TYPES OF BUSINESS RISKS

In conducting their business on the domestic market and outside Poland, the companies of the PGNiG Group are exposed to a number of risks. Major threats identified by the Group include: regulatory risk, market and currency risk, risk related to disruptions in gas supplies and risk of delayed investment projects.

Regulatory Risk

Pursuant to the applicable rules for price regulation, when approving tariffs for a given period, the President of URE considers external factors which are beyond PGNiG SA's control. While verifying costs of operating activities, the President of URE may consider certain cost unjustified or may reject our assumptions with respect to main drivers of cost changes and profit targets, which reflect business risk. This is so because an objective of the President of URE is to protect more vulnerable customers. The URE may also refuse to accept tariff prices and charge rates we apply for. Lower tariff prices and charges adversely affect PGNiG SA's profitability.

PGNiG SA is additionally exposed to the risk associated with the inadequacy of secondary legislation under the current legal acts regulating the Polish gas market. Changes in the legal environment gradually implemented in connection with Poland's accession to the European Union may not allow for the specific nature of our business.

Market and Currency Risk

Prices of imported gas are determined in the US dollar or the euro, and are based on indexation formulae reflecting the prices of petroleum products. Changes in foreign exchange rates and prices of petroleum products materially affect acquisition cost of imported gas. The market of crude oil and petroleum products has been rather unpredictable recently. Material changes in fuel prices on the international markets affect the prices of imported gas. Therefore, any forecasts of natural gas prices are encumbered with a high risk of error.

Risk of Competition

PGNiG SA's share in the domestic gas supply market approximates 98%, with the remaining 2% divided among other suppliers, which, however, purchase gas from PGNiG SA. Hence the most substantial risk of competition is connected with other companies seeking licenses for exploration and prospecting of deposits in Poland and abroad, which is a part of the strategy providing for acquiring access to own hydrocarbon resources. A strong competitive edge may be gained especially by large companies which enjoy established positions on the international markets, allowing them to accept the high risk of exploration activities. Competitors are also able to define, value, offer and purchase numbers of fields (including the operator's activities and underlying licences) larger than it would be possible in the case of PGNiG SA, given the size of our financial and human resources.

Exploration Risk

Exploration activities are associated with the risk of potential failure to discover deposits. A number of factors and assumptions adopted when determining the size of resources and the production projections may turn out erroneous due to flaws in the methods and measurement equipment used in the geophysical surveys, drilling and production testing. Data on economically producible reserves of crude oil and natural gas is only estimative, and the actual production, income and expenses relating to a given deposit may differ from the estimates. Any negative adjustment to the size of the resources or to the production volumes leads to a lower revenue and adversely impacts PGNiG SA's financial performance.

Risk Related to Disruptions in Gas Supplies

In the previous years, the deliveries of natural gas from the markets east of Poland were disrupted. Taking into consideration the difficult relations between the main supplier and the transit countries (Ukraine and Belarus), similar incidents are likely to occur in the future.

Risk Related to Estimation of Capital Expenditure

A protracted investment process exacerbates the risk related to estimation of capital expenditure. A variety of factors, such as fluctuations of the prices of commodities and production materials (notably steel), necessity to comply with the requirements regarding safety of individuals and property as well as environmental protection (Natura 2000 network), unforeseeable circumstances and market competition, may cause the estimated capital expenditure to materially deviate from the amounts assumed in the investment plan.

Risk of Delayed Investment Projects

PGNiG SA's obligation to comply with the Public Procurement Law frequently prolongs the tender procedure. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing investment projects. Some of the factors which markedly delay the investment process and postpone the commencement of construction-site work are: local governments' failure to adopt local land development plans (MPZPs), obstacles in incorporating investment projects into the MPZPs and obtaining the required administrative decisions, and difficulties in obtaining permission to commence work from land owners.

Risk of Loss of Highly Qualified Personnel

The presence of foreign companies on the Polish market intensified the outflow of highly qualified employees with vast professional experience. This risk is especially high with respect to professionals specialised in the exploration of natural gas and crude oil deposits.