Polskie Górnictwo Naftowe
i Gazownictwo SA

DIRECTORS' REPORT ON THE OPERATIONS OF THE PGNIG GROUP IN 2012

Warsaw, March 5th 2013

Contents:

Section I: Key Developments in 2012

January	PGNiG SA, through its subsidiary PGNiG SPV 1 Sp. z o.o., acquired 99.8% of shares in Vattenfall Heat Poland SA.
February	PGNiG Norway AS acquired a 50% interest in licence PL648S (and became the licence operator), a 20% interest in licence PL646, and a 30% interest in licence PL350B. All of the licences are located on the Norwegian Continental Shelf. PGNiG Finance AB issued the first, EUR500m tranche of five-year eurobonds.
March	The PGNiG Supervisory Board appointed Ms Grażyna Piotrowska-Oliwa as President of the PGNiG Management Board. PGNiG SA acceded to a power purchase agreement as part of the CCGT project in Stalowa Wola. The President of the Energy Regulatory Office approved a new gas fuel tariff (Part A – Gas Fuel Supply Tariff No. 5/2012). 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.
April	PGNiG SA completed construction of a high-pressure pipeline between the Kłodawa mixing plant and the LMG oil and gas production facility. The pipeline will enable the 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, and will be used as a storage facility to cover temporary shortages of nitrogen-rich gas.
May	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. PGNiG TERMIKA SA completed the construction of a wet flue gas desulphurisation unit at the Siekierki CHP plant. The unit supports eight out of the total of 14 boilers installed at the CHP and controls sulphur emissions from 70% of the CHP's generating capacity. Mr Marek Karabuła resigned from his position as member of the PGNiG Management Board.
June	PGNiG SA issued the first tranche of long-term bonds under the bond programme launched in May 2012. The nominal value of notes issued was PLN 2.5bn.

July	PGNiG Norway AS discovered a new field, Snadd Outer, within the PL212E licence area. The field lies near the Snadd North gas field and borders the Skarv field. PGNiG TERMIKA SA executed transaction documentation for a five-year PLN 1.5bn note programme with four banks: PKO BP SA Nordea Bank Polska SA, ING Bank Śląski SA and Bank Zachodni WBK SA. Under the programme PGNiG TERMIKA SA may issue (by way of a private placement) discount or coupon notes with maturities of up to one year, with the interest rate based on WIBOR+margin. PGNiG TERMIKA SA issued the first tranche of notes with a total nominal value of PLN 450m.
September	As exploration work in the PL 350 and PL 350B licence areas on the Norwegian Continental Shelf failed to confirm the assumed geology, PGNiG Norway AS discontinued work on the licences.
October	PGNiG SA and VNG-Verbundnetz Gas AG executed amendment No. 1 to the Lasów Gas Sales 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. PGNiG SA put the Lubiatów oil field and the Międzychód gas field on stream. The fields were developed as part of the Lubiatów-Międzychód-Grotów project, whose purpose is 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 launch of production from the Lubiatów and Międzychód fields will contribute to increasing the overall crude output. PGNiG SA completed its exploration programme in Denmark. As no commercial hydrocarbon flow was identified, the Felsted-1 well was abandoned and licence 1/05 expired.
November	PGNiG SA and Gazprom Export signed an annex to the contract for sales of natural gas to the Republic of Poland. In connection with the agreement, the arbitration proceedings before the Stockholm Arbitration Tribunal were closed. PGNiG SA completed the construction of a high-pressure gas pipeline and optic-fibre cable with related infrastructure from the Kościan gas production facility to KGHM Polkowice/Żukowice. The pipeline will be used to sell natural gas produced at Kościan directly to KGHM Polkowice/Żukowice.

December	The President of the Energy Regulatory Authority approved a change to Gas Fuel Supply Tariff No. 5/2012 and extended its effective term until September 30th 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. The President of the Energy Regulatory Office approved new Tariffs for Gas Fuel Distribution Services for gas distribution companies. PGNiG Norway AS launched production of oil and gas from the Skarv field. The launch of production on the Norwegian Continental Shelf is part of the PGNiG Group's strategy to increase its oil and gas output.

Section II: Information on the PGNiG Group

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

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG SA), registered office in Warsaw, ul. Marcina Kasprzaka 25, was established through transformation of the state-owned enterprise Polskie Górnictwo Naftowe i Gazownictwo into a state-owned stock company. On October 30th 1996, the Company was entered in the commercial register as Polskie Górnictwo Naftowe i Gazownictwo SA of Warsaw, under entry No. RHB 48382. On November 14th 2001, PGNiG SA was entered into the Register of Entrepreneurs of the National Court Register under No. KRS 0000059492.

On May 24th 2005, the Polish Securities and Exchange Commission admitted PGNiG shares to public trading. The Company floated its shares on the Warsaw Stock Exchange on September 23rd 2005. PGNiG shares have been listed on the Warsaw Stock Exchange since October 20th 2005. Currently, the share capital of PGNiG SA amounts to PLN 5.9bn and is divided into 5,900,000,000 shares with a par value of PLN 1 per share.

The PGNiG Group holds the leading position in most segments of the Polish gas sector, that in oil and gas exploration and production, gas fuel storage, natural gas trading and natural gas distribution. The Group's oil and gas upstream operations provide it with a competitive advantage on the liberalised gas market. In 2012, the PGNiG Group expanded its operations to include electricity and heat generation.

1. Development directions

The key strategic objective pursued by the PGNiG Group is to secure shareholder value growth. The growth in the PGNiG Group's value is to be achieved through the development of the domestic gas, electricity and heat markets and expansion into selected foreign markets. As part of the value-building process the Group launched a restructuring programme, consisting in consolidation of companies from different business areas and scale-back on activities deemed non-core. The restructuring is designed to prepare the PGNiG Group for the expected changes on the gas market and to generate cash that may be applied to finance capital expenditure.

One of the strategic objectives defined in the Group's policy is to develop its trading operations and ensure security and continuity of natural gas supplies to Poland by entering into gas purchase contracts. An appropriate diversification structure will allow the Company to supply gas to Poland from various countries and suppliers, which will significantly enhance the bargaining position of PGNiG SA and will guarantee balanced gas supplies to the Group's customers.

High commodity prices on the global markets and growing competition for access to natural gas reserves prompt the PGNiG Group to step up its efforts aimed at enhancing the growth potential of its exploration and production business in Poland and abroad by expanding its own natural gas and crude oil reserves and acquiring new licences in foreign markets.

Another important growth area for the Group is the extension and construction of underground gas storage facilities. The PGNiG Group wishes to secure sufficient storage capacity in order to enhance its ability to flexibly respond to customer needs, to secure the continuity and stability of gas supplies, and to minimise the risk of disrupted gas supplies from foreign sources.
The distribution business plays an important in the building of the PGNiG Group's value. One of the Group's strategic objectives is to improve margins in the distribution business by maximising revenue from regulated operations, rationalising costs and developing the distribution network. To facilitate these efforts, the PGNiG Group distribution companies will be consolidated.

The PGNiG Group also strengthens its presence on the electricity and heat markets and increases its engagement in the power and heat projects, i.e. construction of CCGT units and extension of municipal and industrial heat systems. The Group also intensifies its trading activity on the electricity market.

Implementation of these objectives ensures gradual transformation of the PGNiG Group from a vertically integrated gas and oil organisation into a strong power conglomerate, grouping businesses from the power and heat industries. The expansion into the electricity and heat markets will strengthen the Group's position on the power market in Poland and in Central Europe.

2. Structure of the PGNiG Group

As at December 31st 2012, the Group comprised PGNiG SA (the Parent), and 39 production and service companies, including:

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

The list of the PGNiG Group companies as at December 31st 2012 is presented in the table below.

Companies of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG SA (PLN)	Ownership interest held by PGNiG SA	% of total vote held by PGNiG SA
	Direct subsidiaries of PGNiG SA – first tier				
1	PGNiG Poszukiwania S.A.	981,500,000.00	981,500,000.00	100.00%	100.00%
in	GEOFIZYKA Kraków S.A.	64,400,000.00	64,400,000.00	100.00%	100.00%
3	GEOFIZYKA Toruń S.A.	66,000,000.00	66,000,000.00	100.00%	100.00%
4	PGNiG 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)	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%

Companies of the PGNiG Group (cont.)

	Direct subsidiaries of PGNiG SA – second tier	Share capital (PLN)	Value of shares held by PGNiG SA's subsidiaries (PLN)	Ownership interest held by PGNiG SA's subsidiaries	% of total vote held by PGNiG SA's subsidiaries
26	Poszukiwania Nafty i Gazu Jasło S.A.	100,000,000.00	100,000,000.00	100.00%	100.00%
27	Poszukiwania Nafty i Gazu Kraków S.A.	105,231,000.00	105,231,000.00	100.00%	100.00%
28	Poszukiwania Nafty i Gazu NAFTA S.A.	60,000,000.00	60,000,000.00	100.00%	100.00%
29	Poszukiwania Naftowe Diament Sp. z o.o.	62,000,000.00	62,000,000.00	100.00%	100.00%
30	Zakład Robót Górniczych Krosno Sp. z o.o.	26,903,000.00	26,903,000.00	100.00%	100.00%
31	Powiśle Park Sp. z o.o.	81,131,000.00	81,131,000.00	100.00%	100.00%
32	Biogazownia Ostrowiec Sp. z o.o.	165,000.00	165,000.00	100.00%	100.00%
33	XOOL GmbH (EUR)[1)]	500,000.00	500,000.00	100.00%	100.00%
34	Ośrodek Badawczo – Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000.00	2,550,000.00	85.00%	85.00%
35	GAZ Sp. z o.o.	300,000.00	240,000.00	80.00%	80.00%
36	PT Geofizyka Toruń Indonezja LLC w likwidacji (in liquidation) (IDR) [1)3)]	8,773,000,000.00	4,825,150,000.00	55.00%	55.00%
	Direct subsidiaries of PGNiG SA – third tier	Share capital (PLN)	Value of shares held by PGNiG SA's subsidiaries (PLN)	Ownership interest held by PGNiG SA's subsidiaries	% of total vote held by PGNiG SA's subsidiaries
1	Oil Tech International F.Z.E. (USD)[1)]	20,000.00	20,000.00	100.00%	100.00%
2	Zakład Gospodarki Mieszkaniowej Sp. z o.o.	1,806,500.00	1,806,500.00	100.00%	100.00%
3	Poltava Services LLC (EUR)[1)]	20,000.00	19,800.00	99.00%	99.00%

[1)] Amounts in foreign currencies
[2)] Financial reporting currency was changed from EUR to USD
[3)] Paid-up capital: USD 40,687.13

Changes in the PGNiG Group's structure

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 then 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%.

Further, the following changes in the Group's structure took place in 2012:

- On February 24th 2012, Mazowiecka Spółka Gazownictwa Sp. z o.o. executed two share purchase agreements, whereby it acquired an aggregate of 58 shares in GAZ Sp. z o.o. of Błonie. Thus MSG's equity exposure to GAZ rose to PLN 240,000, with the ownership interest increasing to 80%;
- On June 6th 2012, PGNiG Sales & Trading GmbH acquired 500,000 shares in XOOL GmbH, with a par value of EUR 1 per share, representing the entire share capital of the company. XOOL GmbH was acquired to expand the Group's trading activities on the German market;
- 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 Serws Sp.z o.o. was registered wit hthe 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 August 11th 2012, the General Meeting of PT Geofizyka Torun Indonesia LLC resolved to open liquidation proceedings as of August 15th 2012;
- On December 5th 2012, Mazowiecka Spółka Gazownictwa Sp. z o.o. sold all 102 shares held in GAZ MEDIA Sp. z o.o. to the Company by way of retirement for consideration;
- On December 18th 2012, Mazowiecka Spółka Gazownictwa Sp. z o.o. acquired 5,000 shares in Powiśle Park Sp. z o.o. from B.S. i P.G. Gazoprojekt S.A., thereby increasing its interest in GAZ MEDIA Sp. z o.o. to 100%.

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 the Group's structure 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.

Changes in share capital

Changes in the Group companies' share capital in 2012:

- 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.
- The share capital of Biogazownia Ostrowiec Sp. z o.o. was increased by PLN 60,000, to PLN 165,000, through an issue of 1,200 new shares with a par value of PLN 50 per share; the new shares were acquired by PGNiG Energia S.A., the company's sole shareholder, and paid for with cash; as at the end of 2012, the share capital increase was not registerd in the National Court Register.

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.

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).

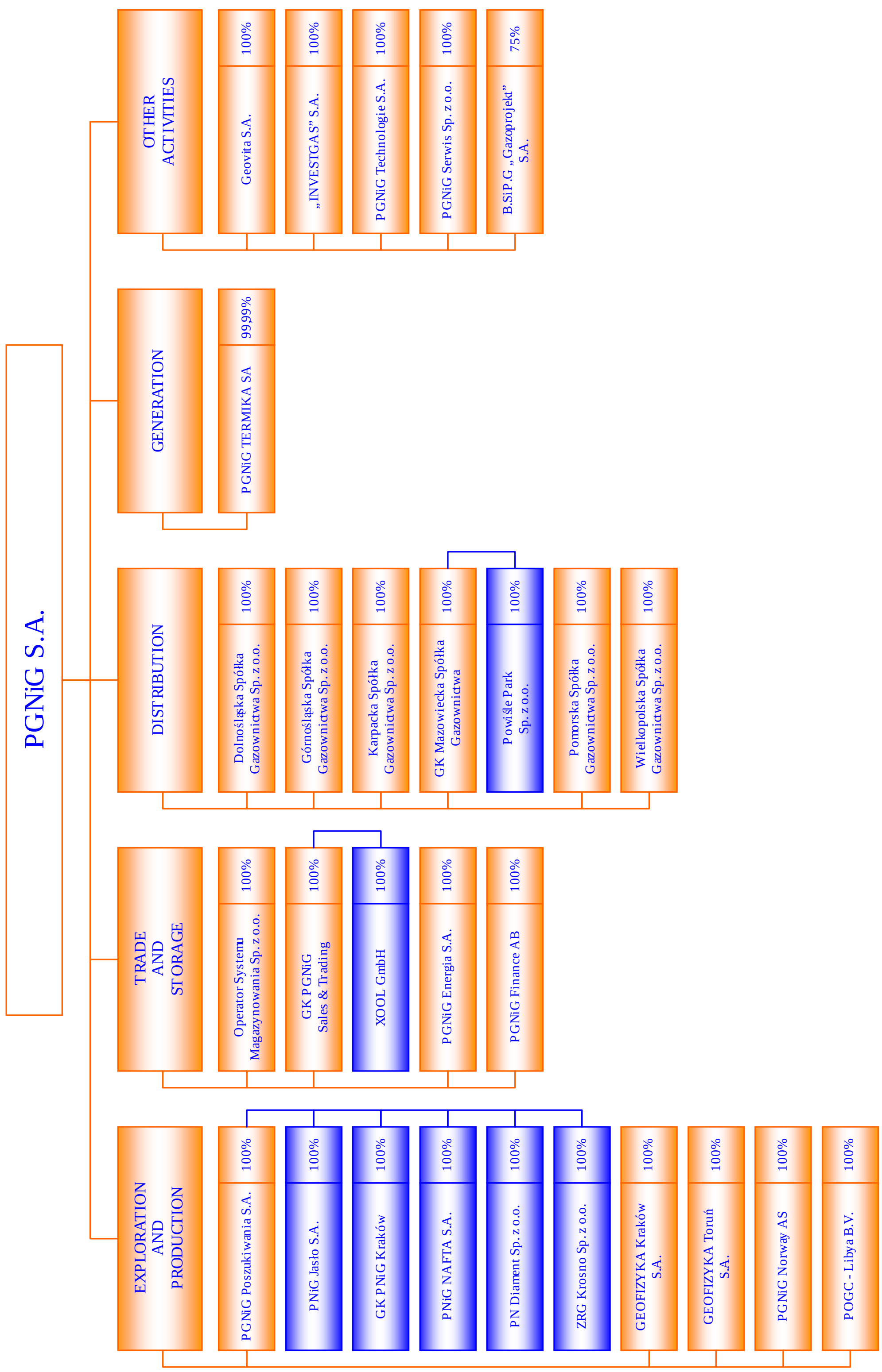
As a result of the acquisition of PGNiG TERMIKA S.A. (former Vattenfall Heat Poland S.A.) in 2012, the PGNiG Group expanded the scope of its operations to include electricity and heat generation. A new segment, Generation, was thus established and includes PGNiG TERMIKA S.A. and PGNiG SPV 1 Sp. z o.o..

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 eurobond issues.

The chart below presents the consolidated companies of the PGNiG Group as at December 31st 2012 (by segments).

CONSOLIDATED COMPANIES OF THE PGNIG GROUP



The Poszukiwania Nafty i Gazu Kraków Group comprises Poszukiwania Nafty i Gazu Kraków S.A. and its subsidiaries Oil Tech International - F.Z.E and Poltava Services LLC.

Changes in management policies

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.

3. Equity links

The list of other related entities of the PGNiG Group as at December 31st 2012 is presented in the table below.

Related entities of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG SA (PLN)	Ownership interest held by PGNiG SA	% of total vote held by PGNiG SA
	Directly related entities of PGNiG SA (first tier)				
1	System Gazociągów Tranzytowych EUROPOL GAZ S.A.	80,000,000.00	38,400,000.00	48.00%	48.00%
2	GAS-TRADING S.A.	2,975,000.00	1,291,350.00	43.41%	43.41%
3	InterTransGas GmbH (EUR)[1)]	200,000.00	100,000.00	50.00%	50.00%
4	Dewon Z.S.A. (UAH)[1)]	11,146,800.00	4,055,205.84	36.38%	36.38%
5	Sahara Petroleum Technology LLC w likwidacji (in liquidation) (OMR)[1)]	150,000.00	73,500.00	49.00%	49.00%
6	PFK GASKON S.A.	13,061,325.00	6,000,000.00	45.94%	45.94%
7	GAZOMONTAŻ S.A.	1,498,850.00	677,200.00	45.18%	45.18%
8	ZRUG Sp. z o.o. (Poznań)	3,781,800.00	1,515,000.00	40.06%	41.71%
9	ZWUG INTERGAZ Sp. z o.o.	4,700,000.00	1,800,000.00	38.30%	38.30%
10	ZRUG TORUŃ S.A. w upadłości likwidacyjnej (in bankruptcy by liquidation)	5,150,000.00	1,300,000.00	25.24%	25.24%
	Indirectly related entities of PGNiG S.A (second tier)	Share capital (PLN)	Value of shares held by PGNiG SA's subsidiaries (PLN)	Ownership interest held by PGNiG SA's subsidiaries	% of total vote held by PGNiG SA's subsidiaries
1	NAFT-STAL Sp. z o.o. w upadłości likwidacyjnej (in bankruptcy by liquidation)	667,500.00	450,000.00	67.40%	67.40%
2	Elektrociepłownia Stalowa Wola S.A.	28,200,000.00	14,100,000.00	50.00%	50.00%
3	Al Mashariq – Geofizyka Torun Limited Company (SAR)[1)] w likwidacji (in liquidation)	500,000.00	250,000.00	50.00%	50.00%
4	Gazobudowa Kraków Sp. z o.o.	79,500.00	37,500.00	47.20%	47.20%

Related entities of the PGNiG Group – cont.

	Indirectly related entities of PGNiG SA (third tier)	Share capital (PLN)	Value of shares held by PGNiG SA's subsidiaries (PLN)	Ownership interest held by PGNiG SA's subsidiaries	% of total vote held by PGNiG SA's subsidiaries
1	Przedsiębiorstwo Badawczo-Usługowe Petromin Sp. z o.o. w likwidacji (in liquidation)	200,000.00	80,000.00	40.00%	40.00%
2	Geotermia Sp. z o.o.	4,000.00	1,000.00	25.00%	25.00%

[1)]In foreign currencies

Changes in the Group's ownership interests in other related entities in 2012:

- On February 24th 2012, by virtue of a court decision, NAFTEK Sp. z o.o. w likwidacji (in liquidation) was deleted from the National Court Register.
- On May 8th 2012, the Extraordinary General Meeting of Al Mashariq – Geofizyka Torun Limited Company adopted a resolution to open liquidation proceedings;
- On October 9th 2012, the District Court in Toruń declared bankruptcy of ZRUG TORUŃ S.A. and opened liquidation of the company's assets.
- On December 19th 2012, the Extraordinary General Meeting of Przedsiębiorstwo Badawczo Usługowe Petromin Sp. z o.o. resolved to wind up the company and initiate the liquidation process.

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

As at the end of 2012, the total par value of PGNiG SA's equity interests held outside the group of related entities was PLN 34.6m. In 2012, the PGNiG Group made no material equity investments outside the group of related entities.

4. 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 of the Group, it is disclosed separately.

Workforce by segments (no. of staff)

	2012	2011
PGNiG Head Office	617	838
Exploration and Production	10,990	12,054
Trade and Storage	3,780	3,841
Distribution	13,255	13,865
Generation	1,069	-
Other activities	2,327	2,185
Total	32,038	32,783

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 five companies of the Group. At the PGNiG Head Office, PGNiG Technologie S.A. and ZRG Krosno Sp. z o.o., it covered 139 former employees. The one-off redundancy payments to the terminated employees at the above companies were financed with PGNiG SA's Central Restructuring Fund reserve. Also, as part of the Programme, Mazowiecka Spółka Gazownictwa Sp. z o.o. and Karpacka Spółka Gazownictwa Sp. z o.o. made redundancy payments from their own funds to a total of 86 employees.

5. Sale and acquisition of natural gas

The PGNiG Group recorded revenue of PLN 28.7bn, 83% of which was derived from sales of natural gas.

Revenue (PLNm)

	2012	2011
Natural gas, including:	23,752	20,269
- high-methane gas	22,363	19,052
- nitrogen-rich gas	1,389	1,217
Crude oil	1,256	1,095
Condensate	7	5
Helium	161	58
Propane-butane	66	60
Electricity	842	11
Heat	978	0
Certificates of origin for electricity	125	0
Gas storage services	36	31
Geophysical and geological services	329	448
Drilling and well servicing services	586	578
Other sales	592	449
Total	28,730	23,004

In 2012, the PGNiG Group sold 14.6bcm of natural gas, with 95% of that amount representing 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	13,865.6	13,595.7
Exploration and Production	723.3	681.7
Total	14,588.9	14,277.4

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 III: 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 Mining
- 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

Division of responsibilities within the Management Board

The President of the Management Board supervised and coordinated the management of the Group. In addition, she was 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 Mangement 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 PGNiG SA's Management Board for Finance, with effect as of March 31st 2013. The reason of the resignation was his appointment as President (CEO) of PGNiG Norway AS.

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 & 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 38.5).

Section IV: 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.

PGNiG shares and shares in PGNiG SA's related entities held by management and supervisory personnel

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

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

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.

Performance of the PGNiG stock

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:

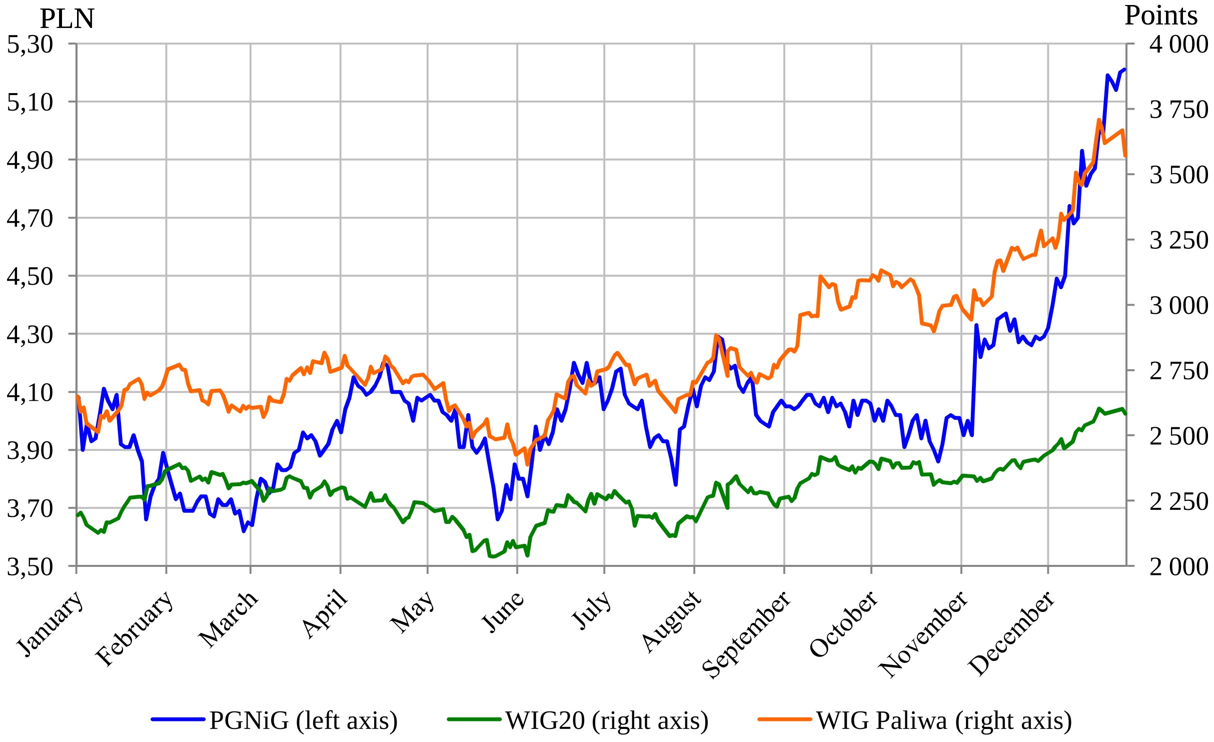
- WIG – all-cap index
- WIG20 – blue-chip index of the 20 largest and most liquid companies

- 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 shows 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 V: 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 form 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 facilityfollowing 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. PGNiG SA 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 (180mcm in 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 ito 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, superceding 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. In addition, the draft 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 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 VI: 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. The segment also provides services related to exploration for hydrocarbons and other raw materials for third-party customers. It uses storage storage capacities available at the Daszewo and Bonikowo underground gas storage facilities.

1. Exploration

In 2012, the PGNiG Group was engaged in exploration for both conventional and unconventional gas (*shale gas* and *tight gas*). The Group conducted exploration and appraisal work, both on its own and in cooperation with partners, in Poland, Pakistan, Denmark, Egypt, Norway and Libya.

1.1. Exploration in Poland

In 2012, the Group's exploration and appraisal work in Poland was conducted in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands. The Group the conducted the work on its own or in partnership with other entities. Drilling work within PGNiG's own licence areas was performed on eight exploration wells, including three research boreholes (Lubycza Królewska-1, Opalino-2 and Lubocino-2H) and one appraisal borehole.

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.

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. In addition, *reprocessing* of four archive seismic profiles with the 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.

1.2. Exploration abroad

In 2012, the PGNiG Group conducted work in licence areas in Pakistan, Denmark, Egypt, Libya and Norway. The Libyan and Norwegian projects were implemented by PGNiG subsidiaries.

<u>Pakistan</u>

PGNiG SA conducts exploration work in Pakistan on the basis of an agreement on 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.

Denmark

Since the execution of the agreement on 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.

Egypt

In Egypt, PGNiG SA conducts exploration work in the Bahariya licence area (Block 3) under an *Exploration and Production Sharing Agreement* (*EPSA*) executed with the government of Egypt of May 17th 2009. The Company holds a 100% interest in the licence. In 2012, the 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.

PGNiG Norway AS

PGNiG Norway AS has been established for the purposes of the Norwegian Continental Shelf project, the aim of which is to provide access to new recoverable reserves of oil and gas outside Poland. The principal business objective of PGNiG Norway AS is the exploration for and production of crude oil and natural gas on the Norwegian Continental Shelf. The company has been pre-qualified by the Norwegian authorities as an operator.

It holds interests in a number of exploratory and production licences on the Norwegian Continental Shelf, in the Norwegian Sea. Jointly with its partners, the company develops the Skarv, Snadd and Idun fields. PGNiG Norway AS holds a 12% interest in the deposits; other interest holders are British Petroleum (operator, 24%), Statoil (36%) and E.ON Ruhrgas (28%). In the other licence areas, the company is engaged in exploration projects.

The Skarv project is one of the largest projects under way in Norway. It involves the drilling of 17 wells, including seven oil production wells, six gas production wells and four injectors. At a later stage of the reserve life, the injectors will be transformed into producers in order to fully exploit the reserve potential. Production from the Skarv field is carried out using a floating production, storage and offloading (FPSO) vessel with a flare tower. The platform, which was built in South Korea, is the largest FPSO vessel in the world, able to operate in rough weather conditions. Its hull is 292 metres long and 51 metres wide. The load capacity of the FPSO platform is 140 thousand m^3 (880 thousand barrels), while the expected load capacity of the shuttle tankers operating on the Skarv field will amount to approx. 135 thousand m^3 (850 thousand barrels). In 2012, following delays due to difficult weather conditions, the finishing work was completed, all subsea structures (foundation slabs, gas pipelines, etc.) were installed, the technical acceptance procedure was successfully completed and the production wells were prepared for coming on stream.

December 31st 2012 saw the launch of oil and gas production from the Skarv field. The produced oil will be sold directly from the FPSO platform to Shell International Trading and Shipping Company Ltd. (under an agreement of October 19th 2011) and transported by a fleet of shuttle tankers. The produced gas will be transmitted over the subsea gas pipelines directly to the European market. On September 11th 2012, PGNiG Norway AS and PGNiG Sales&Trading GmbH signed an agreement under which PGNiG Norway AS will be selling to PGNiG Sales&Trading GmbH its share of the natural gas produced from the Skarv field. The agreement was concluded for a period of ten years, and its value is estimated at EUR 1.3bn. The selling price will be determined with reference to gas prices quoted on the *European Energy Exchange (EEX)*, and payments for gas deliveries will be settled in EUR.

In 2012, PGNiG Norway AS was also engaged in exploration work. In late 2011 and early 2012, an exploration well was drilled in the PL350 licence area. Results from the well were not satisfactory, and the company decided to discontinue work in this licence area. Licence PL350 and its PL350B extension were relinquished to the Norwegian authorities. In 2012, the Company also carried out exploration work in the PL212E and PL558 licences. The work in the PL212E licence resulted in the discovery of the Snadd Outer field. PGNiG Norway AS's interest in the newly discovered field is 15%.

In 2012, following the conclusion of a licencing round, PGNiG Norway AS acquired:
- a 50% interest in and the direct operatorship of licence PL648S,
- a 20% interest in licence PL646, the direct operatorship of which was awarded to Wintershall Norge AS (40% interest),
- a 30% interest in licence PL350B, the direct operatorship of which was awarded to E.ON Ruhrgas Norge AS (40% interest), the licence expired in September in 2012.

In 2012, PGNiG Norway AS took part in two licence rounds. The rounds will be concluded in H1 2013.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	0	0
Net profit (loss)	PLNm	74	-132
Equity	PLNm	370	291
Total assets	PLNm	5,019	4,661
Headcount as at December 31	persons	22	23

In 2013, PGNiG Norway AS plans to produce approx. 370 thousand tonnes of crude oil and approx. 0.3 bcm of natural gas. The actual production volumes will depend on the well production rates, efficiency with of the start-up phase and the rate at which successive wells will be brought on stream.

The company will also continue appraisal work in the Snadd Outer field and its exploration and appraisal project in the Snadd field. The company intends to acquire new licence areas by participating in annual licence rounds or by acquiring interests from other entities. In future, the company wants to participate, as a partner, in drilling projects in deep-sea areas (below 1,000 metres) and in the Arctic Zone.

<u>POGC – Libya B.V.</u>

The core business of Polish Oil and Gas Company – Libya B.V. consists in exploration for and production of hydrocarbons in Libya. The company conducts exploration work in licence area No. 113 located within the Murzuq petroleum basin in Libya, under an *Exploration and Production Sharing Agreement* of February 25th 2008 concluded with the Libyan government.

In 2012, POGC – Libya B.V. reopened its Tripoli office and commenced implementation of safety procedures necessary to ensure safety of employees of the Tripoli branch office and of field workers. In the second half of 2012, the force majeure event was declared to have ceased and exploration work under the EPSA, suspended in 2011 due to the civil war in Libya, was resumed. At the time of resuming the work, the company obtained all necessary drilling permits and ordered performance of preparatory work related to the planned drilling activities.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	0	0
Net profit (loss)	PLNm	-9	-21
Equity	PLNm	315	48
Total assets	PLNm	321	53
Workforce as at December 31	persons	58	36

In 2013, the company intends to complete the preparatory work and drill three exploration wells. The company also plans to commence the last stage of 3D seismic work and acquire an additional 2D seismic survey. In a longer run, the company assumes it will be awarded new projects in Libya under the DPSA (*Development and Production Sharing Agreement*) and EPSA.

1.3. Exploration services

In 2012, Exploration and Production companies rendered services involving geophysical and drilling work and performed specialists well servicing activities. Drilling operations were conducted in search for hydrocarbons and other minerals. The companies provided services for the PGNiG Group and third-party customers.

GEOFIZYKA Kraków S.A.

GEOFIZYKA Kraków S.A. offers geophysical services (2D/3D vibroseis and dynamite data acquisition), well logging data processing and interpretation, measurements, special well interventions, interpretations, perforating and downhole seismic surveys.

In 2012, GEOFIZYKA Kraków S.A. generated revenue of PLN 169m, 59% of which was derived from services rendered in Poland, mainly to companies related to the PGNiG Group. The company rendered 2D and 3D seismic services and performed well logging. GEOFIZYKA Kraków S.A. was also engaged in field seismic work for Energia Karpaty Zachodnie Sp. z o.o. and carried out microseismic surveys for ENI Polska Sp. z o.o. and the University of Science and Technology in Kraków**.** On foreign markets, the company provided 2D and 3D seismic services exclusively for third-party customers, i.e. OMV Exploration & Production GmbH in Austria, Hjørring Varmeforsyning in Denmark, RWE Gas Storage in the Czech Republic and OGDCL in Pakistan. Sale of services to third-party customers outside Poland accounted for 41% of the company's total revenue.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	169	247
Net profit (loss)	PLNm	-16	9
Equity	PLNm	86	103
Total assets	PLNm	232	236
Workforce as at December 31	persons	1,182	1,604

In 2013, on the domestic market, GEOFIZYKA Kraków S.A. will provide 2D and 3D seismic services to PGNiG SA. Outside Poland, the company will perform 3D seismic services for OMV Exploration & Production GmbH in Austria and 2D and 3D seismic services for POGC – Libya B.V.

GEOFIZYKA Toruń S.A.

GEOFIZYKA Toruń S.A. offers a range of seismic services, from design and data acquisition, to digital data processing, to comprehensive geophysical and geological interpretations. The company also provides services in the area of well logging and well interventions, including interpretation of well data. Further, the company's offering includes a variety of near-surface geophysical services in the field of geology, hydrogeology and environmental protection, as well as design and delivery of deep anode groundbeds for cathodic protection.

In 2012, GEOFIZYKA Toruń S.A. generated revenue of PLN 349m. Sale of services to customers outside the PGNiG Group accounted for 73% of total revenue. On foreign markets, the company provided services mainly to third-party customers. The services primarily included acquisition of 2D and 3D seismic data and were provided in Germany, India, Egypt and Hungary. In Poland, the company continued seismic data acquisition for FX Energy Poland Sp. z o.o., BNK Polska Sp. z o.o. and Wisent Oil&Gas Sp. z o.o. The services provided for entities related to the PGNiG Group included acquisition, processing and interpretation of seismic data and well logging.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	349	371
Net profit (loss)	PLNm	12	21
Equity	PLNm	189	188
Total assets	PLNm	262	253
Workforce as at December 31	persons	1,576	1,881

In 2013, on the domestic market, GEOFIZYKA Toruń S.A.'s operations will include acquisition, processing and interpretation of 2D and 3D seismic data and in-well measurements, including data interpretation. The services will be rendered to third-party customers, i.e. FX Energy Poland Sp. z o.o., Cuadrilla Poland Sp. z o.o., Lane Energy Poland Sp. z o.o., and PGNiG SA. On foreign markets, the company will continue the data acquisition projects in Germany and India. GEOFIZYKA Toruń S.A. will also execute a new project involving seismic field work in Italy.

PNiG Jasło S.A.

The business of Poszukiwania Nafty i Gazu Jasło Spółka z o.o. comprises drilling of core, exploration and production wells, well workovers, well abandonment services, provision of specialist well servicing services such as cementing, mud services or well completions, as well as operation of drilling rig instrumentation and control systems.

In 2012, the company recorded revenue of PLN 148m, 75% of which was revenue from services rendered to PGNiG SA. These services included drilling exploratory, appraisal and production wells, remedial treatments, advanced recovery techniques and well abandonment services, as well as specialist services, such as mud, datawell, packer and cementing services. The services provided by the company for third-party customers included drilling gas wells for Orlen Upstream Sp. z o.o. and FX Energy Poland Sp. z o.o., drilling a geothermal well for Termo-Glob Sp. z o.o., as well as specialist services: cementing service for FX Energy Poland Sp. z o.o. and Energia Torzym Sp. z o.o.

Sp. k., and packer service for Hydro Nafta Sp. z o.o. The company also provided specialist services abroad: data-well services in Ukraine and cementing services in Lithuania.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	148	302
Net profit (loss)	PLNm	-77	2
Equity	PLNm	66	141
Total assets	PLNm	262	280
Workforce as at December 31	persons	814	917

PNiG Kraków Group

The PNiG Kraków Group comprises Poszukiwania Nafty i Gazu Kraków S.A., as well as its subsidiaries – Oil Tech International – F.Z.E. and Poltava Services LLC. Poltava Services LLC was established in Ukraine in 2011. The core business of PNiG Kraków S.A. comprises geological, exploration and production drillings, well workovers, as well as drilling, testing and operation of wells. The company also provides hospitality, catering, rental and training services. Oil Tech International – F.Z.E. provides drilling teams, materials, machinery and equipment. Poltava Services LLC's services include drilling and lease of drilling teams.

In 2012, the PGNiG Kraków Group generated PLN 333m of total revenue. Services performed for third-party customers provided revenue of PLN 296m, which accounted for 89% of the company's total revenue; exports represented 87% of the total. In 2012, the PNiG Kraków Group continued drilling work in Uganda, Kazakhstan, Pakistan and Ukraine. The group has also signed new contracts for drilling in Uganda, Ukraine and Ethiopia, and commenced work under these contracts. In 2012, the group completed its work in the Czech Republic. On the domestic market, the PNiG Kraków Group's main customer was PGNiG SA, for which the group drilled mainly exploratory and appraisal wells, including shale gas exploratory wells.

Group's highlights

	Unit	2012	2011
Revenue	PLNm	333	421
Net profit (loss)	PLNm	16	17
Equity	PLNm	152	175
Total assets	PLNm	488	498
Workforce as at December 31	persons	1,036	1,226

PNiG NAFTA S.A.

The core business of Poszukiwania Nafty i Gazu NAFTA S.A. comprises exploration for oil and gas, including in particular designing and drilling appraisal, exploration and production boreholes and preparing borehole documentation. The company also drills wells for underground storage of gas, decommissions wells in used-up reserves, reconstructs developed wells, and provides support services through its workshop (specialising in repair of drilling equipment) and storage facilities.

In 2012, the company posted revenue of PLN 239m, with 71% of that amount representing sales of services to third-party customers. The company traded mainly on the Polish market. The services primarily included drilling work for Energia Torzym Sp. z o.o. Sp. k., ORLEN Upstream Sp. z o.o. and FX Energy Poland Sp. z o.o. The company also drilled wells for companies exploring for shale gas: Talisman Energy Polska Sp. z o.o., Chevron Polska Energy Resources Sp. z o.o. and ORLEN Upstream Sp. z o.o. Work on export contracts included continued drilling work in Egypt and a new drilling project in Georgia. For PGNiG SA, the company drilled exploratory wells and performed workovers in Poland.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	239	302
Net profit (loss)	PLNm	-5	16
Equity	PLNm	188	201
Total assets	PLNm	346	359
Workforce as at December 31	persons	808	860

PN Diament Sp. z o.o.

The core business of PN Diament Sp. z o.o. are specialist well services, including drillings, major remedial treatments, well abandonment services, cementing services, enhanced recovery techniques and other services with the use of coiled tubing and nitrogen equipment, as well as well completion, downhole measurements, drillstem testing and mud services. The company's also renders general, road and environmental construction services.

In 2012, PN Diament Sp. z o.o. generated PLN 201m of total revenue, of which 55% was earned on services rendered to third-party customers. The services provided to third-party customers comprised mainly drilling of research boreholes, including two wells drilled for KGHM Polska Miedź S.A. in its copper deposits licence area, five wells in Lithuania and two exploratory wells for Liesa Energy Sp. z o.o. The company also performed well servicing in Lithuania, Ukraine, Spain and Romania and carried out general and road construction work, as well as construction and reclamation of waste dumps.

The projects executed for the PGNiG Group involved remedial treatments, workovers, well abandonment (including abandonment of PGNiG SA's well in Denmark) and other specialist well services, such as mud services, testing and completion, cementing of casing strings, acidizing, setting of cement plugs and services with the use of coiled tubing, slickline and nitrogen equipment.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	201	206
Net profit (loss)	PLNm	3	10
Equity	PLNm	104	103
Total assets	PLNm	196	152
Workforce as at December 31	persons	723	707

ZRG Krosno Sp. z o.o.

Zakład Robót Górniczych Krosno Sp. z o.o. is a provider of well servicing services. Its business includes mainly well interventions, such as workovers of active oil and gas wells, shallow drillings, coring, well abandonment services, decommissioning of infrastructure and waste pits, and other reclamation work. The company also performs a wide range of well servicing activities consisting in the application of enhanced recovery techniques, measurements and laboratory services.

In 2012, ZRG Krosno Sp. z o.o. generated PLN 50m in revenue, with the services provided to PGNiG SA accounting for 55% of the total. The work performed for PGNiG SA consisted in well intervention services, including workovers, well reconditioning, application of enhanced recovery techniques and measurement of reservoir parameters. The company also rendered services to third-party customers in Poland and abroad. In Poland, it completed drilling of the coal well for NWR KARBONIA S.A, rendered well stimulation services for Geotermia Podhalańska S.A. and measured reservoir parameters for DART ENERGY Poland Sp. z o.o. Foreign operations included the workover and decommissioning of wells for RWE Gas Storage s.r.o. and Unigeo (the Czech Republic) and well stimulation for Tacrom Services s.r.l. (Romania).

Company's highlights

	Unit	2012	2011
Revenue	PLNm	50	72
Net profit (loss)	PLNm	-10	1
Equity	PLNm	32	43
Total assets	PLNm	50	59
Workforce as at December 31	persons	360	395

In December 2012, PGNiG SA consolidated its exploration and service 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. The companies' assets were transferred to PGNiG Poszukiwania S.A., which was renamed Exalo Drilling S.A. on February 6th 2013.

In 2013, Exalo Drilling S.A. will provide drilling services related to hydrocarbon exploration (including exploration for shale gas), copper exploration and geothermal borehole drilling. The company intends to continue as a provider of well service treatments and well intervention services (in particular workovers), well stimulation, reservoir measurements and well abandonment services.

PGNiG SA will continue to be the main customer of Exalo Drilling S.A. on the domestic market. Other key customers will include Polish and foreign investors holding licences for hydrocarbon exploration in Poland, such as Orlen Upstream Sp. z o.o., FX Energy Sp. z o.o., Lane Energy Poland Sp. z o.o. and ExxonMobil Usługi Sp. z o.o. The company also intends to drill for copper for KGHM Polska Miedź S.A. and Mozów Copper Sp. z o.o and to drill a geothermal borehole for Geotermia Podhalańska and a ventilation shaft for KWK Knurów-Szczygłowice.

Foreign market operations will involve continued execution of drilling projects in Uganda, Egypt, Ethiopia, Georgia, Kazakhstan, Pakistan, Ukraine and Lithuania, provision of services with the use of coiled tubing and nitrogen equipment and data-well services in Ukraine. The company also plans to render workover and well abandonment services in the Czech Republic.

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	723.3	681.7
	- high-methane gas	mcm	71.9	63.9
	- 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	455.7	489.8
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.

Underground gas storage facilities

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, the PGNiG Group 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 carried out 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, the PGNiG Group will continue to explore for hydrocarbons in Egypt and Pakistan. In Egypt, it will drill its first exploration well. In Norway, PGNiG Norway AS will continue appraisal work in the Snadd Outer field and its exploration and appraisal project in the Snadd field. POGC – Libya B.V. plans to drill three exploration wells, commence the last stage of 3D seismic work and acquire an additional 2D seismic survey.

Natural gas production

The PGNiG Group 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 4.8 bcm of high-methane gas equivalent with a calorific value of 39.5MJ/cubic meter, of which approximately 4.4 bcm will be produced in Poland, 0.3 bcm in the Norwegian Continental Shelf 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. Also, the PGNiG Group will continue to produce hydrocarbons from the Skarv field and commence natural gas production in Pakistan.

Crude oil production

In 2013, the PGNiG Group plans to produce ca. 1,120 thousand tonnes of crude oil, including 750 thousand tonnes in Poland and 370 thousand tonnes in the Norwegian Continental Shelf. The 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

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 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. In addition, 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.

<u>Cost of exploration</u>

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.

<u>Safety, Environmental Protection and Health Regulations</u>

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.

<u>Qualified personnel</u>

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.

Unforseen 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.

Changes in laws and regulations

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

Political and economic situation

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

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

In certain countries, operations of exploration companies may be hindered by the lack of adequate infrastructure, which may be an obstacle in transporting equipment, personnel and materials to the sites. Problems may also arise in providing supplies and ensuring appropriate health care. These risks may lead to a limitation or suspension of the Company's exploration activities.

Section VII: 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 (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%

New agreements

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, as well as 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 executed 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 executed 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. 2.0% (i.e. 269.9 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	13,865.6	13,595.7
	- high-methane gas	mcm	13,360.9	13,102.9
	- nitrogen-rich gas*	mcm	504.7	492.8
2	Propane-butane	thousand tonnes	1.2	1.8

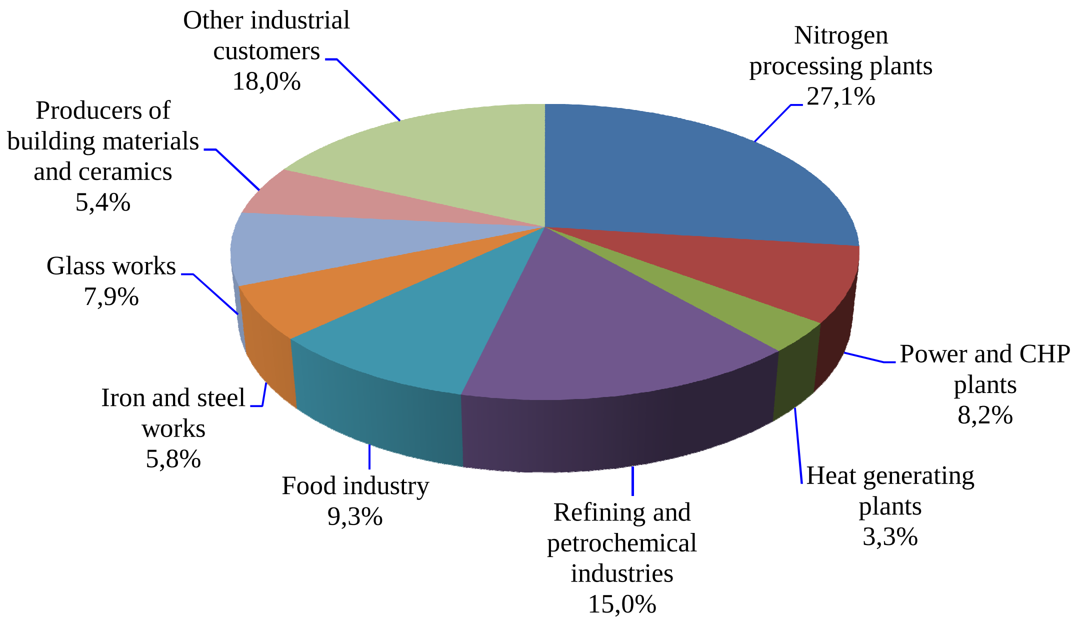
* Measured as high-methane gas equivalent.

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 1.5% 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	8,268.2	59.6%	8,149.7	60.0%
Trade and services	1,523.3	11.0%	1,467.6	10.8%
Households	3,851.7	27.8%	3,730.2	27.4%
Wholesale customers	222.4	1.6%	221.5	1.6%
Exports	0.0	0.0%	26.7	0.2%
Total	13,865.6	100.0%	13,595.7	100.0%

Structure of natural gas sales to industrial customers in 2012



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.

As of July 1st 2012, as part of long-term storage services, the PGNiG Group made available to third parties 173.5m m^3 of working capacity at the Wierzchowice Underground Gas Storage Facility. A further capacity of 1.5m m^3 was made available as of August 1st 2012.

As at December 31st 2012, the PGNiG Group made available a total of 1,821.5m m^3 of working storage capacity for third party access and for OGP GAZ-SYSTEM S.A.; of this volume, 1,796m m^3 was made available under long-term agreements and 25.5m m^3 – under short-term agreements. Additionally, 0.39m m^3 of the storage capacity of the Mogilno underground gas storage cavern is used to cover the facility's own needs. The table below presents storage facilities' working capacities and the working capacities made available to third parties as at December 31st 2012.

	Working capacities (mcm)	Working capacities made available to third parties (mcm)
Brzeźnica underground gas storage facility	65.0	65.0
Husów underground gas storage facility	350.0	350.0
Mogilno cavern underground gas storage facility	411.9	411.5
Strachocina underground gas storage facility	330.0	330.0
Swarzów underground gas storage facility	90.0	90.0
Wierzchowice underground gas storage facility	575.0	575.0
Total	1,821.9	1,821.5

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. Trade and Storage Segment's companies

Operator Systemu Magazynowania Sp. z o.o.

Operator Systemu Magazynowania Sp. z o.o. was established to ensure compliance with the requirements of Directive 2009/73/EC with respect to legal separation of gas fuel storage functions from other types of business conducted by vertically integrated gas utilities. The company provides gas fuel storage services at the Husów underground gas storage facility, the Wierzchowice underground gas storage facility, the Mogilno underground gas storage cavern, the Swarzów underground gas storage facility, the Brzeźnica underground gas storage facility, and the Strachocina underground gas storage facility. As at December 31st 2012, the company operated storage facilities with a total working capacity of 1,821.9m m^3.

On May 11th 2012, PGNiG SA and Operator Systemu Magazynowania Sp. z o.o. executed an agreement for exclusive operation of storage facilities and designation of the storage system operator. Execution of such agreement was required under the Polish Energy Law and was a precondition for appointing OSM Sp. z o.o. the storage system operator.

Until May 31st 2012, the function of the storage system operator had been performed by PGNiG SA. By virtue of a decision of the President of the Energy Regulatory Office of May 22nd 2012, Operator Systemu Magazynowania Sp. z o.o. was appointed the system operator for the period from June 1st 2012 to May 31st 2022. On May 16th 2012 the President of the Polish Energy Regulatory Office granted to OSM Sp. z o.o. a licence to store gas fuel in storage facilities, valid from June 1st 2012 to May 31st 2022.

In order to ensure equal treatment of customers, the storage services are provided based on the Rules of Provision of Storage Services and the Gas Fuel Storage Tariff. The current versions of the Rules and the Gas Fuel Storage Tariff are available on the Storage System Operator's website.

On October 29th 2012, Operator Systemu Magazynowania Sp. z o.o. and OGP GAZ-SYSTEM S.A. concluded an Inter-Operator Transmission Agreement. The agreement defines detailed terms, conditions and methods of cooperation between the companies and serves as the basis for the allotment to OSM Sp. z o.o. of throughput capacities at the inter-system physical entry points to the transmission system and at the inter-system physical exit points from the transmission system at connection points with the storage facilities. The agreement was executed based on the Transmission Grid Code drafted by OGP GAZ-SYSTEM S.A. and approved by the President of the Energy Regulatory Office on July 24th 2012.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	339	0
Net profit	PLNm	15	-1
Equity	PLNm	19	4
Total assets	PLNm	78	4
Workforce as at December 31	persons	27	3

PGNiG Sales &Trading Group

The PGNiG Sales &Trading Group comprises PGNiG Sales &Trading GmbH and its subsidiary XOOL GmbH. PGNiG Sales & Trading GmbH was established to trade on international gas and electricity markets. In 2012, PGNiG Sales & Trading GmbH acquired 100% of shares in XOOL GmbH; the acquired company sells natural gas on the German market, where its has approximately 17,000 customers.

In 2012, 74% of PGNiG Sales & Trading GmbH's revenue was derived from sales of natural gas to PGNiG SA. The fuel was supplied to Poland with the use of the available transmission capacities at the Lasów entry point and the reverse flow service on the Yamal Pipeline at the Mallnow point. In 2012, the company sold and delivered 890m m^3 of natural ags to PGNiG SA.

PGNiG Sales & Trading GmbH conducted natural gas trading activities in Germany, where it traded on the European Energy Exchange (EEX). The company also executed transactions on virtual trading platforms and concluded EFET (European Federation of Energy Traders) standard contracts for supply of natural gas on OTC markets. In order to to be able to deliver physical supplies of natural gas to the German market, PGNiG Sales & Trading GmbH executed contracts with transmission system operators in the NetConnectGermany and Gaspool market areas.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	1,462	450
Net profit (loss)	PLNm	0	-3
Equity	PLNm	38	41
Total assets	PLNm	518	221
Workforce as at December 31	persons	37	14

There are plans to consolidate PGNiG Sales & Trading GmbH's wholesale trading operations within PGNiG SA in 2013. After the transformation, the company will continue to sell natural gas and electricity to end customers in Germany.

PGNiG Energia S.A.

PGNiG Energia S.A. is engaged in preparation of investment projects, trades on wholesale electricity markets, and also trades in certificates of origin for electricity and CO_2 emission allowances.

In 2012, PGNiG Energia S.A. traded in electricity on the Polish and German wholesale electricity markets; it also traded in proprietary rights to certificates of origin for electricity generated from renewable sources and CO_2 emission allowances. The company rendered commercial balancing and customer support services for PGNiG TERMIKA SA and sold electricity to the PGNiG Group.

In 2012, PGNiG Energia S.A. generated revenue of PLN 165m, 61% of which was derived from sales to third-party customers. Sales of electricity accounted for 90% of the company's total revenue. Apart from the PGNiG Group, the company sold electricity mainly to PSE Operator S.A. and Alpiq SE. The company traded electricity also during sessions on the Polish Power Exchange.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	165	24
Net profit (loss)	PLNm	-4	-2
Equity	PLNm	34	27
Total assets	PLNm	54	32
Workforce as at December 31	persons	38	48

The merger of PGNiG Energia S.A. and PGNiG SA is planned to take place in 2013.

5. 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.

The storage business is to be reorganised in the coming years. The storage assets will be transferred to Operator Systemu Magazynowania Sp. z o.o. Also, technical and management competence, as well as investment and operating activities related to storage services will be consolidated within the company.

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.

6. Risks

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 VIII: Distribution

The segment's core business consists in the transmission of high-methane and nitrogen-rich gas, as well as of small amounts of propane-butane and coke-oven gas over the distribution network. Natural gas distribution is the business of six Gas Distribution Companies, which supply gas to households, as well as to industrial and wholesale customers. These entities are also responsible for operation, maintenance and expansion of the distribution network. Based on a decision of the President of the Energy Regulatory Office, since mid-2007 the Gas Distribution Companies have had the status of Distribution System Operators.

Until December 31st 2012, settlements with customers using the services of the Gas Distribution Companies were based on Tariffs for Gas Fuel Distribution Services, approved by the President of the Energy Regulatory Office on June 30th 2011.

By virtue of a decision of January 9th 2012, the President of the Energy Regulatory Office approved a change in the Tariff for Gas Fuel Distribution Services for Pomorska Spółka Gazownictwa Sp. z o.o. The change consisted in replacing the previous W-9 service group with two new groups: W-9A and W-9B.

By virtue of a decision of March 16th 2012, the President of the Energy Regulatory Office approved a change in the Tariff for Gas Fuel Distribution Services for Mazowiecka Spółka Gazownictwa Sp. z o.o. The change extends the scope of the Tariff to include LNG regasification services.

By virtue of decisions of December 17th 2012, the President of the Energy Regulatory Office approved new Tariffs for Gas Fuel Distribution Services for the Gas Distribution Companies; the tariffs have been applied in settlements with customers since January 1st 2013.

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

1. Dolnośląska Spółka Gazownictwa Sp. z o.o.

Dolnośląska Spółka Gazownictwa Sp. z o.o. (Lower Silesian Gas Distribution Company, "DSG") supplies gas to customers in the Wrocław province and the Zielona Góra / Gorzów Wielkopolski province, as well as in the Wolsztyn county of the Poznań Province. The total volume of natural gas transmitted by DSG over the distribution network in 2012 was 1,038.6 mcm (measured as high-methane gas equivalent), of which high-methane gas and nitrogen-rich gas accounted for approximately 719.6 mcm and 319.0 mcm, respectively. The company provides services to ca. 752.9 thousand customers. In 2012, DSG connected 8.2 thousand new customers to the gas network.

In 2012, the company continued replacement of cast-iron piping across its distribution network. Cast-iron pipelines are found in suburban areas where they are used to supply gas to a small number of customers. The company replaced low-pressure cast-iron gas pipelines in Wałbrzych (ul. Niepodległości, Burczykowskich and Beskidzka), Jawor (ul. 1-go Maja) and Bolesławiec (ul. Matejki).

Other work carried out by DSG involved extension and modernisation of the gas network. Major projects carried out in 2012 included:

- Modernisation of approximately 5 km of an intermediate pressure gas pipeline from Lądek Zdrój to Stronie Śląskie; the project was designed to eliminate leakages in the existing gas network; the project was completed;
- Continued construction work under stage I of gas network roll-out to Długołęka, as well as Domaszczyn, Kamień and Szczodre in the Długołęka commune; the project consists in construction of a medium pressure gas pipeline and a pressure reduction station; in 2012, the gas pipeline was completed and gas supply to customers was launched along the section from the Mirków gas station to the Shell service station in Długołęka, and along the section from the intersection of ul. Słoneczna and Robotnicza to ul. Polna in Długołęka, and construction work was performed along the section from the Shell service station to the intersection of ul. Słoneczna and Robotnicza in Długołęka; the construction of the gas pipeline is planned to be completed and the network is expected to be launched in Q1 2013;
- Construction of a pressure reduction station in the Miękinia commune; the project was completed;
- Continued work under stage I of gas network roll-out to Mieroszów using the LNG technology; in 2012, the construction of an LNG regasification plant, pressure reduction station and medium pressure mains was completed, including a service pipe to a major customer; the project was completed;
- Gas network roll-out to Radomierzyce and Biestrzyków in the Siechnice commune, as well as Suchy Dwór, Mędłów, Żórawina and Wojkowice in the Żórawina commune; in 2012, design work continued in respect of the main gas pipeline to these locations; during construction, the gas pipeline had to be rerouted;
- Gas network roll-out to Jerzmanowo and Jarnołtów residential estates in Wrocław; in 2012, design documentation for stage I of the project was prepared;
- Gas network roll-out to Pszenno in the Świdnica commune; in 2012, design documentation was prepared.

In 2012, the company worked on several projects which were co-financed from EU funds under the Infrastructure and Environment Operational Programme and the Province of Wrocław Regional Operational Programme, i.e.:

- Connection of the villages of Pęgów and Zajączków in the Oborniki Śląskie commune to the gas supply system; the project involves construction of medium-pressure gas pipelines with connections; in 2012, project design documents were drafted for the pipelines construction;
- Connection of the village of Krzeszów in the Kamienna Góra commune to the gas supply system; the project involves construction of medium-pressure gas pipelines with connections; in 2012, construction of the gas network and first gas connections were completed;
- Distribution network roll-out in selected locations in the Strzelin and Wiązów communes, Strzelin county; the project involves construction of high-pressure and medium-pressure gas pipelines with connections, two pressure reduction stations, as well as a connection and governor reduction station for a key customer; in 2012, design documents were drafted for stages I, II, III, IV and VI of the project and work on drafting design documents for the high-pressure gas pipeline was continued (stage V);
- Modernisation and technical upgrade of intermediate-pressure gas pipeline in ul. Sportowa and ul. Armii Krajowej in Żarów;
- Modernisation and technical upgrade of the gas network in ul. Złotoryjska, ul. Mikołaja Reja and ul. Władysława Grabskiego in Legnica;
- Modernisation and technical upgrade of the gas network in Lubin (ul. Gajowa, ul. Ptasia and ul. Wrzosowa);
- Modernisation and technical upgrade of the gas network in the Polanka housing estate, in Polkowice;
- Modernisation and technical upgrade of the gas network in ul. Kolejowa in Świdnica;
- Modernisation and technical upgrade of critical sections of the gas network in Wrocław;
- Development of gas infrastructure in ul. Bystrzycka, ul. Noworudzka and ul. Świdnicka in Wałbrzych;

- Development of gas infrastructure in ul. Spółdzielcza in Jaworzyna Śląska.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	368	356
Net profit	PLNm	66	45
Equity	PLNm	1,201	1,157
Total assets	PLNm	1,396	1,373
Length of network, excl. connections	km	7,976.7	7,809.0
Workforce as at December 31	persons	1,299	1,424

In 2013, the company will continue to connect to the gas supply system the villages of Długołęka, Domaszczyn, Kamień and Szczodre in the Długołęka commune, as well as Pęgów and Zajączków in the Oborniki Śląskie commune. The company will also continue the design work to connect to the gas network the villages of Strzelin, Kurów, Witowice and Wiązów in the Strzelin commune, Radomierzyce and Biestrzyków in the Siechnice commune, Suchy Dwór, Mędłów, Żórawina and Wojkowice in the Żórawina commune, Pszenno in the Świdnica commune, as well as the Jerzmanowo and Jarnołtów housing estates in Wrocław.

In the area covered by the DSG network, a number of other gas sellers and distributors are intensifying their activities. In future, they may take over the company's existing or prospective customers (both industrial customers and households). There are three key competitors in the region: G.EN. Gaz Energia S.A., EWE Energia sp. z o.o. and Grupa DUON S.A.

2. Górnośląska Spółka Gazownictwa Sp. z o.o.

Górnośląska Spółka Gazownictwa Sp. z o.o. (Upper Silesian Gas Distribution Company, "GSG") supplies gas to customers in the Katowice and Opole provinces, in 41 communes of the Kraków province, in 5 communes of the Łódź province and in 3 communes of the Kielce province. It serves approximately 1.3 million customers. The total volume of gas transmitted by GSG Sp. z o.o. over the distribution network in 2012 was 1,812.2 mcm.

In 2012, GSG connected 7.1 thousand new customers to the network. The company also worked on upgrading the gas network, and continued the roll-out of the grid in areas west of Częstochowa. Major projects carried out in 2012 included:

- Completion of reconstruction of the high-pressure gas pipeline from Zdzieszowice to Tworzeń (section from Wielowieś to Tworóg); the technical acceptance of the project has been completed and gas has been injected into the pipeline;
- Reconstruction of the medium-pressure gas pipeline from ul. Obrońców Poczty Gdańskiej in Zawiercie to ul. Niepodległości in Poręba; in 2012, leakage testing was performed and the project was prepared for technical acceptance;
- Reconstruction of the low-pressure gas pipeline with connections in the town of Bytom-Szombierki (Puszkina, Rostowskiego, Zakątek, Bałtycka, Tatrzańska, Małachowskiego, Dywizji Kościuszkowskiej and Podhalańska streets); the project was started and completed in 2012;
- Reconstruction of the low-pressure gas pipeline with connections in the town of Bytom (Przemysłowa, Składowa, Siemieradzkiego, Pilotów, Żwirki i Wigóry, Staszica, Orzeszkowej,

Zygmunta Starego, Myśliwca, Malczewskiego, Rejtana, Rajska, Obozowa, Robotnicza and Pionierów streets); the project was started and completed in 2012;
- Start of construction of a medium-pressure gas pipeline in the town of Chmielowice (ul. Lipowa), and in Wójtowa Wieś (ul. Wasylewskiego, ul. Kwoczka and ul. Prószkowska); in 2012, the construction of the gas pipeline in Chmielowice and design work for the gas pipeline in Wójtowa Wieś were completed;
- Construction of a gas distribution pipeline with a connection to the measurement station for the CHP complex in Bielsko Biała (ul. Tuwima); the project was started and completed in 2012;
- Start of construction of medium-pressure pipelines with a connection in Rybnik (ul. Górnośląska, ul. Orzechowa, ul. Janasa, ul. Śmiałego, ul. Rymera and ul Modrzewiowa);
- Start of construction of medium-pressure gas pipelines in Rybnik (ul. Boguszowicka, ul. Pochyła and ul. Jaśminowa);
- Drafting of design documents for a gas connection to the Katowice CHP plant;
- Upgrade, using the Compact Pipe method, of further sections of the decommissioned coke-oven gas pipeline in the Katowice province. in 2012, two sections (9.5km and 9.8km) were upgraded.

GSG Sp. z o.o. also executed two projects co-financed with EU funds under the Infrastructure and Environment Operational Programme:

- roll-out of the distribution network in the municipalities and communes of Blachownia, Herby, Wręczyca Wielka, Kłobuck, Opatów and Krzepice; the project involves construction of (i) an approximately 18 km high-pressure gas pipeline from Blachownia to Kłobuck, with a pressure reduction station, (ii) high- and medium-pressure gas pipelines and two pressure reduction stations for the towns of Herby and Blachownia, and (iii) a 52 km medium-pressure gas pipeline serving Wręczyca Wielka and Kłobuck; in 2012, design work continued and building permits were obtained for projects in Krzepice, Blachownia and other municipalities;
- roll-out of the distribution network in the Komprachcice and Dąbrowa communes; the project involves construction of 62 km of medium-pressure gas pipelines which are planned to be placed in service in 2012-2013; approximately 64% of gas network was completed in 2012.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	621	609
Net profit	PLNm	84	102
Equity	PLNm	1,655	1,620
Total assets	PLNm	1,944	1,893
Length of network, excl. connections	km	21,218.0	20,960.9
Workforce as at December 31	persons	2,583	2,631

In 2013, the company will continue the roll-out of the gas distribution system in the communes of Komprachcice, Dąbrowa, Herby, Blachownia, Wręczyca Wielka, Kłobuck, Opatów and Krzepice. The company will continue the preparation of design documentation for connection of the Elektrociepłownia Katowice CHP plant to the gas distribution network; once connected, the plant will be the company's largest customer. In the coming years, GSG will continue the roll-out of the gas distribution network in areas to the west of Częstochowa and in the Opole region, as well as the construction and modernisation of high-pressure networks delivering gas to power generation units.

The ongoing deregulation of the gas market prompted the company's peers to refocus their business away from gas distribution to gas fuel trade. EWE Energia Sp. z o.o. and its subsidiaries operate in northern parts of the GSG coverage area, providing gas distribution and trading services.

3. Karpacka Spółka Gazownictwa Sp. z o.o.

The operations of Karpacka Spółka Gazownictwa Sp. z o.o. (Carpathian Gas Distribution Company, "KSG") cover the area of four provinces in south-eastern Poland, namely the provinces of Kraków, Rzeszów, Kielce and Lublin. The company's operating area is crossed by one of the main gas pipelines of the Polish transmission system, fed with both imported and domestically-produced natural gas. The company serves ca. 1.5m customers. The total volume of gas transmitted by KSG over the distribution network in 2012 was 1,999.8 mcm.

In 2012, KSG connected 26.3 thousand new customers to the network. The company also worked on upgrading its gas distribution networks to enhance the security of network operation, and implemented network extension projects. The key projects in this area included:

- Completion of reconstruction of a 6.6 km medium-pressure gas pipeline from ul. Piłsudskiego to the Biegonice district in Nowy Sącz;
- Continued design work related to the upgrade of a 61 km high-pressure gas pipeline from Sandomierz to Ostrowiec Świętokrzyski; the project completion date was rescheduled for 2016;
- Continued design work related to the upgrade of a 37 km high-pressure gas pipeline from Parszów to Kielce; the project is scheduled for completion in 2015;
- Continued reconstruction of a 20.2 km high-pressure gas pipeline from Warzyce to Gorlice (stages IV and V in the Skołyszyn and Jasło communes); in 2012, construction and assembly work was carried out on Section I in the Skołyszyn commune and Section II in the Jasło commune (a 13.7 km section of the high-pressure gas pipeline was completed), and design work was performed on Section III covering the town of Jasło;
- Continued work on reconstruction of a 12.2 km high-pressure gas pipeline from Tuszyma to Mielec; construction and assembly work was completed in 2012;
- Design work related to the upgrade of a 20.8 km high-pressure gas pipeline from Lubienia to Parszów; the project is scheduled for completion in 2016;
- Continued design work related to the upgrade of a 10.5 km high-pressure gas pipeline from Krzeszowice to Alwernia; the project is scheduled for completion by the end of 2015;
- Continued design work related to the upgrade of a 5 km high-pressure gas pipeline from Mójcza to Masłów; the project is scheduled for completion at the end of 2014;
- Roll-out of the gas distribution network in the Szczawnica commune; the project comprises construction of a 13.5 km high-pressure gas pipeline with a pressure reduction station, and a 51 km medium-pressure gas pipeline network with connections; in 2012, the company withdrew its application for EU funding for the project due to difficulties with securing all the required approvals and permits by the specified deadline; the project was postponed until after completion of the design documentation;
- Continued design work related to the construction of a 22.2 km intermediate pressure gas pipeline from Głusk to Bychawa as part of the distribution network roll-out in the Bychawa region; the project is scheduled for completion by the end of 2016;
- Design work related to the construction of an 8.6 km intermediate pressure gas pipeline as part of the duplex supply for the city of Mielec; the project is scheduled for completion by the end of 2015.

KSG Sp. z o.o. also executed projects cofinanced from EU funds under the Infrastructure and Environment Operational Programme:

- continued distribution network roll-out in the Włodawa area; the project comprises construction of a 57.6 km high-pressure gas pipeline from Kamień to Włodawa, with an approximately 18.5 km medium-pressure gas network and three pressure reduction stations; the project is scheduled for completion in 2015; in 2012, design work was completed and the construction of high- and medium-pressure gas pipelines with auxiliary infrastructure (stage I, II and III) commenced; also, the company continued design work relating to stage IV of the project, including a distribution network in the region of Włodawa, Wola Uhruska, Hańsk and Ruda Huta;

- continued design work for the planned roll-out of the gas distribution system in the Włoszczowa and Małogoszcz communes; the project comprises construction of a 43.3 km high-pressure gas pipeline with pressure reduction stations, and a 51 km medium-pressure gas pipeline with eight gas governor stations; the project is scheduled for completion in 2015;
- continued design work for the planned roll-out of the gas distribution network to industrial and municipal customers and households in the Chęciny and Sitkówka-Nowiny communes; the project comprises construction of a 4.5 km high-pressure gas pipeline with a pressure reduction station, and a 67.2 km medium-pressure gas pipeline network with connections and gas governor stations; the project is scheduled for completion in 2015; in 2012, construction work in stage I one of the project commenced.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	795	776
Net profit	PLNm	164	154
Equity	PLNm	2,458	2,370
Total assets	PLNm	2,913	2,846
Length of network, excl. connections	km	45,397.3	45,004.6
Workforce as at December 31	persons	3,207	3,320

In 2013, KSG intends to continue design, construction and assembly work related to the roll-out of the gas distribution network in the Włodawa region, the Chęciny and Sitkówka-Nowiny communes and the Włoszczowa and Małogoszcz communes. Also, the company will continue design work related to the upgrade of the pipelines linking Sandomierz with Ostrowiec Świętokrzyski, Parszów with Kielce, Lubienia with Parszów, Krzeszowice with Alwernia and Głusk with Bychawa.

In terms of network infrastructure, KSG enjoys a considerable advantage over potential competitors in the area of traditional distribution of natural gas. However, its peers are beginning to distribute gas fuel with the use of the LNG technology. The market entry barriers are significantly lower, as entry into the LNG segment requires much less capital expenditure. LNG suppliers do not need to incur high expenditure to relocate operations to another geographical area. Global trends suggest that the share of LNG in the natural gas market will grow, with the resulting intensification of competition.

4. Mazowiecka Spółka Gazownictwa Group

Mazowiecka Spółka Gazownictwa Sp. z o.o. (Mazovian Gas Distribution Company, "MSG") supplies gas to customers in the provinces of Warsaw, Łódź and Białystok, as well as in certain parts of the provinces of Lublin, Olsztyn and Kielce. In 2012, MSG Sp. z o.o. transmitted 2,117.0 mcm of gas over the distribution system. Through the managed network gas pipelines and gas stations, the company supplies gas to ca. 1.5m customers.

In 2012, the company conducted projects related to the operation, extension and upgrade of its gas network. MSG connected ca. 24.2 thousand new customers to the gas network. Major projects carried out in 2012 included:

- Continued construction of the Błonie commune section of the medium-pressure gas pipeline from Kopytów to Pass; the project is designed to secure gas supplies to customers in the Błonie commune and to increase the volume of gas fuel collected by the largest industrial customer in the area, i.e. the Błonie-Pass Strefa Przemysłowa co-generation plant; in 2012, the design documentation for the reconstruction of gas connections was prepared and the connections switched to the newly built pipeline; the project completion was postponed until 2013
- Completion of the construction of a pressure reduction station in Kutno
- Continued construction of a pressure reduction station in Klęk-Kiełmina in the Stryków commune
- Continued of design work for the project providing for connecting the Brwinów and Pruszków municipalities to the gas network, including the construction of medium-pressure gas pipeline with a length of ca. 6.8 km; project completion is scheduled for 2014
- Construction of a medium-pressure gas-pipeline in Warsaw at ul. Zdziarska, along the eastern bank of Kanał Markowski, and at ul. Wyszkowska and ul. Chudoby along the northern bank of Kanał Markowski; in 2012, optional routes were agreed for the pipeline being designed and preparation of the pipeline feasibility study was under way
- Upgrade of a 15 km high-pressure gas pipeline from Piotrków Trybunalski to the Warta river (stage I: Piotrków); construction work commenced in 2012
- Upgrade of the Łódź Ring, including the upgrade of the high-pressure gas pipeline from ul. Konstantyna to Meszcze; the project involves a series of tasks whose execution will enable the technical condition of the gas network to be improved; the project provides for the reconstruction of ca. 52 km of gas pipelines, overhaul and upgrading work on gas stations on the gas pipelines of the Łódź Ring and the construction of high-pressure regulating station; the execution of individual stages of the project is scheduled until 2018; in 2012, concept work on project execution commenced and tender procedure for certain tasks was initiated
- Connection of Chrzęsne, Postoliska, Jarzębia Łąka, Fiukały, Zalesie and Mokra Wieś to the gas network; the project provides for the construction of medium-pressure gas pipelines with a length of ca. 19.35 km and 214 connections; in 2012, the construction of the pipelines and 51 connections was completed.

In 2012, MSG Sp. z o.o. was also engaged in execution of projects for which EU co-financing agreements had been signed, including:

- "Installation of additional gas lines in the communes of Prażmów, Tarczyn, Góra Kalwaria and Żabia Wola – stage I"; the project involves constructing about 100 km of medium-pressure gas pipeline and about 1,400 of gas service lines in 2011-2014; in 2012, 5.5 km of gas pipeline along with gas service lines were placed in service in Ustanów (Prażmów commune); in August 2012, the agreement for EU co-financing of the project was terminated, some of the reasons being difficulties encountered in timely preparation of the engineering design documentation and lack of capacity reserve in the high-pressure gas pipeline between Sękocin (Warsaw) and Lubienia, which is the potential way for feeding the gas lines planned to be constructed as part of the project; any further work on the project will depend on results of the analyses which are currently being carried out concerning the possibility to implement selected parts of the project
- "Construction of a medium-pressure gas pipeline in the villages of Kiełmina, Józefów and Zelgoszcz, to provide gas supplies to investment areas in the Stryków commune"; in 2012 construction work was conducted; completion of construction work, technical acceptance and financial settlement of the project are scheduled for 2013
- "Alteration of the gas pipeline in ul. Biegańskiego in Łódź"; construction work was completed in Q4 2012; technical acceptance and financial settlement of the project are scheduled for 2013
- "Alteration of the gas lines in Rawa Mazowiecka in order to improve security of supply for gas customers within the borders of the town and in the Łódź Special Economic Zone"; construction work was completed in Q4 2012; technical acceptance and financial settlement of the project are scheduled for 2013
- "Providing access to natural gas in the town of Suwałki based on the LNG technology"; the project involves construction of an LNG re-gasification station, a 23 km medium-pressure gas

pipeline with service lines and a pressure reduction station; construction work is scheduled for 2012-2014; in 2012, a building permit was obtained and a contractor was selected to perform the construction work on the pressure reduction station at ul. Nowomiejska; also, design work was carried out on further sections of the medium-pressure gas pipeline network and the LNG re-gasification station; construction of the gas network began and about 2.3 km of gas lines were installed

- "Development of the gas distribution system in the Białystok urban area"; the purpose of the project is to improve accessibility of mains gas in the town of Białystok and in the neighbouring communes of Choroszcz, Wasilków, Supraśl and Juchnowiec Kościelny; the project involves, among other things: extension of the high-pressure gas station in Lewickie along with construction of 9.3 km of an intermediate-pressure gas pipeline to enable the supply of gas to the municipal CHP plant, extension of the high-pressure gas station in Grabówka and construction of 18 km of new gas distribution lines; in 2012 construction and assembly work was conducted in the pressure reduction station in Lewickie, work was completed on extension of the high-pressure gas station in Grabówka (including on alteration of the medium-pressure gas pipeline); extension of medium-pressure gas pipelines in the town of Białystok and the communes of Supraśl, Choroszcz, Juchnowiec Kościelny and Wasilków was substantially completed; as part of the project, 9.2 km of gas networks and 269 gas service lines were constructed by the end of 2012
- "Installation of gas lines in the town of Stanisławów along with improvement of accessibility of mains gas in Mińsk Mazowiecki"; the project involves construction of about 20 km of intermediate-pressure gas pipeline starting from the exit point on transmission network in Rojków, construction of about 20 km of intermediate-pressure and medium-pressure gas lines in Stanisławów and construction of three new high- and medium-pressure gas stations; implementation of this project will also guarantee improved mains gas accessibility and greater security of gas supply for customers in Mińsk Mazowiecki, owing to duplex supply source for the town.

In its financial statements, MSG consolidates Powiśle Park Sp. z o.o., a company established to construct a building that will accommodate MSG's offices as well as residential units and office and commercial space for sale.

Group's highlights

	Unit	2012	2011
Revenue	PLNm	757	717
Net profit	PLNm	123	101
Equity	PLNm	2,325	2,260
Total assets	PLNm	3,100	2,937
Length of network, excl. connections	km	19,651.3	19,208.0
Workforce as at December 31	persons	2,670	2,912

In 2013, MSG Sp. z o.o. will continue to execute projects for which it obtained EU funding. The company also plans to continue the construction of the gas station in Klęk-Kiełmina in the Stryków commune, roll-out of the gas distribution networks in the Brwinów and Pruszków communes, upgrading of the high-pressure gas pipelines forming the southern part of the Łódź ring, along with the pipeline running in the direction of Piotrków Trybunalski, as well as to commence construction of selected high-pressure reduction and measurement stations enabling increased supplies to the company's pipelines from the Warsaw ring. The company intends to perform planning and documentation work related to construction of the high-pressure gas pipeline from Kozienice to Radom and connection of the gas network to the transit gas pipeline system in Zambrów, as well as to develop a method for improving gas supplies in the area of O/ZG Łódź operations.

5. Pomorska Spółka Gazownictwa Sp. z o.o.

The geographical reach of Pomorska Spółka Gazownictwa (Pomeranian Gas Distribution Company, "PSG") covers the provinces of Gdańsk and Bydgoszcz, a part of the province of Olsztyn, two communes (Sławno and Postomino) in the province of Szczecin and the Wieczfnia Kościelna commune in the province of Warsaw. The area covered by the company's operations poses certain geographical challenges to installation of gas supply lines (a large number of lakes and woods). The percentage of households and businesses connected to PSG's gas network is approximately 41%. The total volume of gas transmitted by PSG over the distribution network in 2012 was 1,176 mcm. The company provides its services to ca. 745.4 thousand customers.

In 2012, PSG worked on extension and modernisation of the gas network. PSG connected ca. 7.6 thousand new customers to the gas distribution network. Major projects in this area included:

- Completion of construction (stage 2) of a high-pressure pipeline as part of project "Duplex Supply for the City of Toruń"; the project was designed to ensure gas supplies to the city of Toruń, to industrial customers, to the municipality of Łysomice and commune of Wielka Nieszawka, and to the Pomeranian Special Economic Zone;
- Continued roll-out of the distribution network to the villages of Jonkowo, Warkały and Giedajty; construction of the pipeline delivering gas to the villages has been completed; the project is at the stage of contract execution; the project is scheduled for completion in 2016;
- Distribution network roll-out to Mała Wieś Gowińska and Wielka Wieś Gowińska; the project involves construction of medium-pressure gas pipelines and connections with a total length of ca. 26.9km; design work was conducted in 2012;
- Connection of Sonac Uśnice Sp. z o.o.; the customer's ultimate gas consumption will be ca. 8.2m m^3 annually; agreement for the construction work was executed in 2012;
- Connection of Proszkownia Mleka Sp. z o.o. of Piotrków Kujawski; in 2012 the project was completed in the Radziejów area and design work was performed for construction of a medium-pressure gas pipeline from Radziejów to Piotrków Kujawski, with connection and pressure reduction station for Proszkownia Mleka Sp. z o.o..

PSG has also worked on network roll-out projects in new areas, which received EU co-financing under the Infrastructure and Environment Operational Programme:

- Continued construction of a high-pressure gas network connecting Szczytno, Młynowo and Muławki near Kętrzyn and distribution network roll-out in the communes; in 2012, project design documents were drafted for the high-pressure gas pipeline from Rybno to Młynowo, the high-pressure gas pipeline from Młynowo to Muławki and pressure reduction and metering stations in Mikołajki and Muławki near Kętrzyn; construction work was completed on the high-pressure gas pipeline from Szczytno to Rybno (first stage), the medium-pressure gas pipeline in Barciany and the medium-pressure gas pipeline in Sątopy-Samulewo;
- Continued construction of the south-eastern gas supply for the city of Gdańsk, and the distribution network roll-out in Wiślinka and Wyspa Sobieszewska; in 2012, the projects involving construction of a high-pressure gas pipeline from Kolnik to Gdańsk, construction of a high-pressure gas station for the city of Gdańsk and construction of a high-pressure gas station for Grupa LOTOS S.A. were completed and the strategic customer Grupa Lotos S.A. was connected, the design work for the first stage of the distribution network roll-out in Wyspa Sobieszewska was completed and construction of a gas network for the first stage of the distribution network roll-out in Wiślinka was completed;
- Continued construction of the DN 300 high-pressure gas network connecting Brodnica, Nowe Miasto Lubawskie and Iława, and the distribution network roll-out; the project involves construction of high-pressure gas pipelines from Brodnica to Nowe Miasto Lubawskie with a pressure reduction and metering station and from Nowe Miasto Lubawskie to Iława and medium-pressure gas pipelines in Nowe Miasto Lubawskie and Kurzętniki; in 2012, work continued on the

design and cost estimate documentation for the high-pressure gas pipeline from Brodnica to Nowe Miasto Lubawskie with a pressure reduction and metering station in Kurzętnik and for the medium-pressure gas pipelines in Nowe Miasto Lubawskie and Kurzętniki; work on the design of the high-pressure gas pipeline from Nowe Miasto Lubawskie to Iława commenced;

- Continued work on the project "Natural gas – energy for future generations, distribution network roll-out in the Osiek and Rypin communes"; the project involves construction of a medium-pressure gas pipeline, with a total length of ca. 50km, running through the Osiek and Rypin communes; in 2012, design documentation was prepared and construction of the medium-pressure gas pipeline connecting Brodnica, Osiek and Rypin commenced; design documentation was also prepared for the pipelines delivering gas to Osiek and Rypin;
- Connection of gas supply to the areas not yet covered by the gas distribution system in the county of Kartuzy; the project involves construction of a medium-pressure gas pipeline, with a total length of ca. 97.2km, running through the Chmielno, Kartuzy, Żukowo, Przodkowo and Somonino communes; in 2012, work on design documentation was conducted for construction of the pressure reduction and metering station and the medium-pressure gas pipeline in Garcz, construction of the medium-pressure gas pipeline from Kiełpino to Mezowo and construction of connections in the Chmielno and Przodkowo communes;
- Continued work on the project "Natural gas – energy for future generations, distribution network roll-out in the Dobrcz and Koronowo communes"; the project involves construction of medium-pressure and high-pressure gas pipelines with connections and a pressure reduction and metering station; in 2012, design work was conducted for the high-pressure gas pipeline and the pressure reduction and metering station in Trzeciewiec and the medium-pressure gas pipeline connecting Trzeciewiec, Dobrcz and Koronowo;
- Continued work on the project "Natural gas – energy for future generations, distribution network roll-out in Łochowo, Łochowice and Lisi Ogon in the Białe Błota commune"; the project involves construction of medium-pressure and high-pressure gas pipelines with connections and construction of a pressure reduction and metering station; in 2012, design work was continued for the high-pressure gas pipeline from Zamość to Łochowo and the pressure reduction and metering station in Łochowo; design work commenced for the medium-pressure gas network in Łochowo and Łochowice and the medium-pressure gas network connecting the Białe Błota commune, Bydgoszcz and the Sicienko commune.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	439	425
Net profit	PLNm	85	76
Equity	PLNm	1,202	1,153
Total assets	PLNm	1,680	1,552
Length of network, excl. connections	km	10,274.0	9,898.8
Workforce as at December 31	persons	1,702	1,768

In 2013, PSG Sp. z o.o. will continue work on projects for which EU co-financing agreements were signed. Further, the company plans to commence gas network extension to Golub-Dobrzyń, Przysiek and Rozgarty in the Zławieś Wielka commune, Kąpino in the Wejherewo municipality, Grębocin near Toruń, Ciele and Zielonka in the Białe Błota commune. The company also intends to roll-out gas network in areas not yet connected to the gas distribution system and connect new customers to the network in Nakło, Występ, Paterek and Potulice.

A number of other gas distribution and trading companies operate in the PSG coverage area, including G.EN. GAZ ENERGIA S.A., US.EN.EKO, KRI S.A., ENERGO-EKO-INWEST Sp. z o.o., P.L. Energia S.A.

6. Wielkopolska Spółka Gazownictwa Sp. z o.o.

Wielkopolska Spółka Gazownictwa Sp. z o.o. (Greater Poland Gas Distribution Company, "WSG") manages a gas distribution network covering the provinces of Poznań and Szczecin, several communes in the provinces of Zielona Góra / Gorzów Wielkopolski, Łódź and Wrocław, as well as one commune in the province of Gdańsk. The percentage of households and businesses connected to WSG's gas network is approximately 43.9% (ca. 74% in towns, ca. 54% in large urban areas, ca. 28% in mixed urban and rural areas, and ca. 18% in typical rural areas).

The total volume of gas transmitted by WSG over the distribution network in 2011 was 1,570.2 mcm (measured as high-methane gas equivalent), including ca. 1,367.1 mcm of high-methane gas, 112.6 mcm of nitrogen-rich (Lw) gas and ca. 90.5 mcm of nitrogen-rich (Ls) gas. At the end of 2012, the total number of customers served by the company was 926.9 thousand.

In 2012, the company conducted projects related to the operation, extension and upgrade of its gas network. Also, WSG connected ca. 7.3 thousand new customers to the gas network. Major projects carried out in 2012 included:

- Completion of switching gas supply systems in the Kościan-Śmigiel distribution area, including gas supply to the ETEX economic zone;
- Completion of the extension of the medium-pressure gas network in Kąkolewo in the municipality of Osieczna;
- Completion of construction of a pressure reduction station in Żukowice;
- Completion of construction of a high-pressure pressure reduction station in Polkowice;
- Completion of construction of a pressure reduction station in Goleniów;
- Connection of the Włoszakowice, Lipno and Przemęt communes to the gas network; in 2012, design work was performed for the medium-pressure gas network from Włoszakowice to Grotnik;
- Construction of the high-pressure gas network Malanów-Tuliszków-Konin Rumin; the project is designed to increase the security of gas supplies to the Konin distribution area and connect the Tuliszków and Rychwał municipalities, and Malanów and Grodziec communes to the gas network; in 2012 the design work was under way, main construction work on the high-pressure network will be conducted in 2014–2016;
- Construction of a system connector between the high-pressure transmission and distribution network in the vicinity of Stare Babice near Koszalin; the project is designed to increase transmission capabilities in the northern part of the company's operating area; in 2012, the selection procedure was under way for the designer of construction of the high-pressure gas pipeline connecting the transmission system exit point with the Stare Babice Node of the distribution system; main construction work is scheduled for 2014–2015;
- Connection of the Dobiegniew municipality to the gas network; in 2012 the designer was selected for the first stage of network extension (the Strzelce Krajeńskie-Licheń sector with connections in Licheń) and the second stage (the Licheń-Długie-Ługi-Dobiegniew-Bierzwik-Mierzęcin sector); main construction work is scheduled for 2014–2016;
- Increase in the throughput capacity of the transmission system exit point in Goleniów; in 2012 the construction work was performed on a high-pressure reduction station together with the high-pressure entry system and medium-pressure exit system;
- Upgrade of the medium-pressure gas network in Szczecin, from the bridge on the Regalica river to ul. Granitowa; the project is completed;
- Upgrade of the low-pressure gas network in the Przyjaźń district in Poznań; to be continued in 2013;
- Upgrade of the medium-pressure gas network in ul. Hangarowa in Poznań; to be continued in 2013.

WSG also pursued four distribution network roll-out projects which received EU co-financing under the Infrastructure and Environment Operational Programme:

- construction of low-pressure and medium-pressure gas pipelines with connections, and a governor station in Syców, county of Oleśnica; the project will create conditions conducive to development of business activity and residential construction in Syców; in 2012 the project was completed, a total of 7.6km of gas network was constructed and 604 customers were connected;
- provision of natural gas supply to entities operating in the northern part of the Pełczyce commune; in 2012 the project was completed, an approx. 21.4km medium-pressure gas pipeline was built;
- provision of equal access to gas network in the Gorzów Wielkopolski county; the project involves construction of an 11.6 km high-pressure gas pipeline from Mościszki (Witnica commune) to Osiedle Warniki (Kostrzyn n. Odrą commune), and construction of a 13.2 km medium-pressure gas pipeline with connections in the village of Białcz; in 2012, construction work was carried out on the high-pressure gas pipeline from Mościszki (Witnica commune) to Osiedle Warniki (Kostrzyn n. Odrą commune), and design work was performed on the medium-pressure pipeline;
- construction of a medium-pressure gas network in the coastal strip, within the Darłowo, Mielno and Dziwnów communes; the project comprises three components, i.e. construction of a gas pipeline from Dziwnów to Międzywodzie, construction of a gas pipeline from Darłowo, through Rusko, Porzecze and Dąbki to Bobolin, and construction of a gas pipeline from Unieście to Łazy; in 2012, all necessary building permits were obtained.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	604	589
Net profit	PLNm	149	117
Equity	PLNm	1,920	1,830
Total assets	PLNm	2,366	2,271
Length of network, excl. connections	km	16,269.3	15,916.0
Workforce as at December 31	persons	1,794	1,810

In 2013, WSG Sp. z o.o. will continue the roll-out of the gas distribution system in the communes of Tuliszków, Malanów, Rychwał, Grodziec, Włoszkowice, Przemęt and Dobiegniew. It will also continue to work on the projects which received EU co-financing under the Infrastructure and Environment Operational Programme.

A number of other gas transmission, distribution and trading companies as well as heat production and distribution operators trade in the WSG coverage area, including: G.EN. GAZ ENERGIA S.A, Grupa DUON S.A., EWE Energia Sp. z o.o., ANCO Sp. z o.o. and Avrio Media Sp. z o.o. Any network roll-out projects undertaken by the company's competitors may in future prevent gas network construction in areas not served by WSG Sp. z o.o. (overbuilding).

7. Risks

Direct competition

Liberalisation of the gas market contributes to intensification in competition faced by the Gas Distribution Companies. Companies distributing natural gas progressively expand their gas networks and attract new customers. Additionally, companies have emerged which offer LNG distribution services. The market entry barriers are definitely lower here, as LNG distribution involves significantly lower capital expenditure and does not require a connection to the gas system or adequate reserve capacity to be maintained in the transmission and distribution networks. Another issue which affects the Gas Distribution Companies' competitive position is the tariff policy of the Energy

Regulatory Office, which prevents the Gas Distribution Companies from operating a flexible pricing policy for their key customers. With the lack of flexible pricing, the competitors' offerings may prove to be an attractive alternative for the Gas Distribution Companies' customers.

Legislation

The long time required to prepare an investment project is an important factor affecting the Gas Distribution Companies' operations. Complex provisions of the Construction Law and regulations governing implementation of investment projects impose the obligation to prepare extensive project and legal documentation. The process is time-consuming, but indispensable for any investment project.

Substitution

Easy and quick access to alternative energy sources (i.e. fuel oil, LPG, hard coal, electricity or heat generated by central CHP plants, or local or community heat plants) may weaken the position of the Gas Distribution Companies on the local energy markets.

Sources of gas supply for MSG Sp. z o.o.'s distribution system

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

Claims raised by property owners

More and more frequently, the Gas Distribution Companies face excessive financial claims raised by owners of land plots where gas network was developed in the past. Under applicable laws, the Gas Distribution Companies do not hold a clear legal title to use the real estate – no transmission easements have been established. Transmission easement serves as a basis for determining the scope of the use of third-party property by a transmission company, for which a relevant consideration is due to the owner. The owners' claims give rise to additional, frequently considerable, costs and thus may adversely affect the financial performance of the Gas Distribution Companies.

Section IX: Generation

In 2012, PGNiG TERMIKA SA (formerly Vattenfall Heat Poland SA) became a part of the PGNiG Group. PGNiG SA acquired the assets of Vattenfall Heat Poland SA in January 2012, via its subsidiary PGNiG SPV 1 Sp. z o.o. Following the purchase of the Vattenfall assets and the related extension of the PGNiG Group's business to include electricity and heat generation, a new business segment (Generation) was established in the Group's structure.

The core business of the segment is generation of heat and electricity. The segment's business also includes execution of major natural gas-fired projects in the power segment.

1. Segment's operations

PGNiG TERMIKA SA is involved in the generation, distribution and sale of heat and electricity. The company also serves as the Group's competence centre for heat and electricity generation and implementation of heat and power projects. The company's main revenue sources are sales of heat, electricity, system services, and certificates of energy origin. The installed capacity of the company's generating assets is 4.8 GW of achieved thermal power and 1 GW of achieved electrical power, which satisfies approximately 75% of the heat demand on the Warsaw metropolitan market. PGNiG TERMIKA SA is also a producer and supplier of heat and the owner of heat sources and heat networks in Pruszków, Komorów and Piastów.

Heat and electricity are generated at the company's six production plants:
- Siekierki CHP Plant
- Żerań CHP Plant
- Pruszków CHP Plant
- Kawęczyn Heating Plant
- Wola Heating Plant
- Regaty Heating Plant.

<u>Licences</u>

As at December 31st 2012, PGNiG TERMIKA SA held an electricity trading licence valid until January 31st 2015, as well as the following licences valid until December 31st 2025:
- production of heat
- transmission and distribution of heat
- production of electricity.

<u>Tariffs</u>

By its decision of May 30th 201, the President of the Energy Regulatory Office approved a tariff for the sale of heat produced by PGNiG TERMIKA SA's generating units (Żerań CHP, Siekierki CHP, Pruszków CHP, Wola Heating Plant and Kawęczyn Heating Plant) and its distribution in the Pruszków area. The tariff is effective from July 1st 2012. The company is also required to apply tariffs for the transmission of heat through the heating network in the following areas:

- Marsa Park – tariff approved on November 14th 2011 and effective until March 31st 2013
- Annopol – tariff approved on April 2nd 2012 and effective until June 30th 2013
- Marynarska – tariff approved on April 5th 2012 and effective until June 30th 2013
- Chełmżyńska – tariff approved on April 5th 2012 and effective until June 30th 2013
- Jana Kazimierza – tariff approved on July 13th 2012 and effective until July 31st 2013

as well as for the production of heat at the Regaty Heating Plant and its transmission to the heating network covering the Regaty residential estate – tariff approved on October 31st 2012 and effective until December 31st 2013.

Production

In 2012, the company produced 4,389.7 GWh of electricity (90.5% of which was cogenerated with heat) and 40,567.8 TJ of heat.

It also provided Network Constrained Generation services under an agreement with PSE Operator S.A. Pursuant to the agreement, the company maintains long-term plant margin and keeps a specific number of generating units available, so as to overcome limitations in the operation of power sources in the national power system and ensure Warsaw's energy security. PGNiG TERMIKA SA is required to generate electricity whenever so instructed by the Transmission System Operator. In the performance of the agreement, the company generated 233.5 GWh of electricity in 2012.

Sale

In 2012, PGNiG TERMIKA SA generated revenue of PLN 1,975m, chiefly from sales of electricity and heat to customers from outside the PGNiG Group. Sale of heat and electricity accounted for 50% and 41% of the company's total revenue, respectively. In 2012, the company sold 3,719.4 GWh of electricity and 40,213.9 TJ of heat. Other revenue was derived mostly from sales of certificates of origin for electricity.

PGNiG TERMIKA SA sold heat mainly to Dalkia Warszawa S.A. (formerly Stołeczne Przedsiębiorstwo Energetyki Cieplnej S.A.), which purchased 97% of the heat generated by the company. In 2012, Dalkia Warszawa S.A. contracted 3.6 GW of PGNiG TERMIKA's heat generation capacity. The balance of heat produced was sold to local customers, mainly in Pruszków and the surrounding areas.

PGNiG TERMIKA SA sold electricity chiefly to Vattenfall Energy Trading Sp. z o.o. and PGNiG Energia S.A., whose aggregate share in the company's sales of electricity was 93% in 2012. The company also sold electricity to smaller customers.

In 2012, proprietary rights attached to the certificates of origin for electricity produced by cogeneration (red certificates) and generated from renewable sources (green certificates) were sold on spot markets or as forward contracts. The sales of certificates of origin for electricity was executed chiefly through Polska Grupa Energetyczna S.A., ENEA S.A., TAURON Polska Energia S.A., PKP Energetyka S.A., ENERGA SA and PGNiG Energia S.A., as well as during sessions on the Polish Power Exchange.

Company's highlights

	Entity	2012	2011
Revenue	PLNm	1,957	
Net profit	PLNm	-115	
Equity	PLNm	652	
Total assets	PLNm	4,345	
Workforce as at December 31	persons	1,069	

As part of the full integration of the Group's power competences at PGNiG Termika SA, in November 2012 PGNiG Termika SA took over from PGNiG Energia SA the operational control over the CCGT project in Stalowa Wola (449 MW of electrical power and 240 MW of thermal power). In 2012, the general contractor for the Stalowa Wola unit was selected, the project execution agreement was signed and the credit facility agreements securing its financing were executed. The project is scheduled for completion in 2015.

2. Planned activities

The sales of electricity, heat and certificates of origin will be the key revenue source for PGNiG TERMIKA SA. The company plans to increase the production of energy by cogenerating electricity and useful heat in cogeneration units. Taking into consideration the risk of rising prices of CO_2 emission allowances, the company will also strive to diversify types of fuel used to fire its Warsaw-based generating assets, gradually replacing coal with gas or renewable fuel (biomass).

In cooperation with Dalkia Warszawa S.A., the company will seek ways to strengthen its position as the leading heat supplier on the Warsaw and Pruszków markets, to expand the area covered by its heat supplies from the municipal heating network, and to connect further users to its network.

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

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

3. Risks

More stringent gas and dust emission standards

In order to meet more stringent gas and dust emission standards expected to be implemented in 2016, producers have to modernise their power and CHP plants and may be forced to shut down a number of generating units (with a total capacity 4,000-6,000 MWe by 2020) where installation of expensive flue gas treatment systems is not economically viable. In order to meet the more stringent emission standards, PGNiG TERMIKA SA has gradually been modernising its generating assets.

Maintaining the share in the municipal heat market

Following extension of the Warsaw municipal waste incineration plant, the quantity of heat supplied to the city's municipal network will increase. As a result, PGNiG TERMIKA SA's share in total heat supplies to the municipal network will change.

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Following extension of the Warsaw municipal waste incineration plant, the quantity of heat supplied to the city's municipal network will increase. As a result, PGNiG TERMIKA SA's share in total heat supplies to the municipal network covering the Warsaw area will fall from the current 98% to 95% in 2019.

Joint marketing efforts conducted with Dalkia Warszawa S.A. and connecting further western districts of Warsaw to the municipal heating network should significantly reduce potential future decline in the volume of energy produced at PGNiG TERMIKA SA's generating plants. With a view to maintaining its share in the municipal heat market, the company also offers “green” heat generated in biomass-fired units, continues to sell energy at competitive prices, and takes advantage of the TPA rule to gain access to new end users.

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Section X: Other Activities

The Other Activities segment provides services involving the design and construction of infrastructure for the extraction, storage and transport of hydrocarbons. This segment also is also engaged in manufacture and repair of machinery and equipment for the minerals extraction and power industries, as well as catering and hospitality services. These operations are conducted mainly by the Group companies other than PGNiG SA.

1. PGNiG Technologie S.A.

PGNiG Technologie S.A. delivers specialist construction and assembly services, including construction of transmission and distribution pipelines, field development, construction of crude oil and natural gas production facilities, and reconstruction of underground gas storage facilities. The company's range of services also comprises the manufacture of field equipment and rig components, as well as manufacture and repair of equipment for the coal mining industry.

In 2012, PGNiG Technologie S.A. conducted work involving construction and assembly of gas transmission pipelines, reconstruction of underground gas storage facilities, and development of hydrocarbon deposits. The company also manufactured drilling equipment and repaired coal mining equipment.

In 2012, PGNiG Technologie S.A. turned in revenue of PLN 367m, of which 58% was revenue derived from sales to PGNiG Group companies. The key customer for the company's services was PGNiG SA. Revenue from the sale of services to PGNiG SA accounted for 47% of total revenue. Key projects in 2012 included construction and assembly of high-pressure gas pipelines, reconstruction of natural gas storage facilities and development of natural gas and crude oil deposits. The projects included:

- construction of 53.85 km of DN300 high-pressure pipeline between the Kłodawa mixing plant and the LMG oil and gas production facility; the project has been completed
- construction of 37.8 km of DN200 high-pressure pipeline between the Szczyglice node and the Żukowice and Polkowice pressure reduction and measuring stations; the project has been completed
- development of gas wells in the Pruchnik, Góra Ropczycka, Lubliniec and KGZ Mirocin fields, and development of oil and gas wells in the BMB field; the project has been completed
- development of the Rylowa-Rajsko field; the project has been completed
- reconstruction of the Husów gas production facility; the project has been completed
- construction of a gas compressor station for the Maćkowice gas production facility; the project has been completed
- extension of the Kościan node; the project has been completed
- construction of a gas compressor station for the Mirocin gas production facility.

In addition, the company began work on the following projects:

- construction of 53 km of DN300 high-pressure pipeline between the Wierzbno terminal and the Paproć gas production facility
- assembly of a new compressor at the Husów Underground Gas Storage Facility
- construction of a gas compressor station at the Hurko gas production facility.

For related companies, PGNiG Technologie S.A. also manufactured drilling equipment, including surface pressure equipment, heads, casing heads and spare parts for production equipment.

As part of projects for third-party customers, the company was involved in construction of high- and medium-pressure gas pipelines, sewage systems, production of equipment and spare parts for drilling rigs and drillships, as well as repairs of coal mining equipment. Projects executed for third-party customers included:

- construction of a 175.2 km DN 700 high-pressure gas pipeline from Rembelszczyzna to Gustorzyn for OGP GAZ-SYSTEM S.A.;
- construction of a 40 km DN800 high-pressure gas pipeline from Rogaska Slatina to Podlog for Plinovodi d.o.o (Slovenia); the project was completed;
- construction of a 22.4 high-pressure gas pipeline from Wiczlino to Kosakowo for OGP GAZ-SYSTEM S.A.;
- production of spare parts for drilling rigs and drillships for Aker Kvaerner MH AS (Norway);
- construction of a high-pressure gas network and a pressure reduction station for LOTOS S.A.'s refinery;
- upgrade of the Hermanowice distribution and metering node for OGP GAZ-SYSTEM S.A.;
- construction of a sewage system in Chudów for Przedsiębiorstwo Gospodarki Komunalnej of Przyszowice;
- assembly work on the DN1400 NEL pipeline in Germany for BONATTI S.p.A.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	367	409
Net profit (loss)	PLNm	-22	1
Equity	PLNm	143	165
Total assets	PLNm	292	294
Workforce as at December 31	persons	1,520	1,507

In 2013 and beyond, PGNiG Technologie S.A. intends to grow its business in the existing market segment, while seeking to ensure that its technical resources and production potential deliver maximum leverage. As part of its development plan, the company intends to become a provider of complete design, construction and installation services for the oil and gas industry in Poland and abroad. The largest project scheduled for 2013 is the on-going construction of the 175.2 km DN700 high-pressure pipeline from Rembelszczyzna to Gustorzyn for OGP GAZ-SYSTEM S.A.

The key projects to be executed in 2013 for PGNiG SA include:

- continued construction of a DN300 high-pressure pipeline between the Wierzbno terminal and the Paproć gas production facility;
- assembly of a new compressor at the Husów Underground Gas Storage Facility;
- construction of a gas compressor station at the Hurko gas production facility;
- production of christmas trees and casing heads.

The company intends to maintain its market position in the area of manufacturing of drilling equipment, including surface equipment for conventional and unconventional deposits, drilling platforms, and equipment for oil and gas production facilities.

In H2 2013, PGNiG Technologie S.A. is to be privatised through equity offering on the Warsaw Stock Exchange.

2. INVESTGAS S.A.

INVESTGAS S.A. specialises in execution of hydrocarbon storage and transport projects. It also executes specialist and general construction projects. The company provides services covering the entire investment process: from preparation, through design, construction and commissioning, to operation of gas storage units in salt caverns and other types of facilities.

In 2012, INVESTGAS S.A. generated PLN 99m of total revenue. In 2012, revenue from services performed for PGNiG SA accounted for 99% of INVESTGAS 's total revenue. Major projects carried out for PGNiG SA in 2012 included work performed under long-term contracts. The continued projects included:

- operation and construction of new caverns in the Mogilno Underground Gas Storage Cavern;
- construction of the Kosakowo Underground Gas Storage Facility;
- construction of a gas pipeline from KGZ Kościan to KGHM Żukowice/Polkowice; the project is completed.

In 2012, the company also continued preparatory work for the construction of the Hermanowice-Strachocina gas pipeline and commenced a contract for supervision of construction of a high-pressure gas pipeline from Szczecin to Gdańsk on behalf of OGP GAZ-SYSTEM S.A.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	99	142
Net profit	PLNm	4	9
Equity	PLNm	42	40
Total assets	PLNm	85	79
Headcount as at December 31	persons	118	114

In 2013 the company will perform long-term contracts for operation, construction and extension of undetrground gas storage facilities for PGNiG SA; preparation of construction of the Hermanowice-Strachocina gas pipeline and the supervision of the construction of a high-pressure gas pipeline from Szczecin to Gdańsk on behalf of OGP GAZ-SYSTEM S.A. The merger of the company with Operator Systemu Magazynowania Sp. z o.o. is planned for 2013.

3. BSiPG Gazoprojekt S.A.

Biuro Studiów i Projektów Gazownictwa Gazoprojekt S.A. specializes in comprehensive design of installations for gas production, storage, transmission and distribution, as well as of gas system stations and switching stations. With a 75% equity interest, PGNiG SA is the majority shareholder in the company. 25% of the BSiPG. Gazoprojekt shares are held by natural persons – the company's employees. Gazoprojekt S.A.

In 2012, BSiPG. Gazoprojekt S.A. recorded revenue of PLN 51m. In 2012, revenue from services performed for the PGNiG Group accounted for 64% of Gazoprojekt 's total revenue. Major projects carried out for the Group included:

- general contractor services in construction of the 176 km DN700 high-pressure gas pipeline from Rembelszczyzna to Gustorzyn

- preparation of preliminary and project design documentation for the 55 km DN300 high-pressure gas pipeline from KRNiGZ LMG to Paproć; the project is completed
- preparation of the project design documentation for Distribution network roll-out in selected locations of the Strzelin and Wiązów communes.

The company's services for third-party customers included the continued preparation of the design documentation of the Kosakowo underground gas storage facility and design supervision over project execution for Control Process S.A.; and completion of work as general contractor on extension of the Odolanów node (Phase 0 – connection of the node with the DN1000 gas pipeline from Wierzchowice to Odolanów) for OGP GAZ-SYSTEM S.A.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	51	45
Net profit (loss)	PLNm	1	5
Equity	PLNm	34	38
Total assets	PLNm	60	49
Workforce as at December 31	persons	241	243

In 2013, the company will operate as general contractor on several projects, including construction of a DN700 high-pressure gas pipeline from Rembelszczyzna to Gustorzyn for PGNiG Technologie S.A.; and overhaul of the underground Vistula river crossing of the DN250 pipeline for Przedsiębiorstwo Eksploatacji Rurociągów Naftowych PRZYJAŹŃ S.A. The company also plans to prepare project design documentation for:

- construction of a 64 km DN300 high-pressure gas pipeline from Polkowice to Żary for OGP GAZ-SYSTEM S.A.;
- construction of a 54 km DN700 high-pressure gas pipeline Skoczów-Komorowice-Oświęcim for MGGP S.A.
- upgrading of the 20.74 km DN300 high-pressure gas pipeline from Radlin to Racibórz for OGP GAZ-SYSTEM S.A.
- extension of the Jeleniów Compressor Station for OGP GAZ-SYSTEM S.A.

4. Geovita S.A.

Geovita S.A. offers accommodation and catering services in Poland, through 11 own facilities and three leased hotels. The company's facilities form a network of recreational, training and spa centres. They are located either at the sea coast, in mountain areas or in the central part of Poland. The company offers its services to Polish and foreign customers.

In 2012, Geovita S.A. reported total revenue of PLN 43m, including nearly PLN 7.5m from sale of hotel management services. The services were mainly provided to third-party customers. Revenues from the services performed for this customer group accounted for 71% of the company's total revenue.

Company's highlights

	Unit	2012	2011
Revenue	PLNm	43	36
Net profit (loss)	PLNm	1	-1
Equity	PLNm	79	78
Total assets	PLNm	96	99
Workforce as at December 31	persons	346	349

In 2013, Geovita S.A. is to be sold.

5. Risks

Legislation

Administrative regulations and procedures related to the preparation of investment projects and obtaining building permits, including in particular regulations governing compliance with the environmental requirements, may significantly delay project execution and expose the company to the risk of cost overruns caused by potential delays in contract performance, and to the risk of lower revenues. The Public Procurement Law and other regulations which stipulate contract price as the only criterion in bid evaluation cause the segment's companies to lose against competitors who offer lower prices for services of inferior quality.

Competition

The operations of companies offering construction and assembly services, design services, as well as manufacturers of drilling equipment are significantly exposed to growing competition from foreign companies, both those operating in their local markets abroad and those entering the Polish market, and from Polish market players. Given the current level of investment in the segment's area of operations, growing competition results in, among other consequences, continually low prices for the services offered by the segment companies. As far as designing of gas transmission installations is concerned, acquisition of medium-sized design offices by large contractors and setting up of new design offices within gas industry operators are unfavourable phenomena which adversely affect the segment companies' capacity to form consortia with project execution companies and secure new orders. Another major threat in this area is the growing competition from new business groups and international engineering corporations.

Economic environment

The deepening economic crisis on the Polish and foreign markets adversely affects investment activity and increases competition. PBG S.A.'s insolvency and delays in payments from several other trading partners had a negative effect on the profitability of the segment companies.

Qualified personnel

Increasing competition from local and foreign companies on the Polish market has intensified the process of their acquiring highly qualified employees with extensive professional experience.

Section XI: Investments

In 2012, capital expenditure incurred by the PGNiG Group on property, plant and equipment and intangible assets was PLN 3,807m. The table below presents the expenditure in the individual segments.

Capital expenditure (PLNm)

	2012
Exploration and Production	1,793
Trade and Storage	582
Distribution	1,144
Generation	241
Other Activities	47
Total	3,807

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 the PGNiG Group in 2012

Exploration

Capital expenditure incurred by PGNiG SA 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.

Norwegian Continental Shelf

The project involves exploration for and production of crude oil and natural gas from the Skarv, Snadd and Idun fields. The Skarv project consists in the development of the fields from a floating production, storage and offloading (FPSO) platform. In 2012, installation of risers to the FPSO platform, anchored in the Norwegian Sea, was completed. Also, finishing work was conducted on the platform and production wells were prepared for coming on stream. Production of oil and gas from the Skarv field was launched in December 2012. In 2012, exploration and appraisal work continued; in its course the Snadd Outer field was discovered. The expenditure incurred in 2012 was PLN 393m.

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 Trade and Storage segment amounted to PLN 582m, 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 project to extend 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.

Distribution

Capital expenditure incurred by the PGNiG Group in the Distribution segment amounted to PLN 1,144m. Most of the projects carried out by the Gas Distribution Companies involved connecting new customers to the distribution networks and upgrading and extending the gas network. For a discussion of key projects in the Distribution segment, see Section VIII Distribution.

Generation

Capital expenditure of the Generation segment amounted to PLN 241m, of which ca. PLN 119m was spent on environmental protection projects. Major projects carried out in 2012 included:

- construction of a wet flue gas desulphurisation unit at the Siekierki CHP plant; in 2012, construction of the installation for two unit boilers (No. 10 and 11) and three water boilers (No. 5, 6 and 7) was completed and the unit was placed in service, and thus the second and last stage of the project was completed; total expenditure on the project was PLN 503m;
- construction of an SCR system for four unit boilers at the Siekierki CHP plant; in 2012, installation for one boiler (No. 11) was commissioned; installation for the next boiler (No. 15) came on line in January 2013; the last stage of the system construction for boiler No. 14 will be implemented in 2013;
- the Myśliborska project – construction of a process wastewater treatment plant at the Żerań CHP plant; the plant was placed in service in December 2012; in order to improve the operation of the wastewater treatment plant in the technology organisation of the Żerań CHP plant, the support systems for waste management will be extended in 2013;
- the Myśliborska project – construction of an ash storage silo with a capacity of 10 thousand tonnes; the project involved construction of an ash storage silo (completed in 2010) and extension of the flyover with pipelines for pneumatic ash transport to the constructed silo (the project was completed in November 2012); total expenditure on the project was PLN19m;
- modernisation of transport infrastructure in the coal yards (No. 2 and 3) at the Siekierki CHP plant; in 2012, the project was completed; total expenditure on the project was PLN 37m;
- construction of a CCGT unit with 450MW electricity capacity at the Żerań CHP plant; in 2012, work was under way to draft documents and obtain the permits required to connect the high-pressure gas collector to the Żerań CHP plant; preparation of tender documentation for construction of the unit was in progress.

Other Activities

In 2012, the Other Activities segment incurred capital expenditure on property, plant and equipment and intangible assets of PLN 47m. Major investment projects included purchase of production plant and equipment, computer software, buildings and structures, and vehicles.

Section XII: 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 minerals extraction, and restore the land to its original condition. Plugging of wells and pits prevents leakage of crude oil and natural gas to the surface and 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, PGNiG TERMIKA SA (the Siekierki, Żerań and Pruszków CHP plants and the Kawęczyn and Wola heat-generating plants), 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 6,024,504 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 carried out 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.

Reclamation of the fuel ash landfill site

PGNiG TERMIKA SA carries out the reclamation of the Myśliborska fuel ash landfill site for EC Żerań. The reclamation design provides for reclaiming the land as green areas (Cells No. 1 and No. 2) and for residential and commercial development (Cell No. 3). In 2012, grading of Cell No. 1 was performed, including covering with a layer of mineral earth, Cell No. 2 was partially filled with ash (from Cell No. 3) and slag; ash and slag was partially emptied from Cell No. 3 and replaced by mineral earth. The reclamation is scheduled to be completed in 2016.

EC Żerań is currently executing projects which will enable it to operate without access to a landfill site. In 2012, the construction of 10,000 tonnes ash storage tank and a process wastewater treatment plant was completed and the facilities were commissioned. The treatment plant receives wastewater (including from process water treatment) which was earlier discharged.

Fulfilment of requirements of the Industrial Emissions Directive

In 2012, in an effort to meet the environmental standards included in Directive 2010/75/EU of the European Parliament and the Council on industrial emissions (IED), PGNiG TERMIKA SA launched a wet flue gas desulphurisation unit at the Siekierki CHP Plant. The unit supports eight out of the total of 14 boilers installed at the CHP and controls sulphur emissions from 70% of the CHP's generating capacity.

The company also executes the project providing for the construction of NOx selective catalytic reduction (SCR) units on four unit boilers at the Siekierki CHP Plant. In 2012, SCR units on two boilers were commissioned. The project having been completed, units representing 60% of the Siekierki CHP Plant's generating capacity will be equipped with SCR units.

The execution of these two projects is partially financed with the funds available under the Infrastructure and Environment Operational Programme of the National Environmental Protection and Water Management Fund, under co-financing agreements concluded by PGNiG TERMIKA SA.

Noise reduction programme at the Siekierki CHP Plant

In 2012, the implementation of a three-year programme of noise reduction at the Siekierki CHP Plant was completed. Noise emissions from the Siekierki CHP Plant's premises were reduced below the maximum level permitted under the standard specified in the integrated permit (45 dB at night) and the risk of limiting future projects was eliminated.

Biomass supplies

In an effort to fulfill the requirements of Directive 2009/28/EC on the promotion of the use of energy from renewable sources and use of biomass other than forest biomass, that is biomass from plantations and crops of energy plants at commercial power plants (Regulation of the Minister of Economy dated October 18th 2012), PGNiG TERMIKA SA procures fuel under long-term contracts for the supply of biomass from plantations of the energy willow. Currently, the company procures biomass from plantations with a total acreage of ca. 400 ha. The use of biomass in energy generation enabled CO_2 emissions to be reduced by 233 thousand tonnes in 2012.

Section XIII: 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 XIV: 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 SA 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 SA;
- 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, the PGNiG Group 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 consolidated financial statements (Note 2.5).

In 2012, the PGNiG Group posted a net profit of PLN 2,234m, up by PLN 479m year on year.

Summary information on the PGNiG Group'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.

Consolidated statement of financial position (PLNm)

ASSETS	Dec 31 2012	Dec 31 2011	Jan 1 2011
Non-current assets	37,084	31,301	28,137
Property, plant and equipment	33,784	29,319	26,360
Investment property	11	7	10
Intangible assets	1,146	343	298
Investments in equity-accounted associates	771	598	556
Financial assets available for sale	48	56	170
Other financial assets	124	10	40
Deferred tax assets	1,124	920	662
Other non-current assets	76	48	41
Current assets	10,833	7,523	6,205
Inventories	3,064	2,082	1,049
Trade and other receivables	5,374	3,378	3,387
Current tax assets	150	164	230
Other assets	84	78	75
Financial assets available for sale	-	22	9
Derivative financial instrument assets	105	285	78
Cash and cash equivalents	1,948	1,505	1,373
Non-current assets held for sale	108	9	4
Total assets	47,917	38,824	34,342

Consolidated statement of financial position (PLNm) – contd.

LIABILITIES AND EQUITY	Dec 31 2012	Dec 31 2011	Jan 1 2011
Equity	27,247	25,218	24,111
Share capital	5,900	5,900	5,900
Share premium	1,740	1,740	1,740
Accumulated other comprehensive income	(90)	114	12
Retained earnings/(deficit)	19,693	17,457	16,445
Equity (attributable to owners of the parent)	27,243	25,211	24,097
Equity attributable to non-controlling interests	4	7	14
Non-current liabilities	11,057	5,760	5,082
Borrowings and other debt instruments	5,509	1,382	970
Employee benefit obligations	319	268	280
Provisions	1,792	1,358	1,221
Deferred income	1,448	1,160	1,089
Deferred tax liabilities	1,936	1,572	1,501
Other non-current liabilities	53	20	21
Current liabilities	9,613	7,846	5,149
Trade and other payables	3,667	3,236	3,103
Borrowings and other debt instruments	4,702	3,617	1,229
Derivative financial instrument liabilities	393	417	104
Current tax liabilities	24	58	226
Employee benefit obligations	356	238	177
Provisions	350	185	216
Deferred income	101	95	94
Liabilities associated with non-current assets held for sale	20	-	-
Total liabilities	20,670	13,606	10,231
Total liabilities and equity	47,917	38,824	34,342

Consolidated income statement (PLNm)

	2012	2011
Revenue	28,730	23,004
Total operating expenses	(26,197)	(21,132)
Raw material and consumables used	(17,447)	(14,059)
Employee benefit expense	(3,054)	(2,850)
Depreciation and amortisation expenses	(2,069)	(1,574)
Contracted services	(3,060)	(3,182)
Work performed by the entity and capitalised	1,006	1,129
Other income and expenses	(1,573)	(596)
Operating profit/loss	2,533	1,872
Finance income	216	135
Finance costs	(380)	(152)
Share in net profit/loss of equity-accounted entities	173	43
Profit/loss before tax	2,542	1,898
Income tax	(308)	(143)
Net profit/loss	2,234	1,755
Attributable to:		
Owners of the Parent	2,236	1,756
Non-controlling interests	(2)	(1)
	2,234	1,755

Consolidated statement of cash flows (PLNm)

	2012	2011
Net cash flows from operating activities	2,552	2,676
Net cash flows from investing activities	(6,149)	(4,227)
Net cash flows from financing activities	4,040.0	1,682.0
Net change in cash	443	131
Cash and cash equivalents at beginning of the period	1,504	1,373
Cash and cash equivalents at end of the period	1,947	1,504

Financial ratios

Profitability

	2012	2011
EBIT (PLNm) operating profit	2,533	1,872
EBITDA (PLNm) operating profit + depreciation/amortisation	4,602	3,446
ROE net profit* to equity at end of the period	8.2%	7.0%
NET MARGIN net profit* to revenue	7.8%	7.6%
ROA net profit* to assets at end of the period	4.7%	4.5%

* net profit attributable to owners of the Parent

Liquidity

	Dec 31 2012	Dec 31 2011
CURRENT RATIO current assets (net of other assets) to current liabilities	1.1	0.9
QUICK RATIO current assets (net of other assets) less inventories to current liabilities	0.8	0.7

Debt

	Dec 31 2012	Dec 31 2011
DEBT RATIO total liabilities to total equity and liabilities	43.1%	35.0%
DEBT/EQUITY RATIO total liabilities to equity*	75.9%	54.0%

* equity attributable to owners of the Parent

1.2. Financial overview

Year on year, the PGNiG Group's operating profit (EBIT) rose by PLN 661m. The strengthening of the Group'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 PGNiG Group's financial position. Operating profit of the Exploration and Production segment was PLN 1,353m, up PLN 38m 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%. The segment's result was adversely affected by the deterioration of financial performance delivered by exploration companies and recognition of impairment losses on tangible assets tested for impairment.

Trade and Storage

The Trade and Storage segment posted operating profit of PLN 325m, up PLN 524m 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.

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.

Distribution

The Distribution segment's operating profit was PLN 878m, up PLN 95m year on year. The rise was driven by an increase in the volume of transmitted gas and higher rates and charges for network services effective as of July 2011. The increase in the volume of transmitted gas was attributable to stronger gas fuel demand from households and smaller industrial plants in the heating season, as well as acquisition of new customers.

Generation

In January 2012, the PGNiG Group commenced generation of electricity and generation and distribution of heat. In 2012, the Generation segment's result came in at PLN 15m. However, the segment's operating performance does not fully reflect its profitability, as the result was adjusted for the effect of amortisation of intangible assets recognised at the time of acquisition of shares in PGNiG Termika SA, including carbon allowances.

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

2012	Exploration and Production	Trade and storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to third-party customers	3,121	23,353	153	1,893	210	-	28,730
Intercompany sales	1,204	360	3,430	64	333	(5,391)	-
Total segment revenue	4,325	23,713	3,583	1,957	543.0	(5,391)	28,730
Segment's expenses	(2,972)	(23,388)	(2,705)	(1,942)	(563)	5,373	(26,197)
Operating profit/loss	1,353	325	878	15	(20)	(18)	2,533
Finance income and costs	-	-	-	-	-	-	(164)
Share in net profit/loss of equity-accounted entities	-	173	-	-	-	-	173
Profit/loss before tax							2,542
Income tax	-	-	-	-	-	-	(308)
Net profit/loss							2,234

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

2011	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to third-party customers	2,879	19,831	141	-	153	-	23,004
Intercompany sales	1,202	155	3,329	-	435	(5,121)	-
Total segment revenue	4,081	19,986	3,470	-	588	(5,121)	23,004
Segment's expenses	(2,766)	(20,185)	(2,687)	-	(579)	5,085	(21,132)
Operating profit/loss	1,315	(199)	783	0	9	(36)	1,872
Finance income and costs	-	-	-	-	-	-	(17)
Share in net profit/loss of equity-accounted entities	-	43	-	-	-	-	43
Profit/loss before tax							1,898
Income tax	-	-	-	-	-	-	(143)
Net profit/loss							1,755

The result on financing activities fell by PLN 17m year on year, despite a PLN 280m rise in interest expense caused by the Group's higher debt. At the same time, the PGNiG Group recognised foreign exchange gains and a higher share in net profit/loss of equity-accounted entities following a revaluation of shares in SGT EUROPOL GAZ SA

The improvement in the Group's financial position is illustrated by an increase in some financial ratios. Return on equity (ROE) improved from 7% in 2011 to 8.2%. Return on assets (ROA) was 4.7%, against 4.5% in 2011, and net margin grew from 7.6% to 7.8%.

As at December 31st 2012, total assets were PLN 47,917m, up PLN 9,093m relative to the end of 2011.

Assets

Property, plant and equipment, of PLN 33,784m as at the end of December 2012 (up PLN 4,465m on December 31st 2011), was the largest item of the Group's assets. This strong growth of property, plant and equipment is attributable to the recognition in the consolidated financial statements of the assets of PGNiG TERMIKA SA following the acquisition of a 99.8% equity interest in Vattenfall Heat Poland SA (currently PGNiG TERMIKA SA) in January 2012. Property, plant and equipment also rose in connection with the PGNiG Group's investment projects. 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.

As at December 31st 2012, intangible assets were PLN 1,146m, having grown by PLN 803m relative to December 31st 2011 primarily due to the consolidation of PGNiG TERMIKA SA. The change follows mainly from the valuation of perpetual usufruct right to land and CO2 emission allowances.

The PLN 173m rise in investments in equity-accounted associates relative to December 31st 2011 was attributable to the revaluation of shares in SGT EUROPOL GAZ SA

The value of other financial assets increased by PLN 114m on December 31st 2011 as a result of granting a loan to Elektrociepłownia Stalowa Wola SA

Compared with December 31st 2011, the PGNiG Group recorded a PLN 204m rise in the deferred tax asset following recognition of investment incentives at PGNiG Norway AS and remeasurement of provisions.

As at December 31st 2012, current assets were PLN 10,833m, up PLN 3,310m (or 44%) year on year.

Relative to December 31st 2011, there was a significant increase in inventories (by PLN 982m or 47%). The inventories disclosed in the balance sheet comprise mainly gas stored in the underground storage facilities. Inventories increased chiefly on the back of higher unit costs of imported gas, increase in the volume of gas stored in the underground storage facilities and first-time recognition of inventories of PGNiG TERMIKA SA (fuel for electricity and heat generation) in the consolidated financial statements.
Trade and other receivables rose PLN 1,996m (59%) 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. Also, the increase results from the acquisition and consolidation of the assets of PGNiG TERMIKA SA, i.e. receivables from the sale of heat and electricity (December 31st 2012: PLN 331m).

Cash and equivalents stood at PLN 1,948m, up PLN 443m relative to the end of 2011. The increase comes from the fact that cash flows from financing activities (proceeds from the issue of debt securities) and operating activities (improved margin on high-methane gas sales) exceeded capital expenditure, including outlays on gas and oil exploration and acquisition of PGNiG TERMIKA SA.

The value and structure of current assets held by the Group guaranteed its ability to settle liabilities in a timely manner. Current ratio was 1.1 compared with 0.9 as at the end of December 2011, while quick ratio rose from 0.7 to 0.8.

Liabilities and equity

Equity is the primary source of financing of the PGNiG Group's assets. Relative to the end of 2011, the Group's equity rose by PLN 2,029m. The change was chiefly an outcome of a PLN 2,234m net profit reported for the period.

As at December 31st 2012, non-current liabilities were PLN 11,057m, up PLN 5,297m on the end of December 2011. The rise is a consequence of an increase in debt, following the issue of eurobonds by PGNiG Finance AB (EUR 500m) and the issue of five-year notes on the domestic market by PGNiG SA (PLN 2.5bn).

Compared with the end of 2011, current liabilities grew by PLN 1,767m (or 23%) as a result of a PLN 1,085m increase in borrowings and other debt securities, in particular following the issue of notes by PGNiG SA and PGNiG TERMIKA SA, as well as a PLN 399m rise in VAT payable driven by higher revenue.

Due to the significant increase in external financing used by the Group, the debt-equity ratios changed. Debt to equity increased from 54% to 75.9%. Debt ratio (total liabilities to total equity and liabilities) was up from 35% to 43.1%.

Material off-balance-sheet items

As at December 31st 2012, the PGNiG Group's most important off-balance-sheet item was represented by contingent liabilities of PLN 9,732m. The key items of contingent liabilities included:

- bond securing performance of PGNiG Norway AS's licence and legal obligations towards the state of Norway, issued by PGNiG SA (PLN 2,566m);
- bond securing performance of POGC-Libya B.V.'s obligations towards National Oil Corporation of Libya, issued by PGNiG SA (PLN 335m);
- bond securing performance of PGNiG Finance AB's obligations towards noteholders, in connection with the eurobond programme, issued by PGNiG SA (PLN 6,132m).

Feasibility of investment plans

In 2013, the PGNiG Group intends to maintain a high level of capital expenditure. The spending will focus on:

- natural gas and crude oil exploration and production, including exploration for unconventional deposits;
- extension of storage facilities;
- development of distribution infrastructure;
- execution of power and heat generation projects.

The PGNiG Group intends to finance investments both from its own funds and using external financing, e.g. raised through the issuance of notes and eurobonds.

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 Group did not publish any financial forecasts.

Key equity investments and capital placements at the PGNiG Group

The PGNiG Group's key equity investments in 2012 included:

- Payment of new tranches (PLN 2,178m) of the loan advanced to PGNiG SPV 1 Sp. z o.o. by PGNiG SA; the loan was granted to finance the acquisition of shares in Vattenfall Heat Poland SA; following the merger of PGNiG SPV 1 Sp. z o.o. and PGNiG TERMIKA SA, the liabilities under the loan were assumed by PGNiG TERMIKA SA;
- Payment of new tranches (NOK 1,165m) of the long-term loan advanced to PGNiG Norway AS by PGNiG SA; the loan was granted to finance capital expenditure related to the Norwegian Continental Shelf project;
- Disbursement of a PLN 70m loan granted to Pomorska Spółka Gazownictwa Sp. z o.o. by PGNiG SA; the loan was advanced to finance investment projects;
- Payment of new tranches (PLN 37m) of loans granted to Mazowiecka Spółka Gazownictwa Sp. z o.o. by PGNiG SA; the loans were granted to finance investment projects;
- Disbursement of a PLN 24m loan granted to PNiG Jasło SA by PGNiG SA; the loan was advanced to finance the purchase of drilling equipment;
- Disbursement of a EUR 3m short-term loan granted to PGNiG Sales & Trading GmbH; the loan was advanced to finance day-to-day operations;
- Issue of short-term notes offered to the PGNiG Group companies; as at December 31st 2012, PGNiG SA's debt under the notes was PLN 212m;
- Share capital increases at subsidiaries: PGNiG SPV 1 Sp. z o.o. (PLN 770m), POGC Libya B.V. (USD 25m to finance day-to-day operations), PGNiG Poszukiwania SA (currently, Exalo Drilling SA) (PLN 10m); also, PGNiG Poszukiwania SA received a non-cash contribution in the form of shares in PNiG Kraków SA, PNiG, Jasło SA, PNiG Nafta SA, PN Diament Sp. z o .o. and ZRG Krosno Sp. z o.o. in the total amount of PLN 971.5m.

2. Financial management

In 2012, the PGNiG Group increased its external financing by launching new domestic notes issuance programmes and a eurobond 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 issue 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, in 2012, the Company issued also a PLN 1.2bn tranche of short-term notes. 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.

On July 4th 2012, PGNiG TERMIKA SA signed an agreement on a five-year PLN 1.5bn note programme with four banks: PKO BP SA, Nordea Bank Polska SA, ING Bank Śląski SA and Bank Zachodni WBK SA Under the programme, effective until December 29th 2017, PGNiG TERMIKA SA may issue (in a private placement) discount or coupon notes with maturities ranging from one month to one year and the interest rate based on WIBOR+margin. The first issue of discount and zerocoupon notes with a total nominal value of PLN 450m took place on July 10th 2012. In 2012, PGNiG TERMIKA SA issued notes for a total nominal value of PLN 600m. Proceeds from the first issue were mainly used to repay a loan advanced by Vattenfall Treasury Financing AB. Proceeds from further issues allow the company to finance investment projects, including the planned construction of a CCGT unit at the Żerań CHP, and day-to-day operations. As at December 31st 2012, the debt outstanding under the programme was PLN 530m.

On February 10th 2012, PGNiG Finance AB issued Tranche I of five-year eurobonds for EUR 500m, yielding 4.098% p.a. The notes were assigned the Baa1 (Moody's) and BBB+ (Standard & Poor's) credit ratings. The notes were issued under a five-year EUR 1.2bn eurobond programme executed on August 25th 2011. As at December 31st 2012, PGNiG Finance AB's debt under the eurobonds in issue was EUR 500m.

In 2012, PGNiG SA carried out new issues of short-term notes under its 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 2012, the debt outstanding under the programme was PLN 2.3bn.

The PGNiG Group used proceeds from the issues of notes and eurobonds 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 Group'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 the PGNiG Group ensure timely financing of all current and planned expenditure related to the core business and investing activities. Its liquidity is under no threat. The Group has adopted an efficient model under which PGNiG SA financially aids its subsidiaries in the execution of investment projects. External financing is raised mainly through debt securities issue programmes. Moreover, PGNiG SA 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 the PGNiG Group 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 the remaining 1% of the transactions. In addition, gas distribution companies and PGNiG Technologie SA invested their cash surpluses in short-term notes issued by PGNiG SA. In 2012, notes issued by PGNiG SA accounted on average for approximately 40% of the subsidiaries' investments. 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, the PGNiG Group entered into credit facility agreements for a total amount of PLN 537m, USD 13m and EUR 4m in order to finance day-to-day operations and investment projects. Also, the Group executed overdraft facility agreements for a total amount of PLN 524m and USD 13m. The remaining credit facilities, for a total amount of PLN 13m and EUR 4m, were used to finance investment projects, including purchase of drilling equipment and a mobile drilling fluid recycling system. The table below presents detailed information on the key credit facility agreements executed by the PGNiG Group in 2012.

Key credit facility agreements executed by the PGNiG Group

Bank	Facility amount (m)		Interest rate	Type	Maturity date
Bank Pekao SA	50	PLN	ON WIBOR + 0.5%	working capital facility	May 24th 2013
Bank Handlowy w Warszawie SA	40	PLN	1M WIBOR + 0.30%	working capital facility	December 31st 2013
Bank Pekao SA	40	PLN	1M WIBOR + 0.45%	working capital facility	July 31st 2013
PKO BP SA	40	PLN	1M WIBOR + 0.55%	working capital facility	July 13th 2013
BRE BANK SA	40	PLN	ON WIBOR + 0.30%	working capital facility	September 5th 2013
Societe Generale SA Polish Branch	40	PLN	1M WIBOR + 0.35%	working capital facility	August 30th 2013
ING Bank Śląski SA	40	PLN	1M WIBOR + 0.60%	working capital facility	December 6th 2013
Bank Millenium SA	40	PLN	1M WIBOR + 0.40%	working capital facility	December 18th 2013
Bank Pekao SA	27	PLN	1M WIBOR + 1.4%	working capital facility	August 23rd 2013
Bank Pekao SA	25	PLN	1M WIBOR + 1.0%	working capital facility	December 31st 2013

In 2012, two overdraft facility agreements were terminated:

- an agreement with Deutsche Bank PBC SA for a PLN 7m overdraft facility bearing interest at 1M WIBOR + 1.6%, repayable by December 31st 2014; the agreement was terminated by PGNiG as part of implementing a uniform financial policy at the Group;
- an agreement with Kredyt Bank SA for a PLN 4m for overdraft facility bearing interest at ON WIBOR + 1.9%, repayable by March 30th 2013; the agreement was terminated by the bank due to a low value of transactions made through the account.

In 2012, the PGNiG Group executed two loan agreements with a subsidiary for a total amount of PLN 172m. The loans were advanced to finance the construction of a CCGT unit in Stalowa Wola.

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

Loans advanced by the PGNiG Group

Company	Loan amount (PLNm)	Currency	Interest rate	Type	Maturity date
Elektrociepłownia Stalowa Wola SA	152	PLN	3M WIBOR + 2.50%	investment loan	December 31st 2032
Elektrociepłownia Stalowa Wola SA	20	PLN	1M WIBOR + 2.50%	investment loan	December 31st 2032

In 2012, the PGNiG Group did not contract or terminate any loans.

Guarantees and sureties provided by the PGNiG Group in 2012 were PLN 171m as at December 31st 2012. These comprised guarantees for a total amount of PLN 100m securing gas supplies by PGNiG Sales&Trading GmbH, sureties for a total amount of PLN 8m for payment of PGNiG Energia SA's liabilities and three performance bonds, for a total amount of PLN 24m, issued for the benefit of OGP GAZ-SYSTEM SA relating to the construction of a DN700 gas pipeline from Rembelszczyzna to Gustorzyn.

Guarantees and sureties received by the PGNiG Group in 2012 amounted to PLN 80m as at December 31st 2012, of which 36% (PLN 29m) were guarantees and sureties for less than PLN 500 thousand each. The remaining guarantees and sureties comprised performance bonds, including under gas sales contracts. The most significant of them were:

- PLN 6m performance bond issued by Fabryka Kotłów RAFAKO SA relating to the construction of a wet flue gas desulphurisation unit for boilers No. K5, K6, K7, K10 and K11 at the Siekierki CHP plant;
- EUR 1m (PLN 4m) advance payment guarantee issued by GE OIL & GAS THERMODYN of France relating to a prepayment for technical equipment;
- PLN 3m surety under civil law provided by Saint-Gobain Construction Products Sp. z o.o. as security for payments for gas;
- PLN 2m guarantee provided by FRITO LAY Sp. z o.o. as security for a gas sales contract.

2.3. Financial risk management

The main objective of the PGNiG Group's financial risk management policy is to limit the volatility of cash flows related to the Group'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, the PGNiG Group 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.

<u>Market Risk</u>

The PGNiG Group 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 Group's financial performance.

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

In 2012, the PGNiG Group used the following financial instruments to manage the gas price risk:

- purchase of Asian commodity call options settled as European options;
- commodity option structures (in most cases consisting of a combination of two commodity options).

In 2012, to mitigate the currency risk the Group used the following financial instruments:

- forward contracts
- FX swaps
- purchases of currency call options
- option structures (consisting in a combination of two options).

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

The PGNiG Group 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

The PGNiG Group's credit risk is related to the likelihood of failure by the counterparties or other entities to meet their obligations to the Group. In 2012, the Group managed credit risk by investing its free cash in instruments carrying the lowest possible credit risk (treasury bills and 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. The PGNiG Group 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 the PGNiG Group 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 Group, consolidating bank accounts and entering into overdraft facility agreements. PGNiG SA 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, PGNiG SA 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 the PGNiG Group'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 and heat tariffs.

The prices of crude oil, petroleum products and gas are an essential factor determining the PGNiG Group's financial position. The 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.

The PGNiG Group'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.

By bringing on stream the Lubiatów and Międzychód fields (the end of 2012) and the Grotów field (January 2013), as well as launching hydrocarbon production from the Skarv field on the Norwegian Continental Shelf, the Group will be able to increase its oil and gas output and thus improve its financial performance. In 2013, the Group will also step up efforts in the area of exploration for and appraisal of both conventional and unconventional hydrocarbon deposits.

The potential intensification of gas exploration by investors operating on the domestic market may stimulate demand for the relevant services provided by the PGNiG Group companies, which will strengthen their financial position.

The Group's performance will also be considerably affected by regulations defining support mechanisms for electricity from high-efficiency co-generation and renewable sources. Legislative changes in this area and fluctuations in prices of certificates of origin (red and green certificates) will have a bearing on the Group's future financial position.

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, the PGNiG Group uses external financing raised by issuing debt securities on the domestic and foreign markets. In February 2012, PGNiG Finance AB issued a EUR500m tranche of five-year eurobonds. Under the new notes programme launched in May 2012, PGNiG SA issued five-year notes with a total nominal value of PLN 2.5bn. The IPO of Exalo Drilling SA is scheduled for 2013. Issue proceeds will be used to finance the company's investment programme.

In the coming quarters, the PGNiG Group intends to maintain the 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.

The PGNiG 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	....