PGNiG

Polskie Górnictwo Naftowe i Gazownictwo SA

Strategy of the PGNiG Group for 2014−2022 Update

April 2016

Agenda

I. Summary of Strategy Update

Reasons for the Strategy update

Given the volatility of oil prices on global markets, an updating review of the Strategy is necessary.

- In H2 2014, the crude price fell from ~USD 105/bbl to ~USD 55/bbl;
- Following a short-lived rebound in Q2 2015 to ~USD 65/bbl, the price dropped to ~USD 30/bbl at the end of 2015.

Key updated assumptions

The following aspects of the Strategy have been updated following the review and verification of the underlying assumptions:

- macroeconomic assumptions (including prices of crude oil, natural gas and electricity, exchange rates);
- market and operating assumptions, including:
  - gas balance;
  - volumes of gas transmitted through the distribution network;
  - capital expenditure in the Generation segment.
- realignment of the strategic ambitions through:
  - modification of the existing operating initiatives;
  - launch of new operating initiatives.

II. Current standing of the PGNiG Group

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

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Stabilisation of financial performance

- **EBITDA:** PLN 5.6bn in 2013, PLN 6.3bn in 2014, PLN 6.1bn in 2015.
- The Exploration and Production segment and the Distribution segment as the key sources of EBITDA.

Very low debt level

- **Low debt level** – at the end of 2015, net debt/EBITDA: ~0.02.
- **Access to long-term financing sources** (available financing programmes for PLN 14.7bn, including PLN 9.7bn underwritten).

Diversified revenue of the Group

- **Undisputed leader** in production of natural gas and crude oil in Poland
- **Active participant** of the gas and crude production market in Norway
- **Main importer** of natural gas to Poland (ca. 9.3bn m^3 in 2015).
- **Largest producer** of heat and **eighth largest producer of electricity** in Poland in volume terms.
- **Owner** of gas distribution network and underground gas storage facilities

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- **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 unless it attains its strategic objectives.**

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

Key changes	Potential implications
Changes in the market environment	▪ A steep **slide in crude prices** – Brent price down ca. 70% in 2014−2015 ▪ Key **implications of the crude price changes**: – lower gas procurement costs under long-term contracts, making imports a more attractive source of supply – deteriorated economics of foreign upstream projects where oil represents a larger proportion of the reserves, leading to lower valuation of the foreign upstream operations ▪ 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 detached from petroleum product prices, and the trend has been observed for the past several years. ▪ In 2014–2015 spot prices of gas in Germany and other European markets declined by over 40%[1], which has made the price of gas imports to Poland much more attractive in view of the PGNiG tariff.
Changes of the regulatory regime	▪ **Significant adverse changes** currently seen in the Group's **regulatory environment**, 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 segments.

[1] Based on TTF spot prices.

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

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Key changes	Potential implications
Gas market deregulation in Poland	▪ As the requirement to sell **a specific portion of gas volumes** on the exchange market has come into force, PGNiG S.A. is required to sell at least 55%[1] of its high-methane gas on commodity exchanges or other regulated markets. ▪ The deregulation process, coupled with the exchange sale obligation, pose **a risk of significant customer loss and reduced revenue form the storage segment**. ▪ The decision of the Office of Competition and Consumer Protection (UOKiK) of December 31st 2013 provides for the deregulation 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 current mix of gas supply sources **covers the entire demand** for natural gas in Poland. ▪ Considering the risk that the PGNiG Group might continue to lose its market share and given the insufficient diversification, 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 S.A. and its competitors entail a **risk of pricing pressure**.

[1] In 2014, PGNiG was required to sell 40% of its total sales volume through the exchange market. As of 2015, the requirement is 55%.

IV. Mission statement, vision, primary objective, and strategic goals

The PGNiG Group's new strategic vision will address the challenges ahead

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Following a review of the PGNiG Group Strategy for 2014–2022,
the PGNiG Group's vision and primary objective have been updated

Mission statement

To increase PGNiG's value through development of the production business area and efficient use of infrastructure while securing uninterrupted supplies of natural gas

Vision

Our vision is to grow from a guarantor of gas supplies into an active, profitable and competitive player on the hydrocarbon production and energy markets, based on the diversity of gas supply sources

Primary objective

To maintain EBITDA at current levels until 2017 and increase it to **ca. PLN 7.4bn** in 2022

Strategic goals

A VALUE PROTECTION

Maintaining stable value of sales (both in retail and wholesale)

B DRIVER

Maximising cash flows from infrastructure and generation areas

C GROWTH

Strengthening and transforming the exploration and production area

D GROWTH FOUNDATIONS

Laying foundations for growth along the value chain

V. Pillars of the PGNiG Group Strategy for 2014–2022

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Strategy of the PGNiG Group for 2014–2022

A Maintaining stable value of sales (both in retail and wholesale)

- 1a Optimising natural gas portfolio management and implementing a new wholesale model
- 1b Implementing new diversification projects
- 1c Developing international LNG trading
- 2a Developing and implementing a new retail model
- 2b Expanding PST's international sales operations

B Maximising cash flows from infrastructure and generation areas

- 3a Maximising value from transmission infrastructure – gas distribution
- 3b Maximising value from transmission infrastructure – heat distribution
- 4 Taking active part in developing 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 Expanding the upstream business outside of Poland

D Laying foundations for growth along the value chain

- 8a Efficiency Improvement Programme in core business
- 8b Disposal of non-core property
- 8c Disposal of non-core companies
- 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

New and modified initiatives are marked in green

VI. Operating initiatives under the Strategy of the PGNiG Group for 2014–2022 (1/4)

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Segment	Initiative	Strategic goals
A Maintaining stable trading volumes (both in retail and wholesale)	1a Optimising natural gas portfolio management and implementing a new wholesale model	▪ Securing terms of gas procurement that would allow PGNiG to purchase gas at prices reflecting the current market situation in Europe (renegotiation of the price terms under the long-term contracts) ▪ Limiting PGNiG S.A.'s loss of sales volumes while optimising the margins
	1b Implementing new diversification projects	▪ Assessing PGNiG's ability to diversify gas sources beyond 2022 ▪ Implementing selected diversification options
	1c Developing international LNG trading	▪ Assessing the rationale for developing international LNG trading within the PGNiG Group
	2a Developing and implementing a new retail model	▪ Defending the market position ▪ Developing a modern sales organisation to compete effectively on the liberalised market ▪ Fully leveraging the potential of PGNiG OD's customer base ▪ Enhancing the attractiveness of the product offering
	2b Expanding PST's international sales operations	▪ Increasing PST's retail sales volumes on foreign markets ▪ Enabling the placement of PGNiG's natural gas on foreign markets

New and modified initiatives are marked in green

VI. Operating initiatives under the Strategy of the PGNiG Group for 2014–2022 (2/4)

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Segment	Initiative	Strategic goals
B Maximising cash flows from the infrastructure and generation area	3a **Maximising value from transmission infrastructure – gas distribution**	▪ Long-term increase in free cash generated by the gas distribution segment ▪ Increasing the volume of transported gas through development projects and new connections
	3b **Maximising value from transmission infrastructure – heat distribution**	▪ Creating a new, stable cash stream for the PGNiG Group by acquiring regulated assets – heating systems
	4 **Taking active part in developing energy market regulations**	▪ 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-fired cogeneration, – in the area of storage and distribution, and – in the exploration and production segment

New and modified initiatives are marked in green

VI. Operating initiatives under the Strategy of the PGNiG Group for 2014–2022 (3/4)

Segment	Initiative	Strategic goals
C **Strengthening and transforming the exploration and production area**	**5** **Maintaining the current volumes of domestic production from conventional and unconventional deposits (excluding shale gas deposits)**	▪ Maintaining production in Poland at ca. 33 mboe per year ▪ Accelerating hydrocarbon development projects in Poland ▪ Improving cost efficiency of production activities and capital efficiency of reserves development; ▪ Implementing best production practices using a system of comparative indicators
	6 **Confirming the geological and economic potential of shale gas deposits in Poland**	▪ Appraising shale gas reserves in Poland ▪ Verifying the economic viability of shale gas production in Poland ▪ Building grounds for a possible decision to continue PGNiG's involvement in shale gas projects in Poland
	7 **Expanding the upstream business outside of Poland**	▪ Developing and implementing a model for creating and managing the target portfolio of foreign investment projects ▪ Developing competence to build and manage the target portfolio of foreign investment projects with varied characteristics (risk, completion stage) in the exploration and production segment ▪ Pursuing M&A projects outside Poland to enhance the upstream segment's value in line with the strategic goals

New and modified initiatives are marked in green

VI. Operating initiatives under the Strategy of the PGNiG Group for 2014–2022 (4/4)

Segment	Initiative	Strategic goals
D Laying foundations for growth along the value chain	8a Efficiency Improvement Programme in core business	▪ Lasting reduction of the PGNiG Group's operating expenses by 2017, i.e. reduction of the manageable cost base ▪ The Initiative's key objective is to improve the PGNiG Group's cost and CAPEX efficiency.
	8b Disposal of non-core property	▪ Disposal of the PGNiG Group's non-core property
	8c Disposal of non-core companies	▪ Disposal of the PGNiG Group's non-core companies
	9 Creating an organisation based on efficient human resource management	▪ Developing and implementing a competency model for the key areas of the Group's business to identify and eliminate the gap between competencies which are required and competencies possessed by 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	▪ Fulfilling and setting business objectives for the PGNiG Group – making the PGNiG Group one of the most innovative companies/groups in the Polish energy sector

New and modified initiatives are marked in green

VII. Key strategic objectives

#1

- Stabilisation of EBITDA at ~PLN 7.4bn in 2022
- Increase in average annual capital expenditure on organic growth and acquisitions by approximately 30% relative to 2008−2013

#2

- Diversifying PGNiG's gas supply portfolio beyond 2022

#3

- Hydrocarbon production in Poland maintained at approximately 33 mboe a year

#4

- Increase in total crude oil and gas production volume (in Poland and abroad) to approximately 55-60 m boe in 2022 through acquisition of exploration and production assets

#5

- Development of new business areas by expanding the value chain in the distribution segment through addition of heat assets

#6

- Significant enhancement of the PGNiG Group’s operational efficiency (savings of approximately PLN 800–900m)