowy w Warszawie S.A.	40	PLN	1M WIBOR + 0.30%	working capital facility	Dec 31 2014
Nordea Bank Polska S.A.	40	PLN	1M WIBOR + 0.40%	working capital facility	Apr 30 2014
mBank S.A.	40	PLN	1M WIBOR + 0.30%	working capital facility	Sep 4 2014
Societe Generale S.A. Polish Branch	40	PLN	1M WIBOR + 0.30%	working capital facility	Aug 29 2014
ING Bank Śląski S.A.	40	PLN	1M WIBOR + 0.40%	working capital facility	Dec 5 2014
Bank Millenium S.A.	40	PLN	1M WIBOR + 0.40%	working capital facility	Dec 18 2014

Credit facility agreements terminated in 2013

In 2013, the PGNiG Group terminated three credit facility agreements with an aggregate value of PLN 5m and USD 3.5m. For more information on the terminated facilities, see the table below.

Credit facility agreements terminated by the PGNiG Group

Bank	Amount of the terminated facility (m)	Currency	Interest rate	Type	Maturity date
BRE Bank S.A. (currently mBank S.A.)	3.5	USD	1M LIBOR + 1.20%	working capital facility	May 30 2014
BRE Bank S.A. (currently mBank S.A.)	3.0	PLN	O/N WIBOR + 1.00%	working capital facility	May 30 2014
Kredyt Bank S.A. (currently BZ WBK)	2.0	PLN	O/N WIBOR + 1.14%	working capital facility	Oct 16 2013

The Group terminated the credit facility agreements following the introduction of a uniform financial policy.

Loans advanced in 2013

In 2013, the Group signed annexes to two agreements of 2012 whereby it granted loans to a related entity. Under the annexes, the loans were increased by an aggregate amount of PLN 35m:

- the PLN 152m loan granted in 2012 was increased by PLN 25m to PLN 177m
- the PLN 20m loan granted in 2012 was increased by PLN 10m to PLN 30m

the interest rates and maturity dates remained unchanged. The loans were advanced to finance the construction of a CCGT unit in Stalowa Wola. The table below presents detailed information on the loans advanced by the PGNiG Group.

Loans advanced by the PGNiG Group

Company	Loan amount (m)	Currency	Interest rate	Type	Maturity date
Elektrociepłownia Stalowa Wola S.A.	25	PLN	3M WIBOR + 2.50%	investment loan	December 31st 2032
Elektrociepłownia Stalowa Wola S.A.	10	PLN	1M WIBOR + 2.50%	investment loan	December 31st 2032

Loans received in 2013

In 2013, the PGNIG Group contracted a PLN 2m loan from Pekao Leasing Sp. z o.o. with a 1M WIBOR + 1.9 interest rate, maturing on January 27th 2014, to refinance expenses related to the purchase of four preventers (units preventing an unexpected blowout of oil or gas during drilling).

Loan agreements terminated in 2013

In 2013, the PGNiG Group did not terminate any loan agreements.

2.3. Guarantees and sureties

Guarantees and sureties provided by the PGNiG Group in 2013 were PLN 224.6m as at December 31st 2013. This amount included chiefly a guarantee of PLN 82.9m securing gas supplies by PGNiG Sales&Trading GmBH, and a PLN 68.4m surety for a guarantee limit for PGNiG Technologie S.A.

Guarantees and sureties received by the PGNiG Group in 2013 amounted to PLN 167.7m as at December 31st 2013, of which 24% (PLN 40.7m) were guarantees and sureties for less than PLN 1m each. The remaining guarantees and sureties comprised bid bonds, insurance guarantees and performance bonds, including under gas sales contracts. The most important of them were four performance bonds issued by the consortium comprising Andritz Energy&Environment GmbH and Bilfinger Infrastructure S.A. in relation to a project involving conversion of the generation unit of OP-230 boiler No. 1 into a biomass-fuelled one, along with construction of a biomass unloading, storage and feeder systems at the Siekierki CHP plant in Warsaw, with a total value of PLN 62.1m.

2.4. Financial risk management

The main objective of the PGNiG Group’s financial risk management policy is to limit the volatility of cash flows related to the Group’s operations to levels which are acceptable in the short- and mid-term perspective and to build the Group’s value in the long term. In the regular course of business in 2013, the PGNiG Group was exposed to a number of financial risks, and in particular to market risk (including commodity price, interest rate and currency risks) as well as liquidity and credit risks.

Market risk

The PGNiG Group manages market risk through identification, measurement, monitoring and mitigation of key sources of risk, i.e. the adverse effect of changes in commodity prices, exchange rates and interest rates on the Group's financial performance.

The key risks to which the Group is exposed include the risk of commodity price and exchange rate fluctuations, which affect the Group's gas purchases. The Group also executed transactions related to electricity prices, property rights and carbon emission allowances.

In 2013, the PGNiG Group used the following financial instruments to manage the gas price risk:
- Purchase of Asian commodity call options settled as European options
- Commodity option structures (consisting in a combination of two commodity options)
- Commodity swaps.

In 2013, to mitigate the currency risk the Group used the following financial instruments:
- Forward contracts
- FX swaps
- Purchase of European currency call options
- Purchase of Asian currency call options
- Option structures (in most cases consisting in a combination of two currency options).

PGNiG S.A. also used *CCIRS* transactions (to mitigate the FX and interest rate risks) to hedge the Eurobonds in issue and the loan advanced to PGNiG Upstream International AS, as well as *IRS* transactions to hedge against changes in the fair value of the loan advanced to PGNiG TERMIKA S.A.

PGNiG S.A. used cash flow hedge accounting with respect to transactions hedging payments for gas and with respect to transactions hedging gas prices. The application of cash flow hedge accounting allows the Company to charge the effective portion of the hedge to revaluation capital reserve, which results in the matching of the effect of valuation of hedging instruments on profit or loss and the result on the hedged item. This approach allows to eliminate profit or loss volatility attributable to valuation of derivative instruments and makes it possible to offset its effect in the income statement in the same reporting period. In consequence, the economic and accounting effects of the hedge are reflected in the same period. Since July 2013, the Company has also applied fair-value hedge accounting with respect to selected loans bearing interest at fixed rates.

Credit risk

The PGNiG Group's credit risk is related to the likelihood of failure by the counterparties or other entities to meet their obligations to the Group. In 2013, the Group managed credit risk by investing its free cash in instruments carrying the lowest possible credit risk (bank deposits and treasury bonds), entering into framework agreements with its trading partners (precisely defining the rights and obligations of the parties), and diversifying the group of its trading partners. The PGNiG Group also worked with leading commercial banks. The key criteria for the selection of counterparties to whom it entrusted a portion of its assets included their financial standing as confirmed by rating agencies, and their respective market shares.

Risk of cash-flow disruptions

The measures taken by the PGNiG Group to mitigate the risk of disruptions in its day-to-day operating cash flows included diversification of electronic banking systems used, ongoing monitoring of credit/debit transactions in bank accounts, collecting information on cash flows within the Group, consolidating bank accounts and entering into overdraft facility agreements. PGNiG S.A. mitigated cash flow volatility related to payments under gas purchase contracts by entering into FX risk hedges (currency options, *FX swaps*, *forwards*) and gas price hedges (Asian options and option strategies).

Liquidity risk

In order to mitigate liquidity risk, PGNiG S.A. has a liquidity reserve in the form of overdraft facilities (for a total amount of PLN 250m). PGNiG S.A. also prepared cash flow projections for the Company and the Group, estimated the condition and value of assets available for sale, maintained highly liquid financial assets and maintained communication with rating agencies.

3. Projected future financial standing

Key factors with a bearing on the PGNiG Group’s financial performance will include crude oil, petroleum products and natural gas prices, conditions prevailing on the currency markets, and the stance taken by the President of the Energy Regulatory Office with regard to gas fuel and heat tariffs.

The prices of crude oil, petroleum products and gas are an essential factor determining the PGNiG Group’s financial position. In 2014, no significant changes in crude oil prices are expected. Natural hedging in the form of higher sales of crude oil and a change of pricing formulas has reduced the sensitivity of the Group’s performance to volatility in crude oil prices.

Gas prices on global markets will be driven primarily by the pace of economic recovery in individual countries. Despite a higher global supply of natural gas, caused by increased production of gas from unconventional deposits, the economic upturn may boost the market prices of gas, raising costs related to gas imports for the PGNiG Group.

A significant factor behind the PGNiG Group’s financial performance are conditions prevailing on the currency markets.. In 2013, the average annual USD exchange rate depreciated relative to 2012. According to forecasts of the Gdańsk Institute for Market Economics, the downward trend will continue into 2014, which will lead to lower costs of high-methane gas imports translated into the złoty, and will have a positive effect on the Group’s financial performance.

Other drivers of the Group’s performance are the rates and charges provided for in the gas fuel tariffs. Pursuant to a decision of the President of the Energy Regulatory Office, PGNiG S.A. is subject to the new PGNiG Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 6/2014) effective from January 1st 2014, which accounts for the new model of the gas market in Poland. On average, the prices and charge rates for the supply of high-methane gas type E, and nitrogen-rich gas types Lw and Ls were increased by 1.5%, 4.7% and 7.3%, respectively.

In 2013, the loss on sales of high-methane gas on the regulated market was lower, following the signing of an annex to the Yamal contract in November 2012. The approval by the President of the Energy Regulatory Office of the new gas fuel tariffs effective from January 1st 2014, as well as the pricing formula for gas purchases based on the prices of petroleum products and the current market prices of gas, will allow the Group to achieve a minimal positive gross margin on this core product.

Since January 1st 2013, PGNiG S.A., as a trading company, has been obliged to purchase energy efficiency certificates (white certificates) in the amount set in the Energy Efficiency Act or else to pay a buy-out price. This obligation was driving up the cost of regulated activities. The new gas fuel tariff accounts for this cost item, which should help improve the Group’s performance in 2014.

The Group’s performance will also be considerably affected by regulations defining support mechanisms for electricity from high-efficiency co-generation and renewable sources. Legislative changes in this area and fluctuations in market prices of certificates of origin (red and green) will have a bearing on the Group’s future financial position.

In December 2012, PGNiG S.A. started to trade in natural gas on the Polish Power Exchange (TGE). By virtue of a decision by the President of the Energy Regulatory Office, such trade is exempt from the tariff obligation. In February 2013, the President of the Energy Regulatory Office that energy utilities were exempt from the obligation to submit their wholesale gas trading tariffs for approval. In addition, the draft act amending the Energy Law and certain other acts provided for an obligation to sell 30% of gas fed into the transmission network in Poland on the energy exchange (in 2013; 40% in 2014 and 55% from 2015 onwards).

The new regulations have had a significant impact on the functioning of the market and, primarily, on the PGNiG Group's business model. The Group made a number of organisational changes (establishment of PGNiG Obrót Detaliczny Sp. z o.o. on December 3rd 2013, and establishment of the Wholesale Trading Division) as well as structural changes designed to adjust the organisation to new market requirements and regulations.

At the transition of 2012 into 2013, the Group launched production from the Lubiatów, Międzychów and Grotów oil and gas fields in Poland, and from the Skarv field on the Norwegian Continental Shelf. As a result, the Group was able to increase its oil and gas output and thus improve its financial performance. Since the beginning of 2013, the PGNiG Group has intensified exploration for both conventional and unconventional hydrocarbon deposits, but the economic effects of this effort will only be visible in several years.

The intensification of conventional and unconventional gas exploration by operators active in Poland may stimulate demand for the relevant services provided by PGNiG Group companies, which will strengthen the Group's financial performance.

In 2013, PGNiG S.A. pursued a short-term value creation strategy for the PGNiG Group until 2014. Its objective was to prepare the Group for operating in a deregulated gas market. The PGNiG Group is intent on maintaining its lead in the upstream segment, while remaining the leading supplier of natural gas, whose product mix also includes heat and electricity. In 2013, the merger of PGNiG Energia S.A. with PGNiG S.A. made it possible to optimise the shared resources and thus provide customers with a broader and better tailored product offering of gas and electricity.

Given the high level of current and planned capital expenditure, the PGNiG Group uses external financing raised primarily by issuing debt securities on the domestic and foreign markets. In 2013, PGNiG S.A issued short-term notes for a nominal amount of PLN 2.1bn and PLN 6.3bn under its issuance programme agreements of, respectively, May 2012 and June 2010, while PGNiG TERMIKA S.A. issued short-term notes for a nominal amount of PLN 540m under the issuance programme of July 2012.In 2014, PGNiG S.A. intends to issue notes under its issuance programme agreements of May 2012 and June 2010, depending on its liquidity needs and market conditions.

In the coming quarters, the PGNiG Group intends to maintain a high level of capital expenditure. Spending will focus primarily on projects involving maintenance of hydrocarbon production rates, and diversification of gas supply sources, as well as on projects in the exploration for and appraisal of crude oil and natural gas deposits, and development of the Company's power generation segment, and also on continuation of projects launched before 2014, involving construction of underground gas storage infrastructure.

Members of the Management Board

President of the Management Board	Mariusz Zawisza	
Vice-President of the Management Board	Jarosław Bauc	
Vice-President of the Management Board	Jerzy Kurella	
Vice-President of the Management Board	Andrzej Parafianowicz	
Vice-President of the Management Board	Zbigniew Skrzypkiewicz	