DIRECTORS' REPORT ON OPERATIONS OF THE PGNIG GROUP IN H1 2013

Warsaw, August 1st 2013

Contents

Section I: Information on the PGNiG Group

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

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG SA), 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 SA of Warsaw, under entry No. RHB 48382. On November 14th 2001, PGNiG SA 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 SA 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 provide it with a competitive advantage on the liberalised gas market. The PGNiG Group business also includes generation and sale of electricity and heat.

1. Structure of the PGNiG Group

As at June 30th 2013, the Group comprised PGNiG SA (the Parent), and 34 production and service companies, including:

- 25 direct subsidiaries of PGNiG SA
- 9 indirect subsidiaries of PGNiG SA.

The list of the PGNiG Group companies as at June 30th 2013 is presented in the table below.

Companies of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG SA (PLN)	Ownership interest held by PGNiG SA	% of total vote held by PGNiG SA
	Direct subsidiaries of PGNiG SA – first tier				
1	Exalo Drilling S.A.	981,500,000.00	981,500,000.00	100.00%	100.00%
in	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.	5,000,000.00	5,000,000.00	100.00%	100.00%
8	INVESTGAS S.A.	502,250.00	502,250.00	100.00%	100.00%
9	Dolnośląska Spółka Gazownictwa Sp. z o.o.	658,384,000.00	658,384,000.00	100.00%	100.00%
10	Górnośląska Spółka Gazownictwa Sp. z o.o.	1,300,338,000.00	1,300,338,000.00	100.00%	100.00%
11	Karpacka Spółka Gazownictwa Sp. z o.o.	1,484,953,000.00	1,484,953,000.00	100.00%	100.00%
12	Mazowiecka Spółka Gazownictwa Sp. z o.o.	1,255,800,000.00	1,255,800,000.00	100.00%	100.00%
13	Pomorska Spółka Gazownictwa Sp. z o.o.	655,199,000.00	655,199,000.00	100.00%	100.00%
14	Wielkopolska Spółka Gazownictwa Sp. z o.o.	1,033,186,000.00	1,033,186,000.00	100.00%	100.00%
15	Geovita S.A.	86,139,000.00	86,139,000.00	100.00%	100.00%
16	PGNiG Energia S.A.	41,000,000.00	41,000,000.00	100.00%	100.00%
17	PGNiG Technologie S.A.	182,127,240.00	182,127,240.00	100.00%	100.00%
18	BUD-GAZ PPUH Sp. z o.o. w likwidacji (in liquidation)	51,760.00	51,760.00	100.00%	100.00%
19	Polskie Elektrownie Gazowe Sp. z o.o.	1,212,000.00	1,212,000.00	100.00%	100.00%
20	PGNiG TERMIKA S.A.	650,000,000.00	650,000,000.00	100.00%	100.00%
21	PGNiG Finance AB (SEK)[1)]	500,000.00	500,000.00	100.00%	100.00%
22	PGNIG Serwis Sp. z o.o.	9,995,000.00	9,995,000.00	100.00%	100.00%
23	PGNIG SPV 4 Sp. z o.o.	995,000.00	995,000.00	100.00%	100.00%
24	BSiPG Gazoprojekt S.A.[2)]	4,000,000.00	900,000.00	22.50%	22.50%
25	NYSAGAZ Sp. z o.o.	9,881,000.00	6,549,000.00	66.28%	66.28%
	Direct subsidiaries of PGNiG SA – second tier	Share capital (PLN)	Value of shares held by PGNiG SA's subsidiaries (PLN)	Ownership interest held by PGNiG SA's subsidiaries	% of total vote held by PGNiG SA's subsidiaries
26	Powiśle Park Sp. z o.o.	81,131,000.00	81,131,000.00	100.00%	100.00%
27	Biogazownia Ostrowiec Sp. z o.o. w likwidacji (in liquidation)	165,000.00	165,000.00	100.00%	100.00%
28	XOOL GmbH (EUR)[1)]	500,000.00	500,000.00	100.00%	100.00%
29	Oil Tech International F.Z.E. (USD)[1)]	20,000.00	20,000.00	100.00%	100.00%
30	Zakład Gospodarki Mieszkaniowej Sp. z o.o.	1,806,500.00	1,806,500.00	100.00%	100.00%
31	Poltava Services LLC (EUR)[1)]	20,000.00	19,800.00	99.00%	99.00%
32	Ośrodek Badawczo - Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000.00	2 565 350.00	85,51%	85,51%
33	GAZ Sp. z o.o.	300,000.00	240,000.00	80.00%	80.00%
34	PT Geofizyka Torun Indonesia 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 SA is entitled to appoint the majority of the company's Supervisory Board members.
Also, PGNiG SA 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 H1 2013:

- On January 2nd 2013, the Extraordinary General Meeting of BUD-GAZ PPUH Sp. z o.o. resolved to wind up the company and commence the liquidation process.
- On January 25th 2013, the Extraordinary General Meeting of PGNiG Poszukiwania S.A. resolved to amend the company's Articles of Association by changing the company name to Exalo Drilling S.A. The amendment was registered with the National Court Register on February 6th 2013.
- 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 registered with the National Court Register.
- On March 27th 2013, the General Meeting of PGNiG Norway AS resolved to amend the company's Articles of Association by changing the company name to PGNiG Upstream International AS; the change of company name was registered on May 23rd 2013.
- 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 commence the liquidation process; the changes were registered with the National Court Register on July 29th 2013.

Changes in the Group companies' share capital in H1 2013:

- Registration of 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;
- 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 SA 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 new issue shares were subscribed for by PGNiG SA; PGNiG SA'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 SA holds 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 SA 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 of the new shares were subscribed for by PGNiG SA and fully paid for with a non-cash contribution in the form of 21,000 shares in BSiPG Gazoprojekt S.A.; PGNiG SA's direct interest in the share capital of BSiPG 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.

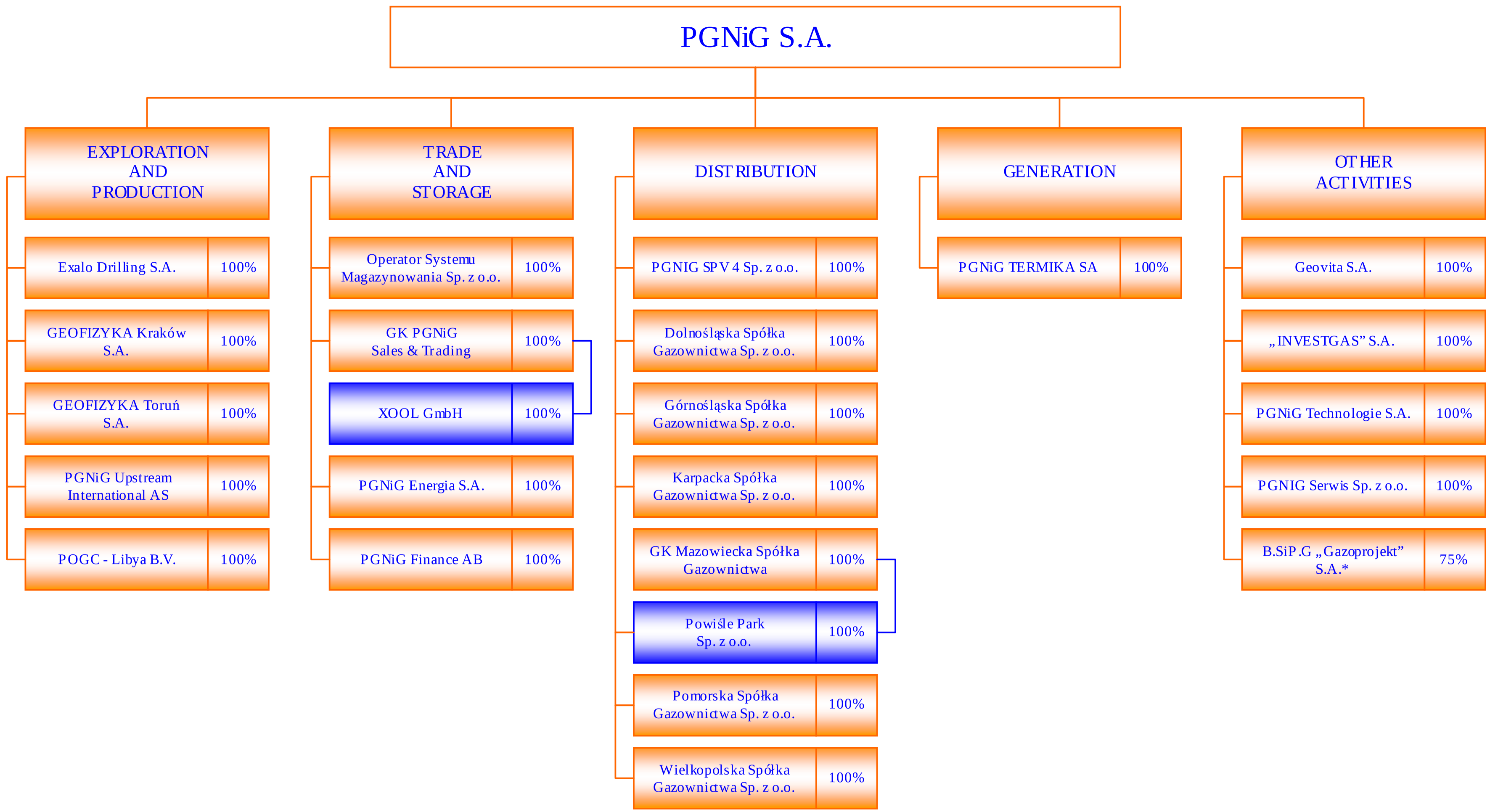
Changes subsequent to the end of the reporting period

The following changes in the Group's structure occurred subsequent to the end of the reporting period:

- The merger, pursuant to Art. 492.1.1 of the Commercial Companies Code, 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.; 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 merger, pursuant to Art. 492.1.1 of the Commercial Companies Code, of Operator Systemu Magazynowania Sp. z o.o. (acquiring company) with INVESTGAS S.A. (target company); 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;
- The merger, pursuant to Art. 492.1.1 of the Commercial Companies Code, of PGNiG SA (acquiring company) with PGNiG Energia S.A. (target company) without share capital increase; the merger was registered with the National Court Register on July 23rd 2013.

The chart below presents the consolidated companies of the PGNiG Group as at June 30th 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%, and its indirect interest through PGNiG Technologie S.A. is 52.50%.

2. Employment

The table below presents employment at the PGNiG Group as at June 30th 2013, by segments. Employment at the PGNiG Head Office is presented in the Trade and Storage segment.

Workforce by segments (no. of staff)

	Jun 30 2013
Exploration and Production	9,982
Trade and Storage	3,905
Distribution	13,174
Generation	1,074
Other Activities	2,112
Total	30,247

Since January 2009, the Group has operated the Programme for Workforce Streamlining and Redundancy Payments to the Employees of the PGNiG Group for 2009–2011 (Stage 3). The term of the Programme has been extended for another calendar year. The Programme is operated on a stand-by basis. It may be implemented in extraordinary circumstances and requires all the companies to follow a procedure which is uniform across the Group.

In H1 2013, the Programme covered 138 former employees of PGNiG Technologie SA. One-off redundancy payments for the terminated employees were financed with PGNiG SA's Central Restructuring Fund reserve.

3. Sales of products, oil and gas production and power generation

The PGNiG Group recorded revenue of PLN 16.8bn, 81% of which was derived from sales of natural gas.

Revenue (PLNm)

	H1 2013
Natural gas, including:	13,614
- high-methane gas	12,840
- nitrogen-rich gas	774
Crude oil	1,051
Condensate	3
Helium	92
Propane-butane	31
Electricity	511
Heat	601
Certificates of origin for electricity	28
Gas storage services	21
Geophysical and geological services	107
Drilling and well servicing services	287
Construction and erection	107
Other sales	337
Total	16,790

In H1 2013, the PGNiG Group sold 8.8bcm of natural gas, of which 96% were sales from the transmission and distribution systems and the balance – direct gas sales from the fields.

Natural gas sales volume (mcm)

	H1 2013
Trade and Storage	8,407.0
Exploration and Production	367.9
Total	8,774.9

The PGNiG Group produced a total of 2.3bcm of natural gas (measured as high-methane gas equivalent), of which 94% was produced from the fields in Poland, and the balance – from the fields in the Norwegian Continental Shelf and in Pakistan.

Natural gas production volume (mcm)

	H1 2013
Poland	2,116.3
Abroad	147.2
Total	2,263.5

In H1 2013, 94.1% of electricity produced by the PGNiG Group was cogenerated with heat.

Electricity and heat production volumes

Product	Unit	Volume
Electricity	GWh	2,511.5
Heat	TJ	24,471.1

Section II: Company's Governing Bodies

1. Management Board

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

- Grażyna Piotrowska-Oliwa – CEO and President of the Management Board
- 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 SA'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 and Chief Financial Officer, 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 submitted a declaration to avoid legal effects of 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 rescinded 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 positions. The reason of the removal was loss of trust and confidence of the PGNiG Supervisory Board towards these 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 appointment of the new President.

On May 6th 2013 the PGNiG Supervisory Board initiated the 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 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 electing a candidate.

As at June 30th 2013, the composition of the PGNiG Management Board was as follows:

- Mirosław Szkałuba – Vice-President
- Jacek Murawski – Vice-President, Finance
- Jerzy Kurella – Vice-President, Trade.

Division of responsibilities within the Management Board

In H1 2013, two resolutions provided for the division of responsibilities within the PGNiG Management Board.

Pursuant to the resolution of the PGNiG Supervisory Board on the division of powers between members of the Management Board, dated September 26th 2012:

- President of the Management Board was responsible for management of the PGNiG Group and supervision of human resources, strategy, marketing and communication, audit and internal control, information protection and defence matters, and oversaw the operation of the PGNiG representative office in Brussels;
- Vice-President of the Management Board for Trade supervised gas purchases, infrastructure and trading activities. His responsibilities also included oversight over foreign representative offices of PGNiG SA (except the office in Brussels);
- Vice-President of the Management Board for Finance was responsible for economics, accounting, business controlling, finance management, taxes, investor relations and investments;
- Vice-President of the Management Board for Procurement and IT supervised assets and administration, Company's and Group's procurement strategies, as well as IT development; his responsibilities also included supervision and coordination of petroleum extraction operations.

Pursuant to the resolution of the PGNiG Supervisory Board on the division of powers between members of the Management Board, dated April 29th 2013:

- Vice-President of the Management Board coordinated the work of the Management Board in all areas of PGNiG Group’s operations and carried out all other actions which, pursuant to the Company’s internal regulations, fall within the scope of powers of the President of the Management Board. He was responsible for human resources management, strategy, marketing and communication, audit and internal control, information protection, defence matters and IT management, as well as supervision and coordination of work related to petroleum extraction, investments, gas purchases, infrastructure and trading activities; his responsibilities also included oversight over foreign representative offices of PGNiG SA;

- Vice-President of the Management Board for Finance was responsible for economics, accounting, business controlling, finance management, taxes, investor relations and the Company’s tariff policy, as well as assets and administration.

On July 1st 2013, the PGNiG Supervisory Board appointed Mr Jerzy Kurella, Vice-President, as acting President of the Management Board until the new President is elected, and approved Management Board’s resolution on the division of powers between the Management Board members, whereby:

- Vice-President of the Management Board, in addition to being the acting President, is also responsible for human resources management, strategy, marketing and communication, audit and internal control, information protection, defence matters and the Company’s tariff policies; he supervises and coordinates work related to petroleum extraction, gas purchases, infrastructure and trading activities; his responsibilities also include oversight over foreign representative offices and branches of PGNiG SA;

- Vice-President of the Management Board for Finance is responsible for economics, accounting, business controlling, finance management, taxes, investor relations, Company's and Group's procurement strategies, as well as formulation of their investment policies;

- Vice-President of the Management Board for IT supervises assets and administration, IT development and management, and cooperation with trade unions; also responsible for compliance with occupational health and safety standards and fire safety regulations.

2. Supervisory Board

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 SA removed Mr. Mieczysław Puławski from the Supervisory Board and appointed Mr. Zbigniew Skrzypkiewicz as a new member of the Board.

As at June 30th 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
- Zbigniew Skrzypkiewicz – Member of the Supervisory Board.

Section III: Shareholder Structure

As at June 30th 2013, the share capital of PGNiG SA 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 State Treasury was the only shareholder directly holding a large block 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 as at June 30th 2013 is presented in the table below:

Shareholder structure

Shareholder	Number of shares as at June 30 2013	% ownership interest as at June 30 2013	Number of votes conferred by shares held	% of total vote at GM as at June 30 2013
State Treasury	4,271,764,202	72.40%	4,271,764,202	72.40%
Other shareholders	1,628,235,798	27.60%	1,628,235,798	27.60%
Total	5,900,000,000	100.00 %	5,900,000,000	100.00 %

<u>PGNiG shares and shares in PGNiG SA's related entities held by management and supervisory personnel</u>

The table below presents PGNiG shares held by the management and supervisory personnel as at June 30th 2013.

PGNiG shares held by the management and supervisory personnel

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

Section IV: Regulatory Environment

1. Licences

As at June 30th 2013, PGNiG SA held the following licences granted by the President of the Polish Energy Regulatory Office under the Energy Law:

- one licence for 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 the amendment to the licence for cogeneration of electricity. The amendment pertains to extension of 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.

As at June 30th 2013, PGNiG SA held the following licences, granted under the Polish Geological and Mining Law:

- 94 licences for exploration for and appraisal of crude oil and natural gas deposits
- 1 licence for appraisal of a salt deposit
- 225 licences to produce crude oil and natural gas from deposits
- 9 licences to store gas in underground facilities
- 3 licences for storage of waste.

2. Changes in PGNiG SA's tariffs

Amendment to Gas Fuel Supply Tariff No. 5/2012, approved by decision of the President of the Energy Regulatory Office, dated December 17th 2012 has been in effect since January 1st 2013. 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 Authority approved a change to Gas Fuel Supply Tariff No. 5/2012. The approved change related to the rules of classifying customers to the tariff groups for the supply of nitrogen-rich gas over the distribution network of Wielkopolska Spółka Gazownictwa Sp. z o.o. It was required in order to bring PGNiG SA's tariff in line with the tariff of WSG Sp. z o.o., and concerned the S-8 and Z-8 tariff groups.

The following tables present the average tariffs (PLN/cubic meter) used in settlements with customers purchasing gas fuels, by fuel type and place of delivery.

Area covered by Dolnośląska Spółka Gazownictwa Sp. z o.o.

	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 Górnośląska Spółka Gazownictwa Sp. z o.o.

	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 Karpacka Spółka Gazownictwa Sp. z o.o.

	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 Mazowiecka Spółka Gazownictwa Sp. z o.o.

	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 Pomorska Spółka Gazownictwa Sp. z o.o.

	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 Wielkopolska Spółka Gazownictwa Sp. z o.o.

	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%

On July 18th 2013 PGNiG SA applied to the President of the Energy Regulatory Office for approval of the new Gas Fuel Supply Tariff. As at the date of this report, the proceedings were pending.

3. Regulatory risks

Polish Energy Law

In H1 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), as well as a parliamentary draft amendment to the Energy Law and certain other acts (the so-called Small Three Pack). On July 25th 2013, 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 (the Tariff Regulation) came into force. The amended Tariff Regulation introduces, among other things, entry-exit transmission tariffs, rules for computation of charges for short-term and interruptible services and for virtual reverse flow services provided by transmission and distribution system operators, as well as rules for computation of charges for storage services rendered on a packaged or stand-alone basis by storage system operators. 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 is to adapt the provisions of the Tariff Regulation to the Gas System Regulation.

Changes to laws and delays in amending legal acts create risks, resulting chiefly from uncertainty as to the final extent of the regulatory changes and the short time given to adapt to them, which might adversely affect the financial performance and development prospects of PGNiG SA. The currently planned legislative changes are to introduce a trading obligation (sale of certain volumes of gas specified in the Act on the gas market) and mechanisms that would facilitate changing gas suppliers. This may lead to a loss of market share by PGNiG SA.

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 until 2016 should be no less than 9% of the annual national consumption of energy. Since January 1st 2013, PGNiG has, as a trading company, 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 paid for gas by customers.

Tariff calculation

PGNiG SA's ability to cover the costs of its core operations depends on prices and charge rates approved by the President of the Energy Regulatory Office. When approving tariffs for a given period, the President of the Energy Regulatory Office takes into consideration external factors which are beyond PGNiG SA's control. In an attempt to protect customers, the President of the Energy Regulatory Office may consider certain business costs to be unjustified. Moreover, the President of the Energy Regulatory Office does not always agree with the assumptions made by PGNiG SA with respect to the main cost drivers and profit targets allowing for business risk. Consequently, the Energy Regulatory Office frequently refuses to approve tariff prices and charge rates applied for by PGNiG SA. Lower tariff prices and charges might adversely affect PGNiG SA's profitability.

In previous years, the President of the Energy Regulatory Office unilaterally extended 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 calculated below costs, as it does not account for the cost of supply of gas fuel to customers in the period by which the tariff's effective period is so extended. As a result, it should be expected that in the next round of tariff approval proceedings, 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 SA.

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 price 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. 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 markets affect the prices of imported gas. Any accurate forecast of natural gas price changes is encumbered with a high risk of error. There can be no assurance that despite the legal possibility of adjusting the prices approved for a tariff term, an increase in the price of imported gas may not be fully passed on to customers, or that changes in gas sale prices may lag behind changes in its import prices.

Section V: Exploration and Production

1. Segment's operations in Poland

Exploration

In H1 2013, the PGNiG Group was engaged in exploration for both conventional and unconventional gas deposits (shale gas and tight gas). In Poland, the PGNiG Group conducted, both on its own and in cooperation with partners, exploration and appraisal work, specifically in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands. Drilling work was performed on nine exploratory wells, including two research boreholes (Wysin-1 and Kochanowo-1), and two appraisal wells.

In H1 2013, seven wells were tested in PGNiG license areas, including three wells drilled in 2012. The tests confirmed the presence of gas in three wells – one exploratory well (Komorze-3k/3kbis), and two appraisal wells (Przeworsk-18 and Siedliczka-3). Four wells did not flow hydrocarbons at commercial rates and were subsequently abandoned (Wadowice Dolne-1, Gosławice-2, Mieczewo-1k and Czarna Wieś-8).

As part of exploration for unconventional deposits in Pomerania, the Opalino-2 (shale gas) and Pławce-2 (tight gas) wells underwent testing. Tests also confirmed the presence of gas in the Lubocino-2h well. In the Lublin area, further analysis of geological data was performed with a view to continuing the work on the Lubycza Królewska-1 well (shale gas). At the same time, drilling of the Kramarzówka-1k well commenced in the Carpathian Foothills, to confirm the presence of an unconventional gas deposits (tight gas) deposit, explored by the Kramarzówka1 well.

As at June 30th 2013, the Group's recoverable reserves were as follows:
- 87.8 bcm of natural gas measured as high-methane equivalent,
- 18.3 million tonnes of crude oil.

Joint ventures

In H1 2013, PGNiG SA conducted joint operations with two other entities in licence areas awarded to PGNiG S.A. – FX Energy Poland Sp. z o.o., and San Leon Energy PLC (the company had acquired the license interests from its former partner, Aurelian Oil & Gas PLC).

Also in H1 2013, PGNiG SA, Tauron Polska Energia S.A., KGHM Polska Miedź S.A., PGE Polska Grupa Energetyczna S.A. and Enea S.A. held negotiations on detailed terms of cooperation under the framework agreement of July 4th 2012 (concerning exploration for and production of shale gas and oil within the Wejherowo licence area).

Under the licences awarded to PGNiG SA, work continued in the following areas:

- "Płotki" – under the agreement for joint operations dated May 12th 2000; licence interests: PGNiG SA (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 SA (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 SA (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%;
- "Bieszczady" – under the agreement for joint operations dated June 1st 2007; licence interests: PGNiG SA (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 SA (operator) – 51%, Orlen Upstream Sp. z o.o. – 49%.

In H1 2013, production continued from the Roszków field in the "Płotki" area, and from the Zaniemyśl field in the "Płotki" – "PTZ" area. In the "Płotki" area, the work on acquisition of the Donatowo-Rusocin 3D seismic survey was completed and the processing of the survey commenced. In the "Płotki" – "PTZ" area, reinterpretation of the Kaleje-Zaniemyśl 3D seismic survey was commenced and completed to select the best location for the Zaniemyśl-4 or Zaniemyśl-3k production well. Based on the results of the reinterpretation, there is no rationale for drilling of the Zaniemyśl-4 well. As a result, design and analytical work was commenced on two project options, i.e. the drilling of the Zaniemyśl-3k horizontal well or a workover of the Zaniemyśl-3 well.

In the "Poznań" licence area, in H1 2013, the Winna Góra field was brought onstream and gas production continued from the Środa Wielkopolska, Kromolice and Kromolice S fields. Work continued on the development of the Lisewo natural gas field, while the development of the Komorze 3K field commenced. Hydraulic fracturing was performed in the Pławce-2 (tight gas) exploration well and the process of initiating production was started. Drilling of the Mieczewo-1k exploration well was also completed, resulting in gas flow with a significant presence of formation water. Based on the geological and field analyses, as well as economic analyses, a decision was made to abandon the well. The processing of the Miłosław 3D seismic survey was also completed and work began on data interpretation. Interpretation of the Taczanów 3D seismic survey was completed.

In the "Bieszczady" area, processing of seismic profiles in the Jaśliska-Baligród zone and reprocessing of the Kostarowce-Zahutyń 2D archive seismic profiles continued. Also, Niebieszczany-1 well was temporarily secured until a decision is made on further well tests.

In H1 2013, in the "Sieraków" area, the Sieraków-3 borehole was drilled. Based on the initial testing of the well, a decision to secure the well for further tests was made.

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 SA – 49%;
- "Ostrowiec" – under the agreement for joint operations dated February 27th 2009; licence interests: FX Energy Poland Sp. z o.o. (operator) – 51%, PGNiG SA – 49%;
- "Kutno" – under the agreement for joint operations dated September 30th 2010; licence interests: FX Energy Poland Sp. z o.o. (operator) – 50%, PGNiG SA – 50%.

In H1 2013, in the "Warszawa-Południe" area, FX Energy Poland Sp. z o.o. performed its own geological interpretation of the Potycz – Boglewice – Grójec area to select an area for the development of a 3D survey. The company also applied to the Ministry of Environment to amend its licence for block 254 (abandonment of a part of the licence area).

Analytical work was completed for the "Ostrowiec" area. In the "Kutno" area work was conducted on documenting results of the drilling of the Kutno-2 well. FX Energy Poland Sp. z o.o. made a decision to abandon the licences covering the "Ostrowiec" and „Kutno" areas.

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

PLC); licence interests: Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (operator) – 80%, PGNiG SA – 20%.

In H1 2013, in "Karpaty Zachodnie" area, the Budzów–Cieszyn–Bestwina–Bielsko-Biała 2D seismic profiles were reprocessed.

In "Karpaty Wschodnie" area, geological and geophysical materials from the Mszana Dolna – Jordanów region were analysed to assess the possibility of commencing drilling works. As a result, a decision not to proceed with the drilling of an exploration well was made and a request to amend the Mszana Dolna license (abandonment of a part of the licensed area) was filed with the Ministry of Environment.

<u>Production</u>

Natural gas and crude oil production in Poland is conducted by two branches of PGNiG SA: the Zielona Góra Branch and the Sanok Branch. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 23 sites, including 14 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 46 sites, including 26 gas production facilities, 10 oil and gas production facilities and 10 oil production facilities.

In H1 2013, the Group produced a total of 2,116.3mcm of natural gas, measured as high-methane gas equivalent. Following the launch of production from the Lubiatów, Międzychów and Grotów (LMG) fields, crude output increased significantly, to 382 thousand tonnes. The table below presents PGNiG Group's production volumes in H1 2013.

Hydrocarbon production volumes in Poland

	Product	Unit	H1 2013
1.	Natural gas, including:	mcm	2,116.3
a.	high-methane gas, including:	mcm	779.9
	- Zielona Góra Branch	mcm	0.0
	- Sanok Branch	mcm	779.9
b.	nitrogen-rich gas, including:	mcm*	1,336.4
	- Zielona Góra Branch	mcm*	1,295.6
	- Sanok Branch	mcm*	40.8
2.	Crude oil, including:	thousand tonnes	382.0
	- Zielona Góra Branch	thousand tonnes	357.7
	- Sanok Branch	thousand tonnes	24.3

* measured as high-methane gas equivalent.

In H1 2013, in the Sanok Branch area three new wells were brought onstream: the Terliczka-6k well on the Terliczka field, the Pruchnik-24 well on the Pruchnik-Pantałowice field, and the Batycze-4 well as part of test production. The total addition to gas production capacity from the new wells is approximately 2.8 thousand cubic metres of gas per hour (measured as high-methane gas equivalent). In the Zielona Góra Branch area, six new oil producing wells were brought onstream: two on the Lubiatów field (Lubiatów-2k, Lubiatów-7h) and four on the Grotów field (Grotów-1, Grotów-2, Grotów-8k, Grotów-9k), with an aggregate daily production capacity of 620 tonnes; and one gas producing well on the Międzychód field (Międzychód-7h) with a capacity of 4.5 thousand cubic metres of gas per hour (measured as high-methane gas equivalent). The Winna Góra field was also brought onstream (Winna Góra-1 well) with a production capacity of 1.2 thousand cubic metres of gas per hour (measured as high-methane gas equivalent).

In H1 2013, PGNiG SA was engaged in a range of activities aimed at maintaining the gas and oil output from the currently producing fields. In order to increase hydrocarbon production, 2,440 metres of production drilling was performed. Major remedial treatments were performed on a total of 6 wells to maintain their operable condition. Those wells flowed hydrocarbons at commercial rates. In H1 2013, well interventions were undertaken on a total of 43 wells, designed mainly to maintain or improve production rates of producing wells or to restore sub-surface extraction equipment to working condition (including one well used as injector).

Underground gas storage facilities

In H1 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 working capacities of the underground storage facilities used by the Exploration and Production segment as at June 30th 2013.

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

Nitrogen-rich gas	H1 2013
Daszewo (Ls)	30.0
Bonikowo (Lw)	200.0

2. Segment's operations abroad

In H1 2013, the PGNiG Group conducted work in licence areas in Pakistan, Egypt, Libya and Norway. The Libyan and Norwegian projects were conducted by PGNiG subsidiaries.

Pakistan

PGNiG SA conducts exploration work in Pakistan under an agreement for hydrocarbon exploration and production in the Kirthar licence area executed between PGNiG SA 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 proportionately to the parties' interests in the licence: PGNiG SA (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 H1 2013, work was carried out on the construction of pipelines and surface installations to commence test production from the Rehman-1 and Hallel X-1 wells. Test production was launched at the end of June 2013.

Egypt

In Egypt, PGNiG SA conducts exploration work in the Bahariya licence area (Block 3) under an Exploration and Production Sharing Agreement (EPSA) executed with the government of Egypt of May 17th 2009. The Company holds a 100% interest in the licence. In H1 2013, two exploration wells were drilled. The wells were abandoned as no commercial hydrocarbon flows were recorded.

Norway

PGNiG Upstream International AS (former PGNiG Norway AS), a PGNiG company, holds interests in 14 exploratory and production licences on the Norwegian Continental Shelf, in the Norwegian Sea and Barents Sea. Jointly with its partners, the company develops 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 field, and began selling the hydrocarbons in January 2013. The oil is sold directly from the FPSO vessel to Shell International Trading and Shipping Company Ltd. and transported by a 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. In H1 2013, the Company produced a total of 80 thousand tonnes of crude oil and other fractions (measured as tonnes of crude oil equivalent) and 146.3mcm of natural gas.

Following the conclusion of another licencing round, in H1 2013 PGNiG Upstream International AS acquired:

- a 40% interest in licences PL702 and PL703 each; the direct operatorship of the licenses was awarded to OMV Norge (60% interest)
- a 30% interest in license PL707; the direct operatorship of the licenses was awarded to Edison International (50% interest)
- a 20% interest in licence PL711, the direct operatorship of the licneses was awarded to Respol Exploration Norge (40% interest).

Libya

Polish Oil and Gas Company - Libya B.V., the Group's subsidiary, conducts 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 H1 2013, the Company completed preparatory work and started to drill the first three exploration wells.

Production volumes

In H1 2013, the Group produced a total of 147.2mcm of natural gas(measured as high-methane gas equivalent) and 80 thousand tonnes of crude oil from the foreign fields. In Norway, PGNiG Group produced high-methane gas and crude oil and other fractions, whereas in Pakistan - nitrogen-rich gas. The table below presents PGNiG Group's production volumes from foreign fields in H1 2013.

Production volumes abroad

	Product	Unit	H1 2013
1.	Natural gas, including:	mcm	147.2
	- Norway	mcm	146.3
	- Pakistan	mcm	0.9
2.	Crude oil	thousand tonnes	80.0

3. Service activities

In H1 2013, the Exploration and Production segment was engaged in drilling exploration, appraisal, research and production boreholes, as well as performance of specialist well-servicing activities and geophysical services. Its services were mainly provided to third-party customers.

Exploration, appraisal and research wells were drilled in the search for hydrocarbons, copper, and geothermal water. 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 engaged in exploration for:

- Conventional gas deposits, e.g. for PGNiG SA 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. 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 Ukraine, Lithuania, Egypt, 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 servicing activities consisting in reservoir measurements, application of enhanced recovery techniques, mud, cementing and datawell services, major remedial treatments, workovers and well abandonment services. In Poland, the PGNiG Group was the main customer for well services. The services rendered to investors from outside the PGNiG Group, including PEC Geotermia Podhalańska S.A., Mozów Copper Sp. z o.o. and FX Energy Poland Sp. z o.o. were chiefly cementing and mud services and reservoir measurements. On foreign markets, Group companies rendered services involving application of enhanced recovery techniques in Russia, Ukraine and Slovakia; remedial treatment, well abandonment, and well intervention services in the Czech Republic; reservoir measurement, cementing and mud services in Lithuania; and coiled tubing services in Ukraine and Russia.

In H1 2013, the Exploration and Production segment provided geophysical services involving field seismic work, seismic survey planning, seismic data acquisition, as well as seismic data processing and interpretation. They also conducted geophysical surveys and performed geological drilling work. In Poland, the Group chiefly performed exploration services, 2D and 3D seismic data acquisition for PGNiG S.A., as well as well logging services. For third-party customers in Poland, i.e. Cuadrilla Poland Sp. z o.o., FX Energy Poland Sp. z o.o., PAK Górnictwo Sp. z o.o., Orlen Upstream Sp. z o.o. and Lane Energy Poland Sp. z o.o., the Exploration and Production segment mainly performed seismic data acquisition and processing services. On foreign markets, seismic field work was performed for customers in Germany, India, Austria, and Hungary.

4. Sales of key products

The segment's key products are natural gas and crude oil. Other products, obtained in the process of crude refining, include crude condensate, sulphur 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 H1 2013, PGNiG Group sales of natural gas totalled 367.9mcm, of which 367.0mcm was sold in Poland, and 0.9mcm was sold in Pakistan. Also, the Group sold 373.9 thousand tonnes of crude oil in Poland, and 74 thousand tonnes of crude oil in Norway. The table below presents volumes of natural gas (including LNG) sold directly from the fields, and volumes of crude oil and other products sold to third-party customers.

Sales of key products

		Unit	H1 2013
1	Natural gas, including:	mcm	367.9
	- high-methane gas	mcm	37.2
	- nitrogen-rich gas*	mcm	330.7
in	Crude oil	thousand tonnes	447.9
3	Condensate	thousand tonnes	1.2
4	Helium	mcm	1.5
5	Propane-butane	thousand tonnes	12.7
6	Nitrogen	thousand kilograms	215.1
7	Sulphur	thousand tonnes	16.6

*Measured as high-methane gas equivalent.

In Poland, the largest amounts of natural gas were sold to industrial customers, accounting for 83% of the total sales volume. As in the past, the crude oil produced in Poland was sold to Rafineria Trzebinia S.A., Rafineria Nafty Jedlicze S.A. and TOTSA TOTAL OIL TRADING S.A. In Q1 2013, PGNiG SA executed a short-term agreement with TOTSA TOTAL OIL TRADING S.A. for test deliveries of crude oil from the Lubiatów field. 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 Company's foreign customers accounted for 46.6% of the total sales volume of crude produced in Poland, and for 87.7% of helium and 23.5% of sulphur sales. Crude oil was sold to a German refinery through the Druzhba pipeline, most of the helium was sold to EU customers, and the sulphur was sold to customers in Germany and the Czech Republic.

5. Planned activities

Exploration in Poland

In H2 2013, PGNiG SA will continue exploratory geophysical work and drilling in Poland on dozens of prospects in the Carpathian Mountains, Carpathian Foothills and the Polish Lowlands. The work will be conducted by PGNiG SA on its own and jointly with partners.

As part of these activities, PGNiG SA also intends to pursue projects focused on exploring new potential opportunities in the area of unconventional resources (*shale gas/oil* and *tight gas*), where little appraisal has so far been made. In Pomerania, the Company plans to drill the Lubocino-3h and Opalino-3 wells, and to begin drilling the Opalino-4 well, as well as to fracture the Piaski-3 well. The Company has plans to drill more pilot wells for *shale gas/oil* exploration in both Pomerania and the Lublin region. The Company will also continue works related to drilling the Kramarzówka-1k well in the Carpathian Foothills.

Final formation testing is to be performed in the deep well Dukla-1, as part of exploration for conventional reserves in the Carpathian Mountains, where little appraisal work has been conducted so far. The Company also intends to begin drilling the Fredropol-1 deep well.

Exploration abroad

In H2 2013, the PGNiG Group will continue its exploration work in Egypt, Pakistan, Libya, and Norway.

On the Norwegian Continental Shelf, the PGNiG Group will carry out appraisal work in the Snadd Outer field and an exploration and appraisal project in the Snadd field. The Group intends to acquire new licence areas by participating in annual licensing rounds and by acquiring interests from other entities. In future, the Group wants to participate, as a partner, in drilling projects in deep-sea areas (below 1,000 metres) and in the Arctic Zone.

Natural gas production

The PGNiG Group is implementing an investment programme aimed at increasing, in the 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 2013 provide for an annual natural gas production volume of approximately 4.8 bcm of high-methane gas equivalent with a calorific value of 39.5MJ/cubic meter, of which approximately 4.4 bcm will be produced in Poland, 0.3 bcm on the Norwegian Continental Shelf and 0.1 bcm in Pakistan. In H2 2013 in Poland, new wells will be brought onstream on the already-producing Wola Różaniecka, Kielanówka-Rzeszów and Wierzchosławice fields operated by the Sanok Branch, and the Jarocin and Lisewo fields operated by the Zielona Góra Branch.

Crude oil production

In 2013, the PGNiG Group plans to produce ca. 1,120 thousand tonnes of crude oil, including 750 thousand tonnes in Poland and 370 thousand tonnes in the Norwegian Continental Shelf. The increased output follows the launch of production from the Lubiatów and Grotów fields in Poland at the end of 2012 and the beginning of 2013, and from the field on the Norwegian Continental Shelf.

Service activities

In H2 2013, the PGNiG Group plans to provide drilling services in Poland and abroad. In Poland, the Group will conduct drilling for PGNiG SA and for third-party customers. Services will also be rendered abroad, in Lithuania, Ukraine, Egypt, Libya, Uganda, Ethiopia, Kazakhstan, Georgia, and Pakistan. Specialist well services will be rendered mainly to PGNiG SA in Poland, and to foreign customers in Russia, Ukraine, 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 SA and third-party customers, as well as seismic acquisition and well logging services for PGNiG Group companies. On foreign markets, the PGNiG Group will provide geophysical services in Pakistan, India, and EU countries.

6. 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. Whether or not a sufficient accumulation exists depends on a number of geological factors. Furthermore, the actual quantity and quality of the accumulated hydrocarbons may differ from estimates. When the results of successful exploration activity, in the form of new reserves, do not offset the production from the existing reserves, PGNiG SA's recoverable reserves will decrease pro rata to the current production volumes.

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 SA's financial performance.

Exploration for unconventional gas deposits

The risk associated with exploration for unconventional gas deposits 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 and high investment expenditure necessary on drillings and construction of production infrastructure. 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.

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 SA, especially those active globally, enjoy strong market positions and have financial resources larger than those available to PGNiG SA 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 SA could offer given its financial and human resources. This competitive advantage is particularly important on the international market.

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 tender for licence 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 SA's control include:
- local governments' failure to approve local zoning plans or amendments to those already approved;
- obstacles in incorporating investment projects 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. Concurrently, PGNiG SA'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 investment 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 to a significant extent depends on the prices of oil derivative products and on exchange rates. In 2011, PGNiG SA introduced the Daily Rate system into the drilling contractors selection procedure, which is expected to reduce the costs of drilling services.

Safety, environmental protection and health regulations

Ensuring compliance with environmental laws in Poland and abroad may significantly increase PGNiG SA's operating expenses. Currently, PGNiG SA 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 the 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. Trends to implement increasingly more stringent environmental protection regulations are seen also in other countries where PGNiG SA conducts exploration operations.

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 SA operates, highly qualified staff is difficult to recruit.

Unforeseen events

Hydrocarbon deposits developed by PGNiG SA are usually located at great depth, which involves extremely high pressures and, in many cases, presence of hydrogen sulphide. Consequently, there 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.

Changes in laws and regulations

The laws and regulations in some countries change frequently and unexpectedly, causing difficulties for entities involved in exploration activity. This problem may be particularly acute in countries where changes in law depend on decisions made by authoritarian governments.

Political and economic situation

In some countries where the PGNiG Group conducts exploration activities there is a risk of armed conflicts or terrorist attacks, which may lead to a limitation, suspension or discontinuation of the exploration and production activities.

Some regions of the world where the PGNiG Group operates are exposed to a risk of social and political unrest. Changes of governments may bring to a halt licensing proceedings before state administration authorities. Additionally, these countries are at risk of internal conflicts and social unrest caused by poor social and demographic conditions. The risks specified above may lead to a limitation, suspension or discontinuation of PGNiG SA's activities.

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.

Section VI: Trade and Storage

1. Gas purchases

In H1 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 SA and PGNiG Sales & Trading GmbH.

PGNiG SA 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 agreements 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 H1 2013, to fulfil its trade obligations, the PGNiG Group purchased a total of 6,649.3 mcm of natural gas, of which 85% represented purchases by PGNiG SA.

Gas purchases, mcm

	H1 2013
PGNiG SA	5,677.0
PGNiG Sales & Trading GmbH	972.3
Total	6,649.3

The table below presents the structure of natural gas purchases by PGNiG SA, measured as high-methane gas equivalent.

Structure of PGNiG SA's natural gas purchases, by supply sources (mcm)

	H1 2013	%
Foreign suppliers:	5,542.6	97.6%
- Gazprom Export	5,056.5	91.2%
- Other foreign suppliers	486.1	8.8%
Domestic suppliers	134.4	2.4%
Total	5,677.0	100.0%

2. Sales

In H1 2013, PGNiG SA executed comprehensive contracts for gas fuel supplies, both from the transmission system and from the distribution system, with 29.7 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 on the domestic and German markets, as well as on power exchanges in Poland and Germany. The sales structure of the PGNiG Trade and Storage segment in H1 2013 is presented in the table below.

Sales structure of key products

		Unit	H1 2013
1	Natural gas, including:	mcm	8,407.0
	- high-methane gas	mcm	8,106.8
	- nitrogen-rich gas*	mcm	300.2
in	Propane-butane	thousand tonnes	0.6

*Measured as high-methane gas equivalent.

PGNiG SA delivered natural gas to customers on the Polish market. Gas was purchased primarily by industrial customers (mainly from the chemical, oil refining, petrochemical and metallurgical sectors) and by households. Households made up the largest group of customers purchasing natural gas, accounting for 97% of the entire customer base (approximately 6.5m). Their share in the total volume of gas sales increased by approximately 5% year on year. Industrial customers had the largest share in the sales volume, though sales to this group decreased by approximately 1% on H1 2012. PGNiG SA commenced the sale of gas on the Power Exchange, where it sold ca. 25 mcm of natural gas in H1 2013. The table below presents the structure of PGNiG SA's sales of natural gas (measured as high-methane gas equivalent) by customer groups.

Sales of natural gas on the Polish market (mcm)

	H1 2013	%
Industrial customers	4,241.7	55.2%
Trade and services	975.7	12.7%
Households	2,327.8	30.3%
Wholesale customers	117.1	1.5%
Exchange	24.6	0.3%
Total	7,686.9	100.0%

PGNiG Sales & Trading GmbH sold gas to end customers mainly on the German market and on the European Energy Exchange (EEX).

Sales of electricity

PGNiG S.A. expanded its product offering by launching sales of electricity to business customers (tariff groups A, B and C). The Company also plans to launch sales of electricity to households (tariff group G) in H2 2013.

PESO project

In H1 2013, PGNiG SA 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. The project involves construction of an LNG regasification station and two-step pressure reduction, metering and odourising stations in Ełk and Olecko, and switching customers in those towns to high-methane gas.

Consolidation of trading operations

On May 27th 2013, the Wholesale Trading Division was established. The Division's operations will involve wholesale trade in natural gas, electricity, heat, certificates of electricity origin and carbon credits.

3. 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 Underground Gas Storage 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 gas storage facility, where gas is stored in worked-out caverns. The capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica underground gas storage 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 agreements providing for the delivery of natural gas 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 effective since January 1st 2013. This amendment relates to the 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. As at the date of this report, the proceedings were still pending.

In H1 2013, PGNiG SA completed construction of the surface section of the Wierzchowice Underground Gas Storage Facility and performed start-up work on the gas injection and withdrawal unit. Start-up of the power engineering section, i.e. the turboexpander, needs to be performed before the extension of the facility (up to 1.2 bcm) can be completed. In June 2013, the Company also commenced work on the extension of the Husów Underground Gas Storage Facility up to 500 mcm.

As at June 30th 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, while 0.39 mcm is used to cover the Mogilno Underground Gas Storage Cavern Facility's own needs. The table below presents storage facilities' working capacities as at June 30th 2013.

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

	Working capacities (mcm)*
Brzeźnica Underground Gas Storage Facility	65.0
Husów Underground Gas Storage Facility	350.0
Mogilno Underground Gas Storage Cavern Facility	407,9
Strachocina Underground Gas Storage Facility	330.0
Swarzów Underground Gas Storage Facility	90.0
Wierzchowice Underground Gas Storage Facility	575.0
Total	1,817.9

*0.39 mcm of working storage capacity is used to cover the Mogilno Underground Gas Storage Cavern Facility's 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 Underground Gas Storage 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.

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 also act as the operator of the settlement point at the physical, inter-operator entry and exit points of the transmission system. In addition, Operator Systemu Magazynowania Sp. z o.o. and INVESTGAS S.A. merged on July 1st 2013. The purpose of the reorganisation of the Group's storage business is to consolidate its storage assets as well as technical and management capabilities within OSM Sp. z o.o., which will improve the operating efficiency of the Trade and Storage segment.

4. Planned activities

Purchases of natural gas

In H2 2013, PGNiG SA will continue to purchase imported gas under the long-term contract with OOO Gazprom Export and short- and medium-term gas supply agreements with European suppliers. With a view to optimising the costs of gas purchases, the Group will purchase natural gas on the German market, under short-term agreements.

Storage

In H2 2013, PGNiG SA will continue work on extending the Mogilno Underground Gas Storage Cavern Facility and the Husów Underground Gas Storage Facility. The Company will also continue the construction (begun in 2007) of the Kosakowo underground gas storage cavern for high-methane gas.

5. 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 SA 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 SA'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 Competition and Consumer Protection Court.

In order to avoid a similar situation in the future, in 2011 PGNiG SA 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 for customers

PGNiG SA is the largest supplier of natural gas in Poland. However, the upcoming 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 issued by the President of the Energy Regulatory Office, natural gas trading handled by PGNiG SA on the exchange is exempt from the tariff obligation. Also, in 2012, PGNiG SA commenced development of the Gas Release Programme which provides for a release of gas prices paid by institutional customers, followed by a release of gas prices for households (in 2-3 years time). Despite the protracted work on the project, a set of three energy acts, including the Gas Law, is to be enacted in 2013. As a result of the expected changes, the Company's share in the natural gas sales volume may fall to the benefit of both existing and new gas trading entities.

Storage

Pursuant to the Act on Mandatory Reserves, as of October 1st 2012, the volume of mandatory reserves must be increased from 20 to 30 days of average annual imports and must be kept in gas storage facilities whose technical parameters ensure delivery of the total reserves to the gas system within 40 days. Delivery of the total reserves to the gas system within the statutory time limit is possible only on condition that the buffering capacity of the storage facilities is increased at the cost of their working capacity. This will result in a reduction of the available trading capacity.
Additionally, due to the required volume of mandatory reserves and the technical parameters necessary to deliver the gas to the system, a significant portion of the reserves were placed at the Mogilno underground gas storage cavern, being Poland's only peak-demand storage facility. As a result, the mandatory reserves significantly limit the use of the Mogilno facility for balance purposes in periods of peak gas demand.

Section VII: Distribution

1. Operations of the Gas Distribution Companies

In H1 2013, the Gas Distribution Companies focused on transmitting high-methane and nitrogen-rich gas, as well as small amounts of propane-butane and coke-oven gas, over the distribution network.

The Gas Distribution Companies also continued work aimed at extending and modernising the gas network and connecting new customers to the existing network and to new sections of the network. The Gas Distribution Companies also replaced the most failure-prone sections of cast-iron piping and modernised the longest operating sections of the piping, whose continued operation posed a safety hazard and caused substantial gas losses.

Since January 2013, settlements with customers using the services of the Gas Distribution Companies have been based on Tariffs for Gas Fuel Distribution Services, approved by the President of the Energy Regulatory Office on December 17th 2011.

Furthermore, the new Distribution Grid Code for Distribution System Operators, approved by the President of the Energy Regulatory Office on December 5th and 6th 2012, became effective as of January 1st 2013. The new Distribution Grid Code incorporates the terms of the new Transmission Grid Code.

To carry out key projects related to extension and modernisation of the gas network, the Gas Distribution Companies concluded agreements for EU co-financing under the Infrastructure and Environment Operational Programme and Regional Operational Programmes. The key projects included:

- Continued construction of a high-pressure gas network connecting Szczytno, Młynowo and Muławki near Kętrzyn, and distribution network roll-out in the communes; in H1 2013, 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, as well as pressure reduction stations in Mikołajki and Muławki near Kętrzyn; construction work was continued on grid connections (Project VIII);
- Continued construction of the south-eastern gas supply line for the city of Gdańsk, and distribution network roll-out in Wiślinka and Wyspa Sobieszewska; in H1 2013, work continued on design documentation for the distribution network roll-out in the Wiślinka and Żuławy communes and in Wyspa Sobieszewska;
- Continued 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 H1 2013, work continued on the design and cost estimate documentation for the high-pressure gas pipeline from Brodnica to Nowe Miasto Lubawskie with a pressure reduction station in Kurzętnik, and for the high-pressure gas pipelines in Nowe Miasto Lubawskie and Iława, as well as for a medium-pressure gas pipeline from Nowe Miasto Lubawskie to Kurzętnik;
- Continued 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 41 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 H1 2013, the design work was continued;

- Continued distribution network roll-out in the Włodawa area. The project comprises construction of a 54.8 km high-pressure gas pipeline from Kamień to Włodawa, with an 18.6 km medium-pressure gas network and three pressure reduction stations; the project is scheduled for completion in 2015; in H1 2013, the construction of high- and medium-pressure gas pipelines with auxiliary infrastructure (stage I, II and III) was continued; also, the company continued the design work on stage IV of the project, including a distribution network in the region of Włodawa, Wola Uhruska, Hańsk and Ruda Huta;
- Continued design work for the planned roll-out of the gas distribution system in the Włoszczowa and Małogoszcz communes; the project comprises construction of a 43.3 km high-pressure gas pipeline with pressure reduction stations, and a 51 km medium-pressure gas pipeline with eight gas governor stations; the project is scheduled for completion in 2015; in H1 2013, procedures were conducted to select the contractor for the construction and assembly of stage II of the project;
- Continued design work for the planned roll-out of the gas distribution network to industrial and municipal customers and households in the Chęciny and Sitówka communes; the project comprises construction of a 4.5 km high-pressure gas pipeline with a pressure reduction station, and a 67.2 km medium-pressure gas pipeline network with connections and gas governor stations; the project is scheduled for completion in 2015; in H1 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;
- Continued work on the Natural Gas – Energy for Future Generations project, and 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 H1 2013, final acceptance documents were signed for the medium-pressure gas pipeline connecting Brodnica, Osiek and Rypin and the metering station in Brodnica; work also continued on design documents for the pipelines delivering gas to Osiek and Rypin;
- Continued work on the 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 2012, design documentation was drafted for the medium-pressure network and pressure reduction stations; in H1 2013, work continued on design of the high-pressure gas network; the design office will submit the design documents (including the building permit) for the entire project in September 2013.

In H1 2013, the Gas Distribution Companies also executed projects financed with their own resources. The key projects included:

- Lease of the gas network connecting KGZ Kościan to KGHM Polkowice/Żukowice (lease agreement between PGNiG S.A. and 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 H1 2013, the construction of the high-pressure station Szczecińska was completed and work on the Brzezińska and Olechów stations continued;
- Continued design work on the upgrade of a 37 km pressure gas pipeline from Parszów to Kielce. The project is scheduled for completion in 2015;
- Continued work on reconstruction of a 20.2 km high-pressure gas pipeline from Warzyce to Gorlice (stages IV and V) in the Skołyszyn and Jasło communes; in H1 2013, construction and

assembly work was completed on Section I in the Skołyszyn commune and Section II in the Jasło commune, and design work was performed on Section III covering the city of Jasło;

- 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 involves construction of a medium-pressure pipeline and a pressure reduction station;
- 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 63.7 km increased medium-pressure pipeline and a 7 km medium-pressure pipeline; in H1 2013, the design work on the stations and increased medium-pressure pipelines commenced.

The table below presents the volume of gas transmitted via the distribution network, the network's length, number of customers, number of new customers connected to the network and the number of employees as at June 30th 2013.

Key data on Gas Distribution Companies

	Entity	DSG	GSG	KSG	MSG	PSG	WSG
Volume of gas transmitted* via the distribution system	mcm	576.5	875.9	1 128.0	1 209.8	751.4	904.1
Length of network, excl. connections**	km	8,020.0	21,344.4	45 593.9	19 886.0	10,432.2	16,389.9
No. of customers	('000)	753.4	1,310.3	1,464.7	1,534.6	745.6	927.7
No. of new customers connected to the network	('000)	2.5	2.9	7.4	7.4	2.6	2.6
Employment	persons	1,270	2,566	3,173	2,737	1,618	1,786

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

On July 1st 2013, as a part of the Distribution segment consolidation process, PGNIG SPV 4 Sp. z o.o. acquired the complete assets of six gas distribution companies. The companies were then transformed into regional branches of PGNiG SPV 4 Sp. z o.o.

On July 1st 2013, the President of the Energy Regulatory Office issued a decision concerning the appointment of PGNIG SPV 4 Sp. z o.o. as the Distribution System Operator and the Natural Gas Liquefaction System Operator for the period until December 31st 2013. The President of the Energy Regulatory Office also granted PGNIG SPV 4 Sp. z o.o. a license for distribution of gas fuels and a license for liquefaction of natural gas and regasification of LNG in LNG regasification plants for the period from July 1st 2013 to December 31st 2030.

Also, on July 1st 2013, PGNIG SPV 4 Sp. z o.o. applied to the President of the Energy Regulatory Office for approval of the new Tariff for Gas Fuel Distribution Services and LNG Regasification Services. As at the date of this report, the proceedings were still pending.

2. Planned activities

As of H2 2013, PGNIG SPV 4 Sp. z o.o.will be responsible for distribution of natural gas as well as for operation, maintenance, construction and roll-out of the distribution network. The company will continue projects that until now have been implemented by the former Gas Distribution Companies, including:

- Construction of the high-pressure gas network connecting Szczytno, Młynowo and Mulawki near Kętrzyn, and distribution network roll-out in the communes;
- 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;
- Upgrade of the high-pressure gas pipelines from Sandomierz to Ostrowiec Świętokrzyski and from Parszów to Kielce;
- Upgrade of the Łódź Ring;
- Roll-out of the gas network in the Włodawa, Włoszczowa and Małogoszcz regions;
- Reconstruction of the high-pressure gas pipelines from Warzyce to Gorlice and from Tuszyma to Mielec;
- Roll-out of the gas network in Herby, Blachownia, Komprachcice and Dąbrowa.

In the coming years, PGNIG SPV 4 Sp. z o.o. will 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,
- Replacing socket joint piping and upgrading high-, medium- and low-pressure networks,
- Introducing 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

Direct competition

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.

Legislation

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 project. 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 of PGNIG SPV 4 Sp. z o.o.'s

The distribution network of PGNIG SVP 4 Sp. z o.o.'s Warsaw Branch is connected to the transmission system operated by OGP GAZ-SYSTEM S.A., which is its main source of gas supplies. The geographical distribution of gas supply sources and the topology of domestic transmission networks are unfavourable across a large portion of the branch's coverage area. A risk exists that there will be no reserve transmission capacity available at the points of entry to the branch's distribution system, which may adversely affect the development of the gas fuel market in most of its area 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, the PGNiG Group 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.

Section VIII: Generation

1. Segment's operations

PGNiG TERMIKA SA 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 implementation 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 75% of the heat demand on the Warsaw metropolitan market. PGNiG TERMIKA SA 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 June 30th 2013, PGNiG TERMIKA SA held an electricity trading licence valid until January 31st 2015, as well as the following licences valid until December 31st 2025:

- production of heat
- transmission and distribution of heat
- production of electricity.

Tariffs

In H1 2013, the tariff was approved on May 30th 2012 for heat produced by PGNiG TERMIKA SA'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 company was also required to apply tariffs for the transmission of heat through the heating network in the following areas:

- 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,

as well as for production of heat at the Regaty Heating Plant and its transmission via the heating network covering the Regaty residential estate – tariff approved on October 31st 2012.

On July 1st 2013, the tariff approved by the President of the Energy Regulatory Office on June 12th 2013 was introduced for the heat produced by PGNiG TERMIKA SA'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

Moreover, on July 1st 2013, new tariffs were introduced which changed the prices and rates for the transmission and distribution of heat in the areas of Marsa Park, Annopol and Chełmżyńska.

Production

PGNiG TERMIKA SA's key products are heat and electricity. In H1 2013, 94.1% of total electricity output was electricity cogenerated with heat. The table below presents PGNiG TERMIKA SA's production volumes.

Electricity and heat production volumes

Product	Unit	Volume
Electricity	GWh	2,511.5
Heat	TJ	24,471.1

It 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 ensure Warsaw's energy security. PGNiG TERMIKA SA is required to generate electricity whenever so instructed by the Transmission System Operator. In performance of the agreement, the company had generated 50.8 GWh of electricity by June 30th 2013.

Sales

The table below presents PGNiG TERMIKA SA's sales of heat and electricity by volume.

Product sales volumes

Product	Unit	Volume
Electricity	GWh	2,138.7
Heat	TJ	24,277.0

PGNiG TERMIKA SA sold heat mainly to Dalkia Warszawa SA (former Stołeczne Przedsiębiorstwo Energetyki Cieplnej SA), which purchased 97% of the heat generated by the company. In 2013, Dalkia Warszawa SA contracted 3.6 GW of PGNiG TERMIKA's heat generation capacity. The balance of heat produced was sold to local customers, mainly in Pruszków and the surrounding areas.

In H1 2013, PGNiG TERMIKA SA sold electricity chiefly to PGNiG Energia SA 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 H1 2013, property rights attached to certificates of origin for electricity produced by cogeneration (red certificates) and generated from renewable sources (green certificates) were sold on spot markets or under forward contracts. Sales of certificates of origin for electricity were executed chiefly through ESV SA, ENEA Obrót SA, TAURON Polska Energia SA and PGNiG Energia SA, as well as on the Polish Power Exchange.

Construction of a CCGT Unit in Stalowa Wola

In H1 2013, as part of the Construction of a CCGT Unit in Stalowa Wola (a joint project between Tauron Polska Energia S.A. and Elektrownia Stalowa Wola S.A.), agreements concerning the closure of construction financing for the CCGT unit were executed and the construction work was begun. Construction work carried out on the project included construction of foundations under the unit's main installations, as well as work on a weir on the San river.

2. Planned activities

In H2 2013, PGNiG TERMIKA SA will seek to roll out the heating distribution system both in cooperation with Dalkia Warszawa SA and on its own, by entering into heat sale agreements directly with end customers on a third-party-access (TPA) basis.

The key customers for the electricity produced by PGNiG TERMIKA SA's plants in H2 2013 will be PGNiG SA and Alpiq Energy SE.

In H2 2013, management of the electricity portfolio and commercial balancing for PGNiG TERMIKA SA will be performed through PGNiG Energia SA, which concludes dated power purchase contracts on the Commodity Derivatives Market, for delivery from 2013. PGNiG TERMIKA SA will also continue to sell electricity on the Commodity Derivatives Market through the agency of Alpiq Energy SE.

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 (with 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 SA 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, which would be transparent and stable over the long term, to support investments in renewable energy sources and co-generation. These factors fundamentally affect the decisions concerning the development plans of PGNiG TERMIKA SA and create a significant risk of deterioration of its 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 a share of 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 SA's share in total heat supplies to the municipal network covering the Warsaw area will fall from the current 98%, to 95% in 2019.

Joint marketing efforts conducted 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 SA's generating plants. With a view to maintaining its share in the municipal heat market, the company also offers "green" heat generated in 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

1. Segment's operations

In H1 2013, the segment's companies conducted work involving construction and assembly of gas transmission pipelines, construction and extension of underground gas storage facilities, and 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 H1 2013 included construction and assembly of high-pressure gas pipelines, construction and extension of natural gas storage facilities, development of natural gas and crude oil deposits, 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 a 175.2 km DN 700 high-pressure gas pipeline from Rembelszczyzna to Gustorzyn, for OGP GAZ-SYSTEM SA;
- Production of parts for drilling rigs and drillship equipment, for Aker Solutions (Norway);
- 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).

The key projects executed for related PGNiG Group companies involved contracts performed for PGNiG SA, including:

- Construction of the Kosakowo Underground Gas Storage Facility;
- Extension of the Mogilno Underground Gas Storage Cavern Facility;
- Construction of 53 km of DN 300 high-pressure pipeline between the Wierzbno terminal and the Paproć gas production facility;
- Production of drilling equipment (wellheads and casing heads).

In addition, the segment provided the related PGNiG Group companies with operator and repair services for the operation of the Mogilno Underground Gas Storage Cavern Facility, and also prepared design documentation for gas transmission systems. For third-party customers, the segment performed design contracts for gas transmission systems, conducted production and repair of coal mining equipment, and provided hotel, restaurant and spa centre services.

2. Planned activities

In H2 2013, the segment will continue construction and assembly work on such projects as the construction of high-pressure gas pipelines from Rembelszczyzna to Gustorzyn, from the Wierzbno terminal to the Paproć gas production facility and from Trojane to Vodice (Slovenia); the upgrade of the Hermanowice distribution and metering node; the construction of a gas compressor station at the Hurko gas production facility, and execution of 4 nodes and 10 blocking and bleeding systems for the construction of the DN 700 high-pressure gas pipeline from Gustorzyn to Odolanów. Work will also commence on the performance of new construction and assembly contracts, the most important of which include contracts for the upgrade of the Żuchlów gas compressor station, the development of the Żuchlów gas field, and the construction of the Rybno-Młynowo high-pressure gas pipeline. The segment's companies intend to maintain their market positions in the area of manufacturing of drilling equipment, including surface equipment for conventional and unconventional deposits, drilling platforms, and equipment for oil and gas production facilities; and also in gas system design, construction and assembly services for oil and gas facilities.

3. Risks related to Other Activities

Legislation

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 the 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.

Competition

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, growing competition results in, among other consequences, continually low prices for the services offered by the segment companies. As far as designing of gas transmission installations is concerned, acquisition of medium-sized design offices by large contractors and setting up of new design offices within gas industry operators are unfavourable phenomena which adversely affect the segment companies' capacity to form consortia with project execution companies and secure new orders. Another major threat 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 SA's insolvency and delays in payments from several other trading partners had a negative effect on the profitability of the segment's 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 H1 2013, capital expenditure incurred by the PGNiG Group on property, plant and equipment and intangible assets was PLN 1,315.8m. The table below presents expenditure in the individual segments.

Capital expenditure (PLNm)

	H1 2013
Exploration and Production	715.4
Trade and Storage	117.1
Distribution	432.4
Generation	41.5
Other Activities	9.4
Total	1,315.8

The following are the key investment projects implemented by the PGNiG Group in H1 2013.

Exploration by PGNiG SA

Capital expenditure incurred by PGNiG SA on exploration work of PLN 239m was incurred chiefly on geophysical surveys, three wells drilled with positive results and wells on which work is still under way.

Project on the Norwegian Continental Shelf

The project involves exploration for and production of crude oil and natural gas on the Norwegian Continental Shelf. In H1 2013, work continued on the completion of the last stage of the development of the Skarv field. The work mainly included the continuation of the drilling programme and technical acceptance of the floating production, storage and offloading (FPSO) vessel.
Expenditure incurred in H1 2013 was PLN 147m.

Lubiatów – Międzychód – Grotów project

The objective of the project is to develop the Lubiatów-Międzychód-Grotów ("LMG") oil and gas field and to facilitate the transport, storage and sale of crude oil, natural gas, liquid sulphur 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 H1 2013, the LMG Central Facility was put into service. Total expenditure incurred on the construction of the Facility amounted to approximately PLN 1,460.1m. The construction of a high-pressure gas pipeline from the Wierzbno terminal to the Paproć gas production facility was also completed in June 2013. Expenditure on the entire project incurred in H1 2013 amounted to PLN 176.1m.

Other investment projects in the Production segment

Other investment projects involved the development of gas reserves (including already producing fields), projects executed in order 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;
- Completion of the development of the Rylowa-Rajsko gas field;
- Development of the Lisewo gas field;
- Drilling work and development of a well in the Radlin field;
- Development of wells in the Wola Różaniecka field.
- Drilling of the Księżpol-19 well.

Trade and Storage

In H1 2013, the capital expenditure of the Trade and Storage segment amounted to PLN 117.1m, of which PLN 81.2m was spent on the 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 start-up work on the gas injection and withdrawal unit;
- Continued construction of the surface section of the Kosakowo Underground Gas Storage Facility and continued leaching work in the caverns;
- Continued leaching work in the caverns of the Mogilno Underground Gas Storage Cavern Facility;
- Commencement of work on the extension of the Husów Underground Gas Storage Facility up to 500 mcm of storage capacity.

Distribution

Capital expenditure incurred by the PGNiG Group in the Distribution segment amounted to PLN 432.4m. Most of the projects carried out by the Gas Distribution Companies involved connecting new customers to the distribution networks and upgrading and extending the gas network. For a discussion of key projects in the Distribution segment, see Section VII Distribution.

Generation

The capital expenditure of the Generation segment amounted to PLN 41.5m, of which ca. PLN 12.4m was spent on environmental projects. Major projects carried out in H1 2013 included:

- Construction of an SCR system for four unit boilers at the Siekierki CHP Plant; in H1 2013, the installation for one boiler (No. 15) came on line, and the last stage of the system's construction for boiler No. 14 was carried out; the project received EU co-financing;
- Upgrade of the rotary air pre-heaters together with boiler blowers for boilers Nos. 10, 11, 14 and 15 at the Siekierki CHP Plant; in H1 2013, work commenced on boilers Nos. 14 and 15;
- Myśliborska project – construction of a process wastewater treatment plant at the Żerań CHP Plant; the plant was put into service in December 2012; in order to improve the operation of the wastewater treatment plant at the Żerań CHP plant, in H1 2013 work on expansion of 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;

- Construction of a CCGT unit with an electrical capacity of approximately 450MW at the Żerań CHP Plant; in H1 2013, work continued on the drafting of tender documentation for construction of the unit and agreements were signed to connect the unit to the transmission network of OGP GAZ-SYSTEM SA and to prepare a design (including obtaining a building permit) for the cooling-water discharge pipeline for the Żerań CCGT unit;
- Reconstruction of the K1 boiler at the Siekierki CHP with a fuel change to biomass; in H1 2013, the tender procedure to select the contractor was completed.

Other Activities

In H1 2013, the Other Activities segment incurred capital expenditure on property, plant and equipment and intangible assets of PLN 9.4m. 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 SA 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 inside, posing a fire hazard. In H1 2013, a total of 17 wells and 13 extraction pits were abandoned.

Carbon credit trading system

In H1 2013, the PGNiG Group reviewed annual reports on carbon dioxide emissions for 2012. After reconciling its CO_2 emissions with emission rights held, and after cancelling used allocations for 2012, the remaining amount was 151,533 Mg CO_2 of free emission units. In 2012, the installations participating in the scheme belonged to PGNiG TERMIKA SA (the Siekierki, Żerań and Pruszków CHP Plants, the Kawęczyn and Wola Heating Plants) and PGNiG SA (the Odolanów and Zielona Góra Branches and the Mogilno Underground Gas Storage Cavern Facility). Emissions from those installations were 6,024,504 Mg CO_2. In H1 2013, emissions from the installations were 3,581,836 Mg CO_2.

Land reclamation and non-productive asset surveying

Pursuant to the Environmental Protection Law, PGNiG SA 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 conditions required under environmental quality standards. In H1 2013, land reclamation work was completed on the property in Kargowa, and the second stage of land reclamation work was launched on the property in Radków. 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. The Company also monitored the environmental impact of the reclaimed landfill site in Zabrze-Biskupice, and a property in Zabrze.

REACH and CLP

In H1 2013, PGNiG SA performed tasks related to supervision of compliance by subcontractors using chemical substances in operations in wells with the regulations of the European Parliament and the Council of the European Union on safe use of chemicals (*REACH*) and on the classification, labelling and packaging of substances and mixtures (*CLP*). A research institute was also contracted to review the correctness of the information contained in the provided data sheets for the chemical substances and mixtures used, as well as of their classification and labelling. All those measures are carried out to confirm the characteristics of the substances used and identify any potential hazards to the natural environment and human safety.

Environmental Management System

In H1 2013, PGNiG SA completed the first stage of the implementation of the Environmental Management System in its trading branches. As part of the work, an environmental review was performed.

Reclamation of the fuel ash landfill site

PGNiG TERMIKA SA carries out the reclamation of the Myśliborska fuel ash landfill site for EC Żerań. The reclamation design provides for reclaiming the land as green areas (Cells No. 1 and 2) and for residential and commercial development (Cell No. 3). In H1 2013, reclamation work was carried out primarily on Cell No. 3. The reclamation work involved moving ash and slag from Cell No. 3 to Cell No. 2, depositing mineral soil and demolishing an embankment and clear cutting 30 trees in Cell No. 3. Further, disassembly of technical infrastructure across the entire area of the landfill was also carried out. All of the reclamation work is scheduled to be completed in 2016.

Fulfilment of the requirements of the Industrial Emissions Directive

In H1 2013, in an effort to meet the environmental standards provided for in Directive 2010/75/EU of the European Parliament and the Council on industrial emissions (IED), PGNiG TERMIKA SA continued implementation of the project for construction of NOx selective catalytic reduction (SCR) units on four unit boilers at the Siekierki CHP Plant. In January 2013, an SCR unit for the third of the four boilers was put into service. The last (fourth) boiler will be fitted with an SCR unit at the end of 2013. The project having been 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 the 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 SA.

Noise reduction project at the Siekierki CHP Plant

In H1 2013, work started on the construction of a noise barrier wall along the eastern boundary of the CHP plant. The purpose of the project is to reduce the risk of exceeding the permitted levels of noise during the execution of future projects on the premises of the Siekierki CHP Plant. The project is scheduled to be completed in H1 2014.

Biomass supplies

In an effort 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 SA procures fuel under long-term contracts for the supply of biomass from energy willow plantations. Currently, the company procures biomass from plantations with a total acreage of ca. 386 ha. The use of biomass to generate energy enabled CO_2 emissions to be reduced by 33,348 Mg in H1 2013.

Section XII: Other Information

Distribution of the 2012 profit

On May 22nd 2013, the Annual General Meeting of PGNiG SA adopted a resolution on the distribution of the 2012 PLN 1,918.5m net profit. 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 SA 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 SA approved the financial statements and the Directors’ Report on the operations of PGNiG SA, 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 SA in respect of their performance of duties in the financial year 2012.

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

Proceedings concerning PGNiG SA’s action against PI GAZOTECH Sp. z o.o. to rescind or declare the invalidity of resolutions by the General Meeting of PI GAZOTECH Sp. z o.o., dated April 23rd 2004, including the resolution obliging PGNiG SA to pay additional contributions 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 SA’s claims and declared the resolution concerning share redemption and the resolution concerning the additional 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. By virtue of its decision of December 14th 2011, the Court of Appeals dismissed PI GAZOTECH Sp. z o.o.’s appeal. The decision was final. On April 24th 2012, PI GAZOTECH Sp. z o.o. lodged a cassation compliant. By virtue of its decision of March 13th 2013, the Supreme Court refused to accept the cassation compliant for consideration. Thus the proceedings in this case were concluded.

Proceedings based on PGNiG SA’s action against PI GAZOTECH Sp. z o.o. to rescind or declare the invalidity of the resolution of the General Meeting of PI GAZOTECH Sp. z o.o., dated January 19th 2005, whereunder PGNiG SA was obliged to pay additional contributions 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 decision is final. On October 30th 2012, PI GAZOTECH Sp. z o.o. lodged a cassation complaint against that decision. As at the date of this report, the Supreme Court’s decision to hear or refuse to hear the cassation complaint was pending.

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 SA of its dominant position on the domestic natural gas wholesale market, which consisted in inhibiting sale of gas against the interest of other business players or consumers and in frustrating 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 SA 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 SA 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 these financial statements, the Competition and Consumer Protection Court had not notified PGNiG SA of a hearing date.

On February 9th 2012, the President of the UOKiK instigated anti-trust proceedings concerning alleged employment by PGNiG SA of practices infringing collective consumer interests. The President of the UOKiK accused PGNiG SA of using, in comprehensive gas fuel supply contracts, a provision classified as an abusive clause. In the course of the proceedings, PGNiG SA 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 the Company and obliged the Company to introduce a new form of comprehensive agreement containing revised general provisions. PGNiG SA is in the process of fulfilling this obligation.

On February 22nd 2013, the President of the UOKiK instigated anti-trust proceedings concerning alleged employment by PGNiG SA of practices infringing collective consumer interests. The President of the UOKiK accused PGNiG SA of using provisions classified as abusive clauses in contract forms based on which comprehensive gas fuel supply contracts are concluded. PGNiG SA initiated an investigation and submitted a motion to the President of the UOKiK for a commitment decision. On June 28th 2013, the President of the UOKiK issued a commitment decision that concluded the administrative proceedings against PGNiG SA. The President of the UOKiK did not impose a fine on the Company in this case. 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 abuse by PGNiG SA of its dominant position on the domestic wholesale and retail natural gas market, consisting in impeding the development of market conditions necessary for the emergence or development of competition through:

- 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.

PGNiG SA initiated an investigation and submitted a motion to the President of the UOKiK for a commitment decision.

In the case referred to above, the President of the UOKiK may impose on PGNiG SA a fine of up to 10% of the revenue generated by the Company in the financial year preceding the date of the decision imposing the fine.

Section XIII: Financial Performance

The interim consolidated financial statements of the PGNiG Group for the six months ended June 30th 2013 have been prepared in accordance with the International Financial Reporting Standards (IFRS) as endorsed by the European Union ("EU") as at June 30th 2013.

The accounting policies applied in preparing the interim consolidated financial statements are presented in the interim consolidated financial statements of the PGNiG Group for the six months ended June 30th 2013.

1. Financial performance

In H1 2013, the PGNiG Group reported a net profit of PLN 1,428m, an improvement of PLN 1,383m year on year.

Summary information on PGNiG SA's financial performance in H1 2013 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	Jun 30 2013	Dec 31 2012
Non-current assets	37,138	37,095
Property, plant and equipment	33,773	33,784
Investment property	11	11
Intangible assets	1,169	1,146
Investments in equity-accounted associates	729	771
Financial assets available for sale	53	48
Other financial assets	188	124
Deferred tax assets	1,142	1,135
Other non-current assets	73	76
Current assets	9,793	10,833
Inventories	2,958	3,064
Trade and other receivables	3,174	5,374
Current tax assets	124	150
Other assets	371	84
Financial assets available for sale	-	-
Derivative financial instrument assets	341	105
Cash and cash equivalents	2,659	1,948
Assets held for sale	166	108
Total assets	46,931	47,928

Consolidated statement of financial position (PLNm) – contd.

LIABILITIES AND EQUITY	Jun 30 2013	Dec 31 2012
Equity	27,985	27,196
Share capital	5,900	5,900
Share premium	1,740	1,740
Accumulated other comprehensive income	(22)	(150)
Retained earnings	20,360	19,702
Equity attributable to owners of the parent	27,978	27,192
Equity attributable to non-controlling interests	7	4
Non-current liabilities	11,380	11,119
Borrowings and other debt instruments	5,734	5,509
Employee benefit obligations	390	381
Provisions	1,708	1,792
Deferred income	1,455	1,448
Deferred tax liabilities	2,038	1,936
Other non-current liabilities	55	53
Current liabilities	7 566	9,613
Trade and other payables	3 822	3,667
Borrowings and other debt instruments	2 474	4,702
Derivative financial instrument liabilities	237	393
Current tax liabilities	169	24
Employee benefit obligations	288	356
Provisions	423	350
Deferred income	129	101
Liabilities related to assets available for sale	24	20
Total liabilities	18,946	20,732
Total equity and liabilities	46,931	47,928

Consolidated income statement (PLNm)

	H1 2013	H1 2012
Revenue	16,790	14,764
Total operating expenses	(14,616)	(14,742)
Raw materials and consumables used	(10,476)	(10,633)
Employee benefit expense	(1,418)	(1,357)
Depreciation and amortisation expenses	(1,162)	(1,004)
Services	(1,513)	(1,487)
Work performed by the entity and capitalised	424	433
Other income and expenses	(471)	(694)
Operating profit	2,174	22
Finance income	150	69
Finance costs	(383)	(196)
Share in net profit/loss of equity-accounted entities	(42)	87
Profit/loss before tax	1,899	(18)
Income tax	(471)	63
Net profit	1,428	45
Attributable to:		
Owners of the Parent	1,425	48
Non-controlling interests	3	(3)
	1,428	45

Consolidated statement of cash flows (PLNm)

	H1 2013	H1 2012
Net cash flows from operating activities	4,554	1,251
Net cash flows from investing activities	(1,559)	(4,360)
Net cash flows from financing activities	(2,283)	2,974
Net change in cash	712	(135)
Cash and cash equivalents at beginning of the period	1,947	1,504
Cash and cash equivalents at end of the period	2,659	1,369

Financial ratios

Profitability

	H1 2013	2012
EBIT (PLNm)operating profit	2,174	22
EBITDA (PLNm) operating profit + depreciation/amortisation	3,336	1,026
ROE net profit* to equity at end of the period	5.1%	0.2%
NET MARGIN net profit* to sales revenue	8.5%	0.3%
ROA net profit* to assets at end of the period	3.0%	0.1%

* net profit attributable to owners of the Parent

Liquidity

	Jun 30 2013	Dec 31 2012
CURRENT RATIO current assets (net of other assets) to current liabilities	1.2	1.1
QUICK RATIO current assets (net of other assets) less inventories to current liabilities	0.9	0.8

Debt

	Jun 30 2013	Dec 31 2012
DEBT RATIO total liabilities to total equity and liabilities	40.4%	43.3%
DEBT/EQUITY RATIO total liabilities to equity*	67.7%	76.2%

*Equity attributable to owners of the Parent.

Year on year, the Group's EBIT improved by PLN 2,152m. The strengthening of the Group's financial position was attributable chiefly to higher profitability of high-methane gas sales and higher production and sales volume of crude oil.

Exploration and Production

Operating profit of the Exploration and Production segment was PLN 1,375m, up PLN 533m on H1 2012. This significant improvement was possible thanks to the launch of production from the Lubiatów, Międzychów and Grotów (LMG) oil and gas fields in Poland at the end of 2012 and the beginning of 2013, and from the Skarv field on the Norwegian Continental Shelf. In effect, the volume of crude sold grew by more than 100% relative to H1 2012. Coupled with a 2.3% decline of the average Brent price in the period, the growth resulted in 78% higher revenue from crude sales. The growth of the segment's business involved only a 15% increase in operating expenses - mainly on higher amortisation and depreciation charges.

Trade and Storage

The Trade and Storage segment saw a significant improvement in its efficiency. In H1 2013, the operating profit was PLN 28m, up PLN 1,463m on H1 2012. This improvement came as a result of a rise in profitability of high-methane gas sales, caused mainly by a reduction in the unit purchase price of imported gas. The November 2012 annex to the contract with OOO Gazprom Export of September 25th 1996 for sales of natural gas to the Republic of Poland changed the pricing terms for supplies of natural gas, including with respect to the gas volumes purchased since the beginning of 2012. The financial effect of the agreement was recognised as a one-off item in PGNiG SA's accounting books in November 2012.

The amendment to Gas Fuel Supply Tariff No. 5/2012 has been in effect since January 1st 2013. The new tariff brought about a 6.7% decrease in the average prices and charge rates for the supply of high-methane gas to customers. Although the unit price of imported natural gas was lowered, the new tariff is still insufficient to fully cover the cost of gas purchase.

The margin on high-methane gas sales also improved thanks to the weakening of the US dollar, which is the currency used in gas import transactions. The USD/PLN exchange rate fell by 2.9% relative to H1 2012.

Distribution

The Distribution segment's operating profit was PLN 636m, up PLN 67m on H1 2012. The improved performance came as a result of an increase in the volume of transmitted gas, especially to Grupa Lotos S.A. The increase was attributable to the acquisition of new customers and stronger gas fuel demand from households in the heating season.

Generation

The operating profit of the Generation segment was PLN 143m, up PLN 90m (170%) on H1 2012. The improved performance was attributable to a decrease in the segment's operating expenses, including lower cost of fuels for heat and power generation (on the back of lower biomass consumption) and lower amortisation of carbon emission allowances identified upon the acquisition of PGNiG TERMIKA S.A.

Segments' operating results

Financial data of the PGNiG Group's segments for H1 2013 (PLNm)

H1 2013	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to third-party customers	2,022	13,646	85	898	139	-	16,790
Inter-segment sales	740	180	2,221	230	92	(3,463)	-
Total segment revenue	2,762	13,826	2,306	1,128	231,0	(3,463)	16,790
Segment's expenses	(1,387)	(13,798)	(1,670)	(985)	(235)	3,459	(14,616)
Operating profit/loss	1,375	28	636	143	(4)	(4)	2,174
Net finance costs	-	-	-	-	-	-	(233)
Share in net profit/loss of equity-accounted entities	-	(42)	-	-	-	-	(42)
Profit before tax							1,899
Income tax	-	-	-	-	-	-	(471)
Net profit							1,428

Financial data of the PGNiG Group's segments for H1 2012 (PLNm)

H1 2012	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to third-party customers	1,476	12,032	64	1 114	78	-	14,764
Inter-segment sales	571	267	1,865	-	152	(2,855)	-
Total segment revenue	2 047	12 299	1 929	1 114	230	(2 855)	14,764
Segment's expenses	(1,205)	(13,734)	(1,360)	(1,061)	(260)	2,878	(14,742)
Operating profit/loss	842	(1,435)	569	53	(30)	23	22
Net finance costs	-	-	-	-	-	-	(127)
Share in net profit/loss of equity-accounted entities	-	87	-	-	-	-	87
Loss before tax							(18)
Income tax	-	-	-	-	-	-	63
Net profit							45

The result on financing activities was down by PLN 235m on H1 2012. It was attributable to an increase in foreign exchange losses from valuation of Euronotes and a credit facility contracted by PGNiG Upstream International AS (former PGNiG Norway AS), as well as lower share in the net profit/loss of equity-accounted entities on the back of the remeasurement of shares in SGT EUROPOL GAZ S.A.

The improvement in the Group's financial position is illustrated by an increase in some financial ratios. Return on equity (ROE) improved from 0.2% in H1 2012 to 5.1%. Return on assets (ROA) was 3%, against 0.1% in H1 2012, and net margin grew from 0.3% to 8.5%.

As at June 30th 2013, total assets recognised in the consolidated statement of financial position were PLN 46,931m, down PLN 997m on the end of 2012.

Assets

Property, plant and equipment, of PLN 33,773m as at the end of June 2013, which remained relatively unchanged relative to December 31st 2013, was the largest item of the Group's assets.

As at June 30th 2013, current assets were PLN 9,793m, down PLN 1,040m (or 10%) relative to December 31st 2012.

The Group's inventories decreased slightly (down by PLN 106m) relative to December 31st 2012, following a decrease in volume of coal stocks.

Trade and other receivables fell by PLN 2,200m (41%) relative to the end of 2012. The change was attributable chiefly to a seasonal decrease in receivables from gas sales and to a settlement of OOO Gazprom Export's liabilities towards PGNiG SA under the annex of November 2012 to the Contract with OOO Gazprom Export for sales of natural gas to the Republic of Poland of September 25th 1996.

Cash and cash equivalents stood at PLN 2,659m, up PLN 711m relative to the end of 2012. The increase comes from the fact that cash flows from operating activities (improved margin on high-methane gas sales and revenue under the 2012 annex to the Yamal Contract with OOO Gazprom Export) exceeded financing and capital expenditure, including acquisition of debt securities and outlays on gas and oil exploration.

The value and structure of current assets held by the Group guaranteed its ability to settle liabilities in a timely manner. Current ratio was 1.2 compared with 1.1 as at the end of December 2012, while 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 789m. The change was chiefly an outcome of a PLN 1,428m net profit reported for the period.

As at June 30th 2013, non-current liabilities were PLN 11,380m, up PLN 261m on the end of December 2012. The figure was driven primary by an increase in the non-current portion of liabilities under borrowings and debt securities, paired with a substantial decline in short-term debt. Furthermore, provisions for well decommissioning costs decreased relative to December 31st 2013, chiefly on the back of a substantial increase of the discount rate and lower average decommissioning cost.

Current liabilities were down PLN 2,047m (21%) on the end of 2012, mostly as a result of a PLN 2,228m decline in the value of borrowings and debt instruments, caused chiefly by the redemption of notes issued by PGNiG SA. The item was also affected by recognition of PLN 767m under dividends payable and a PLN 145m increase in current tax payable, as well as a PLN 818m decrease in VAT payable, which resulted from lower trade receivables. In addition, in 2013 the PGNiG Group recognised a provision for the buy-out price for efficiency certificates, which stood at PLN 76m as at June 30th 2013.

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% as at the end of 2012 to 67.7% as at June 30th 2013. Debt ratio (total liabilities to total equity and liabilities) fell from 43.3% to 40.4%.

Transactions concluded on non-arm's length terms

In H1 2013, PGNiG SA and its subsidiaries did not enter into any material related-party transactions on non-arm's length terms.

Guarantees and sureties

In H1 2013, PGNiG SA and its subsidiaries did not grant any borrowing sureties or guarantees to any entity where the total value of such sureties or guarantees would represent 10% or more of PGNiG SA's equity.

The Company's ability to meet published financial forecasts

In H1 2013, the PGNiG Group did not publish any financial forecasts.

2. Projected future financial performance

Key factors with a bearing on the PGNiG Group's financial performance will include crude oil and natural gas prices on the international markets, 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 natural gas are an essential factor determining the PGNiG Group's financial position. The average price of Brent crude fell 2.3% on H1 2012. If the current trend prevails over the following months, it will have a positive effect on the Company's regulated activities.

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.

The PGNiG Group's financial performance depends to a significant extent on conditions prevailing on the currency markets. In H1 2013, the US dollar depreciated against the złoty. Further weakening of the dollar will lower the PLN-denominated purchase costs of imported high-methane gas, translating into stronger financial performance by the Company.

The Group's financial results also depend on gas fuel and heat tariffs. As of January 1st 2013, a new, lower tariff was introduced for high-methane gas, which is insufficient to fully cover the cost of its acquisition. As the tariff expires on September 30th 2013, in July 2013 PGNiG SA applied to the President of the Energy Regulatory Office for approval of the new gas fuel supply Tariff. In addition, on July 1st 2013 a higher tariff was introduced for heat generated by PGNiG TERMIKA SA, which should improve the financial performance of the Generation segment.

Since January 1st 2013, PGNiG SA, 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 drives up the cost of regulated activities and is not reflected in the existing tariff.

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 SA started to trade in natural gas on the Polish Power Exchange (TGE), which by virtue of a decision by the President of the Energy Regulatory Office, is exempt from the tariff obligation. In February 2013, the President of the Energy Regulatory Office announced the exemption of power utilities from the obligation to submit wholesale gas trading tariffs for approval. The draft act amending the Energy Law and certain other acts (the so-called Small Energy Three-Pack) provides for an obligation to sell 30% of gas fed into the transmission network in Poland on the energy exchange (in 2013; 40% in 2014). Because of the uncertainty concerning the date of introduction of the act and its final scope, it is difficult to produce forecasts, even for the next six months.

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. In H1 2013, the PGNiG Group intensified exploration for both conventional and unconventional hydrocarbon deposits, but the first economic effects of this effort will only be visible after several years.

In H2 2013, the PGNiG Group intends to maintain a high level of capital expenditure. Spending will focus on projects involving maintenance of hydrocarbon production capacities, diversification of gas supply sources, and projects related to the exploration for and appraisal of crude oil and natural gas deposits and development of the Company’s power generation segment.

Members of the Management Board

Vice-President of the Management Board	Jerzy Kurella	....
Vice-President of the Management Board	Jacek Murawski	....
Vice-President of the Management Board	Mirosław Szkałuba	....