# STRATEGY FOR THE PGNIG GROUP UNTIL 2015

**PGNiG SA's primary objective is to ensure reliable and secure supplies of pure and environment-friendly energy, using competitive and innovative energy solutions. The Company continues to be open to new challenges, while keeping up its traditions and maintaining customer trust. In its operations, PGNiG SA endeavours to be a reliable partner, which increases the company's value in line with the principles of sustainable growth.**

Polish Gas and Oil Company is a company with tradition, enjoying a well-established leading position on the Polish gas market. Over the long years of its development, the Company has gathered valuable assets and controls numerous segments of the energy market (natural gas production, storage, sale and distribution), which provides a robust foundation for its further growth and steady increase in value.

The overarching strategic objective pursued by PGNiG SA is to achieve a shareholder value growth. The Group's operations are based on the following six strategic pillars:

**1) developing the trading business;**
**2) securing natural gas supplies;**
**3) developing the exploration and production business;**
**4) expanding the existing and construction of new storage capacity;**
**5) improving the profitability of the distribution operations;**
**6) expanding the scope and scale of operations (extending the value chain).**

The main objectives proposed for all areas of activity make up the PGNiG Group's vision that by 2015 the Group will be a modern and effectively managed organisation, controlling the entire value chain of the gas sector – from deposits to customer relations, owning assets from the fuel, chemical and power sectors.

## Developing the Trading Business

PGNiG SA's trading business consists in satisfying the domestic demand for gaseous fuel through transactions of purchase/sale of natural gas. PGNiG SA sells natural gas to both retail and industrial customers, and undertakes other measures actively supporting the trade (building lasting customer relations, designing new products, constructing tariffs as well as off-tariff product and service price lists, and broadly meant marketing actions).

Given the dynamic changes in the legal and business environments, the PGNiG Group has to undertake numerous steps in the trade area, as only then will the Group be able to maintain its leading position on the Polish market under free competition conditions.

With respect to development of the trading business, PGNiG SA has set the following objectives:
- consolidating the dominant position on the domestic market;
- ensuring market-level profitability of the gas trading business;
- developing a coherent trading policy for the PGNiG Group.

**Consolidating the dominant position on the domestic market**

In view of the energy market liberalisation in Poland, maintaining the dominant position proves a great challenge. PGNiG SA plans a number of actions designed to secure the Company's dominant position on the domestic market, including:
- increase in the annual volume of gas sold to small and medium-size customers (i.e. customers buying less than 50 mcm of gas per year) on average by 1.5%. This is to be achieved thanks to increased demand from the existing customers and expansion of the customer base. Winning new customers, both corporate and retail ones, involves connecting new areas within the territory of Poland (not yet covered by the Group's operations) to

the gas transmission network;
- increase in sales to large industrial customers (including by 100% to customers from the power and heat sector). Connecting new, large customers contributes to major increases in sales and secures long-term contracts for gas supplies.

**Ensuring market-level profitability of the gas trading business**

Sales of natural gas in Poland are restrictively regulated under tariffs in all market segments. Such a model of gas trade regulation has numerous adverse consequences, such as losses on natural gas imports, under-priced gas from domestic sources or imposing the entire trade risk on trading companies. In order to ensure profitability of gas trading and increase market competition, PGNiG SA has taken the following measures:
- activities aimed at changing the regulation of the gas sector in Poland. Short-term objectives provide for increasing the natural gas sale price to a rational level which would fully cover the justified costs of gas trading business, as well as exploration and production business. A longer-term objective is to release trading companies from the obligation to submit tariffs for approval;
- reducing the costs of customer service through optimisation of internal processes across the organisation;
- implementation of a management system for risk relating to changing weather conditions. Such a system would support minimising the enterprise's loss or offsetting lower sales caused by unfavourable weather conditions.

**Developing a coherent trading policy for the PGNiG Group**

The execution of tasks connected with this objective should contribute to increases in sales of natural gas and number of customers. It should also support the enhancement of PGNiG SA's portfolio with new products. The objective will be achieved through:
- enhancing the attractiveness of the offer for customers. Broadening the product and service portfolio is another, in addition to sales of natural gas, significant source of revenue;
- streamlining the trading and marketing processes. In addition to actions aimed at streamlining the process of connecting new customers to the network, the Company plans to implement solutions bringing the customer service quality and availability to the highest level. The number and locations of Customer Service Points (BOKs) will be revised, e-BOKs will be established and the call centre service will be further developed. All these organisational units will ensure comprehensive service covering all products and services offered by PGNiG SA. Servicing customer complaints will also be centralised to ensure the uniform standard in the examination of complaints.

**What we have already managed to achieve**

In 2008, the Trade Branch of PGNiG SA was liquidated and six Gas Trade Branches were established, with offices in Gdańsk, Poznań, Tarnów, Warsaw, Wrocław and Zabrze. The new branches are superior to 23 Gas Plants. The geographical areas of operations of the six Trade Branches correspond with the areas covered by the operations of the relevant Gas Companies, members of the PGNiG Group. The next phase will include process streamlining, as well as implementation of uniform customer service standards and a visualisation system. The reorganisation is designed to better adapt the Company to the requirements of competitive market.

The PGNiG Group has also taken the first steps to broaden the product offering by developing the CNG market and increasing the production of LNG. This is particularly important on the Polish market, where sale, transmission and distribution of gas are all subject to regulation.

## Securing Natural Gas Supplies

In order to balance the domestic demand for natural gas, the PGNiG Group produces gas from its own reserves and purchases gas from abroad. The Group's own production covers around 30% of the demand, with the balance covered by imports from foreign partners, mainly from east of Poland (with OOO Gazprom Export being the largest supplier). Given the strong dependence on natural gas supplies from a single source, the Company strives to diversify the sources and directions of gas supplies. Therefore, the following steps have been taken to guarantee secure and uninterrupted supplies of natural gas:
- construction of new transmission facilities has commenced with view to enabling gas supplies to Poland from new directions;
- focus on establishing appropriate structure of import contracts;
- conduct of international oil and gas trading.

**Construction of new transmission facilities**

The construction of appropriate infrastructure supporting diversification of supplies will enable import of natural gas to Poland from different directions and multiple suppliers. In order to develop the infrastructure which would enable the Company to supply natural gas to its customers at competitive prices, PGNiG SA has envisaged the following strategic initiatives:
- cooperation with OGP GAZ-SYSTEM SA which is executing the Baltic Pipe project, in order to streamline and optimise to the maximum extent the completion of the construction of an undersea pipeline supporting natural gas supplies from Denmark to Poland and, in a longer term, also from Poland to Denmark;
- implementation of the Scanled project, which will give the Company access to the Norwegian reserves of natural gas. This will enable PGNiG SA to both transmit its own gas produced from the fields on the Norwegian Continental Shelf and import gas produced there by other entities;
- cooperation with OGP GAZ-SYSTEM SA on the LNG Regasification Terminal project. The key advantage of the project is the possibility of gas supplies bypassing the traditional transport routes;
- construction of system interconnections on Poland's Western border in 2011 and on the Southern border in 2014, implementation of a number of complementary projects. The construction of system interconnections will support trade with neighbouring countries and participation in Europe's balancing markets. The investment projects planned in this scope include:
  - construction of a system interconnection with Germany;
  - construction of the Southern system interconnection, which will secure access to the gas hub in Baumgarten;
  - extension of the Lasów interconnection by OGP GAZ-SYSTEM

SA in cooperation with PGNiG SA.
Once the strategic projects are implemented, the system interconnections will enable the export of surplus natural gas to Western Europe when the supplies to the Polish market exceed demand.
- steps promoting the development of the Polish gas transmission system (OGP GAZ-SYSTEM SA is responsible for the development as the Transmission System Operator). Creation of an efficient network of gas transmission pipelines is among the key preconditions for the delivery of gas sourced from the diversification projects to customers.

**Establishing appropriate structure of import contracts**

Given the strong dependence on a single supplier from a single direction, the PGNiG Group strives to change the structure of imports by balancing supplies from the East with supplies from the West and North (over the transmission networks and as LNG), with a rational level of the Group's own production.

Appropriate structure of import contracts will be achieved through:
- securing imports of 3.0 bcm–4.5 bcm of natural gas in the years 2010–2014 until the strategic projects are completed;
- extension of the Yamal contract for another 15–20 years;
- signing a contract (contracts) for supplies of the natural gas to the LNG regasification terminal;
- reservation of up to 3.0 bcm annually of the capacities of the Scanled and Baltic Pipe gas pipelines;
- reservation of the Danish transmission system's capacity at a level corresponding to the reservation of the Scanled pipeline capacity;
- reservation of approx. 1 bcm annually of the Nabucco gas pipeline's capacity.

**Conduct of international oil and gas trading**

Upon launch of international trading in natural gas and crude oil, the PGNiG Group will become an active player on the liberalised European gas market, not only in the production segment, but also in the trade segment, thus extending the controlled value chain. Trading will support the processes of diversifying gas supply sources and risk management, while securing competitive selling prices. Being a player on the European market will be particularly important if surplus supplies of natural gas occur in Poland.

**What we have already managed to achieve**

As part of the construction of appropriate infrastructure supporting diversification of supplies, the PGNiG Group has commenced the execution of projects related to the Northern (Scandinavian) region and sea transport of liquefied gas. In 2008, the Company spent approximately PLN 320m on these projects, with the largest part of that amount expensed on the development of fields on the Norwegian Continental Shelf (i.e. a 12% interest in the exploration and production area covering the Skarv/Snadd/Idun fields). Moreover, at the beginning of 2009, a PGNiG Group company responsible for the execution of the Scandinavian projects, PGNiG Norway AS, acquired interests in two new exploration licences: PL 350 and PL 419.

PGNiG SA has also commenced the construction of the Boernicke-Police system interconnection between Poland and Germany. The project is designed to support trade with the German market. In 2008, the construction of a gas pipeline with a length of about 14 km was commenced. The interconnection capacity is to reach 3 bcm annually. Work is also in progress on system interconnections with the Czech Republic and Slovakia.

## Developing the Exploration and Production Business

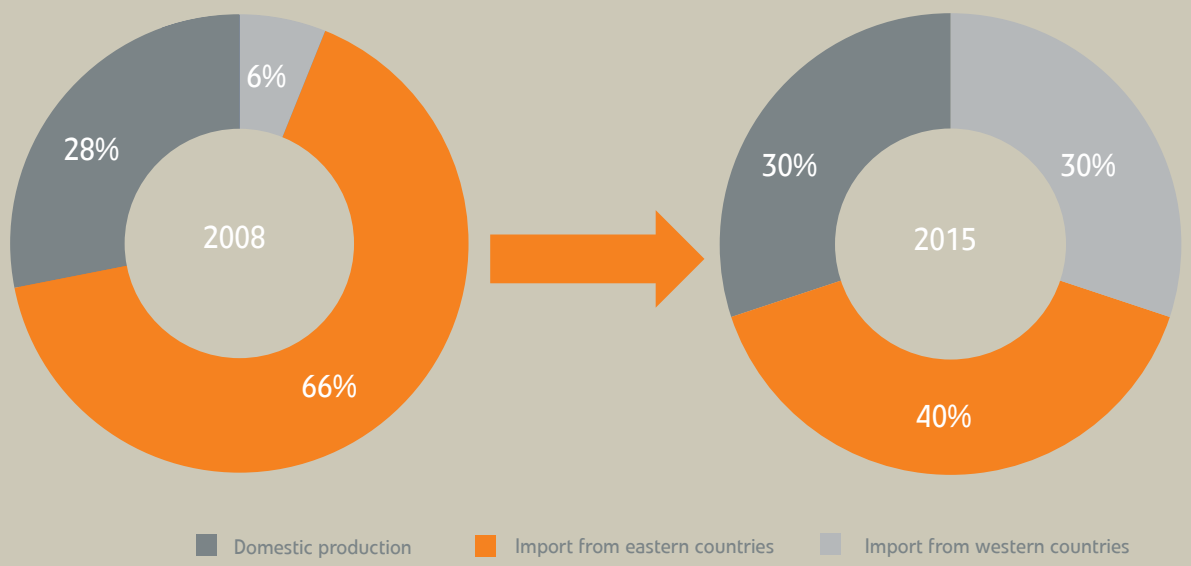
Access to the Company's own reserves both in home and abroad is a key to a success. For this reason, PGNiG Group will continue to develop its exploration and production business in Poland and abroad. The limited domestic reserves and growing cost of developing new fields make it necessary for the PGNiG Group to undertake exploration and production business outside Poland. Currently, the Group's exploration and production business abroad concentrates within the Norwegian Continental Shelf, North Africa and Middle East. While selecting expansion directions, the Company will factor in the probability of finding deposits of crude oil and natural gas, political situation in the country exporting these hydrocarbons, feasibility of gas supplies to Poland, legal environment and feasibility of cooperation with other sector players (both Polish and foreign), as well as PGNiG Group's ability to finance the projects.

Actions aimed at developing the exploration and production business include:
- increasing own production of natural gas to approx. 6.2 bcm (high-methane gas equivalent) and of crude oil to approx. 1.8m tonnes annually in the coming years;
- streamlining operations in the exploration and production segment;
- positioning of PGNiG SA as an international gas player.

**Increasing own production of natural gas and crude oil**

The intensification of PGNiG SA's exploration and production activity over the recent years offers prospects of higher natural gas and crude oil production. Domestically, new hydrocarbon fields have been prospected and production capacities of the developed fields have been determined. Thanks to the purchase of licences and launch of business on foreign markets, PGNiG SA has increased its reserves of hydrocarbons. Continuous exploration work leading to new discoveries will in turn enable increased production. The Group's objectives in this scope include:
- raising the production capacity of domestic natural gas to approx. 4.5 bcm (high-methane gas equivalent) and of crude oil to approx. 1.0m tonnes annually;
- starting production of oil and gas from fields located abroad in 2011. The PGNiG Group has been continuously monitoring the market with view to acquiring new exploration and production assets. The Group has also been participating in selected licence rounds. The development of business on the Norwegian Continental Shelf should, in a long term, ensure at least 1.5 bcm of the annual production of natural gas from the equity gas reserves;
- maintaining the resources sustainability index at no less than

CURRENT AND PREFERRED STRUCTURE OF GAS SUPPLIES TO POLAND




1.1 over the next five years. Around 30 exploratory and prospecting boreholes will be drilled annually;
- maintaining domestic licence areas of no less than 45–50 ths. km$^2$, which should secure domestic production at the planned level.

**Streamlining operations in the exploration and production segment**

Streamlined and rational production of natural gas, understood as compliance with the technological regime, enables the Company to maintain a high share of domestically produced gas in the domestic gas consumption, while preserving the reserves for the next generations. As exploration and production represent a very important area of the PGNiG Group's business, numerous initiatives are planned in this scope, including:
- restructuring the PGNiG Group's exploration companies, which will improve their operational efficiency. The consolidation of these companies (full or partial) will produce synergies contributing to a reduction of unit operating expenses. The restructured organisation will be able to compete on the changing exploration and production market;
- improving the methodology of exploration work in Poland;
- introducing new systems for charging for work performed by the service companies, including the daily rate system. The introduction of such more effective systems will help to optimise the cost of exploration work. Currently, the exploration work is performed under turn-key contracts.

**Positioning of PGNiG Group as an international gas player**

PGNiG Group's strategic objective is to build its stable position as an exploration and production group on the key markets, in the following three regions of the world:
- the North Sea, Norwegian Sea and, in the future, Barents Sea (Norway and Denmark, United Kindgdom, Germany);
- North Africa (Libya, Egypt, Algeria, Tunisia, Morocco and Mauretania);
- Indian sub-continent (India and Pakistan).

On the international market, the Group will implement a multifaceted strategy, providing for acquiring interests in licences or other exploration and production projects, either directly from entities interested in their disposal or through alliances with other companies (e.g. consortia).

Maesures undertaken in this scope will include:
- achievement of a significant position on key markets. In those areas, PGNiG SA intends to establish strong business entities able to independently conduct exploration business in a given country, including as a licence operator;
- achievement of a visible profile on subsidiary markets;
- maintaining the position of a respected and recognised provider of maintenance services. The competitiveness of services offered on the international market will be achieved through the optimum restructuring of the service (maintenance) companies.

**What we have already managed to achieve**

In 2008, PGNiG SA spent approximately PLN 310m on increasing its production capacities. The majority of the related tasks were connected with the development of new fields or enhancement of productivity of the existing mines. The most important tasks were the LMG Project providing for the development of the Lubiatów, Międzychód, Grotów crude oil and natural gas fields (in August 2008, PGNiG SA signed a PLN 1.4bn agreement for the execution of the project with a consortium composed of PBG SA Polska, Technip KTI SpA of Italy and Thermo Design Engineering Ltd. of Canada), construction of the nitrogen removal facility in Grodzisk Wielkopolski, development of the Kaleje field and construction of a part of the Kaleje-Muchy gas pipeline.

## Expanding the Existing and Construction of New Storage Capacity

The storage business plays a key role in stabilising the fluctuating market demand for natural gas and guaranteeing supply security. Given the development of the market and the need to harmonise storage capacity with the applicable legal requirements, PGNiG SA will continue to expand the existing and construct new underground gas storage facilities. In 2015, the planned investment projects providing for the expansion of storage capacity should enable the Company to cover the demand for gaseous fuel from PGNiG SA's customers for at least 70 days.

The strategic objectives relating to the expansion of capacity of underground gas storage facilities include:

- ensuring that sufficient storage capacity is available to accommodate the needs of PGNiG SA's customers and to secure compliance with statutory provisions concerning mandatory stocks;
- establishment of the Storage System Operator;
- provision of gas storage services on commercial terms;
- improvement of the profitability of the storage business.

**Ensuring sufficient storage capacity to accommodate the needs of PGNiG SA's customers and to secure compliance with statutory provisions concerning mandatory stocks**

Due to the necessity to respond to customers' needs more flexibly, guarantee uninterrupted and stable supplies, mitigate the risk related to limitations in supplies of imported gas, as well as to fulfil the statutory obligation to keep mandatory stocks, the Company has to operate adequate storage capacity. To this end, PGNiG SA plans to:

- expand the existing storage capacity, chiefly in respect of high-methane natural gas, by approx. 2 bcm, to a total target capacity of approx. 3.8 bcm;
- raise funds, including from the EU, for financing the execution of investment projects.

**Establishment of the Storage System Operator**

The establishment of the Storage System Operator (SSO) is designed to harmonise PGNiG SA's internal structure and business organisation with the EU and Polish legal regulations, with the objective to ensure observance of the Third Party Access principle.

**Provision of gas storage services on commercial terms**

PGNiG SA plans to introduce gas storage service, for both its own customers and importers of natural gas. The scale of this business will depend on both the demand and free storage capacity. The Company also plans to build underground storage facilities in cooperation with external partners in order to provide gas storage services on commercial terms.

**Improvement of the profitability of the storage business**

Storage business requires a licence and is subject to regulation, which means that PGNiG SA is obliged to submit a storage services tariff for approval. PGNiG SA has undertaken steps to ensure that the return on capital employed is taken into account in drawing up of the storage tariff, which would guarantee the profitability of investment projects. Given the risk inherent to such business, the minimum return on capital employed in the construction of storage facilities should reach at least 10%–11%.

**What we have already managed to achieve**

PGNiG SA seeks to raise EU funding for the construction of four underground gas storage facilities located in Wierzchowice, Strachocina, Kosakowo and Mogilno. In 2008, the Company spent nearly PLN 110m on the construction and expansion of high-methane gas storage facilities, with the largest part of the amount applied towards the expansion of the Strachocin and Mogilno facilities. In November 2008, the Management Board of PGNiG SA and the consortium led by the Polish company PBG SA signed an agreement for the expansion of the Wierzchowice Underground Gas Storage facility, from its current capacity of 0.575 bcm to a capacity of 1.2 bcm. The value of the agreement is almost PLN 1.1bn. Also in November 2008, the formal and legal process of separation of the Storage System Operator was completed. Under a decision of December 31st 2008, the President of the URE appointed PGNiG SA as the SSO.

## Improving the Profitability of the Distribution Operations

Distribution plays a material role in building the value of the PGNiG Group. For this reason, maximum cost effectiveness and optimisation of stable revenue of the gas companies are key elements of the Group's strategy. Each of the operators will implement a strategy tailored to the nature of its area of operations.

The strategic objectives designed to improve the profitability of the distribution business are as follows:

- improvement of the profitability of the distribution business;
- cost optimisation;
- optimum development of the distribution network.

**Improvement of the profitability of the distribution business**

The distribution business is subject to regulation, with tariffs calculated based on justified costs and allowing for the return on capital employed as specified by the President of the URE. In order to improve the profitability of distribution services, the PGNiG Group will seek to obtain approval for such rates which would enable the Group to implement the planned investment projects relating to the expansion of the distribution system. In the distribution area, the targeted return on capital employed (ROE) should reach 7%–8% in 2015. Such ROE would guarantee the execution of the necessary investments in the expansion of the distribution network.

**Cost optimisation**

In building the value of the distribution business, cost rationalisation at the gas companies and maintaining satisfactory profitability are of key importance. These objectives will be achieved through the implementation of numerous initiatives, including:

- reduction of operating costs;
- consolidation of the Group distribution companies' procurement processes, which will contribute to lower costs related to the core business, in the area of construction, expansion and modernisation of the distribution system.

**Optimum development of the distribution network**

In the investment activities of the Gas Companies, the top priority is given to connecting new customers in the areas adjacent to the gas network. Through the expansion of gas networks within the communities/municipalities situated within the reach of the transmission and distribution networks, the Company will increase the network density and connect new towns and villages to the network. The following three strategic initiatives will serve this purpose:

- defining uniform rules for the expansion of the distribution network, preceded by market research covering individual geographic areas. Defining uniform rules and procedures will streamline the decision-making process with respect to the distribution network development;
- development of a uniform map of gas distribution pipeline capacity, which will enable the identification of both bottlenecks and free capacity, as well as optimum expansion of gas pipelines according to the customers' demand for gaseous fuel;
- raising EU funds for financing investment projects providing for the expansion of the distribution network, which will significantly contribute to the development of regions where access to gas pipelines is particularly limited.

**What we have already managed to achieve**

In 2008, the Gas Companies incurred capital expenditure totalling over PLN 940m. The investment tasks related mainly to the expansion of gas networks and connection of new customers.

## Expanding the Scope and Scale of Operations

As the Management Board of PGNiG SA perceives further growth potential for the Group, it will take measures leading to the expansion of the scope and scale of operations through strategic alliances and – following appropriate analyses – mergers and acquisitions in the following sub-sectors:

- power generation;
- heat generation;
- great chemical synthesis;
- crude oil.

**Expansion of the PGNiG Group**

The initiatives undertaken with view to expanding the scale of operations will include:

- extension of the value chain to include power generation. The PGNiG Group will join Polish and foreign projects related to the acquisition of new power generation sources, principally those where natural gas will be used as the fuel. It is projected that by 2015 PGNiG SA will hold interests in power plants representing a total of 300 MW of installed capacity. However, the implementation of this plan to a large extent depends on changes in the regulatory regime (replacement of tariffs with negotiated price formulae in the power sector);
- optimisation of power generation and electricity consumption. The PGNiG Group will examine the possibilities of economically viable participation in the electricity market, both from demand and supply side;
- acquisition of $CO_2$ capture (CCS) competences;
- acquisition of coal gasification competences;
- extension of the value chain in the great chemical synthesis sector. Execution of joint projects with companies operating in that sector will contribute to an increase in gas sales and enable the development of a part of domestic gas fields. PGNiG SA does not exclude the establishment of capital links with chemical companies in favourable circumstances;
- alliances with petrochemical companies. Such companies may form a natural extension of PGNiG SA's value chain, especially in the area of exploration and production of natural gas and crude oil, both domestically and abroad, as well as in the area of using natural gas as fuel for power plants, crude oil processing and storage of crude oil and petroleum products.

**What we have already managed to achieve**

In 2008, PGNiG SA acquired 4,000,001 shares in Zakłady Azotowe w Tarnowie-Mościcach SA for PLN 78m. Moreover, the Company signed two letters of intent: (i) with Tauron SA, for the expansion of the Stalowa Wola Power Plant and (ii) with Grupa Lotos and Energa SA, concerning the possibility of joint construction of gas-fired power generation units.