

A nighttime photograph of an industrial site, likely an oil or gas field. In the foreground, there are large, dark, corrugated metal pipes or conduits laid out in rows. In the background, a tall drilling rig or derrick is illuminated by bright lights, and several other industrial structures and vehicles are visible under a dark sky.

Strategy of the PGNiG Group for 2014-2022

December 2014

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I. The Group's market position and financial situation have been stable so far

Current standing of the PGNiG Group

Financial performance in line with market expectations

- **EBITDA:** PLN 5,612m in 2013 and PLN 4,986m in 1-3Q 2014.
- Approximately 60% of EBITDA from the Exploration and Production segment and ca. 30% from the Distribution segment.

Relatively low debt

- **Safe level of debt** – at end of Q3 2014, net debt/EBITDA < 0.6.
- Access to **long-term financing sources** (bond issue programme of up to PLN 7bn extended until July 31st 2020, new bond issue programme of up to PLN 1bn until September 30th 2024).

Diverse revenue streams

- **Acknowledged leader** in production of natural gas and crude oil in Poland.
- **Active participant** of natural gas and crude oil production market in Norway.
- **Main importer** of natural gas to Poland (ca. 11 bcm annually).
- **Largest producer** of heat and eighth largest producer of electricity in Poland in terms of volume.
- Owner of **gas distribution network and underground gas storage facilities**.



- The PGNiG Group's financial situation and market position have been stable so far.
- However, various market and regulatory challenges the Group will face in the coming years may adversely affect its EBITDA.

II. Key challenges facing the PGNiG Group (1/2)

Key changes

Potential implications

Changes in the market environment

- The changes taking place on the Polish gas market are accompanied by **steep price declines elsewhere in Europe**.
- Gas prices on European markets are becoming increasingly more detached from oil products prices, and the trend has been observed for the past several years.
- Year to date, spot prices of gas in Germany and other European markets have declined by over 30%^[1], which has made the price of gas imports to Poland much more attractive in view of the current PGNiG tariff.

Changes of the regulatory regime

- The Group's **regulatory environment is undergoing major adverse changes**, particularly in the following areas:
 - taxation of hydrocarbon production,
 - upstream business licensing system,
 - requirement to sell gas by auction or on the exchange market,
 - uncertainty surrounding the support model for gas-fired co-generation.

These changes will **adversely affect revenues** of the Group's operating segments.

II. Key challenges facing the PGNiG Group (2/2)

Key changes

Potential implications

Gas market liberalisation in Poland

- As the **requirement to sell gas on the exchange market** has come into force, PGNiG SA is required to sell at least 55%^[1] of its high-methane gas on commodity exchanges or other regulated markets.
- The liberalisation process, coupled with the exchange sale obligation, pose **a risk of significant customer loss and reduced revenue from the storage segment**.
- The decision of the Office of Competition and Consumer Protection (UOKiK) of December 31st 2013 provides for the liberalisation of contracts with customers with respect to contractual capacities and gas fuel volumes contracted for a given gas year and introduces procedures for switching gas suppliers.

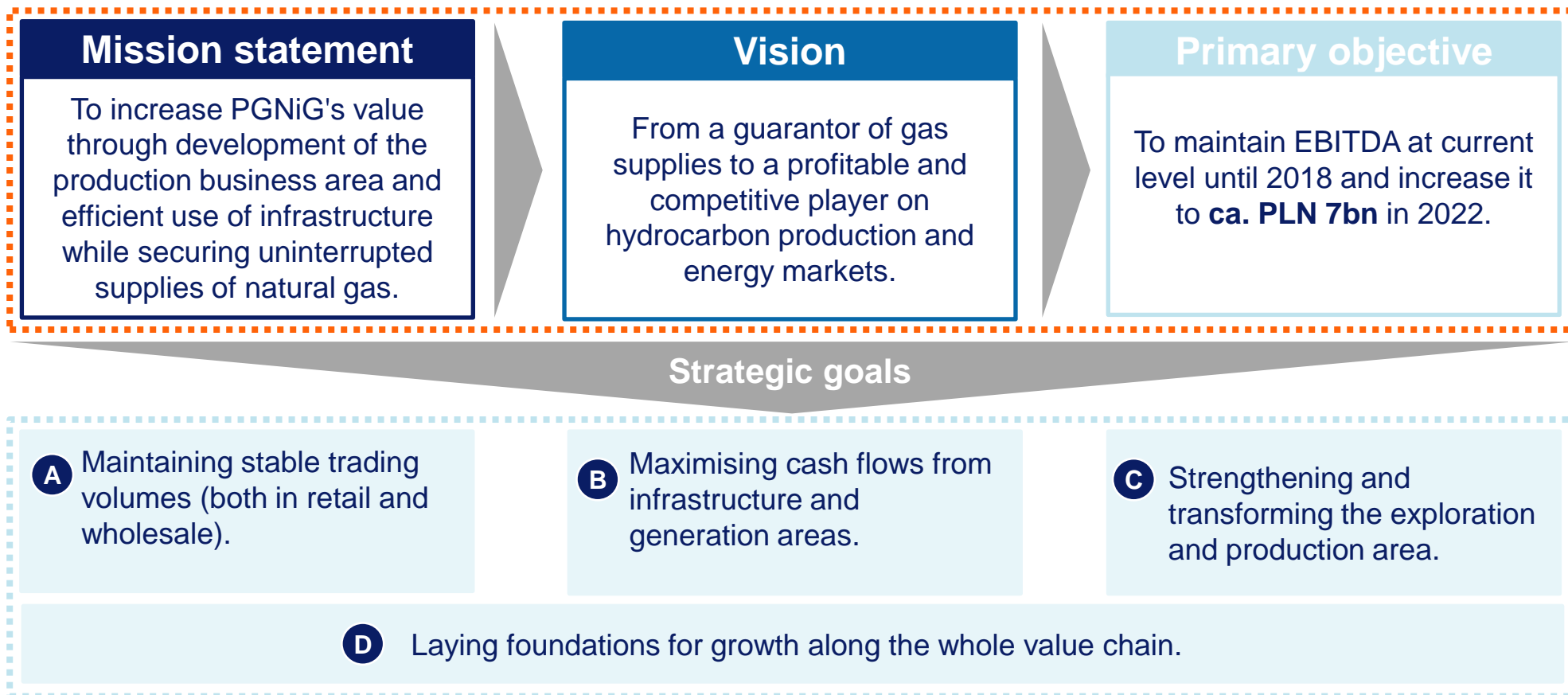
Need to change the structure of imported gas sources

- The Group's existing mix of gas supply sources **covers all demand** for gas in Poland.
- Considering the risk that the PGNiG Group might continue to lose its market share, there is **a risk of imbalance in the Group's gas portfolio**.
- Additionally, the PGNiG Group's gas supply sources are largely made up of contracts priced by reference to the prices of oil products (Yamal and Qatar contracts).
- Differences in pricing formulas between PGNiG SA and its competitors entail a **risk of pricing pressure**.

III. The new vision and strategic objectives will address the challenges ahead

Mission statement, vision, primary objective, and strategic goals

The **Strategy of the PGNiG Group for 2014-2022** has been developed to address the challenges facing the Group in the coming years.



IV. Pillars of the Strategy of PGNiG Group for 2014-2022



Strategy of the PGNiG Group for 2014-2022

A Maintaining stable value (both in retail and wholesale)

- 1** Optimisation of natural gas portfolio.
- 2** Developing and implementing a new retail and wholesale model.

B Maximising cash flows from infrastructure and generation areas

- 3** Maximising value from grid infrastructure (gas and heat distribution).
- NEW AREA OF DEVELOPMENT:
ACQUISITION OF HEAT NETWORKS**
- 4** Taking active part in creating energy market regulations.

C Strengthening and transforming the exploration and production area

- 5** Maintaining the current volumes of domestic production from conventional deposits.
- 6** Confirming the geological and economic potential of shale gas deposits in Poland.
- 7** Development of the upstream business outside of Poland.
- NEW AREA OF DEVELOPMENT:
ACQUISITION OF FOREIGN ASSETS**

D Laying foundations for growth along the entire value chain

- 8** Efficiency Improvement Programme and focus on core business.
- 9** Creating an organisation based on efficient human resource management, focused on objectives and resource acquisition.
- 10** Stepping up R&D activities and searching for innovative areas of growth.

V. Operating initiatives under the Strategy (1/4)

Segment	Initiatives	Strategic goals
A	1 Optimisation of natural gas portfolio management	<ul style="list-style-type: none"> Enhancing flexibility of the pricing and delivery terms in the gas procurement contracts, while ensuring the Group's ability to secure uninterrupted supplies of natural gas. Optimising portfolio management and trading policies for the liberalised natural gas market. Developing and implementing the final gas purchase portfolio after 2022. Reducing the adverse impact of long-term gas supply contracts and of the agreement with the LNG terminal operator concerning allocation of regasification capacities.
	2 Developing and implementing a new retail and wholesale model	<ul style="list-style-type: none"> High customer satisfaction – qualitative change in the customer service model (building sales organisation) and implementation of a new product offer. Achieving such operating efficiency at PGNiG retail subsidiary (Spółka Obrotu Detalicznego) that would allow PGNiG to reduce customer service costs. Minimising the extent of decline of PGNiG's share in the market's total volume of gas sales. Creating conditions conducive to fulfilling the requirement to sell gas on commodity exchanges or other regulated markets. Developing and implementing an operational model for the foreign markets. Limiting the negative impact of the gas market liberalisation in Poland on the PGNiG Group's performance. Generating a positive margin on wholesale gas trading.

V. Operating initiatives under the Strategy (2/4)

Segment	Initiatives	Strategic goals
B Maximising cash flows from infrastructure and generation areas	3 Maximising value from grid infrastructure (gas and heat distribution)	<ul style="list-style-type: none"> ■ Maximising profitability at WACC approved for distribution operations by the President of Energy Regulatory Office. ■ Increasing the volume of transported gas through development investments and new connections. ■ Seeking incremental value growth in new segments – long-term increase in cash flows through effective implementation of new network infrastructure projects (heat distribution). ■ Achieving synergies in network distribution areas.
	4 Taking active part in creating energy market regulations	<ul style="list-style-type: none"> ■ Preparing a detailed programme to support changes in the regulatory environment, aimed at improving the profitability of the fuel and energy industry and gas distribution sector, in particular through supporting highly-efficient gas based co-generation, storage and distribution, as well as the exploration and production segment. ■ Proposing alternative regulatory solutions to mitigate the risks inherent in the long-term contracts and statutory obligations. ■ Proposing regulatory changes that would support development of new segments (e.g. CNG, LNG).

V. Operating initiatives under the Strategy (3/4)

Segment	Initiatives	Strategic goals
C Strengthening and transforming the exploration and production area	5 Maintaining the current volumes of domestic production from conventional deposits	<ul style="list-style-type: none"> Maintaining production level from the existing licence areas by, <i>inter alia</i>, implementing an enhanced recovery programme. Implementing best production practices using a benchmarking system. Improving the capital efficiency of reserves development. Accelerating development of hydrocarbon reserves in Poland – shortening the duration of development projects. Confirming the potential and economic viability of production from domestic conventional hydrocarbon reserves.
	6 Confirming the geological and economic potential of shale gas deposits in Poland	<ul style="list-style-type: none"> Appraising shale gas reserves. Finding external partners to jointly explore for shale gas. Verifying the economic viability of production in Poland. Pursuing industrial-scale production of unconventional hydrocarbons.
	7 Development of the upstream business outside of Poland	<ul style="list-style-type: none"> Developing competences to build and manage the target portfolio of foreign projects with varied characteristics (risk, completion stage) in the exploration and production segment. Building the value of exploration and production segment in line with the adopted strategic objectives by pursuing new projects abroad. Developing and implementing a model for building and managing the target portfolio of foreign projects.

V. Operating initiatives under the Strategy (4/4)

Segment	Initiatives	Strategic goals
D Laying foundations for growth along the entire value chain	8 Efficiency Improvement Programme and focus on core business	<ul style="list-style-type: none"> Improving operational efficiency throughout the PGNiG Group. Achieving sustainable savings in operating expenses. Improving effectiveness of capital expenditure in all business areas of the PGNiG Group. Reducing the PGNiG Group's involvement in non-core capital and equity assets with rates of return below WACC.
	9 Creating an organisation based on efficient human resource management, focused on objectives and resource acquisition	<ul style="list-style-type: none"> Building teams, organisation and culture to support implementation of the PGNiG Group's strategic objectives. Developing and implementing competency model for the key areas of the Group's business to identify and eliminate differences between competencies which are required and competencies already available at the organisation. Supporting personnel development in the areas intended to close competency gaps and implementing a talent development programme. Implementing the organisation's knowledge management system.
	10 Stepping up R&D activities and searching for innovative areas of growth	<ul style="list-style-type: none"> Building competitive advantage and leveraging to the maximum the potential offered by the PGNiG business model by improving technological efficiency in the hydrocarbon exploration and production area. Enhancing the PGNiG Group's development potential through innovation. Creating conditions for continued development of the PGNiG Group based on implementation of promising commercial technologies in the areas closely related to the PGNiG Group's core business. Efficient acquisition of EU funds supporting innovation and R&D activities.

VI. This year we have started The Efficiency Improvement Programme in the area of internal operational efficiency

The Efficiency Improvement Programme comprises of 18 optimisation initiatives.

The initiatives are implemented in three streams:

- *Stream A* – Initiatives dedicated to individual business segments within the PGNiG Group
- *Stream B* – Cross-sectional initiatives related to all business segments of the PGNiG Group
- *Stream C* – Initiatives related to the mechanisms for expenditure allocation within the PGNiG Group



Expected total savings generated by The Efficiency Improvement Programme:

- ~ 15%-20% of the identified 2013 cost base
- up to ~PLN 700m-800m of repeatable effects on EBITDA as of the end of 2018

VII. The PGNiG Group's business portfolio until 2022 will be adapted to the expected market changes

1 Upstream

Domestic -
conventional

Domestic -
unconventional

International

2 Infrastructure

PSG (gas)

Network heat

DISTRIBUTION

Storage system
operator (OSM)
(storage)

Termika S.A.
(generation)

International

3 Trade

Wholesale
Trading Division
(OOH)
(wholesale)

Sales to
households
(B2C)

Sales to business
customers
(B2B)

RETAIL

VIII. Key strategic objectives

#1



- Stabilisation of EBITDA at ~PLN 7bn in 2022.
- The average annual investment in organic growth and acquisitions increased by approx. 20% compared to the average annual investment in 2008-2013.

#2



- Hydrocarbon production in Poland maintained unchanged, i.e. approx. 33 mboe per year.

#3



- Increase in crude oil and natural gas production volume in total (Poland and abroad) to approx. 50-55 mboe in 2022 through acquisition of exploration and production assets.

#4



- Development of new areas of operation by extending the value chain in the distribution segment through addition of heat assets.

#5



- Significant enhancement of the PGNiG Group's internal operational efficiency (savings of PLN 800m).

