Polskie Górnictwo Naftowe i Gazownictwo SA

DIRECTORS' REPORT ON THE OPERATIONS OF PGNiG SA IN 2012

Warsaw, March 5th 2013

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Section I: General Information

1. Incorporation of the Company

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG SA), registered office in Warsaw, ul. Marcina Kasprzaka 25, was established as a result of transformation of state-owned enterprise Polskie Górnictwo Naftowe i Gazownictwo into a state-owned stock company. The Deed of Transformation and the Company’s Articles of Association were executed in the form of a notarial deed dated October 21st 1996 (Rep. A No. 18871/96).

The Minister of State Treasury executed the Deed of Transformation in performance of the provisions of the Regulation of the President of the Polish Council of Ministers of September 30th 1996 on transformation of the state-owned enterprise Polskie Górnictwo Naftowe i Gazownictwo of Warsaw into a state-owned stock company.

On October 30th 1996, the Company was entered in the commercial register as Polskie Górnictwo Naftowe i Gazownictwo S.A. of Warsaw, under entry No. RHB 48382. The Company became a legal person as of the date of its registration. On November 14th 2001, the Company was entered into the Register of Entrepreneurs of the National Court Register under entry No. 0000059492.

In performance of the obligations provided for in the "PGNiG SA Restructuring and Privatisation Programme" adopted by the Polish Council of Ministers on October 5th 2004, on May 24th 2005 PGNiG shares were admitted to public trading pursuant to a decision of the Polish Securities and Exchange Commission.

By virtue of a decision of the District Court for the Capital City of Warsaw, dated October 6th 2005, an increase in PGNiG SA's share capital was registered. Following the increase the share capital now amounts to PLN 5.9bn and is divided into 5,900,000,000 shares, including:

- 4,250,000,000 Series A bearers shares with a total par value of PLN 4,250m
- 750,000,000 Series A1 bearer shares with the total par value of PLN750m
- 900,000,000 Series B bearer shares with the total par value of PLN 900m.

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.

2. Business profile

PGNiG SA is the largest Polish company in the hydrocarbon exploration and production industry, and on the natural gas market. PGNiG SA is the leader in all areas of the Polish gas sector, including natural gas import, exploration, oil and gas production, gas fuel storage and sale of natural gas.

Pursuant to its Articles of Association, the Company performs activities aimed at ensuring energy security of Poland. These relate in particular to the following:

- ensuring continuity of gas supplies to consumers and maintaining the necessary stocks of gas,
- ensuring safe operation of gas networks,
- balancing the gas system, managing operations and capacity of the power equipment connected to the common gas network,
- natural gas production.

3. PGNiG SA's organisational structure

On June 5th 2012, the Storage System Operator Branch was wound up due to the launch of operations by Operator Systemu Magazynowania Sp. z o.o., the storage system operating company, as of June 1st 2012.

On September 1st 2012, a new Geology and Hydrocarbon Production Branch was established in Warsaw. The Branch coordinates and oversees technical aspects of hydrocarbon exploration and production in Poland and abroad, that is planning oil and gas exploration work, carrying out geological work connected with exploration for and development of hydrocarbon deposits, hydrocarbon production, and environmental protection. It incorporates Head Office departments involved in supervision over the exploration and production process and units responsible for geology, environmental protection and drilling transferred from the Sanok and Zielona Góra branches. The main function of the Sanok and Zielona Góra branches will continue to be oil and gas production, and operation of hydrocarbon production facilities.

PGNiG SA operates a multiple-unit structure. As at December 31st 2012, the structure comprised the Head Office and 15 branches. Their activities are presented in the table below.

Core activities of PGNiG SA's organisational units

Unit	Activity
Head Office, Warsaw	Corporate supervision over the Company branches Supervision over the PGNiG Group as part of ownership supervision
Geology and Hydrocarbon Production Branch in Warsaw	Management and coordination of exploration for and production of natural gas and crude oil
Sanok Branch	Production of natural gas and crude oil Direct sale of off-system natural gas and other products and services
Zielona Góra Branch	Production of natural gas and crude oil Direct sale of off-system natural gas and other products and services
Odolanów Branch	Processing of nitrogen-rich natural gas into high-methane gas
Operator Branch in Pakistan	Exploration for and production of hydrocarbons in licence areas in Pakistan
Egypt Branch	Exploration for and production of hydrocarbons in licence areas in Egypt
Denmark Branch	Exploration for and production of hydrocarbons in licence areas in Denmark
Well Mining Rescue Station in Kraków	Provision of rescue services to the petroleum mining industry

Core activities of PGNiG SA’s organisational units - continued

Unit	Activity
Lower Silesian Gas Trading Division in Wrocław	Comprehensive customer service related to sale of natural gas and other products and services
Upper Silesian Gas Trading Division in Zabrze	
Carpathian Gas Trading Division in Tarnów	
Mazovian Gas Trading Division in Warsaw	
Pomeranian Gas Trading Division in Gdańsk	
Greater Poland Gas Trading Division in Poznań	
Central Measurement and Testing Laboratory in Warsaw	Provision of services ensuring accuracy and reliability of measurements related to natural gas

As at December 31sr 2012, PGNiG SA operated foreign representative offices in Moscow (Russia), Brussels (Belgium), Kiev (Ukraine) and Vysokoye (Belarus).

On January 15th 2013, the names of six PGNiG gas trading divisions were changed to: Lower Silesian Trading Division in Wrocław (Dolnośląski Oddział Handlowy we Wrocławiu), Upper Silesian Trading Division in Zabrze (Górnośląski Oddział Handlowy w Zabrzu), Carpathian Trading Division in Tarnów (Karpacki Oddział Handlowy w Tarnowie), Mazovian Trading Division in Warsaw (Mazowiecki Oddział Handlowy w Warszawie), Pomeranian Gas Trading Division in Gdańsk (Pomorski Oddział Handlowy w Gdańsku), and Greater Poland Trading Division in Poznań (Wielkopolski Oddział Handlowy w Poznaniu).

4. Changes in management policies

In 2012, the following changes were made to the management policies and the segmental structure of PGNiG SA and the PGNiG Group.

<u>Changes in management policies of PGNiG SA and the PGNiG Group</u>

In 2012, PGNiG consolidated its exploration and servicing companies within the Group's Exploration and Production segment. PGNiG Poszukiwania S.A. was merged 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. All the companies' assets were transferred to PGNiG Poszukiwania S.A. (which was renamed Exalo Drilling S.A. with effect as of February 2013).

In 2012, a process was launched to establish a shared services centre, which will provide finance, accounting, HR and payroll as well as IT services. The centre will operate under the name PGNiG Serwis Sp. z o.o. and will provide support to some of the PGNiG Group companies. On January 1st 2013, it started rendering services to PGNiG TERMIKA S.A.

2012 also saw the commencement of efforts to integrate the Group's power competences at PGNiG TERMIKA S.A. The company became the Group's competence centre for heat and electricity generation and implementation of heat and power projects.

Changes in the segmental structure of PGNiG SA and the PGNiG Group

In 2012, the segmental structure of the Company and the Group changed. One new segment was formed, and selected subsidiaries and the underground gas storage facilities were reclassified based on their business profiles.

The Brzeźnica, Strachocina and Swarzów underground gas storage facilities were transferred from the Exploration and Production segment to the Trade and Storage segment after PGNiG SA provided access to the facilities' working capacities to third parties (on a TPA basis).

As a result of the acquisition of PGNiG TERMIKA S.A. (former Vattenfall Heat Poland S.A.) in 2012, the PGNiG Group expanded the scope of its operations to include electricity and heat generation. A new segment, Generation, was thus established and includes PGNiG TERMIKA S.A. and PGNiG SPV 1 Sp. z o.o..

INVESTGAS S.A. was transferred from the Trade and Storage segment to the Other Activities segment. INVESTGAS S.A. specialises in the provision of comprehensive design services, construction and assembly services, construction supervision services for projects involving construction of gas storage facilities and pipelines, as well as gas storage facility operation services.

PGNiG Energia S.A. and PGNiG Finance AB, previously reported under the Other Activities segment, were transferred to the Trade and Storage segment. PGNiG Energia S.A.'s core business consists in wholesale trade in electricity as well as trade in carbon and other greenhouse gas allowances. PGNiG Finance AB's business involves servicing PGNiG's Euronotes issues.

5. Ownership interests

PGNiG SA holds shares in production and service companies. As at December 31st 2012, PGNiG SA had 35 related entities, including:

- 25 subsidiaries;
- 10 other related entities.

The table below presents related entities of PGNiG SA as at December 31st 2012.

PGNiG SA’s related entities

	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
	Subsidiaries				
1	PGNiG Poszukiwania S.A.	981,500,000.00	981,500,000.00	100.00%	100.00%
2	GEOFIZYKA Kraków S.A.	64,400,000.00	64,400,000.00	100.00%	100.00%
3	GEOFIZYKA Toruń S.A.	66,000,000.00	66,000,000.00	100.00%	100.00%
4	PGNiG Norway 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. (USD)[1)2)]	26,724.00	26,724.00	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.	166,914,000.00	166,914,000.00	100.00%	100.00%
18	BUD-GAZ PPUH Sp. z o.o.	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.	862,316,000.00	616,016,000.00	71.44%	99.99%
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.	5,000.00	5,000.00	100.00%	100.00%
24	B.S. i P.G. Gazoprojekt S.A.	4,000,000.00	3,000,000.00	75.00%	75.00%
25	NYSAGAZ Sp. z o.o.	9,881,000.00	6,549,000.00	66.28%	66.28%
	Other related entities				
26	System Gazociągów Tranzytowych EUROPOL GAZ S.A.	80,000,000.00	38,400,000.00	48.00%	48.00%
27	GAS-TRADING S.A.	2,975,000.00	1,291,350.00	43.41%	43.41%
28	InterTransGas GmbH (EUR)[1)]	200,000.00	100,000.00	50.00%	50.00%
29	Dewon Z.S.A. (UAH)[1)]	11,146,800.00	4,055,205.84	36.38%	36.38%
30	Sahara Petroleum Technology llc w likwidacji (in liquidation) (OMR)[1)]	150,000.00	73,500.00	49.00%	49.00%
31	PFK GASKON S.A.	13,061,325.00	6,000,000.00	45.94%	45.94%
32	GAZOMONTAŻ S.A.	1,498,850.00	677,200.00	45.18%	45.18%
33	ZRUG Sp. z o.o. (Poznań)	3,781,800.00	1,515,000.00	40.06%	41.71%
34	ZWUG INTERGAZ Sp. z o.o.	4,700,000.00	1,800,000.00	38.30%	38.30%
35	ZRUG TORUŃ S.A. w upadłości likwidacyjnej (in bankruptcy by liquidation)	5,150,000.00	1,300,000.00	25.24%	25.24%

1) Amounts in foreign currencies
2) Financial reporting currency was changed from EUR to USD

On January 11th 2012, PGNiG SPV 1 Sp. z o.o. executed a final share purchase agreement with Vattenfall AB, whereby PGNiG SPV 1 Sp. z o.o. acquired 24,591,544 shares in Vattenfall Heat Poland S.A., which represented 99.8% of the company's share capital and conferred the right to 99.8% of the total vote at the General Meeting of Vattenfall Heat Poland S.A. On January 23rd 2012, the company was renamed PGNiG TERMIKA S.A.

In H1 2012, PGNiG SPV 1 Sp. z o.o. acquired 13,005 PGNiG TERMIKA shares from the company's minority shareholders, thus its ownership interest in the company increased to 99.9%.

On December 17th 2012, the Extraordinary General Meetings of PGNiG TERMIKA S.A. and of PGNiG SPV 1 Sp. z o.o. resolved to merge PGNiG TERMIKA S.A. with PGNiG SPV 1 Sp. z o.o., with PGNiG TERMIKA S.A. as the surviving company. The merger was effected through the transfer of all assets and obligations of PGNiG SPV 1 Sp. z o.o. to PGNiG TERMIKA S.A. in exchange for shares in the surviving company, which were delivered to the shareholder of PGNiG SPV 1 Sp. z o.o. The merger was registered with the National Court Register on December 31st 2012.

Following the merger, the share capital of PGNiG TERMIKA S.A. amounts to PLN 862,316,000.00 and is divided into 86,231,600 shares with a par value of PLN 10 per share, including 61,601,600 new Series C shares acquired by PGNiG SA in exchange for shares in PGNiG SPV 1 Sp. z o.o. PGNiG SA's ownership interest in PGNiG TERMIKA S.A. is now 71.44%.

24,629,273 PGNiG TERMIKA shares are treasury shares in respect of which the voting rights are not exercised. As at the end of 2012, legal proceedings were under way to establish court deposits as it was not possible to pay off some of PGNiG TERMIKA S.A.'s minority shareholders whose shares were purchased under Art. 418 of the Commercial Companies Code. Until the court issues final decisions on the establishment of the court deposits with respect to 727 shares in PGNiG TERMIKA S.A., PGNiG SA's share in the total vote at the company's General Meeting is 99.99%.

Other changes in ownership interests within the Group in 2012:

- On June 6th 2012, PGNiG SA acquired 100 shares in MLV 26 Sp. z o.o., with an aggregate par value of PLN 5,000, representing the entire share capital of the company. The total purchase price was PLN 7,500. On June 14th 2012, a change of the company name to PGNiG Serwis Sp. z o.o. was registered with the National Court Register. The company was purchased to provide HR and payroll, finance, accounting, as well as IT services to PGNiG Group companies.
- On June 8th 2012, PGNiG SA acquired 100 shares in MLV 27 Sp. z o.o., with an aggregate par value of PLN 5,000, representing the entire share capital of the company. The total purchase price was PLN 7,500. The company's name was changed to PGNiG SPV 4 Sp. z o.o.; it was registered with the National Court Register on August 29th 2012.
- On July 3rd 2012, PGNiG Poszukiwania S.A. w organizacji (in the process of incorporation) was formed in order to consolidate PGNiG SA's exploration and service operations. The company's share capital was PLN 10,000,000 and was divided into 10,000,000 shares with a par value of PLN 1 per share. All the shares were subscribed for by PGNiG SA. The company was registered with the National Court Register on July 27th 2012. On December 19th 2012, the Extraordinary General Meeting of PGNiG Poszukiwania S.A. resolved to merge the company 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. As at the end of 2012, the merger was not registered with the National Court Register.
- On October 9th 2012, the District Court in Toruń declared bankruptcy of ZRUG TORUŃ S.A. and opened liquidation of the company's assets.

Also in 2012, registry courts registered transformation of the following entities into joint-stock companies:

- January 2nd 2012 – PNiG Jasło Sp. z o.o.
- June 1st 2012 – PNiG Kraków Sp. z o.o.
- June 1st 2012 – PGNiG Technologie Sp. z o.o.
- June 14th 2012 – PNiG NAFTA Sp. z o.o.
- July 2nd 2012 – GEOFIZYKA Kraków Sp. z o.o.
- July 2nd 2012 – GEOFIZYKA Toruń Sp. z o.o.
- July 2nd 2012 – GEOVITA Sp. z o.o.

The following changes in ownership interests occurred subsequent to the end of the reporting period:

- On January 2nd 2013, the Extraordinary General Meeting of BUD-GAZ PPUH Sp. z o.o. resolved to wind up the company and commence its 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. 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.

6. Changes in PGNiG SA's equity holdings

In 2012, the following changes in PGNiG SA's equity interests occurred:

- Share capital increase at PGNiG SPV 1 Sp. z o.o. by PLN 770,000,000, to PLN 770,020,000, by way of an issue of 15,400,000 new shares with a par value of PLN 50 per share. The new issue shares were acquired by PGNiG SA. The share capital increase was registered on January 25th 2012.
- Share capital increase at Pomorska Spółka Gazownictwa Sp. z o.o. by PLN 1,553,000, to PLN 655,199,000. The new issue shares were acquired by PGNiG SA and paid for with an in-kind contribution in the form of a perpetual usufruct right to a plot of land situated in Toruń, along with the ownership title to buildings and structures erected thereon. The share capital increase was registered on March 7th 2012.
- Share capital increase at PGNiG Energia S.A. by PLN 11,000,000, to PLN 41,000,000 by way of an issue of 110,000 new shares with a par value of PLN 100 per share. All new issue shares were acquired by PGNiG SA. The share capital increase was registered on March 22nd 2012.
- Share capital increase at PGNiG Serwis Sp. z o.o. to PLN 9,995,000. The new issue shares were acquired by PGNiG SA. The share capital increase was registered on June 29th 2012.
- Share capital increase at PGNiG Poszukiwania S.A. by PLN 971,500,000, to PLN 981,500,000, by way of an issue of 971,500,000 new shares with a par value of PLN 1 per share. All new issue shares were paid for with an in-kind contribution in the form of shares in 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. held by PGNiG SA. The share capital increase was registered with the National Court Register on September 10th 2012.

On February 15th 2013, the Extraordinary General Meeting of PGNiG SPV 4 Sp. z o.o. resolved to increase the company's share capital 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. As at the date of this report, the share capital increase was not registered with the National Court Register.

<u>Investments outside the group of related entities</u>

As at the end of 2012, the par value of PGNiG SA's equity interests held outside the group of related entities was PLN 21.9m. In 2012, PGNiG SA made no material equity investments outside the group of related entities.

7. Workforce

The table below presents workforce at the PGNiG Group as at December 31st 2012, by segments. As the PGNiG Head Office provides services to all segments in the Group, it is disclosed separately.

Workforce by segments (no. of staff)

	2012	2011
PGNiG Head Office	617	838
Exploration and Production	4,408	4,405
Trade and Storage	3,678	3,710
Other Activities	37	38
Total	8,740	8,991

At the end of 2011 and at the beginning of 2012, mass redundancies were effected as part of restructuring of the PGNiG Head Office. Employment contracts with 112 employees of the Head Office were terminated.

In H2 2012 the Voluntary Termination Programme was launched at PGNiG SA, as part of which 855 employees of the Company terminated their employment contracts. Most of the contracts were terminated with effect as of December 31st 2012.

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. Its operation is based on the "stand-by" principle. It may be implemented in extraordinary circumstances and requires all the companies to follow a procedure which is uniform across the Group.

In 2012, the Programme was implemented at three companies of the Group: PGNiG Head Office, PGNiG Technologie S.A. and ZRG Krosno Sp. z o.o., and covered 139 former employees of those companies. The one-off redundancy payments to the terminated employees were financed with PGNiG SA's Central Restructuring Fund reserve.

8. Sale and acquisition of natural gas

PGNiG SA recorded revenue of PLN 25.5bn, 92% of which was derived from sales of natural gas.

Revenue (PLNm)

	2012	2011
Natural gas, including:	23,548	20,383
- high-methane gas	22,154	19,164
- nitrogen-rich gas	1,394	1,219
Crude oil	1,256	1,095
Condensate	7	5
Helium	161	58
Propane-butane	67	60
Gas storage services	16	31
Other sales	484	189
Total	25,539	21,821

In 2012, PGNiG SA sold 14.7bcm of natural gas, with 95.1% of that amount represented sales from the transmission and distribution systems and the balance – direct sales from gas fields.

Natural gas sales volume (mcm)

	2012	2011
Trade and Storage	14,005.4	13,699.2
Exploration and Production	723.4	681.8
Total	14,728.8	14,381,0

In 2012, PGNiG SA acquired 15.4bcm of natural gas, with 71.2% of that amount sourced from imports, mostly from countries east of Poland. Natural gas production from fields in Poland represented 28.0% of the total volume acquired. The table below presents the structure of natural gas supplies to the Group, measured as high-methane gas equivalent.

Supply sources of natural gas (mcm)

	2012	2011
Foreign suppliers	10,999.9	10,915.3
Domestic production	4,317.3	4,329.4
Domestic suppliers	127.2	112.3
Total	15,444.4	15,357.0

Section II: Governing Bodies

1. Management Board

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

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

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

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

As at January 1st 2012, the composition of the PGNiG Management Board was as follows:

- Radosław Dudziński – Vice-President, Strategy
- Sławomir Hinc – Vice-President, Finance
- Marek Karabuła – Vice-President, Petroleum Extraction
- Mirosław Szkałuba – Vice-President.

At its meeting on March 7th 2012, the Supervisory Board appointed Ms Grażyna Piotrowska-Oliwa to the position of President of the PGNiG Management Board, with effect as of March 19th 2012, for the joint term of office expiring on March 13th 2014.

On May 11th 2012, Mr Marek Karabuła resigned from his position as member of the PGNiG Management Board. The reason for the resignation was his appointment to the position of President of the Management Board of POGC Libya B.V.

As at December 31st 2012, 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

<u>Division of responsibilities within the Management Board</u>

The President of the Management Board supervised and coordinated the management of the Group. She was also responsible for such areas as human resources management, strategy, marketing and communication, audit and internal control, information protection and defence matters, and supervised the operation of PGNiG SA's representative office in Brussels.

The Vice-President of the Management Board in charge of Trade supervised such areas as acquisition of gas, infrastructure and trading activities. His responsibilities also included oversight over foreign representative offices of PGNiG SA (except the office in Brussels).

The scope of responsibilities of the Vice-President of the Management Board in charge of finance included economics, accounting, business controlling, finance management, taxes, investor relations and investments.

The Vice-President of the Management Board in charge of Procurement and IT supervised such areas as assets and administration, procurement strategy for the Company and the Group, as well as IT development. His responsibilities also included supervision and coordination of .

Contracts with Management Board members

The employment contracts concluded with all the Management Board members contain a clause in Par. 8, which reads: "In the event of removal from office or termination of this employment contract for reasons other than breach of basic duties under the employment contract, the employee is entitled to a severance payment equal to three times the employee's monthly salary."

As at December 31st 2012, the non-competition agreements concluded with the President of the Management Board - Ms Grażyna Piotrowska - Oliwa, and Vice-Presidents - Mr Radosław Dudziński, Mr Sławomir Hinc and Mr Mirosław Szkałuba, were in force. The non-competition agreements continue in force for 12 months from the date of the employment contract termination. In return for observing the competition ban during the term of the non-competition agreement, a Management Board member is entitled to a monthly compensation of 100% of such member's average gross remuneration for the last three months received in connection with the legal relationships between the member and the Company.

Changes subsequent to the end of the reporting period

On January 22nd 2013, Mr Sławomir Hinc tendered his resignation from the position of Vice-President of the PGNiG 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.

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.

2. Supervisory Board

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

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

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

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

If the Supervisory Board is composed of up to six members, two members are appointed from among the candidates elected by the Company's employees. If the Supervisory Board is composed of seven to nine members, three members are appointed from among the candidates elected by the Company's employees.
As at January 1st 2012, the composition of the PGNiG Supervisory Board was as follows:

- Stanisław Rychlicki – Chairman of the Supervisory Board
- Marcin Moryń – Deputy Chairman of the Supervisory Board
- Mieczysław Kawecki – Secretary of the Supervisory Board
- Grzegorz Banaszek – Member of the Supervisory Board
- Agnieszka Chmielarz – Member of the Supervisory Board
- Mieczysław Puławski – Member of the Supervisory Board
- Jolanta Siergiej – Member of the Supervisory Board

On January 5th 2012, Mr Stanisław Rychlicki, Chairman of the Supervisory Board, tendered his resignation from the position with effect as of January 10th 2012.

On January 12th 2012, the Extraordinary General Meeting of PGNiG SA removed Mr Grzegorz Banaszek from the Supervisory Board and appointed Mr Wojciech Chmielewski to serve on the PGNiG Supervisory Board. Also on January 12th 2012, the Minister of State Treasury, acting in consultation with the Minister of Economy, appointed Mr Janusz Pilitowski to serve on the PGNiG Supervisory Board.

On January 13th 2012, the PGNiG Supervisory Board appointed Mr Wojciech Chmielewski as its Chairman.

On March 19th 2012, the Extraordinary General Meeting of PGNiG SA appointed Ms Ewa Sibrecht-Ośka to the Supervisory Board.

As at December 31st 2012, 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

Remuneration of management and supervisory personnel

For information on the remuneration paid to management and supervisory personnel, see the annual separate financial statements for the year ended December 31st 2012 (Note 37.4).

Section III: Shareholder Structure

As at December 31st 2012, 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 December 31st 2012 is presented in the table below.

Shareholder structure

Shareholder	Number of shares as at Dec 31 2012	% of share capital held as at Dec 31 2012	Number of votes conferred by shares held	% of total vote at GM as at Dec 31 2012
State Treasury	4,271,810,954	72.40%	4,271,810,954	72.40%
Other shareholders	1,628,189,046	27.60%	1,628,189,046	27.60%
Total	5,900,000,000	100.00%	5,900,000,000	100.00 %

As at December 31st 2012, 728,189,045 PGNiG shares were delivered to eligible employees or their heirs. The shares represented 97.1% of the pool of shares available to be acquired free of charge by eligible persons.

<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 December 31st 2012.

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

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

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

<u>Performance of the PGNiG stock</u>

PGNiG shares have been listed on the Warsaw Stock Exchange since September 23rd 2005. As at December 31st 2012, the Company shares was included in the following indices:

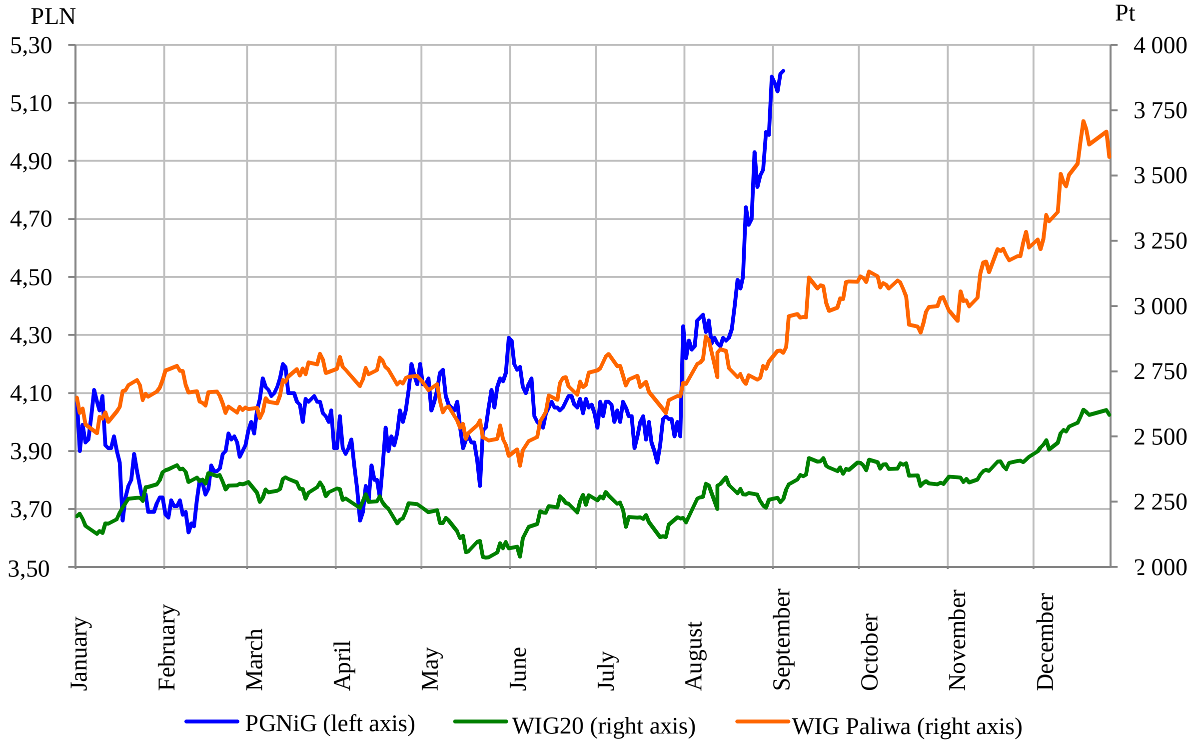
- WIG – all-cap index
- WIG20 – blue-chip index of the 20 largest and most liquid companies

- WIG-Paliwa – index of the fuel sector companies
- WIG-div – total return index of 30 companies with the highest dividend yields and regular dividend payments
- WIG-Poland – index of Polish companies listed on the WSE
- Respect Index – index of socially responsible companies.

The rate of return on PGNiG SA stock in 2012 was 27.7%. In the period from PGNiG's first listing to December 31st 2012, the rate of return was 36.7%. Investors who acquired the PGNiG shares on the WSE at their issue price earned a 74.8% return (excluding dividends).

The following figure presents the relative performance of the PGNiG stock against the WIG 20 and WIG Paliwa indices. The table presents the values of the WSE indices and the PGNiG share price in 2012.

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



WSE indices and the PGNiG share price

Index	Value/price as at Dec 31 2011	2012 high	2012 low	Value/price as at Dec 31 2012	PGNiG SA's weight in the index as at Jan 8 2013
WIG	37,595	47,921	36,653	47,461	3.5%
WIG20	2,144	2,603	2,036	2,583	5.0%
WIG-Fuels	2,568	3,708	2,388	3,571	31.3%
Respect Index	2,005	2,636	1,987	2,591	11.2%
PGNiG SA	PLN 4.08	PLN 5.21	PLN 3.62	PLN 5.21	-

Source: gpwinfostrefa.pl

Section IV: Regulatory Environment

The PGNiG Group's activities are regulated by the following laws:

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

1. Polish Energy Law

The activities of the PGNiG Group in the area of gas fuel trading, distribution and storage are regulated and require a licence granted by the President of the Energy Regulatory Office and, in the case of trading activities, a tariff approved by the President of the Energy Regulatory Office. The tariff determines the prices of gas fuels.

In 2012, the Polish Energy Law was amended three times. Two of the amendments followed from the provisions of the Energy Efficiency Act, and did not apply to gas fuel trading. The third of the amendments reflected amendments to the Polish Code of Civil Procedure. It states that proceedings concerning an appeal against a decision by the President of the Energy Regulatory Office should be conducted pursuant to the provisions of the Code applicable to proceedings concerning power regulation matters, rather than those applicable to proceedings concerning business matters. The change results from the abandonment of a separate procedure for business matters.

On November 29th 2012, an amendment to the Minister of Economy's Regulation on detailed conditions for the operation of the gas system (the so-called Gas System Regulation) came into force. The amendment introduces the notion of a "virtual gas trading point" and defines the key rules for gas fuel trading at such points.

1.1. Licences

As at December 31st 2012, 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.

By virtue of a decision issued by the President of the Energy Regulatory Office at the request of PGNiG SA on March 16th 2012, the Company’s licence to store gas fuel was changed to include “gas fuel storage in storage facilities”. The President of the Energy Regulatory Office also approved the changes in the working storage capacities of the Strachocina underground gas storage facility, the Wierzchowice underground gas storage facility and the Mogilno cavern underground gas storage facility following their expansion; and of the Husów underground gas storage facility for technological reasons.

On May 16th 2012 the President of the Energy Regulatory Office granted a licence authorising Operator Systemu Magazynowania Sp. z o.o. to store gas fuel in storage facilities, valid from June 1st 2012 to May 31st 2022. In light of the above, by way of a decision of May 29th 2012 the President of the Energy Regulatory Office revoked as of May 31st 2012 PGNiG’s licence to store gas fuels in storage facilities.

On December 12th 2012, PGNiG SA applied for amendment to the licence for production of electricity through co-generation. The amendment pertains to extension of the scope of activities covered by the licence to include another co-generation unit, situated at the oil mine in Nosówka in the Rzeszów Province. As at the date of this report, the proceedings were pending.

1.2. Tariff policy

Dependence of the PGNiG Group’s revenue on the tariffs approved by the President of the Energy Regulatory Office is one of the factors affecting the Group’s regulated business. Tariffs are crucial to the Company’s ability to generate revenue that would cover incurred justified costs plus return on capital employed and a reasonable margin. Gas prices and charges are directly connected with the applied tariff preparation methodology.

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

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

On December 20th 2012, PGNiG SA commenced trading in natural gas on the Power Exchange. In accordance with a decision by the President of the Energy Regulatory Office, trading on the exchange is exempt from the tariff obligation.

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

1.3. Changes in PGNiG SA’s tariffs

Until March 30th 2012, the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 4/2011) approved by the President of the Energy Regulatory Office on June 30th 2011 was used in settlements with customers.

By virtue of a decision of January 11th 2012, the President of the Energy Regulatory Office refused to change the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 4/2011) with respect to gas fuel prices, which was to be applied in settlements with customers from November 15th to December 31st 2011.

By virtue of a decision of March 16th 2012, issued following a request of PGNiG SA dated October 25th 2011, the President of the Energy Regulatory Office approved the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 5/2012) which, in line with the request by PGNiG SA, was to be applied in settlements with customers from January 1st to March 31st 2012. The tariff became effective as of March 31st 2012 and, pursuant to the decision of the President of the Energy Regulatory Office, it will continue in force until December 31st 2012. On average, the prices and charge rates for the supply of high-methane gas type E, and nitrogen-rich gas types Lw and Ls were increased by 12.5%, 12.6% and 11.3%, respectively.

On June 15th 2012, PGNiG SA applied to the President of the Energy Regulatory Office requesting a change to the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 5/2012).

By virtue of a decision of September 13th 2012, the President of the Energy Regulatory Office refused to change the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 5/2012), stating that there were no grounds for its revision. On September 27th 2012, PGNiG SA appealed against the decision to the Competition and Consumer Protection Court at the Regional Court in Warsaw. As at the date of this report, the proceedings were pending.

On December 17th 2012, the President of the Energy Regulatory Office approved a change to Gas Fuel Supply Tariff No. 5/2012 and extended its effective term until September 30th 2013. The approval related to removal from the tariff of the provisions permitting the use (in accordance with the adopted sale policy) of prices lower than the tariff prices, revision of prices and charge rates, and introduction of regulations on trading at a virtual gas trading point. The amended tariff came into force on 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 referred to 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 group	Tariff No. 4/2011	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)	
	1	2	3	2/1	3/2
W-1.1	2.5779	2.7648	2.4969	7.3%	-9.7%
W-2.1	2.0167	2.2036	1.9816	9.3%	-10.1%
W-3.1	1.8340	2.0209	1.8029	10.2%	-10.8%
W-4	1.7036	1.8905	1.6693	11.0%	-11.7%
W-5 - W-7C	1.5629	1.7507	1.7071	12.0%	-2.5%
W-8A - W-10C	1.3185	1.5063	1.4651	14.2%	-2.7%

Tariff group	Tariff No. 4/2011	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)	
	1	2	3	2/1	3/2
S-1	1.8537	2.0010	1.7900	7.9%	-10.5%
S-2	1.4415	1.5888	1.4044	10.2%	-11.6%
S-3	1.3152	1.4625	1.3013	11.2%	-11.0%
S-4	1.1911	1.3384	1.1801	12.4%	-11.8%
S-5 - S-7B	1.1225	1.2677	1.2338	12.9%	-2.7%
S-8 - S-9	1.0113	1.1566	1.1225	14.4%	-2.9%

Tariff group	Tariff No. 4/2011	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)	
	1	2	3	2/1	3/2
Z-1	1.4575	1.5830	1.4156	8.6%	-10.6%
Z-2	1.3255	1.4510	1.2888	9.5%	-11.2%
Z-3	1.1749	1.3004	1.1623	10.7%	-10.6%
Z-4	1.0954	1.2209	1.0841	11.5%	-11.2%
Z-5 - Z-7B	1.0825	1.2088	1.1793	11.7%	-2.4%

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

Tariff group	Tariff No. 4/2011	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)	
	1	2	3	2/1	3/2
W-1.1	2.5468	2.7337	2.4726	7.3%	-9.6%
W-2.1	2.0803	2.2672	2.0440	9.0%	-9.8%
W-3.1	1.8014	1.9883	1.7660	10.4%	-11.2%
W-4	1.7314	1.9183	1.6909	10.8%	-11.9%
W-5 - W-7C	1.5854	1.7732	1.7314	11.8%	-2.4%
W-8A - W-11C	1.3243	1.5121	1.4681	14.2%	-2.9%

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

Tariff group	Tariff No. 4/2011	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)	
	1	2	3	2/1	3/2
W-1.1	2.4284	2.6153	2.3594	7.7%	-9.8%
W-2.1	1.9928	2.1797	1.9590	9.4%	-10.1%
W-3.1	1.7450	1.9319	1.7288	10.7%	-10.5%
W-4	1.6960	1.8829	1.6843	11.0%	-10.5%
W-5 - W-7BC	1.5918	1.7796	1.7355	11.8%	-2.5%
W-8A - W-10C	1.2933	1.4811	1.4310	14.5%	-3.4%

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

Tariff group	Tariff No. 4/2011	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)	
	1	2	3	2/1	3/2
W-1.1	2.8082	2.9951	2.7039	6.7%	-9.7%
W-2.1	1.9019	2.0888	1.8693	9.8%	-10.5%
W-3.1	1.7044	1.8913	1.6877	11.0%	-10.8%
W-4	1.6918	1.8787	1.6755	11.0%	-10.8%
W-5 - W-7C	1.5658	1.7536	1.7086	12.0%	-2.6%
W-8A - W-10C	1.2341	1.4219	1.3669	15.2%	-3.9%

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

Tariff group	Tariff No. 4/2011	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)	
	1	2	3	2/1	3/2
W-1.1	2.6499	2.8368	2.5658	7.1%	-9.6%
W-2.1	2.0396	2.2265	2.0058	9.2%	-9.9%
W-3.1	1.8144	2.0013	1.8006	10.3%	-10.0%
W-4	1.7530	1.9399	1.7451	10.7%	-10.0%
W-5 - W-7C	1.6114	1.7992	1.7606	11.7%	-2.1%
W-8A - W-10C	1.3075	1.4953	1.4601	14.4%	-2.4%

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

Tariff group	Tariff No. 4/2011	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)	
	1	2	3	2/1	3/2
W-1.1	2.6742	2.8611	2.5856	7.0%	-9.6%
W-2.1	1.9479	2.1348	1.9143	9.6%	-10.3%
W-3.1	1.8085	1.9954	1.7881	10.3%	-10.4%
W-4	1.7181	1.9050	1.7032	10.9%	-10.6%
W-5 - W-7C	1.5291	1.7169	1.6715	12.3%	-2.6%
W-8A - W-10C	1.2698	1.4576	1.4140	14.8%	-3.0%

Tariff group	Tariff No. 4/2011	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)	
	1	2	3	2/1	3/2
S-1	1.8642	2.0115	1.8046	7.9%	-10.3%
S-2	1.4032	1.5505	1.3774	10.5%	-11.2%
S-3	1.2723	1.4196	1.2602	11.6%	-11.2%
S-4	1.1974	1.3447	1.1889	12.3%	-11.6%
S-5 - S-7B	1.1246	1.2699	1.2365	12.9%	-2.6%

Tariff group	Tariff No. 4/2011	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)	
	1	2	3	2/1	3/2
Z-1	1.6976	1.8231	1.6422	7.4%	-9.9%
Z-2	1.2649	1.3904	1.2408	9.9%	-10.8%
Z-3	1.1314	1.2569	1.1208	11.1%	-10.8%
Z-4	1.0645	1.1900	1.0570	11.8%	-11.2%
Z-5 - Z-7B	1.0184	1.1446	1.1157	12.4%	-2.5%

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

Tariff group	Tariff No. 4/2011	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)	
	1	2	3	2/1	3/2
E-1A - E-2C	1.1818	1.3713	1.3302	16.0%	-3.0%
Lw-1 - Lw-2	0.9130	1.0582	1.0196	15.9%	-3.6%
Ls-1 - Ls-2	0.7564	0.8827	0.8537	16.7%	-3.3%

On January 13th 2012, PGNiG SA applied to the President of the Energy Regulatory Office requesting approval of a new Gas Fuel Storage Services Tariff (Part B – Gas Fuel Storage Services Tariff No. 1/2012), which would be effective in settlements with customers from April 1st 2012 to Match 31st 2013. The tariff submitted for approval reflects changes in storage charge rates relating to the expected commissioning of new storage capacities (180mcmin the Strachocina underground gas storage facility and 34mcm in the Mogilno cavern gas storage facility). On April 13th 2012 the President of the Energy Regulatory Office approved the proposed Tariff, to be effective until March 31st 2013.

On June 15th 2012 the President of the Energy Regulatory Office approved the Gas Fuel Storage Services Tariff No. 1/2012 for Operator Systemu Magazynowania Sp. z o.o. The Tariff became effective as of July 1st 2012 and will continue in force until May 31st 2013. The OSM Tariff replaced the PGNiG Gas Fuel Storage Services Tariff (Part B – Gas Fuel Storage Services Tariff No. 1/2012) in settlements with customers for gas fuel storage services.

On December 17th 2012, the President of the Energy Regulatory Office approved a change to Gas Fuel Storage Tariff No. 1/2012 of Operator Systemu Magazynowania Sp. z o.o. The change related to the rates of charges for the storage services, the service quality, and settlement methods under short-term contracts. The amended tariff came into force on January 1st 2013. The effective term of the tariff was not changed.

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

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

- sets the timetable for building up the mandatory stock of natural gas: the volume of mandatory stock should cover 20 days' average daily imports of gas as of October 1st 2010, and 30 days' average daily imports of gas as of October 1st 2012;

- provides that the return on the capital employed in the storage business should be at least 6%;
- stipulates that the cost related to maintaining, releasing and restocking the reserves represents justified operating expenses within the meaning of Art. 3.21 of the Polish Energy Law.

On December 4th 2011, the amended 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 came into force. The amendment provides for:

- the possibility to store mandatory stocks in another EFTA member state, upon fulfilment of certain conditions set in the Act,
- the possibility to exempt a power utility company whose business involves international trade in natural gas or an entity which imports natural gas from the obligation to keep mandatory stock, if the number of their customers does not exceed 100 thousand and the natural gas volume imported in a calendar year does not exceed 100mcm.

3. Polish Geological and Mining Law

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

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

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

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

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

In 2012, the Ministry of Environment awarded PGNiG SA one licence for exploration for and appraisal of crude oil and natural gas deposits, the terms of 23 licences were extended and one licence expired. In 2012, the Ministry of Environment also granted to the Company one licence for extraction of crude oil and natural gas from deposits, seven licences were amended, and one licence expired.

As at December 31st 2012, PGNiG SA held the following licences, granted pursuant to the Geological and Mining Law:

- 95 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 (underground gas storage facilities)
- 3 licences for storage of waste

The New Polish Geological and Mining Law of June 9th 2011 (Dz.U. of 2001, No. 63, item 638) became effective as of January 1st 2012. The Act satisfies the requirements of Directive 94/22/EC of the European Parliament and of the Council of May 30th 1994. The Act introduces the tender procedure for the licence for exploration for and appraisal of hydrocarbons and for production of hydrocarbons, superseding the previous tender procedure with respect to the establishment of mining rights.

4. Regulatory risks

Polish Energy Law

In 2012, work was under way on a set of three acts which are to regulate the energy sector, i.e. the Gas Law, the Energy Law and the Law on Renewable Energy Sources. Work also continued on amending the Regulation of the Minister of Economy on detailed rules for determining and calculating tariffs for gas fuels and on settlement of transactions in gas fuels trading (the Tariff Regulation). The draft of the amended Tariff Regulation introduces, among other things, entry-exit transmission tariffs, rules for computation of charges for short-term and intermittent services and for virtual reverse flow services provided by the 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 the storage system operator. The draft 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 through costs of gas fuel transport to the tariffs of other energy utilities. Another purpose of the draft is to adapt the provisions of the Tariff Regulation to the Gas System Regulation.

Changes of laws and delays in amending legal acts create risks stemming chiefly from uncertainty as to the final scope of the regulatory changes and short time for adaptation to such changes, which might adversely affect the financial performance and growth prospects of 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. In line with the provisions of the new act, PGNiG SA, as a trading company, is required to purchase energy efficiency certificates or, alternatively, to pay the non-compliance penalty. This 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 as 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 2012, the President of the Energy Regulatory Office again unilaterally extended tariff's effective term (as was the case in previous tariff proceedings). The Company is of the opinion that such actions by the President of the Energy Regulatory Office create a 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 effective term is extended by the President of the Energy Regulatory Office. 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. Further, the President of the Energy Regulatory Office protracts tariff proceedings; consequently, a new tariff takes effect later than originally applied for by PGNiG SA. It was only on March 16th 2012 that Gas Fuel Supply Tariff No. 5/2012 was approved, while the Company had submitted the relevant application on October 25th 2011. By virtue of a decision of September 13th 2012, the President of the Energy Regulatory Office refused to change the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 5/2012). PGNiG SA appealed against the decision to the Competition and Consumer Protection Court at the Regional Court in Warsaw.

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

Section V: Exploration and Production

The segment's business focuses on extracting hydrocarbons from underground formations and preparing products for sale. The segment comprises the entire process of oil and gas exploration and production, starting from geological analyses, through geophysical surveys and drilling work, to field development and hydrocarbon production. It uses storage capacities available at the Daszewo and Bonikowo underground gas storage facilities.

1. Exploration

In 2012, PGNiG SA was engaged in exploration for both conventional and unconventional gas (shale gas and tight gas). In Poland, PGNiG SA 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 three research boreholes (Lubycza Królewska-1, Opalino-2 and Lubocino-2H), and one appraisal well.

In 2012, three wells were tested in the Carpathian Foothills, including two wells drilled in 2011. The tests confirmed presence of gas in two wells – one exploratory well (Kramarzówka-1) and one appraisal well (Lubliniec-12). No hydrocarbon flow at commercial rates was recorded from the third well (Łapanów-6K), and the well was subsequently abandoned. The Company continued to work on a well in the licence area in Denmark. The well (Felsted-1) proved negative and was decommissioned.

One of the positive wells was a 3,357m appraisal well Kramarzówka-1, drilled in the Carpathian Foothills in 2011. The well produced a natural gas flow. The drilling of a deep well Dukla-1 in the Carpathians was completed. In the Lublin region, the well Lubycza Królewska-1 was drilled (shale gas) and analytical work to determine the fracturing potential began.

As at December 31st 2012, the Group's recoverable reserves were:
- 89.4 bcm of natural gas measured as high-methane equivalent,
- 20.7 million tonnes of crude oil.

<u>Joint ventures in Poland</u>

In 2011, PGNiG SA cooperated with other entities in areas covered by licences awarded to PGNiG SA, FX Energy Poland Sp. z o.o., and Aurelian Oil & Gas PLC.

Under 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 of Mining Users 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 2012, production continued from the Roszków field in the "Płotki" area, and from the Zaniemyśl field in the "Płotki" – "PTZ" area. Work on the acquisition of the Donatowo-Rusocin 3D seismic survey commenced in the "Płotki" area, while in the "Płotki" – "PTZ" area reprocessing of the Kaleje-Zaniemyśl 3D seismic survey was started to select the best location for the Zaniemyśl-4 production well.

In the "Poznań" licence area, in 2012, gas production continued from the Środa Wielkopolska, Kromolice and Kromolice S fields, and also work continued on the development of the Winna Góra and Lisewo gas fields. Drilling of the Komorze-3k borehole, where a new natural gas field was discovered, was completed. Preparations for hydraulic fracturing were under way in the Pławce-2 (*tight gas*) exploration borehole. In the Żerków-Pleszew area, processing and interpretation of the second stage 3D seismic survey data was completed. A contractor was selected to perform the drilling work on the Mieczewo-1k exploration well. The installation of a drilling rig for the well began. Miłosław 3D and Taczanów 3D seismic surveys were performed, and the processing of the acquired data began.

In the "Bieszczady" area seismic 2D field work was completed and processing of seismic profiles was commenced in the Jaśliska-Baligród zone. Gravimetric field work and interpretation of the acquired data were completed in the Hoczew-Lutowiska area. The partners in the project decided to secure the Niebieszczany-1 borehole. The subsequent testing of the borehole was scheduled for 2013. Reprocessing of the Kostarowce-Zahutyń 2D archive seismic profiles began. 2D seismic acquisition work was completed in the Rakowa-Paszowa area.

In 2012, after a geological and geophysical analysis in the "Sieraków" area, the location of the Sieraków-3 borehole was determined and preparatory work commenced at the site. The borehole will be drilled instead of the previously planned Sieraków-2 borehole.

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

- "Warszawa-Południe" (blocks 234, 235, 254, 255, and 274N) – 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" (blocks 163 and 164) – 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" (blocks 211, 212, 231 and 232) – 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 the "Warszawa-Południe" area, 234.2 km of 2D seismic were acquired and the seismic data was processed. Reprocessing of four archive seismic profiles with a total length of 44.5 km was completed. Geological interpretation of the Potycz-Boglewice-Grójec area, including 563.7 km of new seismic profiles and 677.7 km archive seismic profiles, was performed.

Analytical work continued for the "Ostrowiec" area. In the "Kutno" area, drilling of the Kutno-2 deep exploration borehole was completed.
Under licences awarded to Aurelian Oil & Gas PLC, work was performed 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 Aurelian Oil & Gas 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 Aurelian Oil & Gas PLC); licence interests: Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (operator) – 80%, PGNiG SA– 20%.

In the “Karpaty Zachodnie” area, 110 km of 2D seismic lines were acquired and interpretation of 108 km of the Bielsko–Cieszyn–Bestwina 2D seismic profiles and 27 km of the Budzów 2D seismic profiles commenced.

In the “Karpaty Wschodnie” area, the 2D seismic survey from the Jordanów zone was processed and geological interpretation of the Mszana Dolna-Jordanów 2D seismic survey was completed.

On July 4th 2012, PGNiG SA entered into a framework agreement concerning shale oil and gas exploration and production in the Wejherowo licence area with four other Polish companies: Tauron Polska Energia S.A., KGHM Polska Miedź S.A., PGE Polska Grupa Energetyczna S.A. and Enea S.A. Under the agreement, joint work will be conducted on a part of the Wejherowo licence area held by PGNiG, and specifically in the Kochanowo, Częstkowo and Tępcz zones, where preliminary surveys and analyses have confirmed the presence of unconventional gas. The joint effort will cover about 160 sq km in the Wejherowo licence area. Expenditure on the Kochanowo-Częstkowo-Tępcz (KCT) project is estimated at up to PLN 1.7bn. PGNiG SA will be the licence operator throughout the exploration and appraisal phase.

<u>Exploration abroad</u>

PGNiG SA conducts exploration work in Pakistan on the basis of 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 Hallel-l well was worked over and a horizontal well, Hallel-xl, was drilled off. The Hallel-xl well produced a gas flow. Subsequently, the construction of facilities, which will enable the performance of a double-well production test on the Rehman-1 and Hallel-X1 wells, commenced. Additional interpretation of 3D seismic data confirmed the presence of potential deposits in the northern part of the licence area. On July 6th 2012, the Directorate General of Petroleum Concessions (the Pakistani concession authority) classified the Rehman field as unconventional (tight gas). As a result, the interest holders can raise gas prices by 50% relative to the price of gas produced form conventional reserves. Following valuation of the Kirthar licence performed by a Canadian firm DeGolyer&McNaughton, in 2012 the operator decided to move to the second exploration stage as part of which a new exploration well is to be drilled by July 2014.

Since the execution of the agreement for assignment of interests in 2007, PGNiG SA has been engaged in exploration activity in the 1/05 licence area in Denmark. Currently, the licence interests are: PGNiG SA (operator) – 80%, Nordsøfonden – 20%. Drilling of the Felsted-1 exploration well was completed in early 2012. As no hydrocarbon flow at commercial rates had been obtained, the well was abandoned. However, the abandonment procedure proved ineffective. To repeat the abandonment procedure, PGNiG SA obtained a consent from the Danish Energy Agency (*DEA*) to extending the licence term. In the end, the well was abandoned and the 1/05 licence expired.

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 2012, field acquisition of 2D seismic data (in total, 2,300 km) was completed, with the 2D seismic image processed and interpreted. Due to the protracting administrative procedures, the drilling of an exploration well is expected to commence at the beginning of 2013.

2. Production

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 2012, PGNiG SA produced a total of 4,317.3 bcm of natural gas (measured as high-methane gas equivalent). Crude oil production was 478.4 thousand tonnes. The table below presents PGNiG SA's production volumes in 2012:

Production volumes

		Unit	2012	2011
1	Natural gas, including:	mcm*	4,317.3	4,329.4
a	high-methane gas, including:	mcm	1,607.6	1,616.4
	- Zielona Góra Branch	mcm	0.0	0.0
	- Sanok Branch	mcm	1,607.6	1,616.4
b	nitrogen-rich gas, including:	mcm*	2,709.7	2,713.0
	- Zielona Góra Branch	mcm*	2,625.6	2,637.2
	- Sanok Branch	mcm*	84.1	75.8
2	Crude oil	thousand tonnes	478.4	455.3
	- Zielona Góra Branch	thousand tonnes	429.9	407.3
	- Sanok Branch	thousand tonnes	48.5	48.0

* Measured as high-methane gas equivalent.

In 2012, in the area covered by the Sanok Branch's operations, four fields (Rylowa, Rajsko, Góra Ropczycka and Lubliniec) came on stream and seven new wells were hooked up in the already producing Zagorzyce, Cierpisz, Mirocin, Pruchnik–Pantałowice and Rudka fields. The total addition to gas production capacity from the newly hooked-up wells is approximately 13.1 thousand cubic metres of gas per hour (measured as high-methane gas equivalent). In the area covered by the Zielona Góra Branch's operations, three oil wells with an aggregate daily production capacity of 332 tonnes were hooked up on the BMB (Barnówko – Mostno – Buszewo) field and two gas wells with an aggregate hourly production capacity of 4.3 thousand cubic metres (measured as high-methane equivalent) were hooked up on the Radlin and Bogdaj – Uciechów field. Additionally, in December the Lubiatów oil field with a daily production capacity of 960 tonnes and the Międzychód gas field with an hourly production capacity of 11.2 thousand cubic metres (measured as high-methane equivalent) were brought online.

In 2012, PGNiG SA was engaged in various activities aimed at maintaining the gas and oil output from the currently producing fields. In order to increase hydrocarbon production, 4,088 metres of production drilling was performed. Major remedial treatments were performed on a total of 24 wells, whose technical condition made their further operation impossible. Of that number, 19 wells flowed hydrocarbons at commercial rates. Three of the wells were worked over to support underground gas storage, whereas two wells were to be used as injectors. In 2012, recovery techniques were applied on a total of 63 wells, designed to maintain or improve production capacities of producing wells or to recover operating condition of sub-surface extraction equipment. Recovery techniques were also applied on wells supporting the underground gas storage and on injectors.

Products such as crude condensate, sulphur and propane-butane are obtained through the refining of crude oil. A portion of 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.

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. The largest amounts of natural gas were sold to industrial customers, which accounted for 84% of the total sales volume.

Sales of key products

		Unit	2012	2011
1	Natural gas, including:	mcm	723.4	681.8
	- high-methane gas	mcm	72.0	64.0
	- nitrogen-rich gas*	mcm	651.4	617.8
2	Crude oil	thousand tonnes	482.1	464.6
3	Condensate	thousand tonnes	2.5	2.2
4	Helium	mcm	3.3	3.4
5	Propane-butane	thousand tonnes	22.6	20.7
6	Nitrogen	thousand kilograms	505.2	535.8
7	Sulphur	thousand tonnes	25.3	23.8

* Measured as high-methane gas equivalent.

In 2012, PGNiG SA continued to sell crude oil to Rafineria Trzebinia S.A., Rafineria Nafty Jedlicze S.A. and TOTSA TOTAL OIL TRADING S.A.

Rafineria Trzebinia S.A. is a long-standing trading partner of PGNiG SA. On December 19th 2012, PGNiG SA and Rafineria Trzebinia S.A. signed an annex to their existing agreement. The annex provides for sale and delivery by rail of crude oil to the Trzebinia refinery. The price for the crude oil, which was raised compared with the previous arrangements, will be determined in the same manner as before, i.e. based on *Brent Dated* prices. Under the annex, crude oil may be delivered to the refinery from the Lubiatów field, which means that the annual volume of supplies will increase. The annex, concluded for an indefinite period, took effect as of January 1st 2013.

In 2012, PGNiG SA continued to supply crude oil to Rafineria Nafty Jedlicze S.A., with which it has a ten-year contract in place, valid until the end of 2017, and to TOTSA TOTAL OIL TRADING S.A.

The Company's foreign customers accounted for 43.8% of the total volume of crude sales, and for 69.3% of helium sales. Crude oil was sold to a German refinery through the Druzhba pipeline, while most of the helium volumes were sold in liquid form to foreign wholesale customers, which resell the product in EU countries.

<u>Underground gas storage facilities</u>

In 2012, the Exploration and Production segment used the working capacities of the Daszewo and Bonikowo nitrogen-rich gas storage facilities. Storage capacities used to meet the needs of the Production segment are not storage facilities within the meaning of the Polish Energy Law.

The table below presents the working capacities of the underground storage facilities used by the Exploration and Production segment as at December 31st 2011 and December 31st 2012.

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

Nitrogen-rich gas	2012	2011
Daszewo (Ls)	30.0	30.0
Bonikowo (Lw)	200.00	200.00

3. Planned activities

Exploration in Poland

In 2013, PGNiG SA plans to carry out exploratory geophysical work and drillings in Poland on a few dozen prospects in the Carpathian Mountains, Carpathian Foothills and the Polish Lowlands. The work will be conducted by PGNiG SA on its own and in cooperation with foreign partners.

In 2013, PGNiG SA also intends to pursue projects focused on exploring new potential opportunities in the area of unconventional resources (shale oil/gas and tight gas), where little appraisal has so far been made. In Pomerania, the Company plans to drill the Lubocino-3h well as part of the drilling campaign covering the Lubocino structure, and fracture the Piaski-3 well. In the Lublin area, further analyses will be performed in the Lubycza Królewska-1 well. The Company has plans to drill more wells in both Pomerania and the Lublin region. In the Carpathian Mountains, final formation testing is to be performed in the Dukla-1 well.

Exploration abroad

In 2013, PGNiG SA will continue to explore for hydrocarbons in Egypt and Pakistan. In Egypt, it will drill its first exploration well.

Natural gas production

PGNiG SA is implementing a capital expenditure programme aimed at increasing, in a long term, 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 the annual natural gas production volume of approximately 4.5 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 and 0.1 bcm in Pakistan. In the Sanok Branch’s operating area, new wells will be brought on stream on the already producing Pruchnik, Maćkowice and Wola Różaniecka fields and the new Mołodycz field. In the Zielona Góra Branch’s operating area, there are plans to bring on stream new wells on the already producing Radlin, Jarocin and Winna Góra fields.

Crude oil production

In 2013, PGNiG SA plans to produce 750 thousand tonnes of crude oil. The increase will be related to the launch of production from the Lubiatów and Międzychód fields in late 2012 and from the Grotów field in January 2013.

4. 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. the exploration risk. This means that not all the identified potential deposit sites 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

The risk associated with exploration for unconventional gas in Poland relates to the lack of confirmed presence of *shale gas* and *tight gas*. Furthermore, even if existence of in-place petroleum is confirmed, its production may prove uneconomic due to insufficient gas recovery 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.

Unpredictable 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, the risk of hydrocarbon blowout or leakage is very high, which in turn may pose a threat to people (workers and local population), natural environment and production equipment.

Section VI: Trade and Storage

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

1. Purchases

In 2012, PGNiG SA purchased gas from abroad and, to a limited extent, from domestic suppliers. 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 transactions for natural gas supplies (using reverse flow on the Yamal Pipeline) with PGNiG Sales & Trading GmbH;
- Individual Agreement with Vitol S.A. for sales of natural gas, dated May 13th 2011, effective until October 1st 2014;
- Agreement with VNG-Verbundnetz Gas AG for sales of the Lasów natural gas, dated August 17th 2006, effective until October 1st 2016.

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

Structure of natural gas purchases by supply sources (mcm)

	2012	%	2011	%
Foreign suppliers:	10,999.9	98.9%	10,915.3	99.0%
- Gazprom Export	9,017.3	82.0%	9,335.5	85.5%
- Other foreign suppliers	1,982.6	18.0%	1,579.8	14.5%
Domestic suppliers	127.2	1.1%	112.3	1.0%
Total	11,127.1	100.0%	11,027.6	100.0%

<u>New agreements</u>

In order to reduce gas acquisition costs, PGNiG SA entered into an agreement with OGP GAZ-SYSTEM S.A. for the provision of virtual reverse services on the Yamal gas pipeline in the period from January 1st 2012 to December 31st 2015. In 2012, PGNiG SA and PGNiG Sales & Trading GmbH executed short-term agreements for supply of natural gas using the reverse flow service on the Yamal Pipeline, for a total of ca. 890.0 mcm.

On March 19th 2012, in exercise of its contractual rights under the Lasów gas sales agreement of August 17th 2006, whose term runs to October 1st 2016, PGNiG SA requested VNG-Verbundnetz Gas AG to lower the price of gas. On March 29th 2012, VNG-Verbundnetz Gas AG requested PGNiG SA to review the pricing terms of the agreement and increase the price of gas. On October 17th, PGNiG SA and VNG-Verbundnetz Gas AG executed amendment No. 1 to the agreement. The parties agreed on a new pricing formula based on the prices of petroleum products and current market prices of natural gas, and set a new capacity charge rate. The amendment came into force on October 1st 2012.

On November 5th 2012, PGNiG SA and OOO Gazprom Export executed an annex to the contract for sale of natural gas to the Republic of Poland, dated September 25th 1996, effective until December 31st 2022, whereby the pricing terms for the gas supplies to Poland were changed. The new pricing formula reflects the developments that have occurred on the European gas market in recent years, and takes into account the prices of petroleum products and the market prices of natural gas.

On December 19th 2012, PGNiG SA signed an agreement with OGP GAZ-SYSTEM S.A. for the provision of transmission services. The transmission services are provided based on the Transmission Grid Code. The agreement was executed for an indefinite term, starting from January 1st 2013, and supersedes all previous agreements.

2. Sales

In 2012, PGNiG SA signed comprehensive agreements for supply of gas fuel, both from the transmission system and from the distribution system, to 89.3 thousand new customers.

The key products sold by the Trade and Storage segment are high-methane gas and nitrogen-rich gas. In 2012, sales of natural gas rose ca. 2.2% (i.e. 306.2 mcm) year on year. The strongest growth was seen in sales to industrial customers, primarily in the oil refining and petrochemical sector, and to households. PGNiG SA sold gas on the Polish market. The structure of the Trade and Storage segment's sales in 2012 is presented in the table below.

Structure of sales of key products

		Unit	2012	2011
1	Natural gas, including:	mcm	14,005.4	13,699.2
	- high-methane gas	mcm	13,497.3	13,204.6
	- nitrogen-rich gas*	mcm	508.1	494.6
2	Propane-butane	thousand tonnes	1.5	1.9

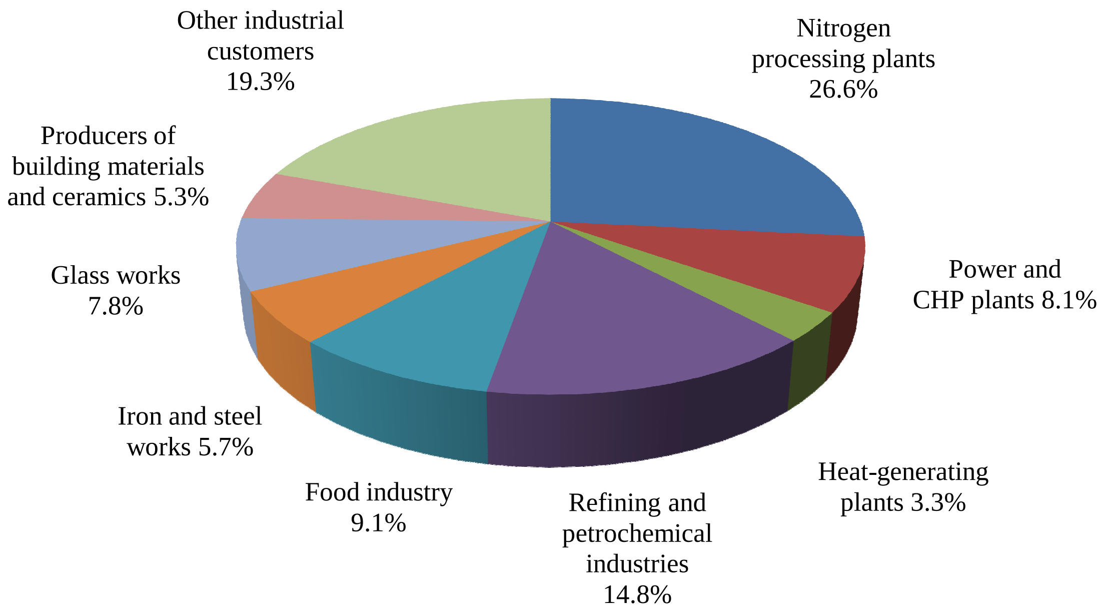
* Measured as high-methane gas equivalent.

Gas was purchased primarily by industrial customers (mainly from the chemical, oil refining, petrochemical and metallurgical sectors), as well as 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 3.3% year on year. Industrial customers had the largest share in the sales volume, with sales to this group having grown by 1.9% on 2011. The table below presents the structure of sales of natural gas (measured as high-methane gas equivalent) by customer groups.

Sales of natural gas through the national grid (mcm)

	2012	%	2011	%
Industrial customers	8,407.2	60.0%	8,252.4	60.3%
Trade and services	1,524.2	10.9%	1,468.5	10.7%
Households	3,851.6	27.5%	3,730.1	27.2%
Wholesale customers	222.4	1.6%	221.5	1.6%
Exports	0.0	0.0%	26.7	0.2%
Total	14,005.4	100.0%	13,699.2	100.0%

Structure of natural gas sales in 2012
to industrial customers



On December 20th 2012, PGNiG SA commenced trading in natural gas on the Power Exchange. In accordance with a decision by the President of the Energy Regulatory Office, trading on the exchange is exempt from the tariff obligation.

In 2012, PGNiG SA continued a gas distribution project consisting in LNG distribution of gas fuel in Ełk and Olecko. This project is a part of an initiative to switch Pisz, Ełk, Suwałki and Olecko to high-methane gas (the PESO project). The project involves the construction of an LNG regasification station and two-step pressure reduction and odorising stations in Ełk and Olecko, and switching customers in those towns to high-methane gas. The construction work is set for completion by the end of 2013. On June 29th 2012, an agreement was signed for co-financing of the project with EU funds under the Infrastructure and Environment Operational Programme.

Sales of electricity

On September 1st 2012, PGNiG SA launched sales of electricity to business customers (tariff groups A, B and C). The Company also began preparations to launch sales of electricity to households (tariff group G).

3. Storage

The Trade and Storage segment uses for its own needs 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 is not a storage facility within the meaning of the Polish Energy Law, was made available to OGP GAZ-SYSTEM S.A.

Short-term peak fluctuations in demand for natural gas are balanced out with 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.

In 2012, PGNiG SA completed the extension of the Strachocina underground gas storage facility. The facility's working capacity was increased from 150mcm to 330mcm. PGNiG SA also placed in service one of the caverns of the Mogilno facility, which increased the facility's working capacity to 411.9bcm. Following these extensions, as of May 1st 2012 PGNiG SA made available for third party access additional 214mcm of working storage capacity. The table below presents working capacities of the storage facilities as at December 31st 2012.

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

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

In 2012, PGNiG SA and Operator Systemu Magazynowania Sp. z o.o. concluded a number of agreements for provision of storage services. The highest-value agreement was concluded on May 31st 2012 and governs long-term provision of gas storage services at the Mogilno, Husów, Wierzchowice, Strachocina, Swarzów and Brzeźnica underground gas storage facilities in the period from June 1st 2012 to March 31st 2016. The aggregate value of all agreements concluded between PGNiG SA and OSM Sp. z o.o. in 2012 exceeded 10% of the PGNiG Group's revenue, and satisfied the definition of "significant agreement".

4. Planned activities

Purchases of natural gas

In 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 fuel acquisition, the Company will purchase natural gas on the German market, under short-term agreements. The gas will be delivered using the virtual reverse flow service on the Yamal gas pipeline.

Storage

In 2013, PGNiG SA will continue to work on extending the Mogilno underground gas storage cavern to include additional five chambers. The Company will also continue the construction (commenced in 2007) of the Kosakowo underground gas storage cavern, designed to store high-methane gas. Completion of the leaching process in the first storage chamber is scheduled for 2013. Placement in service of the Wierzchowice underground gas storage facility, originally scheduled for Q4 2012, was postponed to 2013. The delay was caused by temporary suspension of work by the general contractor.

In the coming years, reorganisation of storage activities is planned. Storage assets will be transferred to Operator Systemu Magazynowania Sp. z o.o., which will also provide technical support, perform management functions and be responsible for investment and operational activities relating to the storage business.

Consolidation of trading operations

In 2013, PGNiG SA intends to consolidate within the Company all its operations involving wholesale trade in natural gas, electricity, heat, certificates of electricity origin and carbon credits.

5. Risks related to trade and storage

Obligation to diversify supplies of imported gas

The maximum share of gas imported from one country in total gas imports 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 requirement 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 requirement to diversify supplies of imported gas in 2007, 2008 and 2009. The 2009 and 2010 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 similar situations 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. Its share in the gas market is estimated at approximately 96%, while the remaining share of 4% is held by suppliers from outside the PGNiG Group, which usually purchase gas from PGNiG SA. However, the planned deregulation of the Polish natural gas market will lead in the coming years to major changes on that market itself and in its legal environment. 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 release of gas prices paid by institutional customers, followed by 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 the existing as well as new gas trading entities.

Electricity generation

Absence of regulations defining support mechanisms for high-efficiency co-generation of heat and electricity and lack of a stable policy of supporting investments in renewable energy sources and co-generation are material risk factors affecting electricity generation activities. These factors are a source of uncertainty in the process of calculating electricity prices for 2013–2015. The risk affects both electricity producers and sellers and is hedged with appropriately formulated agreements for sale/purchase of property rights.

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 was 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: Other Activities

PGNiG SA’s organisational unit classified in the “Other Activities” segment is the Central Measurement and Testing Laboratory Branch. The Branch provides services ensuring accurate and reliable measurements of natural gas quality and volume. It also performs calibrations and testing of measurement devices and systems used in the natural gas industry, including testing of new measurement and analysis equipment. The Branch also offers advisory services, issues opinions, prepares expert reports, and validates and supervises field quality-testing laboratories.

In 2012, the Branch’s main areas of activity included:

- metrological inspections of measurement systems on the Yamal-Europe transit gas pipeline (Polish section),
- estimations of CO_2 emission indicators on the Yamal-Europe transit gas pipeline (Polish section),
- metrological inspections and supervision of a measurement station at Polish border (Cieszyn),
- metrological inspections of measurement systems at industrial customers’ metering stations (47 facilities),
- checking natural gas measurement systems for the purposes of assessment of CO_2 emissions by large industrial emitters, in accordance with the requirements effective by the end of 2012,
- assessment of the possibility and necessity to upgrade natural gas measurement systems for the purposes of assessment of CO_2 emissions by large industrial emitters, in accordance with the requirements that will be effective as of 2013,
- measurement oversight over the process analyser systems for the evaluation of gas quality in the transmission and distribution networks, at production sites and in storage facilities,
- validations and measurement supervision of the field laboratories controlling the quality of natural gases.

The Branch released a number of technical papers, including on the measurement and settlement of LNG collected from vessels and stored at the sea terminal, transported by road and rail tankers, as well as reports on the implementation of natural gas settlements in energy units.

The Branch provided its services mainly to companies of the PGNiG Group, EUROPOL GAZ S.A. and OGP GAZ-SYSTEM S.A.

<u>Planned activities</u>

The Branch intends to maintain its position as the leading research laboratory and an attestation centre, carrying out metrologic inspections of measurement systems and devices used in the natural gas industry. The Branch also intends to remain the key laboratory in the area of quality assessment of natural gases of all types and forms and biogas; evaluation of measurement and process analyser systems used to estimate e.g. CO_2 emissions; and in the area of measurement supervision of the field laboratories. The Branch also intends to develop services related to measurement and settlement of LNG shipped by sea.

Further, the Branch plans to expand research activities concerning gas volume converters and establish itself as a leading research centre in the area of quality assessment of natural gases and biogas.

Section VIII: Investments

In 2012, capital expenditure on property, plant and equipment and intangible assets amounted to PLN 1,652m. The table below presents the expenditure in the individual segments.

Capital expenditure (PLNm)

	2012
Exploration and Production	1,078
Trade and Storage	574
Other Activities	0
Total	1,652

In 2012, there was a change in the presentation of capital expenditure relative to the previous year. The item now includes expenditure on geophysical surveys and capitalised finance costs, but it no longer includes expenditure on dry wells.

Below are described the key projects implemented by PGNiG SA in 2012

Exploration

Capital expenditure on exploration work of PLN 408m was incurred chiefly on geophysical surveys, two wells drilled with positive results and wells on which work is still under way.

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 2012, the construction and site acceptance test of the LMG Central Facility was completed. The facility is to be placed in service in April 2013. Due to difficulties with obtaining the required approvals and permits to build the previously planned gas pipeline to the Grodzisk nitrogen rejection unit, an alternative route was set out for the high-pressure pipeline between the Wierzbno terminal and the Paproć gas production facility. In 2012, the engineering work was completed and the construction of the pipeline started. The total value of the project is estimated at approx. PLN 1.6bn. The expenditure incurred in 2012 amounted to PLN 308m.

High-pressure gas pipeline from Kłodawa mixing plant to LMG oil and gas production facility

The project involves the construction of a high-pressure gas pipeline from the Kłodawa mixing plant to the LMG oil and gas production facility, which will connect two production areas and enable transmission of natural gas from the Dębno region, through the Kłodawa mixing plant and LMG oil and gas production facility to the Grodzisk mixing and nitrogen rejection unit. The gas pipeline will also be used as a storage facility to cover temporary shortages of nitrogen-rich gas. 2012 saw the completion and final acceptance of the pipeline. Total expenditure on the project was PLN 105m.

Gas pipeline to KGHM

The project involves the construction of a high-pressure gas pipeline and optic-fibre cable with infrastructure, from the Kościan gas production facility to KGHM Polkowice/Żukowice; the pipeline will be used to sell natural directly to KGHM Polkowice/Żukowice. Total expenditure on the project was PLN 208m.

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 related to the operation of the hydrocarbon production area. The key investment projects included:

- upgrade and extension of the existing gas production facilities;
- development of the Rylowa-Rajsko gas field;
- completion of development of the Rudka and Góra Ropczycka gas fields;
- development of the Radlin and Wola Różaniecka wells.

Trade and Storage

In 2012, capital expenditure of the Traede and Storage segment amounted to PLN 574m, of which PLN 481m was spent on the underground gas storage facilities. Major projects in the area of underground gas storage facilities included:

- completion of work in the underground section, continued construction of the surface part and site acceptance tests for most of the units comprising the Wierzchowice underground gas storage facility;
- continued construction of the surface part of the Kosakowo underground gas storage facility and continued leaching work in the caverns;
- continued leaching work in four caverns, and completion of leaching work and placement in service of another cavern at the Mogilno underground gas storage cavern.

In addition, 2012 saw completion of the extension at the Strachocina underground gas storage facility. Total expenditure on the project was PLN 436m. The project received EU co-financing under the Infrastructure and Environment Operational Programme. Until the date of this report, the co-financing had amounted to approx. PLN 70m.

Section IX: Environmental Protection

Well and mining pit abandonment

Pursuant to the Polish Geological and Mining Law, PGNiG SA is required to properly abandon worked-out mining pits, eliminate the danger and repair any damage caused by mining activities, 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 to water courses. Furthermore, if gas wells remain unplugged, there is a risk that escaping gas could accumulate inside, posing a fire hazard. In 2012, a total of 15 wells and five mining pits were abandoned.

Carbon credit trading system

In 2012, the Zielona Góra Branch and the Odolanów Branch, as well as the Mogilno Underground Gas Storage Cavern Facility, were covered by the carbon dioxide emission trading scheme (ETS). Emissions from those installations were 85,655 Mg CO_2.

Methane emissions

2012 saw the completion of a detailed review of methane emissions from the gas distribution system. Its purpose was to estimate the volume of methane emissions from particular elements of the system, review the emission indicators applied to date, and develop uniform indicators and calculation methods for methane emissions. Standardised and reliable methane emission indicators will help reduce the cost of environmental fees and charges.

Land reclamation and non-productive asset surveying

Pursuant to the Environmental Protection Law, PGNiG SA conducts diagnosis tests, surveys and land reclamation work in the areas polluted in the course of past activities with a view to restoring them to the condition required under the environmental quality standards. In 2012, tests and surveys were undertaken in the area surrounding the abandoned well and old discovered waste pit on in the former operating area of the Zielona Góra Branch in Międzyzdroje. The Company also monitored the environmental impact of the reclaimed landfill site in Zabrze-Biskupice and a property in Zabrze, and conducted supplementary tests and surveys on a property located in Szczecin.

REACH and CLP

In 2012, PGNiG SA took measures to ensure compliance of the labelling of substances produced by the Company 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*). In 2012, PGNiG SA adjusted the Material Safety Data Sheets for natural gas, crude oil, hydrocarbon condensate, LPG, LNG, helium and nitrogen, to meet the *CLP* Regulation. The Company notified *ECHA* (*European Chemicals Agency*) of the classifications of the above substances.

Environmental Management System

In 2012, a recertification audit of the Environmental Management System was carried at the PGNiG Head Office, with a positive result. The certificate confirming compliance of the system with PN-EN ISO 14001:2005 was extended until 2015. A recertification audit was also conducted at Mazowiecka Spółka Gazownictwa Sp. z o.o. to review the company's Environmental Management System, implemented in 2011.

Section X: Other Information

Distribution of the 2011 profit

On June 6th 2012, the Annual General Meeting of PGNiG SA adopted a resolution to allocate the 2011 net profit of PLN 1,615.7m and retained earnings of PLN 72.5m to the Company's statutory reserve funds.

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

On June 6th 2012, the Annual General Meeting of PGNiG SA approved the financial statements and the Director's Report on operations of PGNiG SA, as well as the consolidated financial statements and the Director's Report on 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 2011.

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 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, along with a petition to be exempt from court fees. 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 which had not been accepted for consideration by the Supreme Court by the date of these financial statements.

Proceedings based on PGNiG SA's action against PI GAZOTECH Sp. z o.o. to rescind or declare 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 rescinded the resolution. On November 12th 2010, PI GAZOTECH Sp. z o.o. filed an appeal with the Regional Court, along with a petition to be exempt from court fees. By virtue of its decision of June 22nd 2012, the Court of Appeals in Warsaw dismissed PI GAZOTECH Sp. z o.o.'s appeal. The decision was final. On October 30th 2012, PI GAZOTECH Sp. z o.o. lodged a cassation complaint, which had not been accepted for consideration by the Supreme Court by the date of this report.

Proceedings based upon PGNiG SA's action against PI GAZOTECH Sp. z o.o. to rescind or declare invalidity of the resolution of the General Meeting of PI GAZOTECH Sp. z o.o., dated October 6th 2005, whereunder PGNiG SA was obliged to pay additional contributions in the amount of PLN 6,552,000, were brought before the Regional Court of Warsaw. On May 30th 2008, the Regional Court dismissed the Company's claim and reversed the decision concerning implementation of measures to safeguard the claim (the temporary injunction order). The proceedings to rescind or declare invalidity of the resolution on additional contributions and to maintain the safeguarding measures have been held before the Court of Appeals and the Regional Court of Warsaw since 2008. By virtue of its decision of May 25th 2010, the Court of Appeals changed the Regional Court's decision concerning maintenance of the safeguarding measures dated May 30th 2008 and dismissed the request for reversing the final decision on implementation of the safeguarding measures. By virtue of its decision of May 21st 2012, the Regional Court of Warsaw declared the resolution of the General

Meeting of PI GAZOTECH Sp. z o.o. on additional contributions invalid. The decision became final as of June 12th 2012.

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 abuse of dominant position by PGNiG SA on the domestic natural gas wholesale market, which consisted in inhibiting sale of gas against the interest of other business players or consumers and 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 UOKiK found these actions to be anti-competitive practices, concluded that PGNiG SA 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 UOKiK with the Competition and Consumer Protection Court at the Regional Court of Warsaw.

On July 4th 2011, the President of UOKiK instigated anti-trust proceedings concerning abuse of dominant position by PGNiG SA on the domestic retail natural gas market. In the President's opinion, the abuse consisted in frustrating the emergence or development of competition on the domestic natural gas wholesale and retail markets by limiting the customers' ability to terminate comprehensive gas fuel supply contracts. In the course of the proceedings, PGNiG SA voluntarily agreed to change certain contractual provisions. By virtue of the decision of April 13th 2012, the President of UOKiK resolved not to impose a fine on the Company and required the Company to change certain contractual provisions. PGNiG S.A has satisfied this requirement.

On February 9th 2012, the President of UOKiK instigated anti-trust proceedings concerning practices employed by PGNiG SA which infringe collective consumer interests. The President of UOKiK accused PGNiG SA of using in comprehensive gas fuel supply contracts a provision classified as illegal contractual clause. In the course of the proceedings, PGNiG SA voluntarily agreed to change certain contractual provisions. By virtue of the decision of August 10th 2012, the President of UOKiK resolved not to impose a fine on the Company and required the Company to introduce a new form of comprehensive agreement containing revised general provisions. PGNiG SA satisfies this requirement.

Proceedings before the Court of Arbitration

Following unsuccessful renegotiation of prices of natural gas supplied under the contract of September 25th 1996 for sale of natural gas to the Republic of Poland (the Yamal Contract), on February 20th 2012 PGNiG SA filed a petition for arbitration with the Arbitration Tribunal of Stockholm against OAO Gazprom and OOO Gazprom Export. On May 24th 2012, OAO Gazprom and OOO Gazprom Export submitted their response to the petition in which they rejected the arguments put forward by PGNiG SA. Notwithstanding the action pending before the Arbitration Tribunal, the parties reached an agreement. On November 5th 2012, PGNiG SA and OOO Gazprom Export executed an annex to the Yamal Contract whereby they changed the pricing terms for gas supplies to Poland. In connection with the agreement, PGNiG SA withdrew its petition for arbitration from the Stockholm Arbitration Tribunal and the arbitration proceedings were closed.

Section XI: Financial Performance

1. Financial performance in 2012

The financial statements of PGNiG SA and the consolidated financial statements of the PGNiG Group for 2012 were audited by Deloitte Audyt Sp. z o.o. The agreement with the audit firm was executed on June 28th 2010 for a period of three years (2010–2012). The agreement provides for:

- audit of the financial statements for 2010, 2011 and 2012 (PGNiG SA and subsidiaries);
- review of the financial statements for Q1 2011, Q1 2012 and Q1 2013 (PGNiG SA);
- review of the financial statements for H1 2010, H1 2011 and H1 2012 (PGNiG SA);
- review of the financial statements for Q3 2010, Q3 2011 and Q3 2012 (PGNiG SA);
- carrying out certain procedures required by the banks providing financing to PGNiG SA for 2010, 2011 and 2012;
- translation of the audited annual and semi-annual financial statements into English.

On June 19th 2012, an annex to the agreement was signed, whereby the scope of services provided by the auditor was changed. Translation of the audited financial statements into English was excluded from the agreement, and the scope of the agreement was extended to include:

- review of financial data related to PGNiG TERMIKA S.A. at the time of acquisition of control over the company by PGNiG SA and review of the fair value measurement of the acquired assets and liabilities of PGNiG TERMIKA S.A.;
- carrying out certain procedures required by the banks providing financing to PGNiG SA for H1 2010, 2011 and 2012.

In connection with the change of the scope of the agreement, the auditor’s fee for auditing the annual financial statements was reduced, while the fee for the other certification services was increased. The change of the fees applies to each reporting period, i.e. 2010, 2011 and 2012.

The table below presents the fees paid or payable by PGNiG SA to the auditor for 2011–2012.

Auditor’s fees (PLN)

	2012	2011
Audit of the annual financial statements	220,000*	220,000*
Other certification services, including review of financial statements	533,159*	468,942*
Tax advisory services	-	-
Other services	8,367	30,669
Total	761,526	719,611

* Fee as per the annex to the agreement, dated June 19th 2012

1.1. Key financial and business data

In 2012, PGNiG SA changed the rules for presentation of the annual financial statements prepared for the reporting period ended December 31st 2012. For a detailed description of the changes in accounting policies, see the annual separate financial statements (Note 2.5).

In 2012, PGNiG SA posted a net profit of PLN 1,918m , up by PLN 185m year on year.

Summary information on PGNiG SA's financial standing in 2012 relative to 2011 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.

<u>Separate statement of financial position (PLNm)</u>

ASSETS	Dec 31 2012	Dec 31 2011	Jan 1 2011
Non-current assets	27,789	22,930	20,660
Property, plant and equipment	14,098	13,036	11,544
Investment property	2	3	3
Intangible assets	204	159	133
Financial assets available for sale	7,263	6,460	6,409
Other financial assets	5,780	2,901	2,261
Deferred tax assets	395	345	289
Other non-current assets	47	26	21
Current assets	8,852	6,321	4,834
Inventories	2,427	1,897	879
Trade and other receivables	5,172	3,170	3,295
Current tax assets	24	5	-
Other assets	17	28	14
Derivative financial instrument assets	105	285	78
Cash and cash equivalents	1,034	935	566
Non-current assets held for sale	73	1	2
Total assets	36,641	29,251	25,494

Separate statement of financial position (PLNm) – contd.

EQUITY AND LIABILITIES	Dec 31 2012	Dec 31 2011	Dec 31 2011
Equity	21,981	20,273	19,170
Share capital	5,900	5,900	5,900
Share premium	1,740	1,740	1,740
Accumulated other comprehensive income	(59)	152	76
Retained earnings/(deficit)	14,400	12,481	11,454
Non-current liabilities	7,278	2,158	1,868
Borrowings and other debt instruments	4,390	-	-
Employee benefit obligations	81	97	99
Provisions	1,576	1,154	1,077
Deferred income	559	257	76
Deferred tax liabilities	632	634	601
Other non-current liabilities	40	16	15
Current liabilities	7,382	6,820	4,456
Trade and other payables	2,763	2,660	2,824
Borrowings and other debt instruments	3,879	3,591	1,219
Derivative financial instrument liabilities	393	417	104
Current tax liabilities	-	-	136
Employee benefit obligations	190	62	50
Provisions	152	88	119
Deferred income	5	2	4
Total liabilities	14,660	8,978	6,324
Total equity and liabilities	36,641	29,251	25,494

Separate income statement (PLNm)

	2012	2011
Revenue	25,539	21,821
Total operating expenses	(23,727)	(20,625)
Raw material and consumables used	(15,483)	(13,523)
Employee benefit expense	(990)	(905)
Depreciation and amortisation expenses	(603)	(568)
Contracted services	(5,811)	(5,618)
Work performed by the entity and capitalised	13	33
Other income and expenses	(853)	(44)
Operating profit/loss	1,812	1,196
Finance income	728	1,027
Finance costs	(280)	(261)
Pre-tax profit/loss	2,260	1,962
Income tax expense	(342)	(229)
Net profit/loss	1,918	1,733

Separate statement of cash flows (PLNm)

	2012	2011
Net cash flows from operating activities	474	847
Net cash flows from investing activities	(4,579)	(2,057)
Net cash flows from financing activities	4,204	1,579
Net change in cash	99	369
Cash and cash equivalents at beginning of the period	935	566
Cash and cash equivalents at end of the period	1,034	935
Including restricted cash	233	199

Financial ratios

Profitability

	2012	2011
EBIT (PLNm)operating profit	1,812	1,196
EBITDA (PLNm) operating profit + depreciation/amortisation	2,415	1,764
ROE net profit to equity at end of the period	8.7%	8.5%
NET MARGIN net profit to revenue	7.5%	7.9%
ROA net profit to assets at end of the period	5.2%	5.9%

Liquidity

	Dec 31 2012	Dec 31 2011
CURRENT RATIO current assets (net of other assets) to current liabilities	1.2	0.9
QUICK RATIO current assets (net of other assets) less inventories to current liabilities	0.9	0.6

Debt

	Dec 31 2012	Dec 31 2011
DEBT RATIO total liabilities to total equity and liabilities	40.0%	30.7%
DEBT/EQUITY RATIO total liabilities to equity	66.7%	44.3%

1.2. Financial overview

Year on year, the Company’s operating profit (EBIT) rose by PLN 61.6m. The strengthening of the Company’s financial position was attributable chiefly to higher profitability of high-methane gas sales.

Exploration and Production

The upstream business continued to secure the stability of the Company's financial position. Operating profit of the Exploration and Production segment was PLN 1,520m, up PLN 92m on 2011. This increase followed chiefly from improved profitability of crude oil sales. As a result of the strengthening of the US dollar, crude oil selling prices rose by approximately 8%. After three new oil wells came on stream in the BMB (Barnówko – Mostno – Buszewo) field, production of crude increased by about 5%.

Compared with 2011, the balance of other income and expenses deteriorated on high new impairment losses on tangible assets recognised following an impairment test.

Trade and Storage

The Trade and Storage segment posted operating profit of PLN 295m, up PLN 525m year on year. This improvement came as a result of a strong rise in profitability of high-methane gas sales, caused mainly by a reduction in the unit purchase price of imported gas. The annex signed in November 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. An adjustment to the segment's result made in the fourth quarter to account for the changed gas import terms offset the losses incurred in the first three quarters of the year. The segment's P&L was also positively affected by sales of nitrogen-rich gas produced in Poland.

PGNiG SA's financial performance depends to a significant extent on conditions prevailing on the currency markets. The US dollar, the main currency used in settlements related to gas imports, on average appreciated relative to 2011. The effect of strengthening of the US dollar on the financial performance of PGNiG SA was contained thanks to the Company's currency risk management policy and the fact that potential depreciation of the złoty had been taken into account in the high-methane gas tariff.

Compared with 2011, the balance of other income and expenses was down PLN **568**m. The decline was caused mainly by higher impairment losses on receivables from gas sales, lower exchange differences, higher net provisions and worse performance on derivatives.

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

2012	Exploration and Production	Trade and Storage	Other Activities	Eliminations	Total
Sales to third-party customers	2,165	23,371	3	-	25,539
Intercompany sales	1,198	94	-	(1,292)	-
Segment's revenue	3,363	23,465	3	(1,292)	25,539
Segment's expenses	(1,843)	(23,170)	(6)	1,292	(23,727)
Operating profit/loss	1,520	295	(3)	-	1,812
Finance income/expenses					448
Share in net profit/loss of equity-accounted entities					-
Profit/loss before tax					2,260
Income tax					(342)
Net profit/loss					1,918

Financial data of PGNiG SA's segments for 2011 (PLNm)

2011	Exploration and Production	Trade and Storage	Other Activities	Eliminations	Total
Sales to third-party customers	1,854	19,964	3	-	21,821
Intercompany sales	1,175	-	-	(1,175)	-
Segment's revenue	3,029	19,964	3	(1,175)	21,821
Segment's expenses	(1,601)	(20,194)	(5)	1,175	(20,625)
Operating profit/loss	1,428	(230)	(2)	-	1,196
Finance income/expenses					766
Share in net profit/loss of equity-accounted entities					-
Profit/loss before tax					1,962
Income tax					(229)
Net profit/loss					1,733

The result on financing operations deteriorated by PLN 318m relative to 2011, chiefly on a decline in dividends received.

The Company's financial position is illustrated by some financial ratios. Return on equity (ROE) improved from 8.5% to 8.7%. Return on assets (ROA) was 5.2%, against 5.9% in 2011, and net margin fell from 7.9% to 7.5%.

As at December 31st 2012, total assets were PLN 36,641m, up PLN 7,390m relative to the end of 2011.

Assets

Property, plant and equipment, of PLN 14,098 m as at the end of 2012 (up PLN 1,062 m, or 8%, on December 31st 2011), was the largest item of the Company's assets. The increase in the value of property, plant and equipment was primarily attributable to the projects implemented by PGNiG SA, and to revaluation of assets. In 2012, there was also a change in the classification of some expenditure on exploration. Instead of expensing expenditure on seismic surveys during the reporting period as had been done before, the Company began to capitalise the expenditure in the initial value of tangible assets.

Financial assets available for sale are another major item of assets. As at December 31st 2012, they totalled PLN 7,263m, up PLN 803m on the end of 2011. The change was attributable to increases in share capital at certain subsidiaries, including mainly PGNiG SPV1 Sp. z o.o., Exalo Drilling S.A. and PGNiG Energia S.A.

The value of other financial assets was PLN 5,780m, having grown PLN 2,879m on December 31st 2011. This growth is attributable to the increase in the value of loans advanced to related entities (including mainly to PGNiG Norway AS) and disbursement of another loan tranche to PGNiG SPV1 Sp. z o.o.

As at December 31st 2012, current assets were PLN 8,852m, up PLN 2,531m (or 40%) year on year.

Relative to December 31st 2011, there was a significant increase in inventories (by PLN 530m or 28%). The inventories disclosed in the balance sheet comprise mainly gas stored in the underground storage facilities. The rise in the value of inventories was primarily caused by the increase of the unit purchase price of imported gas, and by the higher volume of gas stocks.

Trade and other receivables rose PLN 2,002 m (63%) relative to the end of 2011. This rise is chiefly attributable to the overpayment which resulted following the introduction in November 2012 of a new pricing formula under the Yamal contract; the formula was applied retroactively to all purchases made from the beginning of 2012.

Cash and cash equivalents were PLN 1,034m, up by PLN 99 m on 2011, and followed primarily from an increase in debt under debt securities in issue.

The value and structure of current assets held by the Company guaranteed its ability to settle liabilities in a timely manner. Current ratio was 1.2 compared with 0.9 as at the end of December 2011, while quick ratio rose from 0.6 to 0.9.

Equity and liabilities

Equity is the primary source of financing of PGNiG SA's assets. Relative to the end of 2011, PGNiG SA's equity rose by PLN 1,708m, or 8%.The level of equity was determined mainly by net profit for the year (PLN 1,918 m) and the decision not to pay dividend from previous year's profit.

As at December 31st 2012, non-current liabilities were PLN 7,278 m, up PLN 5,120 m (237%) on the end of December 2011. Higher non-current liabilities were largely attributable to the notes issue and a loan contracted with PGNiG Finance AB for the purpose of financing capital expenditure and day-to-day operations.

Current liabilities rose PLN 562m (8%) relative to the end of December 2011, chiefly as a result of an increase in borrowings and other debt securities, mainly in connection with the issuance of short-term notes within the PGNiG Group.

Trade and other payables rose PLN 103 m (4%) relative to December 31st 2011. The increase was chiefly caused by growing payables under supplies of imported gas.

Due to the significant increase in external financing used by the Company, the debt-equity ratios changed. Debt to equity increased from 44,3% to 66.7% as at the end of 2012. Debt ratio (total liabilities to total equity and liabilities) went up from 30.7% to 40.0%.

Feasibility of investment plans

In 2013, PGNiG SA intends to maintain a high level of expenditure on investments, in particular on oil and gas exploration projects (including in unconventional deposits) and development of the storage infrastructure. PGNiG SA intends to finance investments both from its own funds and using external financing, e.g. raised through the issuance of notes.

Transactions concluded on non-arm's length terms

In 2012, PGNiG SA and its subsidiaries did not enter into any material related-party transactions on non-arm's' length terms.

Explanation of differences between the actual results and the forecasts for 2012

In 2012, the Company did not publish any financial forecasts.

2. Financial management

In 2012, PGNiG SA increased its external financing by launching a new domestic notes issuance programme.

On May 22nd 2012, PGNiG SA executed transaction documentation for a five-year PLN 4.5bn note programme with two banks: ING Bank Śląski S.A and Bank Pekao S.A. Under the programme, the Company may issue (by way of a private placement) fixed or floating rate notes with maturities of up to 10 years. The first placement of notes was carried out on June 19th 2012. PGNiG SA issued five-year notes with a nominal value of PLN 2.5bn. Under the programme the Company also issued short-term notes with a nominal value of PLN 1.2bn. In 2012, the Company issued notes with a total nominal value of PLN 3.7bn. As at December 31st 2012, the debt outstanding under the programme was PLN 3.7bn.

In 2012, PGNiG SA placed new issues of short-term notes under the issuance programme agreement of June 10th 2010 (as amended under two annexes of 2011). Under the programme, PGNiG SA may issue discount notes or coupon notes with maturities ranging from one month to one year, for up to PLN 7bn. The total nominal value of notes issued in 2012 was PLN 33bn. As at December 31st 2011, the debt outstanding under the programme was PLN 2.3bn.

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

Furthermore, pursuant to the agreement of December 1st 2010 (as amended under annex of 2011), the Company continued to issue short-term discount notes to the PGNiG Group companies. In 2012, the Company issued notes for a total nominal value of PLN 4.1bn. The note programme is designed to enable the flow of cash from the companies with excess liquidity and optimises liquidity management within the Group. As at December 31st 2012, PGNiG SA's debt under the notes in issue was PLN 212m.

Assessment of financial resources management

The funds available to PGNiG SA ensure timely financing of all current and planned expenditure related to the core business and investing activities. External financing is raised mainly through debt securities issue programmes. PGNiG SA also has a liquidity reserve in the form of overdraft facilities (PLN 280m in total). In 2012, the Company used the facilities to a limited extent only. The negative margin on sales of imported natural gas resulted in a downgrade of the credit rating and a considerable rise in borrowing costs. On September 5th 2012 and November 28th 2012, the rating agency Standard and Poor's downgraded PGNiG's credit rating, respectively, from BBB+ to BBB, and from BBB to BBB- with stable outlook, while on November 20th 2012 the rating agency Moody's downgraded PGNiG's credit rating from Baa1 to Baa2 with negative outlook.

2.1. Short-term investments

The financial investments made by PGNiG SA in 2012 were short-term, with maturities of up to three months. The Company invested in instruments carrying the lowest possible credit risk, mainly bank deposits, which represented 99% of the placements. Conditional purchases/sales of treasury securities accounted for less than 1% of the transactions. Such placements were consistent with PGNiG SA's financial investment policy adopted by the Company's governing bodies, and with the Issue Prospectus.

2.2. Loans and borrowings

In 2012, PGNiG SA entered into overdraft facility agreements for a total amount of PLN 280m. The table below presents the details of credit facility agreements executed by the Company in 2012.

PGNiG SA's credit facility agreements

Bank	Facility amount (PLNm)	Interest rate	Type	Maturity date
Bank Handlowy w Warszawie S.A.	40	1M WIBOR + 0.30%	working capital facility	December 31st 2013
Bank Pekao S.A.	40	1M WIBOR + 0.45%	working capital facility	July 31st 2013
PKO BP S.A.	40	1M WIBOR + 0.55%	working capital facility	July 13th 2013
BRE BANK S.A.	40	ON WIBOR + 0.30%	working capital facility	September 5th 2013
Societe Generale S.A. Polish Branch	40	1M WIBOR + 0.35%	working capital facility	August 30th 2013
ING Bank Śląski S.A.	40	1M WIBOR + 0.60%	working capital facility	December 6th 2013
Bank Millenium S.A.	40	1M WIBOR + 0.40%	working capital facility	December 18th 2013

In 2012, PGNiG SA did not terminate any credit facility agreement.

In 2012, PGNiG SA executed loan agreements only with related entities, for aggregate amounts of NOK 730m, EUR 10m and PLN 307m. Loans denominated in NOK and PLN were advanced to finance investment projects. PGNiG SA's loans were used to finance expenditure on the project in the Norwegian Continental Shelf (NOK-denominated loan), construction of a CCGT unit in Stalowa Wola, construction and extension of gas network and construction of new connections. PGNiG SA also granted a revolving loan of EUR 10m to finance day-to-day operations related to wholesale and retail trading in electricity and related products.

The table below presents detailed information on the loans advanced by PGNiG SA.

Loans advanced by PGNiG SA

Company	Loan amount (PLNm)	Currency	Interest rate	Type	Maturity date
PGNiG Norway AS	730	NOK	3M NIBOR + 2.25%	investment loan	December 20th 2021
PGNiG Sales&Trading GmbH	10	EUR	3M EURIBOR +2.00%	working capital loan	December 31st 2015
Pomorska Spółka Gazownictwa Sp. z o.o.	70	PLN	1M WIBOR + 3.00%	investment loan	December 31st 2024
Elektrociepłownia Stalowa Wola S.A.	152	PLN	3M WIBOR + 2.50%	investment loan	December 31st 2032
Elektrociepłownia Stalowa Wola S.A.	20	PLN	1M WIBOR + 2.50%	investment loan	December 31st 2032
Mazowiecka Spółka Gazownictwa Sp. z o.o.	63	PLN	1M WIBOR + 2.50%	investment loan	July 31st 2024
PNiG Jasło S.A.	2*	PLN	3M WIBOR + 2.00%	investment loan	February 28th 2018

*PLN 2m represents capitalised interest (in 2012) on a PLN 60m loan advanced in 2011.

On February 14th 2012, PGNiG SA and PGNiG Finance AB, a subsidiary, executed a loan agreement, whereby PGNiG Finance AB advanced a EUR 500m loan to the Company, bearing interest at a fixed rate of 4.064% (4% + 0.064% margin), maturing on February 13th 2017. PGNiG Finance AB financed the loan using proceeds from issue of eurobonds. PGNiG SA used the loan to finance its key investment projects and day-to-day operations.

In 2012, PGNiG SA did not terminate any loan agreements.

2.3. Guarantees and sureties

Guarantees and sureties provided by PGNiG SA in 2012 amounted to PLN 108m as at December 31st 2012, and comprised guarantees for a total amount of PLN 100m securing gas supplies by PGNiG Sales&Trading GmBH, and sureties for a total amount of PLN 8m for payment of PGNiG Energia S.A.'s liabilities.

Guarantees and sureties received by PGNiG SA in 2012 amounted to PLN 33m as at December 31st 2012, of which 42% (PLN 14m) were guarantees and sureties for less than PLN 500 thousand each. The remaining guarantees and sureties comprised performance bonds, including under gas sales contracts, and bid bonds. The most significant of them were:

- surety under civil law of PLN 3m provided by Saint-Gobain Construction Products Sp. z o.o. as security for payments for gas;
- performance bond of PLN 3m provided by PGNiG Technologie S.A. in respect of assembly of a new compressor at the Husów underground gas storage facility;
- guarantee of PLN 2m provided by FRITO LAY Sp. z o.o. as security for a gas sales contract.

2.4. Financial risk management

The main objective of PGNiG SA's financial risk management policy is to limit the volatility of cash flows related to the Company's operations to levels which are acceptable in the short- and mid-term perspective and to build the company value in the long term. In the regular course of business in 2012, PGNiG SA was exposed to a number of financial risks, and in particular to market risk (including commodity price, interest rate and currency risks) as well as liquidity and credit risks.

Market Risk

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

The key risks to which the Company is exposed include the risk of commodity price and exchange rate fluctuations, which affect the Company's gas purchases.

In 2012, PGNiG SA used the following financial instruments to manage the gas price risk:
- purchases of Asian commodity call options settled as European options;
- commodity option structures (consisting in a combination of two commodity options);

In 2012, to mitigate the currency risk the Company used the following financial instruments:
- forward contracts
- FX swaps
- purchases of currency call options.

PGNiG SA also used CCIRS transactions (to mitigate the FX and interest rate risks) to hedge the Euronotes in issue and the loan advanced to PGNiG Norway AS.

PGNiG SA used cash flow hedge accounting with respect to transactions hedging payments for gas and with respect to transactions hedging gas prices. The application of cash flow hedge accounting allows the Company to charge the effective portion of the hedge to revaluation capital reserve, which results in the matching of the effect on profit or loss of valuation of hedging instruments and the result on the hedged item. This approach allows to eliminate profit or loss volatility attributable to valuation of derivative instruments and makes it possible to offset its effect in the income statement in the same reporting period. In consequence, the economic and accounting effects of the hedge are reflected in the same period.

Credit risk

PGNiG SA's credit risk is related to the likelihood of failure by the counterparties or other entities to meet their obligations to the Company. In 2012, the Company managed credit risk by investing its free cash in instruments carrying the lowest possible credit risk (bank deposits and treasury bonds), entering into framework agreements with its counterparties (precisely defining the rights and obligations of the parties), and diversifying the group of its trading partners. PGNiG SA also worked with leading commercial banks. The key criteria for the selection of counterparties to whom the Company entrusted a portion of its assets included their financial standing as confirmed by rating agencies, and their respective market shares.

Risk of cash-flow disruptions

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

Liquidity risk

In order to mitigate liquidity risk, the Company has a liquidity reserve in the form of overdraft facilities (for a total amount of PLN 280m). PGNiG SA also prepared cash flow projections for the

Company and the Group, estimated the condition and value of assets available for sale, maintained highly liquid financial assets and maintained communication with rating agencies.

3. Projected future financial standing

In November 2012, PGNiG SA and OOO Gazprom eksport executed an annex to the Yamal contract changing the pricing terms for the supplies of natural gas to Poland. The new pricing formula reflects developments that have occurred on the European gas market in recent years and changes the sensitivity of PGNiG's financial performance to external macroeconomic factors. In 2013, the purchase price of natural gas will depend on the prices of petroleum products and the current market prices of gas. Other factors with a significant bearing on PGNiG's business performance will include conditions prevailing on the currency markets, and the position taken by the President of the Energy Regulatory Office with regard to gas fuel tariffs.

The prices of crude oil, petroleum products and gas are an essential factor determining PGNiG SA's financial position. An increase in shale gas production in the US and the construction of new LNG terminals worldwide may drive down the purchase prices of gas, and affect the outcome of renegotiations of purchase contracts. A fall in the market prices of gas would lower the cost of its acquisition.

PGNiG SA's financial performance depends to a significant extent on conditions prevailing on the currency markets. In Q4 2012 the US dollar weakened, which had a favourable effect on the cost of high-methane gas imports. However, analysts do not expect the US dollar to depreciate any further in the coming months.

Another factor with a bearing on the financial performance of the Company relates to the level of rates and charges provided for in gas fuel 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. 2013 will usher in major changes as regards the prices of gas sold by PGNiG. In December 2012, the Company 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 exemption of power utilities from the obligation to submit wholesale gas trading tariffs for approval.

As the Lubiatów and Międzychód fields came on-stream in 2012, PGNiG SA is able to increase crude oil and gas production volumes, which will support its financial performance. In 2013, the Company will intensify efforts in the area of exploration for and appraisal of both conventional and unconventional hydrocarbons.

PGNiG SA has adopted a short-term value creation strategy for the PGNiG Group until 2014. Its aim is to prepare the Group to operate on the deregulated gas market. The PGNiG Group is intent on maintaining its lead in the upstream segment, while remaining the leading supplier of natural gas, whose offering also includes heat and electricity.

Given the high level of current and planned capital expenditure, PGNiG SA uses external financing raised by issuing debt securities on the domestic and foreign markets. In February 2012, PGNiG SA contracted a loan from its subsidiary PGNiG Finance AB, which issued five-year eurobonds for EUR 500m. Then, in May 2012 PGNiG SA executed transaction documentation for a five-year PLN 4.5bn notes issuance programme addressed to investors in Poland. The first issue of five-year notes under the programme, with a nominal value of PLN 2.5bn, took place in June 2012.

In the coming quarters, PGNiG SA intends to maintain a high level of capital expenditure. The spending will focus on projects involving extension of underground gas storage facilities, maintenance of hydrocarbon production capacities, and diversification of gas supply sources, as well as on 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

President of the Management Board	Grażyna Piotrowska-Oliwa	
Vice-President of the Management Board	Radosław Dudziński	
Vice-President of the Management Board	Sławomir Hinc	
Vice-President of the Management Board	Mirosław Szkałuba	